

The Scottish Life  
Fund

# A guide to how we manage our with profits fund



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## About this guide

This guide tells you:

- how we manage our with profits fund
- how our with profits policies work
- what benefits policyholders can expect from them.

The guide sets out our current approach. We might change the approach from time to time to respond to changing circumstances.

We use certain terms in this guide that need a more detailed explanation than we can give in the text. We have highlighted these **like this** and included them in a summary of useful terms at the end of this guide.

## Who should read this guide?

You should read this guide if you have a with profits or **deposit administration** policy that was taken out with Scottish Life before 1 July 2001. Your policy is invested in **The Scottish Life Fund**. This guide explains how we currently manage **The Scottish Life Fund** and how this affects your policy.

We will refer to **‘The Scottish Life Fund’** as ‘the fund’ throughout the rest of this guide.

You should read this guide and keep it safe with your other policy documents, which you may find helpful to refer to as you go through it. This guide does not change the terms of your policy; it gives you further information to help you understand it better.

If you would like a copy of this guide in large print please call us on 08450 502020.

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# Principles and Practices of Financial Management

We manage the fund by following our Principles and Practices of Financial Management (PPFM).

The Principles are high level statements setting out how we intend to manage the fund over the long term. The Practices are more specific statements that describe how we intend to follow the Principles in managing the fund on a day-to-day basis.

The PPFM is a very detailed technical document so this guide sets out a summary of the key points in simpler terms. If there is any conflict between the simplified wording in this guide and that in the PPFM, the wording in the PPFM will apply.

We may change the Principles and Practices from time to time to respond to changing circumstances. If we make any changes we will publish them on our website. We will send you an updated copy of this guide if we make any significant changes.

You can obtain a copy of the current PPFM by visiting our website [www.royallondongroup.co.uk](http://www.royallondongroup.co.uk).

## Our Guiding Principles

We will follow some overall Guiding Principles when managing the fund: We will manage the fund in a sound and prudent manner and aim to:

- make sure that, at the appropriate time, we can pay all the amounts guaranteed to our policyholders;
- uphold all policy terms and conditions;
- satisfy our regulator, the Financial Services Authority, that we are managing the fund in an appropriate way.
- treat all our policyholders fairly.

We have appointed an independent person to provide advice on the way we manage the fund and to help us treat with profits policyholders fairly and monitor our compliance with the PPFM.

## What is a with profits policy?

A with profits policy is a legal contract between a policyholder and us. With profits policies can be **conventional**, meaning that payment of premiums guarantees an amount to be paid at a date in the future or they can be **unitised**, meaning that premiums buy units in the fund.

The fund invests in a wide range of investments and with profits policyholders share in the profits and losses made on these investments. Instead of receiving direct investment returns such as dividends or interest, with profits policyholders receive bonuses on their policies. With profits policies also share in the profits and losses made on other types of policies within the fund.

Following the demutualisation of **Scottish Life** the fund was transferred to **Royal London**. **Royal London** is a mutual society which means that it does not have any shareholders. Profits and losses made within the fund remain for the benefit of with profits policyholders rather than a share of the profits being paid out to shareholders.

### What is guaranteed?

For **conventional** policies the guaranteed amount we promise to pay may be:

- one lump sum payment (a sum assured) or
- a series of payments (a pension).

For **unitised** policies the amount that we guarantee to pay is the face value of units held within the policy.

We will pay the guaranteed amount or the face value of units on the set event or date in the policy schedule. The set event or date may be:

- the end of the policy term, as agreed when you started your policy (the maturity date) or
- when you retire (on your originally selected pension date) or
- the date of death if you were to die before the end of the policy.

There may also be other times when we will guarantee to pay you a minimum amount. Please refer to your policy schedule for details.

### The bonuses

We aim to increase the guaranteed amount for **conventional** policies and the number of units for **unitised** policies by adding regular bonuses throughout the term of your policy. Regular bonuses are normally added every year. Interim bonus may also be paid on claims between regular bonus dates. Some **unitised** policies have a unit price that changes on a daily basis to reflect the addition of regular bonus, but the effect is the same.

We may also pay a final bonus when you take your benefits. If you cash in your policy, transfer your policy, switch to another fund or stop paying premiums early we may pay you a reduced amount of the bonuses you would have received had you kept your policy until the end of the term. We may also apply other charges and a **market value reduction** as set out in "How do you decide how much to pay me if I cash in, transfer my policy or stop paying premiums early?" - on page 11.

More detail on the bonuses we pay and how they are determined is contained on page 9 - "How do you decide bonuses?".

## What is a deposit administration policy?

A **deposit administration** policy is similar to a with profits policy. Each premium secures a guaranteed amount payable on a set event or date in the future, as described in the policy schedule.

