

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



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'll find in it

This guide is for you and the other individual policyholders who are investing in the conventional With-Profits pensions policies of Scottish Provident Limited (Scottish Provident). This includes 'self-employed pension plan' and 'executive pension plan' 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 for you to retire.

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 you to retire

Section 5. How the money in the fund is invested

Section 6. How we manage risk

Section 7. Charges and expenses

Section 8. Our approach to new business

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

Section 10. How to find out more

3. Your policy and our business

Scottish Provident is a life assurance 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 pensions policies described in this guide are only one of the types that are 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 you to retire

Some of the money you pay is used to pay for running costs and for some policies some is used for life assurance cover in case you die early, but most is invested in our With-Profits fund. When you reach the retirement date in your policy we aim to offer you retirement benefits based on 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:

- **Executive pension plans** – these policies are normally arranged for you by your employer. They have a normal retirement date, usually set by your employer.
- **Self employed pension plans** – these are policies taken out by people who did not have any scheme offered by an employer. They offer a range of retirement dates, often from age 60 to age 75.
- **Retirement date** – in the case of an executive pension plan the date your employer told us you were expected to retire, or one of the optional retirement dates, usually between age 60 and age 75, listed in a self employed pension plan. Each policy will have its own retirement date. Normally these dates are on a birthday between the 60th and 75th birthdays.

- **Retirement benefits** – all the policies described in this guide offer a choice between a pension or a lump sum with a reduced pension. There are often limits set by the taxman about how much can be taken as a lump sum. Each policy will have a fixed minimum level of benefits as long as all the premiums are paid. The policy will also set the exchange rate between cash and pension; for example, on some executive pension plans the rate for males at age 65 is £9 of cash for each £1 per annum of pension.
- **Annual bonus** – an annual bonus is a guaranteed addition to the retirement benefits. It is paid for by the fund 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 minimum retirement benefits. Each year we check whether the fund can afford to give everyone such an addition, but this does not mean that there will be a bonus every year.
- **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. 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 included 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.
- **Cash value of retirement benefits** – we need to know the value of all our pension policies as a cash amount. Some pension policies have retirement benefits that are a guaranteed amount of pension per annum rather than a guaranteed amount of cash. So we need to check how much this is in cash by using current market rates and views on how long people may live.

- **Final bonus** – when policies reach their retirement date we compare asset shares with the cash value of retirement benefits. 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.

In either case the full effect of the investment result is allowed for over time. Generally we prefer to pay asset share as far as possible with relatively little smoothing.

Guarantee at retirement date

If at the retirement date the asset share is less than the cash value of retirement benefits you would not get a final bonus, but you do get the guaranteed minimum retirement benefits plus any annual bonuses we have added.

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 want to cash-in your pension policy early

There are often rules imposed by the taxman about what you can do with a pension policy and you cannot normally take the money and use it for anything other than a pension. You can usually take a transfer value from us to some other pensions provider.

If you do cash-in your policy early, you may be doing so at a time when there is no guarantee about the option to take a pension. Any transfer value will be based only on the cash amount, which is often the less valuable option.

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.

There will usually be some flexibility allowing you to take your pension before or after the date you or your employer originally set, but you should check with us whether this affects any of the guarantees in your policy.

What happens on death before retirement date

We do not use asset shares as a guide to death payments. Different policies issued at different times had different rules and you need to check your policy document.

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. Sometimes it is fairer to have no annual bonus and use all the investment result to change the final bonuses.

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 policyholders' 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 many losses 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 minimum benefits are 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 life assurance policies include insurance benefits such as payments on death, but these are much less common on pensions policies. The fund buys annuities for pensions policyholders on retirement. If pensioners are expected to live longer than that will add to our costs. The expected cost of any insurance is allowed for in the asset share calculation.

It is possible that the actual experience for any insurance provided by the With-Profits fund might be different to what we expected. These differences will contribute to the overall profits and losses in the fund. From time to time we may adjust the investment result to reflect these profits and losses.

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. Some existing pension schemes continue to have rights to buy further benefits for existing members and to admit new members. All this is possible, but customers and scheme trustees 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, then one option would be to add this in when we work out the investment result that we use when deciding whether we can afford to pay 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 one from our website. If you need more information about your own policy then you can phone us 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 on **0845 270 1075**

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.

Scottish Provident is a brand name used by Scottish Mutual Assurance Limited. Scottish Mutual Assurance Limited is registered in Scotland Number SC133846. Scottish Provident Limited is registered in Scotland Number SC212709. Both are authorised and regulated by the Financial Services Authority. Scottish Provident Trustees Limited is registered in Scotland Number SC108046. All are Resolution companies and have their Registered Office at: 301 St Vincent Street, Glasgow G2 5HN. Scottish Provident Pension Trustees Limited is a Resolution company, registered in England Number 2404622. Registered Office: 1 Wythall Green Way, Wythall, Birmingham, B47 6WG England. Phone: 0141 248 6321.

SCPR 5408 JAN 07 LD