

October 2007

# Understanding with profits



## 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. It may also depend on why units are being encashed.

We guarantee a minimum payout under your Trustee Investment Plan in certain circumstances, for example for units that have been held for more than 15 years that are encashed at a plan anniversary. In these circumstances 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

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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 Trustee Investment Plan business, except for Trustee Investment Plans that are invested in the Pooled With Profits Fund. We have a separate Understanding With Profits booklet for these plans and for all our other types of UK with profits business.

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](http://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 0131 245 9696.**

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.

What is a Trustee Investment Plan?

A Trustee Investment Plan is an investment-only contract available to occupational pension schemes.

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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.

The unit price normally increases daily. This daily increase reflects the guaranteed minimum unit price growth rate and any regular bonus rate we declare.

The price of units in the Pension Inflation Plus Fund changes in line with monthly changes in the Retail Prices Index, so it can go down as well as up; there are no regular bonuses or guaranteed minimum growth rates.

See "What are your guarantees?" on page 6.

On each anniversary date, we encash those units that were allocated more than 15 years previously. Unit price guarantees apply to these encashments.

You can reinvest the proceeds of these encashments as a premium into any with profits or investment-linked funds that are available to you at that time.

See "What are your guarantees?" and "What happens if guarantees do not apply to units encashed?"

You can ask us to encash other units at any time. If we are to encash only part of your with profits investment, we encash units proportionately across all previously allocated units relating to your whole with profits investment.

We provide the returns 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?

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. Any regular bonus is in addition to the guaranteed minimum growth. 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 also pay a final bonus when units are encashed, for example at the plan anniversary for those units allocated more than 15 years previously. The level of final bonus may change over time, and may be zero.

We may apply different levels of final bonus depending on when your units were allocated and why your units are being encashed.

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

See section 3  
“How do we set payouts?”

How we decide the bonuses

### **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.

### **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?

We guarantee not to reduce the unit price for units that have been held for more than 15 years that are encashed at a plan anniversary. The guaranteed benefits are the number of units encashed times the unit price applying on the encashment date.

We guarantee not to reduce the unit price for up to 10% of the number of units that you still hold on the first day of a plan year, and that we allocated to your plan more than two years before that date, and that you ask us to encash in that plan year.

What happens if guarantees do not apply to units encashed?

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.

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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?

You will receive at least a fair payout when units are encashed. 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 may depend on why units are being encashed. 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](http://www.standardlife.co.uk/withprofits). You can also get a copy of this information by contacting us on 0131 245 9696.**

The deductions we make are normally for such things as our expenses and the cost of guarantees. These deductions (except for the cost of guarantees) correspond to charges under similar plans not invested in with profits.

When we calculate asset shares for some other classes of with profits business 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) for Trustee Investment Plan business to reflect this difference.

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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 differ according to why the with profits investment is ending. For example, we may concentrate our smoothing on payouts where guarantees apply.

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 use of the inherited estate in section 8.

### If guarantees apply

As explained earlier, we will pay the higher of:

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

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

We use the asset share, plus any further discretionary adjustments (up or down), for typical policies to work out payout calculation factors, which are then used for all plans in the same group. We use a series of typical single premium policies, one for each bonus year in which a premium was paid into the plan. We apply these payout calculation factors to your unit value to determine your fair payout.

### If guarantees do not apply

We currently intend that your fair payout is broadly in line with the asset share, plus any further discretionary adjustments (up or down), relating to the units encashed. These discretionary adjustments, and so your fair payout, may depend on why units are being encashed.

## 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 where guarantees apply and may smooth for other types of encashment.

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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 unless a higher guaranteed amount is payable. Otherwise, our aim is that fair payouts are between 80% and 125% of the asset share relating to units encashed.

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.

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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 of assets invested in higher-risk assets such as equities and property, for example where the financial strength of the Heritage With Profits Fund is reduced following a sudden or sustained fall in asset values. Any change in the asset

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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

Running our business inevitably involves some risks. The largest risk is that the investment return on 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 our assessment is 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 (monitoring expenses and taking action where appropriate).

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.

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

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.

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

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 policies that have remained continuously in with profits since 9 July 2006.

### **9. How we manage new business**

We no longer accept new money into with profits Trustee Investment Plans. However, we sell other types of with profits plans that invest in the Heritage With Profits Fund, and aim to offer competitive terms for them. We have no plans to stop selling other types of with profits business, although we set limits on the new business that can be invested in the Heritage With Profits Fund.

### **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 unutilised plans (including Trustee Investment 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 the expenses and cost of life cover on these plans are met by this Fund.

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

## **Understanding with profits**

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](http://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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