October 2007

Understanding with profits

STANDARD LIFE

Summary: how your with profits investment works

We aim to treat all planholders fairly. Your with profits payout takes account of the premiums you pay us, the returns on the assets we invest in, our deductions, and any discretionary adjustments (up or down) that we make. The amount of your with profits payout also depends on whether you stay in with profits to the maturity date or retirement date, if any, set at the start of your plan.

Some with profits plans guarantee a minimum payout, for example when you die or when your plan reaches the maturity date or retirement date. In such cases, we will pay at least this minimum amount regardless of the performance of the assets we hold over the period that your plan is invested in with profits.

We invest in a wide range of assets, including equities (company shares), property and bonds (loans to governments or companies). These types of assets can rise or fall in value. When we set fair payouts we may smooth out some of the effects of short-term changes in asset values. We may hold different mixes of assets to back different classes of with profits plan. This mix of assets may change over time.

We may use bonuses in delivering fair payouts. We may add regular bonuses to gradually build up any guaranteed benefits; and, if necessary, we will pay a final bonus to top up your benefits to your fair payout plus any enhancement.

The remainder of this booklet provides further information on how your with profits investment works.

How your Standard Life with profits Investment works

Your plan documents define the terms and conditions that apply to your plan

1. Introduction

This booklet tells you how we manage our with profits business for most types of unitised with profits plans that Standard Life operates in the UK. We also have separate Understanding With Profits booklets for Stakeholder plans and other types of with profits plans.

This Understanding With Profits booklet is intended only to give a simplified description of how we manage this with profits business. It does not in any way:

- vary the existing terms and conditions of your plan;
- create any new or additional obligations; or
- restrict the way we manage our with profits business.

**We set out a fuller, more technical description of how we manage our UK with profits business in a separate document called Principles and Practices of Financial Management for the Heritage With Profits Fund (the Heritage PPFM).
Please see the Heritage PPFM if you want more information on the topics covered in this booklet.**

**Our website www.standardlife.co.uk/withprofits will always have the most up-to-date version of all Understanding With Profits booklets and of the Heritage PPFM. You can also get copies by contacting us on 0845 60 60 100.
(Call charges may vary.)**

If we make any changes to the Heritage PPFM that materially change this booklet, we will send you a new booklet at or before the time we send you your next yearly statement. We will also send you a booklet if we propose to change any of the principles we apply in managing this with profits business.

2. What is a with profits investment?

Your with profits investment provides a share in the performance of a relevant with profits fund. The relevant with profits fund (the fund) is the mix of assets that we hold to back your class of with profits investment. Other features that a with profits investment may have include certain guaranteed benefits, some smoothing of investment returns, and other discretionary adjustments. We explain these features, and which assets we invest in, later in this booklet.

Unitised plans

What is a unitised plan?

With a unitised plan we allocate a number of units to your plan for each premium you pay. The with profits units allocated represent your with profits investment. We may cancel units to meet charges under your plan.

See page 6
"What are your guarantees?"

The unit price normally increases daily. This daily increase reflects any regular bonus rate we declare. Guaranteed payouts may apply at the maturity date or retirement date originally selected at the start of your plan. This date is specified in your plan documents. Guaranteed payouts may apply when those covered die, for example for whole-of-life plans such as With Profits Bonds.

See page 7
"What happens if guarantees do not apply when your with profits investment ends?"

For pension plans, we may sometimes allocate units using a specially increased price, and so allocate fewer units to your plan. The circumstances where we may do this are set out in your plan documents.

We provide the returns on unitised with profits plans through the unit price and any final bonus. In certain circumstances we may reduce the unit price when your with profits investment ends.

What are the bonuses for unitised plans?

There are two types of bonus: regular and final. We may use these bonuses to provide some of the return on with profits plans.

Regular bonus

We may increase the amount guaranteed under your plan, over time, by adding regular bonuses. We usually declare regular bonus rates once a year.

We add any regular bonus by increasing the with profits unit price each day. The regular bonus is a percentage of the unit price. This percentage may be 0%.

Final bonus

We may pay a final bonus when your with profits investment ends. The level of final bonus may change over time, and may be zero.

We may apply different levels of final bonus depending on when you invested in with profits, the type of plan you have, why your with profits investment is ending and whether you have paid all the agreed premiums when due.