The returns achieved on the investments backing **deposit administration** policies are distributed by way of interest additions each year, these have a similar effect to bonuses for with profits policies. However, **deposit administration** policies are not affected by profits or losses on other types of policies and they do not attract a final bonus.

## How do you decide how much to pay me?

The amount we pay you is made up of a guaranteed amount for **conventional** and **deposit administration** policies or the face value of units for **unitised** policies plus any regular bonuses we have added to your policy. If you have a with profits policy we may also pay you a final bonus. We may reduce the total value we pay you if you decide to cash in some or all of your policy or transfer it or take early retirement.

When determining how much we will pay you we aim to be fair to you and to the other policyholders remaining in the fund.

We use **asset shares** to help us decide how much to pay you at the maturity date, pension date or on death.

We calculate **asset shares** by:

- looking at the premiums paid into the fund;
- making deductions to cover our expenses, tax (for life policies) and the costs of providing benefits and guarantees to the policies; and
- allowing for the investment returns earned by the investments of the fund.

We calculate **asset shares** for sample policies. These sample policies are chosen to be a good match for the full range of policies actually invested in the fund. The sample **asset share** calculations are performed so that we can keep track of the relationship between the amounts we pay you and the investments available in the fund. This ensures that the bonuses we pay are fair across the whole range of with profits and **deposit administration** policies.

Please note that **asset shares** are simply a measuring tool. We use the **asset shares** on sample policies to help us set bonus rates and we use **asset shares** in aggregate to assess the **working capital** within the fund. We do not quote **asset shares** on individual policies.

We compare the sample **asset share** for each group of policies with the guaranteed amount or face value of units and regular bonuses that we have already promised to pay. We will pay you at least the guaranteed amount or face value of units providing you have paid all the premiums due under your policy.

If the **asset share** is higher than the amounts we have already promised then we may pay a final bonus. However the amount of final bonus we pay also depends on the amount of **smoothing** that we apply at the time of payment.

We apply **smoothing** to the amounts we pay over and above the guaranteed amount or face value of units to make sure that you receive your fair share of the fund either at the end of your policy or on death.

We explain **smoothing** in “What is smoothing and how do you apply it?” on page 10.

The range in which we aim to target most maturity values, as a percentage of asset share is 75% to 125%.

At any time in the future we may change the way we determine how much each policyholder receives but only if the change is fair.

## How do you decide bonuses?

We usually announce bonus rates once a year. We may do this more often if we need to reduce the amounts we pay on claims to protect the interests of remaining policyholders, for example, if investment conditions are bad. Alternatively we may need to increase the amounts we pay if, for example, investment conditions are exceptionally good.

### Regular bonuses

We announce regular bonuses that increase the guaranteed amount or the number of units in your policy gradually over the policy's lifetime. Once added, a regular bonus becomes part of the guaranteed amount or face value of units and cannot be taken away. However the guaranteed amount or face value of units and the regular bonus added will probably be reduced if you cash in your policy early, transfer your policy, switch to another fund or stop paying premiums early.

We decide regular bonus rates by considering what we think the fund can afford to pay now and in the future. To do this we look at current economic and investment conditions and the outlook for the future.

If we feel that announcing a regular bonus would harm the ability of the fund to pay guaranteed amounts when they are due either now or in the future then we may decide not to announce a regular bonus. Similarly we may reduce the regular bonus where continuing with the previous rate might lead to guarantees at a level that unduly restricts investment freedom.

Different regular bonuses may be announced for different types of policy in order to treat each policy group within the fund as fairly as possible (for example life policies and pension policies or policies with different guaranteed amounts).

We try not to change the amount of regular bonus we announce too much from year to year. Currently the rates of regular bonus are low.

### Interim bonuses

We may also pay an interim bonus on claims between regular bonus dates to make up for some or all of the expected regular bonus that may have been earned by the policy since the last regular bonus was announced. We determine interim bonuses in the same way as regular bonuses and there are situations when we might not pay any interim bonus.

### Final bonuses

We may also announce a final bonus for with profits policies. This is designed to increase what with profits policyholders get back from their policies if the regular bonuses we have added to your policy do not fairly reflect the sample **asset shares** that we have calculated for the particular type of policy.

We compare the **asset share** for sample policies with their guaranteed amounts or face value of units. A scale of final bonuses is then determined after we have applied the appropriate **smoothing**. Some of these final bonuses may be zero, typically where the sample **asset share** is less than the guaranteed amount or the value of units held.

We may change final bonuses at any time in order to protect the fund and to ensure that all policyholders receive their fair share in both good times and bad times. There are no restrictions on the size of final bonus that we might pay or how much it might change from one year to the next. We might not pay any final bonus.

Final bonuses are NOT guaranteed in any circumstances.

## What is smoothing and how do you apply it?

**Smoothing** is one of the main features of with profits and **deposit administration** business that we have to consider when determining the payout for these policies. It is one of the key ways in which we can be fair to all policyholders.

