

A guide to how we manage conventional life policies in our With-Profits fund



SCOTTISH
PROVIDENT

You'll find important information about your policy and how it works in this guide. Please read this guide and then keep it safely with your other policy documents.

1. Who this guide is for and what you will find in it

This guide is for you and the other policyholders who are investing in the conventional With-Profits life policies of Scottish Provident Limited (Scottish Provident). This includes 'whole of life' and 'endowment' policies. We explain these terms in section 4. The guide aims to explain:

- How the With-Profits fund works
- What you should expect the fund to do for you
- What affects how much your policy is worth when the time comes to cash it in.

You can find full details of the fund and how it works in a document called the "Principles and Practices of Financial Management". This summary version tells you about the main points in the full Principles and Practices document dated January 2007. If we change the full document, we will tell you and if the change is an important one that affects your policy we will send you a revised guide like this one.

2. What you'll find in the following sections

Section 3. Your policy and our business

Section 4. How we work out what to pay you when the time comes for your policy to be cashed-in

Section 5. How the money in the fund is invested

Section 6. How we manage risk

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3. Your policy and our business

Scottish Provident is a life insurance company that was set-up in 1837. From 2001 until 2006 the company was owned by Abbey National. In September 2006 the company was acquired from Abbey by Resolution plc. Resolution is a specialist in life assurance management and also owns a number of other life assurance funds.

Like all UK insurance companies, we are regulated by the Financial Services Authority and we always aim to operate within FSA requirements. We also follow rules that were approved by the court when Abbey took over Scottish Provident in 2001 and which continue to apply even though Abbey has sold Scottish Provident to Resolution. These rules include that:

- Scottish Provident must aim to set payments to policyholders so that there is no money left when the last policy is paid off
- There are strict rules about the charges, fees or profits we can take out of the fund.

Over the years Scottish Provident has sold many different kinds of policy. The conventional life policies described in this guide are only one of the types invested in the same fund. We have other guides, like this one, about the other types of policy.

4. How we work out what to pay you when the time comes for your policy to be cashed-in

Some of the money you pay is used to pay for running costs and for life assurance cover in case you die early, but most is invested in our With-Profits fund. When your policy is cashed-in we aim to pay you a fair share of the fund.

Before we describe how we work out this fair share we'd like to explain a few technical terms:

- **Endowment policy** – endowment policies pay out a lump sum on a fixed date, or on earlier death. They are often used for saving to pay off a mortgage.
- **Whole of life policy** – these pay out a lump sum on death.
- **Maturity date** – the fixed date when an endowment policy will pay out the lump sum. Each policy will have its own maturity date. Often this is the 25th anniversary, but shorter and longer policies are also common.
- **Sum assured** – the fixed minimum payment at maturity or death under a whole of life or endowment policy. This is set when the policy is taken out and is guaranteed as long as all the premiums are paid.
- **Annual bonus** – an annual bonus is a guaranteed addition to the sum assured. It is paid for out of any surplus money that the fund has built up, for example if there is an investment profit and the fund has earned more than the amount we need to cover the sum assured. Each year we check whether the fund can afford to give everyone such an addition, but this does not mean there will be a bonus every year. There is more about annual bonus later.

- **Investment result** – this is the amount we credit to the asset share. The fund owns a variety of investments. These produce interest and dividends. The fund also sees the benefit, or the cost, of capital gains and losses as, for example, shares go up and down in value on the stock market. In some years the capital losses could be larger than the income, leaving an overall loss. The fund has to pay tax and other charges. The tax is less on pensions than on life policies. There will always be some expenses from buying and selling investments and from looking after them. Sometimes there may be other gains or charges arising from other risks, particularly our management of the costs of guarantees. These are explained later. All of these factors make up the investment result that we work out each year.
- **Asset share** – this is our main guide to a fair share of the fund. We work out the asset share of a policy by:
 - (i) Taking the money paid for the policy
 - (ii) Allowing for each year's investment result, and
 - (iii) Taking off any costs not allowed for in the investment result.

We do not do this individually for each policy. We do it for a selection of typical policies and then aim to pay a proportionate amount to other policies.

- **Final bonus** – when endowments reach their maturity date we compare asset shares with sum assured and annual bonuses. If asset shares are higher, then we would normally add a final bonus. We expect to check the final bonuses and change them if necessary at least twice a year.