See section 6 “How we invest the money backing with profits plans’” for details of how guarantees affect investment freedom.

How we decide the bonuses for unitised plans

How we decide regular bonus
The aim of regular bonus is to build up guaranteed benefits. We try not to let guaranteed benefits become so high that they limit investment freedom too much, because this might reduce the benefits that we could eventually pay out through final bonus.

The factors affecting the regular bonuses we declare include:

- how we expect our assets to perform in the future – if our long-term view changes so that we expect lower investment returns, we may declare lower regular bonuses;
- actual returns in past years – if they have been poor we may have to declare lower regular bonuses;
- the level of regular bonus in recent years – we aim to make any changes gradually over time;
- the financial position of the Heritage With Profits fund; and
- whether the regular bonus is for pension plans or other plans, because different tax rules apply.

See section 3 “How do we set payouts?”

How we decide final bonus
When your with profits investment ends, we assess what would be a fair payout.

If your fair payout plus any enhancement is higher than your unit value, we will pay a final bonus to make up the difference.

What are your guarantees?

For some pension plans the same guarantee, less any outstanding initial unit charges, may apply at other retirement dates not more than 5 years before the originally selected date – please see your plan documents for details.

Pension plans
Your guaranteed benefits apply at the retirement date originally selected at the start of your plan, provided you use them to buy an annuity at that date. In this case we generally guarantee not to reduce the unit price. The guaranteed benefits are the number of units cancelled times the unit price. This unit price guarantee may not apply to some units allocated in the previous 5 years.

If you die before retirement, the value of the units cancelled at that date is normally payable as a minimum. We guarantee not to reduce the unit price in this event.

Other plans
For most plans, your guaranteed benefits apply at the maturity date you selected at the start of your plan. Provided you have not stopped paying premiums early, we guarantee not to reduce the unit price. The guaranteed benefits are the number of units cancelled times the unit price.

These guaranteed benefits also apply if those covered die before the maturity date, but a higher amount may be guaranteed under the terms of your plan, which are set out in your plan documents.

With Profits Bonds have no maturity date. For these plans we guarantee not to reduce the unit price if those covered die. The guaranteed benefits are the number of units cancelled times the unit price, but a higher amount may be guaranteed under the terms of your plan. We may also guarantee not to reduce the unit price on some regular withdrawals from With Profits Bonds. Please see your plan documents for details.

What happens if you stop paying premiums to a unitised plan?
If you stop paying premiums early, fewer units will be allocated to your plan than if you had continued paying premiums throughout the term of your plan.

For pension plans, if you stop paying premiums early your guarantees in respect of units allocated to your plan are unchanged.

See section 3 "How do we set payouts?"

For other plans, if you stop paying premiums early, we may reduce the unit price at the maturity date if your fair payout plus any enhancement is less than the unit value.

What happens if guarantees do not apply when your unitised with profits investment ends?
If your fair payout plus any enhancement is higher than your unit value, we will pay a final bonus to make up the difference.

If your fair payout plus any enhancement is lower than your unit value, we may reduce the unit price. Your payout, after any reduction, will be at least your fair payout plus any enhancement.

We are most likely to reduce the unit price if in the period since you invested in with profits:

- there has been a large fall in the value of the assets of the fund; or
- investment returns have been poor for a sustained period.

We recommend that you seek advice from your financial adviser if you are thinking about ending your with profits investment.

3. How do we set payouts?
We explained earlier that you will receive at least a fair payout when your with profits investment ends. We use asset shares as a tool to help set fair payouts. The asset share represents the underlying value of a plan; the fair payout may be more or less than this. We describe below what an asset share is and how we use asset shares, with any further adjustments, to set fair payouts. Your fair payout depends on the type of plan you have and why your with profits investment is ending. In some circumstances you could get back less than you invested.

What is an asset share?
Briefly, the asset share of a with profits policy is the accumulation at the relevant returns of the premiums paid, less any amounts withdrawn, less the deductions we make.

The relevant returns are the investment returns on the assets that back that class of with profits policies. Asset values, and so asset shares, may go down as well as up.

We publish information on the asset mix for different classes of with profits policies on our website at www.standardlife.co.uk/withprofits. You can also get a copy of this information by contacting us on 0845 60 60 100. (Call charges may vary.)

