



Understanding with profits

For With Profits Pension Annuity Plans

Standard Life 

This booklet tells you how we manage our With Profits Pension Annuity business only. There are separate Understanding With Profits booklets for other types of with profits plans.

These booklets do not in any way:

- ▶ vary the existing terms and conditions of your plan; or
- ▶ 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.



We can only give a simplified explanation of with profits in this booklet.

We set out a fuller, more technical explanation of how we manage our 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 a copy of any of these documents by calling us on **0845 60 60 007**. (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, normally 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.



How your Standard Life with profits investment works

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1. Introduction

What is a with profits investment?

A with profits investment is a medium- to long-term investment that aims to offer some protection against short-term changes in investment markets.

We invest the money you pay us, and the money paid by other with profits investors, in a pool of assets. We use the return we get on these assets to set the annuity income payments for your plan. We describe how we do this in section 3.

Our approach

Our aim when managing our with profits business is to achieve competitive returns for with profits plans while continuing to:

- ▶ meet all our contractual obligations to planholders; and
- ▶ maintain an appropriate level of financial strength.

This is underpinned at all times by our commitment to treating planholders fairly.

We need to make decisions when we haven't set rigid rules about what we will do. Rigid rules might force us to do something that is not in the best interests of planholders.

We need to make decisions about what to do to achieve this aim. For example, we need to decide how we should invest the money backing with profits plans and whether we should apply smoothing for payouts (see sections 5 and 6). We make these decisions in good faith, and we only take actions that we believe are in the best interests of with profits planholders.

Your annuity income payments take account of the outcome of these decisions. They may be topped up, for example if we are making payments from the inherited estate (see section 8).

This booklet is a summary of the most important parts of the Heritage PPFM for planholders who have a With Profits Pension Annuity.

The With Profits Committee provides independent judgment on treating with profits planholders fairly. It also monitors how we comply with the Heritage PPFM, to ensure we protect the interests of with profits planholders.

We explain in section 3 how we decide the Declared Rate of Return.

2. What is a With Profits Pension Annuity?

A With Profits Pension Annuity is a retirement income plan where we pay you an income for life in return for a payment from a pension plan. If you selected a pension for a dependant, then we will pay them an income for life after you die.

Your income payments can go down as well as up. We usually review the level of the income we pay you once a year. Any change we make depends on:

- ▶ the Declared Rate of Return at the time of the review; and
- ▶ your anticipated bonus rate. When you took out your plan you chose an 'anticipated bonus rate'. The higher the rate you chose, the higher the starting level of your annuity income was. You can change your anticipated bonus rate at any time.

If the Declared Rate of Return is higher than your anticipated bonus rate, your annuity income will go up. If it is lower, your annuity income will go down.

We can change the income payments at other times by setting a new Declared Rate of Return. We would only do this if it was necessary in order to maintain fairness among with profits investors. This might be, for example, if there has been a large fall in asset values since the last review.

What are the guarantees?

We guarantee that the lowest rate of return we will declare in any one year is minus 10%, regardless of the actual investment returns. This means that if your anticipated bonus rate is 0% your annuity income will not go down by more than 10% in any year. However, if you have chosen an anticipated bonus rate more than 0% your annuity income could go down by more than 10% in a year.

3. What affects how much you may get?

The starting level of your annuity income depends on several factors including the size of payment we receive from your pension plan and the anticipated bonus rate you choose. After that, the level of your income depends on the anticipated bonus rate and the Declared Rate of Return.

How we decide the Declared Rate of Return

The starting point for the Declared Rate of Return is the return on the asset mix for our With Profits Pension Annuity business, less the deductions we make. The return on the asset mix is made up of income, for example dividends and interest payments, and changes in asset values. Asset values can go down as well as up, so the return can be negative or positive.

We then make adjustments, for example:

- ▶ up or down – for smoothing (see section 5);
- ▶ up – for any distribution of inherited estate (see section 8).

We guarantee that the lowest rate of return we will declare in any one year is minus 10% (see Section 2).

Each time we set a new Declared Rate of Return there can be a large change from the previous rate, despite any smoothing of investment returns.

What are the deductions?

There are deductions for a contribution to the capital of the Heritage With Profits Fund and for the costs of running our with profits business, for example staff salaries, head office and branch costs, investment costs and commission paid to intermediaries.

We take into account a fair share of these costs when we set the initial level of annuity income and the Declared Rate of Return.