Smoothing

An asset share can move up and down, depending mainly on the latest investment result. Smoothing can mean two things:

- Smoothing can mean not always allowing the value given for a policy to move up or down as quickly as the asset share
- Smoothing can mean that if the asset shares for similar policies starting at different times are different by irregular amounts, we may set final bonuses to reduce the irregularities.

We prefer to pay asset shares as far as possible with little smoothing.

Guarantee at maturity date

If at the maturity date of an endowment the asset share is less than the sum assured and bonus you would not get a final bonus, but you do get the full guaranteed sum assured and annual bonuses.

Guarantees like these can cost the fund money and there is more about how we manage this risk in section 6.

What happens if you cash-in, or “surrender”, your endowment policy early

If you cash-in your policy early, you will probably be doing so at a time when there is normally no guarantee. We use asset share as a guide when deciding how much the fund can afford to pay you.

We had quite heavy costs when your policy started. These costs are allowed for when we work out the asset share. So cashing-in early may mean you get back less than you have paid in.

Some of our endowment policies have what are known as early maturity options. They will pay a reduced guaranteed sum assured on surrender before maturity after a certain policy anniversary has been reached, normally the tenth. Your original policy document will tell you if you have this guarantee.

What happens on death with an endowment or whole of life policy

We do not use asset shares as a guide to death payments. We pay the full sum assured and annual bonuses that have been added. For a whole of life or an endowment policy, we also add on any final bonus that we would pay for an endowment that started at the same time as your policy and is now due to mature.

More about annual bonuses

An annual bonus increases the amount your policy is guaranteed to pay out. We add these only when the fund can afford to do so. There may be years when we do not have any annual bonus. But this does not mean that your policy is not earning anything. The full amount of the investment result is still being used to build up the asset shares that help us decide whether you are due any final bonus.

If there is an annual bonus then the guarantees get bigger and are more likely to cost the fund money. Different policies have different guarantees and some policyholders would benefit more than others. So sometimes it is fairer to have no annual bonus and use all the investment result to change final bonus.

Altered policies

Some people alter their policies, for example they might increase the size of the sum assured. We do not work out separate asset shares for altered policies, but aim to use the same rates of final bonus as for unaltered policies.

An example might be a customer who stops paying premiums and so is due only a reduced benefit. We expect to use the same rate of final bonus as for a continuing policy, but with this percentage applied to the reduced benefit.

Our right to share in bonuses

If there are any annual or final bonuses we are entitled to a share of the profits. The rules for this were approved by the court when Abbey took over Scottish Provident. For every £10 that there is available, £9 goes to pay for policyholder bonuses and £1 goes to our shareholders.

5. How the money in the fund is invested

The fund may use any of the usual types of investments. These include stocks and shares which are bought and sold on the stock markets, unit trusts, fixed interest loans to local or national governments or to companies, and bank deposits. Some of the fund may be invested in land and property and in some less common investments.

History shows that company shares tend to do better than fixed interest loans in the long run, but the value of shares can go up and down quite a lot, with losses in some years. Because of the guarantees in the fund we aim not to put too much into the type of stocks whose value might fall over short periods. We aim for a balance between choosing types of stocks that we think have a good chance of growing in value on one hand and not risking too great a loss on the other.

A typical mix of investments might be to have about half of the fund in fixed interest loans and about a third in shares on UK and overseas stock markets with the rest in a wider variety of investments. The actual mix at any time might be different. Our usual aim is to share in the overall movement of the market, rather than to try and choose individual stocks.

6. How we manage risk

This section tells you a little more about the main risks in the fund, how these might affect you and how we try to manage the risks.

Investment risk

The fund is not limited to investments guaranteed by big banks and governments. We aim to earn a higher return than deposits would earn, but you don't usually get offered a higher return unless there is also some risk of loss attached. We aim to limit the risk in two main ways:

- We put only part of the fund into shares on the stock market and keep quite a large part in safer fixed interest loans
- We don't put too much money into any one stock or company.
We spread the fund over a large number of separate investments.

Even so, the fund performance will be different from year to year and may be a profit or a loss.