The deductions we make are normally for such things as our expenses; tax; costs of life cover, critical illness cover and guarantees; and a contribution to the capital of the Heritage With Profits Fund. For most unitised plans, these deductions (except for the cost of guarantees) correspond to charges under similar plans not invested in with profits.

When we calculate asset shares, we may need to make assumptions about the amounts to deduct for the cost of life cover and tax. If the actual cost of life cover and tax is different from these assumptions, then we may adjust the asset share (up or down) to reflect the difference.

How we use asset shares to set fair payouts
After calculating the asset share but before we set fair payouts, we may make further discretionary adjustments:

See section 4 "What is smoothing?"

- up or down for any smoothing; and
- if you are leaving with profits early, down to the extent necessary to protect the interests of remaining planholders. For example, in certain circumstances, we may need to make additional deductions for the cost of guarantees on their plans.

Any adjustments we may make, whether up or down, may depend on why the with profits investment is ending. For example we may sometimes make smoothing adjustments for maturities and retirements where guarantees apply, but not for other types of payouts.

In addition to the fair payout, we may pay an enhancement in respect of any distribution of inherited estate.

We tell you more about the assets we hold to back with profits plans in section 6, and about the inherited estate in section 8.

As explained earlier, we will pay the higher of:

- your fair payout plus any enhancement; and
- any applicable guaranteed amount.

How do we set fair payouts for unitised plans?

If you have a With Profits Bond, your fair payout is the asset share, plus any further discretionary adjustments (up or down), for your plan.

A bonus year is from 16 November in one year to 15 November in the next.

For most other unitised plans, we use the asset share, plus any further discretionary adjustments (up or down), for typical policies for a group of plans to set payout calculation factors, which we then use for all plans in that group. We may, for example, group together plans that started in the same bonus year. We set payout calculation factors at least once a year.

We apply these payout calculation factors to your unit value to determine your fair payout. The payout calculation factor(s) may differ according to why the with profits investment is ending.

For unitised pension plans we currently apply separate payout factors to the units allocated to your plan in each bonus year and then add the resulting values together to produce your fair payout. The factors we use are based on typical single premium policies.

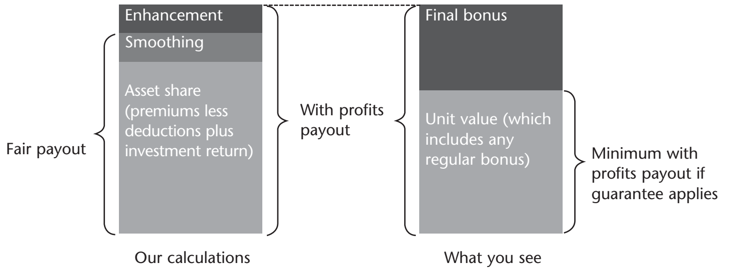
The following two diagrams show how the with profits payout for a unitised plan is calculated and delivered.

- The left-hand side of both diagrams shows a breakdown of the fair payout value of the plan at a time when we are smoothing payouts up and paying an enhancement in respect of a distribution of the inherited estate but making no other discretionary adjustments (see above).
- The right-hand side shows how the with profits payout is delivered (see section 2).

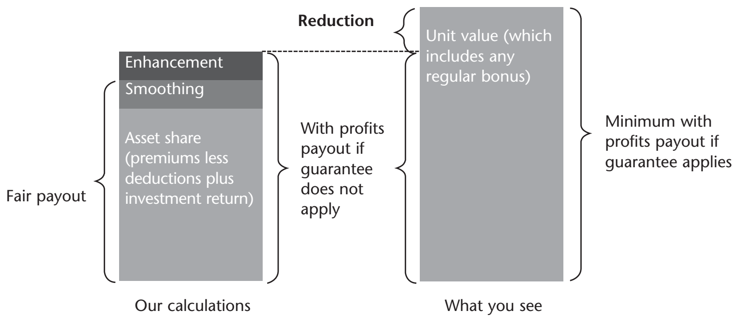
Plan values and payouts may differ in other circumstances as described above, and could result in different diagrams. The height of the boxes does not indicate the relative size of each element of the with profits payout.

See section 8 "What is the inherited estate and how do we use it?"