There may also be deductions for the cost of guarantees on with profits business.

4. Can I move out of with profits?

You can move out of with profits at any time by converting to a conventional pension annuity. A conventional pension annuity provides an income that stays the same or increases at a fixed rate or in line with inflation. You can't cash in a With Profits Pension Annuity or a conventional pension annuity.

If you convert to a conventional annuity, we would use your fair share of the Fund to calculate the level of your income under that annuity. We would not smooth investment returns when calculating your fair share of the Fund. This is to maintain fairness between planholders who remain in with profits and those who choose to move out.

Important: If you are thinking about stopping your with profits investment, we strongly recommend you talk to your financial adviser. There may be a cost for this.

5. What is smoothing?

Smoothing is the process by which we can even out some of the short-term fluctuations in investment returns to reduce the immediate impact on annuity income payments.

We invest the Heritage With Profits Fund in a wide range of assets, including equities (company shares), property, bonds and cash deposits. The returns on these assets vary over time and asset values sometimes change sharply over a short period. To offer some protection from this, we may smooth out some of the short-term changes, up or down.

This can result in annuity income payments being higher or lower than they would have been without smoothing.

We aim to operate smoothing so that the value of the total payments we make to with profits planholders is the same as if there were no smoothing. If an annuity income payment is higher than it would have been without smoothing, there is a smoothing loss for the Fund. If the annuity income payment is lower, there is a smoothing gain.

When we set the Declared Rate of Return, we take into account a fair share of the smoothing losses and gains the Fund has made since your plan started. So if there have been more smoothing losses than smoothing gains, the level of your annuity income will be lower than it would have been if we did not make this allowance.

On the other hand, if there have been more smoothing gains than smoothing losses, the level of your annuity income will be higher.

We may sometimes reduce the amount by which we smooth investment returns or we may not smooth them at all. This may happen if, for example, there has been a rapid fall in the value of assets.

Although smoothing can even out some of the effects of short-term changes in asset values, it won't protect planholders from long-term falls. If there is a big drop in asset values, and they stay low, then annuity income payments will go down even if we are still smoothing up.

On the other hand, smoothing won't stop planholders benefitting from long-term improvements in asset performance.

6. How we invest the money backing with profits plans

The assets of the Heritage With Profits Fund include:

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

We may also invest in derivatives. These can include investments that give us the right, or obligation, to buy or sell assets at a particular price at a particular time.

We use the returns the Fund gets on these assets to set with profits payouts such as annuity income payments. The returns we use for each class of with profits business depend on the asset mix for that business. The asset mix depends on the type of plan and the guarantees.

Bonds are sometimes called 'fixed interest assets'. Government bonds are also called 'gilts'.

The asset mix will change over time as asset values change. We also regularly review the asset mix that backs each class of with profits business and may then make additional changes. In the next section we explain how and why we do this. We may make these changes by selling some types of asset and buying other types of asset.

We publish up-to-date information on the asset mix for different classes of with profits plans on our website

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.)

How we decide the asset mix

We decide the asset mix by considering:

- ▶ the extent of guarantees for each class of with profits business; and
- ▶ an appropriate balance between risk and expected return.

The main restriction on the way we invest is the need to ensure we maintain the strength the Heritage With Profits Fund while also meeting our obligations to planholders.

Risks associated with investment

Assets such as equities tend to have more variable values. We expect them to provide higher returns over the longer term, but there is also a greater risk that they will have a low value when we need to make payments. In particular, the assets backing a class of with profits business could be worth less than any guarantees. In this case the Fund has to meet the shortfall. We might then have to make guarantee deductions when calculating the Declared Rate of Return and increase the guarantee deductions for other types of with profits plan.

Because of this, the higher the level of guarantees for a class of with profits business, the more we may need to invest in lower-risk assets like bonds and cash deposits. They generally have more stable values but over the longer term we expect them to give lower returns.

Sometimes, we might need to significantly reduce the proportion invested in higher-risk assets like equities and properties. This could happen if the financial strength of the Heritage With Profits Fund reduces following a sudden or long-lasting fall in asset values.

Any change in the asset mix is likely to result in a change in future returns and plan payouts, including annuity income payments.

Other risks associated with investment include:

- ▶ companies performing poorly. For example, they could
 - reduce dividends
 - not make promised interest payments
 - not make capital repayments
 - go out of business
- ▶ governments not making promised interest payments or not making capital repayments
- ▶ having to sell assets to meet payouts when prices are depressed.