The fund invests in a range of assets and the value of these goes up and down, sometimes significantly, over time. One year a particular investment may do very well, the next its value could fall sharply.

We try to add bonuses in a way that protects policyholders to some extent from large falls in the assets held by the fund. Instead of adding big bonuses in good years and small or no bonuses in bad years, we try to smooth them out. So we hold back some of the investment gains earned during good years and release them as bonuses when returns have been poorer or seem likely to get poorer.

Before we announce the bonuses, in order to decide how much **smoothing** to apply, we will:

- look at how much **working capital** the fund has in comparison with the target amount we would like to have;
- consider how much regular bonus we should announce and how much this bonus will cost; and
- look at how the payouts on recently maturing policies compared with their **asset shares** and whether they are bigger or smaller.

Although bonus rates may go up and down, or we may decide not to allocate any bonus at all, they will usually be much more stable than the returns on the investments held by the fund.

Although we use it to reduce the impact of changes in investment returns, **smoothing** can't fully protect your investment. This is particularly the case following, for example, long periods of poor investment returns or sudden large market falls. When these happen we are likely to reduce final bonuses and payouts but still pay more than **asset share**.

Overall we aim for the effect of **smoothing** to cancel itself out over the long term. This means that, over time, the amounts held back in good years should offset the amounts required in bad years.

We aim to be consistent between different types of policyholder (e.g. people who hold life or pension policies) and policyholders leaving the fund today and those that will leave in the future.

**Smoothing** protects the financial interests of all policyholders remaining in the fund. For policyholders who cash in their policy, transfer their policy, switch to another fund or stop paying premiums early, less **smoothing** is applied.

## How do you decide how much to pay me if I cash in, transfer my policy or stop paying premiums early?

If you decide to cash in your policy, transfer your policy, switch to another fund or stop paying premiums early then we need to work out how much to pay you in order to be fair to you and to those remaining in the fund.

Payments when you cash in, transfer your policy or stop paying premiums early will normally be less than guaranteed amounts for **conventional** and **deposit administration** policies.

This is to reflect the underlying value of the policy and to make an allowance for expenses we have incurred that we have not managed to recover out of the premiums already paid.

For **unitised** policies we may apply charges to make an allowance for expenses we have incurred that we have not managed to recover from charges to date. We may also pay out less than the face value of units plus final bonus by applying a **market value reduction**. We apply a **market value reduction** when the **asset share** for a policy is lower than the face value of units plus final bonus. The **market value reduction** ensures fairness between those policyholders who leave the fund early and those who remain.

We will calculate payments in these circumstances, or following any kind of alteration to the original terms of the contract, using a basis that makes allowance for our expenses and the early payment of the guaranteed amount or face value of units. We may make changes to this basis from time to time

to ensure fairness to all policyholders. We may pay a final bonus on with profits policies in these circumstances but this will usually be at a rate that is lower than you would normally get if you kept your policy for the full term and continued paying premiums. We may not pay any final bonus at all.

The range in which we aim to target most payments when you cash in or transfer your policy, switch to another fund or stop paying premiums, as a percentage of **asset share** is 75% to 125%.

## How do you decide the investment strategy?

Our investment strategy aims to obtain the best possible returns for policyholders whilst still making sure that we can pay all their guaranteed amounts.

These aims can conflict because usually the assets that provide the best return are also the most risky (for example company shares). In order to pay all the guaranteed amounts we need to invest some of the fund in more stable assets where we are certain of a guaranteed return or there is less variability in the return (for example government bonds).

We do this by investing in a wide range of assets and the fund invests mostly in a mixture of government and other fixed interest bonds, company shares, property and cash.

In addition to the items described above, we also take into account

- the regulatory requirement to hold a certain amount of **working capital** as a 'cushion' against bad times;
- the expected return from each type of asset we hold; and
- the expected variability of the returns from each type of asset.

We 'match' certain types of guarantee with appropriate investments such as government bonds or cash and invest a proportion of the rest of the fund in company shares and property. When calculating **asset shares** on sample policies we vary the proportions in each type of investment to reflect variations in the level of guarantees over time.

The proportions invested in each of these types of asset are reviewed regularly by an internal committee. This committee works within specific guidelines agreed in advance to achieve an appropriate balance of investment risks.

In recent years the typical mix of investments underlying the with profit **asset shares** might be to have about 15% in company shares, 5% in property, 70% in fixed interest investments and the balance in cash and other investments.

We publish the mix of assets in the fund at 31 December each year. For more information please visit our website [www.royallondongroup.co.uk](http://www.royallondongroup.co.uk)

## How might your business activities affect my payout?

The fund is closed to new business and the type of business activities that can directly affect the fund are limited by a legal agreement put in place when the fund was transferred to **Royal London**.