Payout diagram 1 – Fair payout plus inherited estate enhancement is higher than the unit value



Payout diagram 2 - Fair payout plus inherited estate enhancement is lower than the unit value



In the circumstances illustrated in payout diagram 2, if the guarantee does not apply we normally pay the fair payout plus any inherited estate enhancement. We do this by reducing the unit price. The **reduction**, the difference between the amount we pay and the unreduced unit value that includes regular bonus, is sometimes called a Market Value Reduction (MVR) or Market Value Adjustment (MVA).

4. What is smoothing?

We hold a wide range of assets to back with profits plans. The return on these assets will vary over time. One year the assets could go up in value, but the next they could go down. We may even out some of the fluctuations in investment returns to reduce the immediate impact of short-term changes in asset values on payouts under our with profits plans.

Smoothing is the name we give this process. We aim to smooth for payouts on maturity and retirement where guarantees apply, and we may smooth for other types of payout.

Smoothing evens out some of the effects of short-term changes in asset values. In the longer term:

- smoothing will not protect planholders from long-term falls in the value of the backing assets;
- smoothing will not stop planholders benefiting from the effects of long-term improvements in the value of the backing assets.

See section 3 "How do we set payouts?"

Sometimes we smooth up, so the fair payout of a with profits policy is higher than its asset share; and sometimes we smooth down, so the fair payout of a with profits policy is lower than its asset share. However, we aim to operate smoothing so that, over time, the total amount of the fair payouts for all with profits policies in the Heritage With Profits Fund is equal to the total value of the asset shares for those policies. When we set fair payouts using typical policies our aim is that fair payouts for the typical policies are between 80% and 125% of their asset share. We also aim to make fair payouts between 80% and 125% of asset share for With Profits Bonds.

We may sometimes reduce the amount of smoothing or apply no smoothing of investment returns at all. We may do this, for example, if there has been a rapid fall in the value of assets and we expect a significant amount of money to be leaving with profits.

If a fair payout is more than the asset share, the Heritage With Profits Fund makes a smoothing loss. If a fair payout is less than the asset share, the Heritage With Profits Fund makes a smoothing gain. When we make adjustments for any smoothing, we take account of the losses and gains that the Fund has made as a result of smoothing on past payouts. The smoothing losses and gains we will allow for are those from fair payouts made while the plan has been invested in with profits.

5. What expenses do we incur?

Like any other business Standard Life incurs expenses. These include the salaries of our staff, the cost of maintaining our head office and branches, our investment costs, any commission paid to intermediaries and any other ongoing costs. When determining asset shares and fair payouts, we make deductions for a fair share of these expenses incurred in the operation of the Heritage With Profits Fund.

6. How we invest the money backing with profits plans

We invest in a mix of assets, including:

- equities (company shares);
- property;
- bonds (loans to governments or companies); and
- cash deposits.

Equity and property assets generally have more variable values than bonds or cash deposits, but over the longer term we expect them to provide higher returns. Bonds and cash deposits generally have more stable values, but over the longer term we expect them to provide lower returns.
We may also invest in derivatives – such as investments that provide rights or obligations to buy or sell assets at a particular price and time – as an efficient way of managing our with profits business.

How we decide the asset mix

We regularly review the asset mix that backs each class of with profits business. We seek to optimise investment returns. The asset mix may not be the same for all classes of with profits plan and may change over time.

We decide what asset mix to hold by considering the extent of guarantees for each class of with profits plan, and the appropriate balance between risk and expected return. When we invest in assets with more variable values, there is a higher risk that the assets will have low values when we need to make payouts to planholders. In particular, the assets backing a class of with profits plan could be worth less than the guaranteed benefits. In this case the shortfall has to be met. The higher the level of guarantees for a class of plan, then the more we may have to invest in lower-risk assets with more stable values, to back that class of plan. However, we generally expect lower-risk assets to give lower returns over the longer term.

Our main restriction on investment strategy is maintaining the financial strength of the Heritage With Profits Fund at an appropriate level whilst meeting our obligations to planholders. The investment return credited to a particular class of with profits plan will reflect the investment return on the mix of assets that backs that class of business.

