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 may also depend on why units are being encashed.

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.

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

How your Standard Life with profits investment works

Contents

1. Introduction

This booklet tells you how we manage our with profits Trustee Investment Plans invested in the Pooled With Profits Fund, which is a part of the Heritage With Profits Fund. It does not apply to other with profits Trustee Investment Plans. We have a separate Understanding With Profits booklet for these plans and for all our other types of UK with profits business.

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

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 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 the Pooled With Profits Fund. Some smoothing may apply. We give more details about smoothing 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.

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 value of your units reflects, amongst other things, investment performance and any gains and losses from smoothing investment returns.

See section 3 "How do we set payouts?"

The value of your units and your fair payout may go down as well as up.

What are your guarantees?
We do not guarantee investment performance. The value of your units may go down as well as up. In some circumstances you could get back less than you invested.

We guarantee that the charges on your fund will not be more than 1% of the value of your units in any year.

What happens when units are encashed?
You will receive at least your fair payout.

See section 7 "What is the inherited estate and how do we use it?"

In addition we may pay an enhancement in respect of any distribution of inherited estate.

3. How do we set payouts?

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 is the asset share, with any further adjustments, relating to the units encashed. The adjustments, and so your fair payout, may depend on why the units are being encashed.

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.

See section 4 "What is smoothing?"

The relevant returns are the investment returns on the assets that back the Pooled With Profits Fund, adjusted for the gains and losses due to smoothing investment returns. Asset values, and so asset shares, may go down as well as up. We tell you more about the assets we hold to back with profits plans in section 6.

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 0131 245 9696.

The deductions we make are normally for such things as our expenses. These deductions generally correspond to charges under Trustee Investment Plans not invested in with profits.

How we use asset shares to set fair payouts
After calculating the asset share for your plan, we set its fair payout. The fair payout is the asset share with any discretionary adjustments we may make, up or down, for any smoothing of investment returns.

See section 7 "What is the inherited estate and how do we use it?"

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

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.

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; 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 of all with profits policies in the fund is equal to the total value of the asset shares for those policies. We aim to make fair payouts between 80% and 125% of asset share.

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 fund makes a smoothing loss. If a fair payout is less than the asset share, the fund makes a smoothing gain. At the close of each day, when we calculate asset shares, we take account of the gains and losses that the fund has made as a result of smoothing on payouts made that day.

5. How do expenses affect your plan?

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. As explained above, when we calculate asset shares, we make a deduction that generally corresponds to the charge under Trustee Investment Plans not invested in with profits, regardless of the actual level of expenses incurred.

6. How we invest the money backing with profits plans

We invest in a mix of assets, including:

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

Equities 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, and in property.

How we decide the asset mix

We regularly review the asset mix that backs the Pooled With Profits Fund. 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. Any change in the asset mix is likely to result in a change in future investment returns and with profits payouts.

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).

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

7. 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. The 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.

The Heritage With Profits Fund includes other business as well as the Trustee Investment Plan with profits business covered by this booklet. Some of this with profits business will share in any distribution of the inherited estate.

The operation of other business in the Heritage With Profits Fund may affect the size of our inherited estate, and hence any amount available for distribution as an enhancement to with profits payouts.

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 in two main ways:

- by backing with profits plans with a mix of assets of sufficient quality and variety; and
- by making reviewable deductions from asset shares (for plans which have investment performance guarantees) for the cost of guarantees.

Writing new business could potentially be a significant risk. However, we set limits on the new business that can be written in the Heritage With Profits Fund.

We are not selling new with profits Trustee Investment Plans. However, we sell other types of with profits plans that do invest in the Heritage With Profits Fund and we have no plans to stop doing so. If we do ever stop selling new with profits plans, we will notify you and will write to explain how we will manage our with profits business in the future.

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 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.

8. 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 (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 for plans which are subject to tax or have investment performance 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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