We aim to control our exposure to risk by investing in a wide variety of good-quality assets.

We set limits on the amount we invest in any one asset, in assets issued by any one company, and in assets that may be difficult to sell (for example because they're not traded on a recognised stock or bond market).

We currently hold some assets as long-term investments. These are some subsidiary companies and other asset holdings that were set up as long-term investments of the Standard Life Assurance Company when it was a mutual company. When it demutualised in 2006, these assets were transferred to the Heritage With Profits Fund. These are separate from the assets that back underlying with profits plan values.

7. How we manage risk

Running our business inevitably involves some risks. The greatest risk is that the investment return on with profits assets is not enough to:

- ▶ meet plan guarantees; and
- ▶ 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 and by making deductions for the cost of guarantees. These deductions go into the Heritage With Profits Fund, and the Fund meets the guarantee top-up costs.

We normally review guarantee deductions once a year, but can review them more often if we need to. We can increase these deductions if the Fund makes a loss in respect of guarantees. This loss may happen because we assess that the cost of guarantees has increased or will increase. Our assessment of the cost of guarantees will vary due to, for example, changes in:

- ▶ asset values;
- ▶ asset mixes; and
- ▶ regular bonus (for plans that have regular bonuses).

Other risks include higher-than-expected costs for with profits business, including costs of providing life cover (on plans that have life cover). We can manage these risks through budgetary controls and underwriting (for example asking health questions on proposal forms). We can also use reinsurance as a way of reducing risk, by passing part of the risk to another insurance company.

We carefully consider the risks of any potential business activity. We only take on additional risks in the Heritage With Profits Fund, for example by writing new business, if we expect them not to have a materially adverse effect on existing planholders.

We need capital to support any business activity. Before we undertake 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 if we were to use that capital in some other way.

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 suitable amount is retained in the Heritage With Profits Fund for liabilities that may arise.

A Declared Rate of Return will only include an inherited estate top-up if we are making distributions from the inherited estate at the time we are setting it.

If we are satisfied that the inherited estate exceeds the amount needed for this we will distribute the excess to planholders. We will make this distribution, over time, as top-ups in with profits payouts, including annuity income payments.

We aim to restrict the distribution of any excess to payouts for plans that have remained continuously in with profits since 9 July 2006. But the inherited estate and other capital made available to the Heritage With Profits Fund will still be available to support new business that is written in it.

9. How we manage new business

We no longer sell new With Profits Pension Annuities, but we still sell other types of with profits plans that invest in the Heritage With Profits Fund. We aim to offer competitive terms for new business and for increases to premiums on existing business.

We have no plans to stop selling new with profits plans, but we set low limits on the new business that can be written in the Heritage With Profits Fund. This means the Fund is expected to become smaller over time. Even so, we expect to continue to manage the Fund for many years in the way we explain in this booklet.

However, there may eventually come a time, when the Fund is very much smaller than it is now, when we stop providing with profits benefits. The plans would then become non-with profits. The size of the non-with profits investments and conventional annuities we will set up will be based on a fair allocation of the Fund's assets to the with profits plans in the Fund at that time. In particular, we intend to distribute any remaining inherited estate to plans that have remained continuously in with profits since 9 July 2006.

If we ever stop selling new with profits plans, we'll let you know and will write to explain how we'll 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. In return they meet certain costs, as explained below.

For unitised plans, provided we meet our obligations to planholders, the shareholders are entitled to the deductions we make when calculating payouts, except deductions for costs of guarantees. The deductions are similar to those described in section 3. In return shareholders meet the expenses and costs of any life cover and critical illness cover on these plans.

For other types of plan, including With Profits Pension Annuities, the deductions go into the Heritage With Profits Fund, and the Fund meets the costs for these plans.

We won't do anything to increase the amount shareholders may receive if it would conflict with our duty to treat customers fairly.

The Board of Standard Life Assurance Limited 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 can add a report of its own to the Board's report.

Find out more

If you'd like further information on this or any of our other products, or if there's anything more about Standard Life we can help you with, just call us on this number, or visit our website.

Call us on 0845 60 60 100

(Mon-Fri, 9am to 5pm). Calls may be monitored and/or recorded to protect both you and us and help with our training. Call charges will vary.

www.standardlife.co.uk

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