

Understanding With Profits

JULY 2006

This booklet gives you important information about how your Standard Life with profits investment works.

We hope you find this booklet useful. Please keep it in a safe place in case you want to refer to it later.



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.

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



Contents

1. Introduction	4
What are Principles and Practices of financial management?	
2. What is a with profits investment?	5
Unitised plans/Conventional plans	
What is a unitised plan?	
What are the bonuses? – regular bonus/final bonus	
How we decide regular bonus	
How we decide final bonus	
What are your guarantees? – pension plans/other plans	
What happens if you stop paying premiums?	
What happens if guarantees do not apply when your with profits investment ends?	
3. How do we set fair payouts?	8
What is an asset share?	
How we use asset shares to set fair payouts	
4. What is smoothing?	10
5. What expenses do we incur?	11
6. How we invest the money backing with profits plans	11
How we decide the asset mix	
How we manage the risks associated with investment	
7. How we manage risk	12
8. What is the inherited estate and how do we use it?	13
9. How we manage new business	13
10. How we balance the interests of with profits planholders and shareholders	14
11. If you need to contact us	14

1. Introduction

This booklet tells you how we manage our with profits business. It covers most types of with profits plans that Standard Life operates in the UK. We have separate **Understanding With Profits** booklets for Stakeholder plans, With Profits Pension Annuities, Trustee Investment Plans, and Group Death in Service and Group Permanent Health Insurance plans.

We set out in more detail how we manage all our UK with profits business covered by this booklet in a separate publication called *Principles and Practices of Financial Management for the Heritage With Profits Fund* (Heritage PPFM). Our Heritage PPFM also explains how the management of this with profits business is subject to the terms of the legal scheme of demutualisation from 2006. This booklet is a summary of the main points from our Heritage PPFM relevant to your plan. If you require a fuller, more technical description, you should refer to our Heritage PPFM.

This **Understanding With Profits** booklet is intended only to give a high-level and 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.

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

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

What are Principles and Practices of financial management?

We manage this with profits business according to a set of Principles and associated Practices that are set out in our Heritage PPFM. Principles are high-level statements of the standards we apply. Practices are more detailed statements of our current approach to managing with profits business.

We don't expect to change our Principles very often. We will normally tell you at least three months in advance of any changes to our Principles. However, Practices change more often, for example to respond to changes in the business or economic environment, or to protect the interests of with profits planholders.

If we make any changes to our Heritage PPFM that materially change this booklet, we will send you a new booklet no later than the next time we send you a 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 is the part of your plan (and it could be the whole of your plan) for which we provide a share in the performance of a relevant with profits fund. The relevant with profits fund is the mix of assets that we hold to back your class of with profits investment. In addition certain guaranteed benefits, some smoothing of investment returns, and other discretionary adjustments may apply to your with profits investment. We give more detail about these, 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.

The unit price normally increases daily. This daily increase reflects the guaranteed minimum growth rate and any regular bonus rate we declare. Guarantees 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. Guarantees may apply when those covered die, for example for whole of life plans such as Variable Protection Plans and With Profits Bonds.

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.

For some 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.

What are the bonuses for unitised plans?

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

Regular bonus

We may increase the amount guaranteed under your plan, over time, by adding regular bonuses.

We add any regular bonus by increasing the with profits unit price each day. The regular bonus rate is a percentage of the unit price. This percentage may be 0%. Any regular bonus is in addition to the guaranteed minimum growth.

We usually declare regular bonus rates once a year

Final bonus

We may also pay a final bonus when your with profits investment ends.

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.

The level of final bonus may change over time, and may be zero.

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 and so potentially reduce the benefits that can eventually be paid out through final bonus – please see section 6 *How we invest the money backing with profits plans* for details of how guarantees affect investment freedom.

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.

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 (please see section 3 *How do we set fair payouts?*) is higher than your unit value, we will pay a final bonus to make up the difference.

What are your guarantees?

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 event 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.

For some 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.

Some Transfer Plans have a guaranteed minimum pension which will form part of the contractual guarantees; your plan documents will tell you if you have one of these.

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 for the units allocated to your plan. 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 guaranteed amount may be payable.

For With Profits Bonds and other whole of life plans there is no maturity date. 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 guaranteed amount may apply. 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?

If you stop paying premiums early, there will be fewer units allocated at your maturity date or retirement date than if you had continued paying premiums throughout the term of your plan.

For pension plans and for whole of life plans if you stop paying premiums early, your guarantees in respect of units allocated are unchanged while your plan remains in force.

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 – please see section 3 *How do we set fair payouts?*.

What happens if guarantees do not apply when your with profits investment ends?

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

If your fair payout plus any enhancement (please see section 3 *How do we set fair payouts?*) 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 to bring your unit value down to your fair payout plus any enhancement.