The business risks that remain in the fund are mainly in respect of activities prior to the transfer to **Royal London**, such as the risks in respect of guaranteed annuities or in respect of breaches of regulatory requirements prior to the transfer.

We monitor closely the risks and liabilities that arise in the fund and seek to minimise the effect of these risks as much as possible. This includes projecting the development of these risks for many years in the future and selecting investments that protect the fund against adverse outcomes.

## What are the expenses and how do you charge for them?

The expenses broadly cover the set up costs, any commission which was paid, ongoing administration costs and investment management costs. The expense levels depend on the size and type of policy.

The way we charge for expenses also depends on the type of policy. For most **conventional** life policies we make an explicit deduction from the **asset share** to cover expenses. For other policies we make an implicit allowance for expenses by reducing the **asset share** by the product charges applied to the policy.

In each case the amount applied represents a fair proportion of the total expenses incurred in administering all policies, using generally accepted techniques.

We make a charge to **asset shares** for example to cover the cost of paying guaranteed amounts (for example the guaranteed sum assured plus regular bonuses we have already announced) or to cover a proportion of the aggregate cost of guaranteed annuity options. We determine the costs by using generally accepted techniques.

## What is working capital and how do you manage it?

So far we have only briefly mentioned the **working capital** of the fund but it plays a very important part in managing with profits business. Reading this section will help you to pull together the information we have provided in the previous sections.

The amount by which the assets of the fund are greater than the amounts already promised to policyholders by way of guaranteed amounts, the face value of units and bonuses at any time is known as **working capital**.

As part of the demutualisation of **Scottish Life** and the transfer of the fund to **Royal London** it was agreed that the **working capital** would be distributed to **qualifying with profits policyholders**. Over time the **working capital** will reduce by crediting the **asset shares** of relevant policies with enhanced investment returns.

As part of this distribution we decide how much **working capital** the fund should have at any point in time. If we think that the fund has too much then we may decide to increase the additions to investment returns. If we think that the fund does not have enough then we may instead reduce or cease these additions to investment returns.

Any exceptional costs which we decide should not be charged directly to with profits policyholders will be met from the **working capital**.

The **working capital** gives us some additional freedom to invest the assets of the fund in company shares and property hopefully to provide higher growth over the longer term.

The **working capital** is also used to meet the cost of any guarantees and **smoothing** after deducting any charges made to policyholders for these.

## How can I find out more?

Each June we will report on how we have complied with the PPFM in the previous year and publish this on our website [www.royallondongroup.co.uk](http://www.royallondongroup.co.uk)

If you need any more information or have any questions on this guide or the PPFM please call us on **08450 502020** between 8.00am and 6.00pm Monday to Friday, except bank holidays.

## Useful terms

### Asset share

Refers to the accumulation of premiums paid into a policy after deducting amounts to cover expenses, charges and tax (for life policies) and after crediting or debiting amounts to reflect the investment returns achieved by the fund.

### Conventional

Refers to a type of with profits policy where payment of premiums guarantees an amount in the future.

### Deposit Administration

Refers to a type of policy that receives smoothed investment returns but does not participate in the profits or losses of the company. Crest Secure and the Capital Account of Talisman policies are both **deposit administration**.

### Market value reduction

A reduction that we may apply to the value of a policy when part or all of it is being cashed in. We apply it to ensure that we treat everyone invested in the fund fairly, both those leaving it and those staying in it.

There are certain circumstances where we cannot apply a market value reduction for example: at the end of the policy term, at the original pension date, or on death. Please refer to your policy document for the circumstances that apply to your policy.

### Qualifying with profits policyholders

With profits policyholders who took out policies prior to 12 September 2000 and who receive enhanced returns to reflect the distribution over time of the **working capital** of the **Scottish Life Fund**.

### Royal London

The Royal London Mutual Insurance Society Limited

### Scottish Life

The Scottish Life Assurance Company which demutualised and transferred its business to **Royal London** on 1 July 2001.

### Scottish Life Fund

The separate fund into which **Scottish Life** with profits and **deposit administration** policies were transferred on 1 July 2001.

### Smoothing

The term given to the way in which we reduce the impact on policyholder payouts of the variation (sometimes quite a large variation) in the returns earned year by year on the investments held by the fund.

### Unitised

The name given to a with profits policy where premiums have been used to buy units in a with profits fund.

### Working capital

Refers to the amount by which the investments of the fund are greater than the amounts already promised to policyholders by way of guaranteed amounts and bonuses.

All literature about products that carry the Scottish Life brand is available in large print format on request to the Marketing Department. All our printed materials are 100% recycled, supporting responsible use of forest resource. Full details of Scottish Life branded products can also be obtained from the Marketing Department at Scottish Life, St Andrew House, 1 Thistle Street, Edinburgh, EH2 1DG.

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