Guarantee risk

Each policy includes times when a minimum payment is guaranteed. If these guarantees mean we are paying more than asset share, then the guarantee is costing the fund money. This could mean there is less left in the fund for other policyholders.

Since the middle of 2004, we have been managing these guarantee costs through a complex set of 'fund protection assets'. These are special investments whose value changes with the overall level of the stock market and as interest rates change. We invested about 6% of the fund to buy enough of these to match what we expected the current guarantees to cost. The value of these assets is designed to rise at times when other stocks are falling and the guarantees are more likely to cost more. The overall effect is that we have insured the fund against most of the guarantee costs but the actual guarantee costs may turn out to be more or less than the fund protection assets. We will check and revise the position from time to time. Any changes may mean there is a cost or a gain to the fund and this will show up in the investment result.

Insurance risk

All policies include insurance benefits such as payments on death. The fund buys annuities for pensions policyholders on retirement. If pensioners are expected to live longer then that will add to our costs. From time to time we may adjust the investment result to reflect these profits and losses. The expected cost of this insurance is allowed for in the asset share calculation.

It is possible that the actual experience might be different to what we expected. These differences will contribute to the overall profits and losses in the fund. For example the fund would make a profit if there are not as many early deaths among the endowment policyholders as we expected.

7. Charges and expenses

We charge the fund for costs at a level set for 10 years after the purchase of Scottish Provident by Abbey. The same practice applies to the costs used in the asset share calculations.

8. Our approach to new business

Our With-Profits fund is closed to new business and we have no current plan to re-open it.

Existing policies can continue to pay their normal regular premiums and these premiums continue to add to asset share. Some existing policyholders also have rights to alter or increase their policy, or even to take out a new policy. This is possible, but customers should always consider taking advice as to whether this is the best course of action for them.

9. What happens if the fund has too much or too little money

At the time of writing (December 2006) our best estimate was that the fund had slightly more than needed to settle all our policyholders' claims. We check the position at least twice a year. However, we can't be sure what will happen in the future and the balance could change. For example:

- If the investments do much better than we expect, or if guarantees cost less than expected we might find the fund has extra money
- If the investments do less well than we expect or guarantees cost more than expected we might find the fund does not have enough money.

The key messages are that any extra money belongs to the policyholders and if there is a shortage then at least part of this is likely to be charged to policyholders. However, if policyholders are likely to have their policy value reduced by more than 5% on account of such a shortage, then the company will share any excess over 5%. If there is extra, one option would be to add this in when we work out the investment result that we use when deciding what we can afford to pay as final bonuses. In the same way if there is not enough then this could show up as a lower investment result, making final bonus lower. Guaranteed benefits cannot be reduced.

Scottish Provident and Resolution have other money earmarked outside the fund that is available if the 5% limit is reached or if there is a threat to guarantees. However, we would not normally expect to use money from outside the fund to support higher final bonuses and we would be very unlikely to agree to use this money to help the fund support a new annual bonus as this would add to the guarantees. Adding to the guarantees can be very expensive and would be considered only if the fund, on its own, had a significant amount of extra money.

10. How to find out more

We hope this guide has been helpful, but remember you need to look at your other policy papers and your regular statements as well.

This is a summary version of our full Principles and Practices document. Some of the more technical details have been left out. We have tried to select the main points that affect most policyholders. If you want more detail about the fund you can ask for a copy of the full Principles and Practices document or you can download it from our website. If you need more information about your own policy then you can phone or write to us.

This guide aims only to help you understand your contract. It does not aim to change the contract between us or to give you advice. We suggest you should always speak to a financial adviser before taking any decisions about your investment.

Our contact details are:

If you want to ask about your own policy you can phone us:

- Customers with endowments, flexible lifetime plans, regular savings plans and critical illness cover phone **0845 741 3002**
- Customers with With-Profit Bonds phone **0845 6000 403**

Or you can write to us at Scottish Provident Limited plc, 301 St Vincent Street, Glasgow G2 5HN.

If you want a copy of our full Principles and Practices document then either:

- Phone **0845 741 3002**; or
- Try our website **www.scotprov.co.uk/withprofitsupdate**

Technical questions about the content of this document or about the full Principles and Practices document are best put in writing to the With-Profits Actuary's Department at the postal address above.

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