We are most likely to reduce the unit price if:

- there is a rapid fall in the value of the assets of the fund; or
- investment returns are poor for a sustained period.

3. How do we set fair 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 the 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.

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 we hold to back with profits policies.

We may hold different mixes of assets for different classes of policy. Asset values, and so asset shares, may go down as well as up.

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.

The asset share may also be adjusted (up or down) to reflect any differences between the actual cost of life cover and tax and what we previously assumed when making deductions from asset shares.

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:

- up or down for any smoothing – please see section 4 *What is smoothing?*; and
- if you are leaving with profits early, down to the extent necessary to protect the interests of remaining planholders.

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 maturities and retirements where guarantees apply.

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

We tell you more about the assets we hold to back with profit plans, and the use of the inherited estate in sections 6 and 8 respectively.

As explained earlier, we will pay the higher of:

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

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

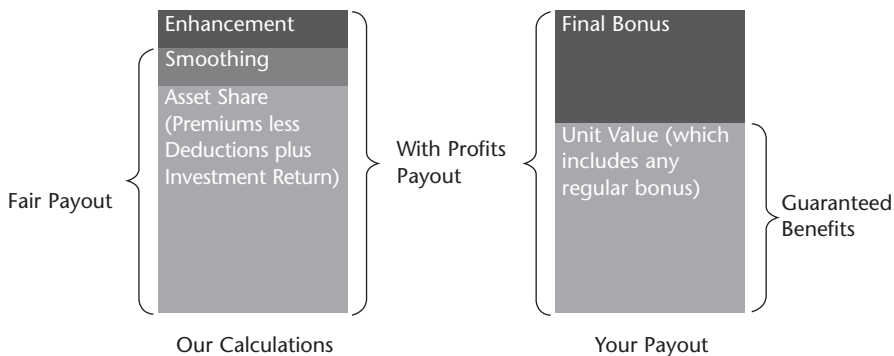
For most other unitised plans, we use the asset share, plus any further discretionary adjustments (up or down), for typical policies for a group of plans to set payout calculation factors, which are then used for all plans in that group. We apply these payout calculation factors to your unit value to determine your fair payout.

We may, for example, group together plans that started in the same bonus year (a bonus year is from 16 November in one year to 15 November in the next). For unitised pension plans we use a series of typical single premium policies, one for each bonus year in which a premium was paid into the plan.

The payout calculation factor, may differ according to why the with profits investment is ending (since, as explained above, any further discretionary adjustments may differ for this reason).

We set payout calculation factors at least once a year.

The following diagram shows how the with profits payout for a unitised plan is calculated (left-hand side – see above) and delivered (right-hand side – see section 2). It shows, for a unitised plan for which all the premiums were paid when due, the payout at maturity, at a time when we are smoothing payouts up and paying an enhancement in respect of a distribution of the inherited estate, and the payout is higher than the unit value. Payouts in other circumstances are 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.



Smaller classes

For some smaller classes of with profits business, and for some types of payout, we may use asset shares for similar types of with profits plan or some equivalent measure to set fair payout levels.

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.

We aim to operate smoothing so that its effect is neutral over time. When we set fair payouts using typical policies (please see above) 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 Homeplan and With Profits Bonds.

We may reduce the amount of smoothing or apply no smoothing of investment returns at all. An example of when we may do these things is 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. 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 fair payouts we recover 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 (which are loans to governments or companies) and cash deposits. Equity and property assets generally have more variable values, 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.

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 higher the proportion of assets backing that class of plan which we may have to invest in lower-risk assets with more stable values. 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 a level the Board decides is appropriate 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).

There may be times when we 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.

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

We publish information on the asset mix for different classes of with profits business on our website. Alternatively please contact us on **0845 60 60 100** for a copy of this information.

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 – please see section 6 *How we invest the money backing 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 the costs of providing life cover being higher than we expected, and expenses being higher than we expected. 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.

Our Board carefully considers the significant risks associated with any particular business activity before we undertake it. One of the objectives when The Standard Life Assurance Company demutualised in 2006 was to transfer some risks associated with business activities from with profits planholders to shareholders. 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. There are limitations on the new business that can be written in the Heritage With Profits Fund. More details of these limitations are set out in our Heritage PPFM.

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?

Our inherited estate is 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 with profits investments that existed continuously from the day before The Standard Life Assurance Company demutualised in 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 our with profits business will then be managed.

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

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, subject to our meeting our obligations to planholders, the shareholders are entitled to the deductions from asset shares (other than 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. We also have conventional plans in the Heritage With Profits Fund. 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 such action 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 provides an independent assessment of 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.

11. If you need to contact us

You can contact us through our website www.standardlife.co.uk

Or by telephone on **0845 60 60 100**.

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