How we manage the risks associated with investment
Risks associated with investment include companies performing poorly and reducing dividends, or borrowers not making promised interest and capital repayments, or our having to sell assets to meet payouts when prices are depressed. We aim to control our exposure to investment risks by investing in assets of sufficient quality and variety. For example we set limits on the amount we invest in any one asset, in assets issued by any one company, and in assets that are not traded on a recognised stock or bond market (and so may be difficult to sell).

Sometimes we may need to reduce significantly the proportion invested in higher-risk assets such as equities and property, for example where the financial strength of the Heritage With Profits Fund reduces following a sudden or sustained fall in asset values. Any change in the asset mix is likely to result in a change in future investment returns and with profits payouts. However, this will not affect any existing guarantees.

Subject to the above considerations the assets backing with profits plans are held solely for investment reasons.

7. How we manage risk

See section 6 "How we invest the money backing with profits plans"

Running our business inevitably involves some risks. The largest risk is that the investment return on the with profits assets is not enough to meet plan guarantees and to maintain the financial strength of the Heritage With Profits Fund. We manage this risk by varying the mix of assets that backs with profits plans.

We also manage this risk through the deductions we make from asset shares for the cost of guarantees. We normally review these deductions once a year, but we may do so more often. We may increase these deductions if we make a loss in respect of guarantees, for example because we assess that the cost of guarantees has increased or will increase. This assessment will vary because of, for example, changes in:

- asset values;
- asset mixes; and
- regular bonus.

Other risks include higher-than-expected costs of providing life cover and higher-than-expected expenses. We may manage these risks through underwriting (for example asking health questions on proposal forms) and reinsurance (passing part of the risk to another insurance company), and through budgetary controls.

We carefully consider the significant risks associated with any particular business activity before we undertake it. We take on additional risks in the Heritage With Profits Fund, for example by writing new business, only if these risks are not expected to have a materially adverse effect on existing planholders.

Capital is needed to support any business activity. Before undertaking a business activity in the Heritage With Profits Fund we compare:

- the expected profitability of the activity; with
- the expected benefits to our with profits planholders of other uses of that capital.

8. What is the inherited estate and how do we use it?

A with profits payout will only include an inherited estate enhancement if we are making distributions from the inherited estate at the time when we make that payout.

On 10 July 2006 The Standard Life Assurance Company transferred all its UK with profits business into the Heritage With Profits Fund of Standard Life Assurance Limited. This Fund was set up with an inherited estate – a pool of assets that provides working capital for our with profits business. The main role of the inherited estate is to ensure that a prudent amount is retained in the Heritage With Profits Fund for liabilities that may arise in the Fund. To the extent that we are satisfied that the inherited estate exceeds the amount needed for this we will distribute any excess, over time, as an enhancement to with profits payouts.

We aim to restrict any distribution of the inherited estate to payouts for former Standard Life Assurance Company policies that have remained continuously in with profits since 9 July 2006.

9. How we manage new business

We aim to offer competitive terms for new business and increases to premiums on existing business. We set limits on the new business that can be written in the Heritage With Profits Fund.

We have no plans to stop selling new with profits plans. If we do ever stop selling them, we will notify you and will write to explain how we will manage our with profits business in the future.

10. How we balance the interests of with profits planholders and shareholders

Standard Life Assurance Limited is a wholly owned subsidiary of Standard Life plc, which is owned by its shareholders. Shareholders are entitled to certain payments from the Heritage With Profits Fund and meet certain costs, as described below.

We explained earlier how we set fair payouts using asset shares as a tool, and the deductions we may make from asset shares. For unitised plans, provided we meet our obligations to planholders, the shareholders are entitled to the deductions from asset shares (except deductions for tax or costs of guarantees). In return they meet the expenses and costs of life cover and of critical illness cover on these plans. For conventional plans the deductions made from asset shares remain in the Heritage With Profits Fund, and this Fund meets the expenses and cost of life cover on these plans.

We will not take any action to increase the amount shareholders may receive if this would conflict with our duty to treat customers fairly.

The Standard Life Assurance Limited Board makes all the decisions about with profits business. The With Profits Committee independently assesses the fairness to with profits planholders of any significant proposed action or exercise of discretion.

We publish a report to UK with profits planholders each year on our website www.standardlife.co.uk/withprofits. This report sets out the Board's opinion on the fairness to planholders of its exercise of discretion during the previous calendar year. The With Profits Committee may append a report of its own to this report.

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