CLOSED SCOTTISH LIFE WITH PROFITS FUND

Your policy is invested in the closed Scottish Life Fund. In this leaflet we call the closed Scottish Life Fund the With Profits fund.

WHAT IS THE INVESTMENT MIX OF THE WITH PROFITS FUND?

The fund is invested in a mixed portfolio which includes Government and other bonds, company shares (both UK and overseas) and property. The aim of the investment strategy is to maximise the long term return on investments for with profits policyholders whilst recognising the need for the fund to meet its guaranteed liabilities and commitments to policyholders.

Tables 1 and 2 show the current investment mix and how we have changed the mix of the investments backing the asset shares of with profits policies in the With Profits fund since 2012.

By **asset share** we mean the accumulation of premiums paid into a With Profits policy after taking off expenses and charges and allowing for the profits and losses.

Table 1 – Conventional With Profits Policies

	Company shares %	Property %	Government and other bonds %	Cash and other investments %
31/12/2016	13	2	80	5
31/12/2015	21	3	73	3
31/12/2014	25	2	70	3
31/12/2013	30	2	65	3
31/12/2012	22	2	74	2

Table 2 – Unitised With Profits Policies

	Company shares %	Property %	Government and other bonds %	Cash and other investments %
31/12/2016	22	3	71	4
31/12/2015	21	3	73	3
31/12/2014	25	2	70	3
31/12/2013	30	2	65	3
31/12/2012	22	2	74	2

Prior to 2016, the **asset mix** for an individual plan varied according to its outstanding term and the level of guarantees. We mentioned last year that we were considering making changes to simplify this approach. Now, with interest rates at or close to historic lows, we have moved away from varying the asset mix by outstanding term. The asset mix now depends on the type of plan you have. Those policies with high levels of guarantees are invested more conservatively.

WHAT WAS THE AVERAGE INVESTMENT RETURN OF THE WITH PROFITS POLICIES IN THE WITH PROFITS FUND FOR 2016?

Table 3 shows the average investment return, before tax and charges, on the investments backing the asset shares of with profits policies in the With Profits fund from 2012 to 2016.

Table 3 – Investment Returns before tax and charges

	Conventional With Profits %	Unitised With Profits %
2016	+ 6.2	+ 7.6
2015	+ 1.8	+ 1.8
2014	+ 6.3	+ 6.3
2013	+ 4.2	+ 4.2
2012	+ 6.6	+ 6.6

Shares and property performed very well during 2016 which helped to boost the more modest positive investment returns from bonds and cash.

We don't know what investment returns will be in the future; you should not assume that they will be the same as they were in previous years. However, we believe that the current investment mix is appropriate for the with profits fund in the current economic conditions.

RISK FACTORS

It is important that you understand the potential risks associated with this fund. We have detailed below the specific risks we think you should be aware of. For further information on each of these risks please refer to our **Guide to Fund Risks**.

Table 3

Investment Risk Factors	Yes/No
Exchange Rate	No
Emerging Markets	No
Concentrated Portfolio	No
Smaller Companies	No
High Yield Bonds	No
Sector Specific	No
Geared Investments	No
Property	Yes
Higher Risk Fund	No
Derivatives	No
Equities	Yes
Bonds	Yes
Money Market	Yes
Stock Lending	No

HOW DO I SHARE IN THE PROFITS AND LOSSES OF THE FUND?

The performance of the With Profits fund is shared out to its investors through a system of bonuses. There are two types of bonus that we may add to your policy:

- **annual bonuses**, which we may add during the lifetime of your policy and which increases the guaranteed minimum amount payable when you retire or when your policy matures, and
- **final bonuses**, which we may add on maturity/retirement. Final bonuses are not guaranteed and may go up or down.

Some unitised policies have a unit price that changes on a daily basis to reflect the addition of regular bonus, but the effect is the same.

The regular bonus rate for 2016 was 0.1% for conventional with profits policies and 2.0% for unitised with profits policies.

A Market Value Reduction (MVR) may be applied to reduce the value of units being cashed in during adverse market conditions. A reduction would be applied to ensure a fair level of payouts to everyone invested in the fund. If we did not do this the investors remaining in the fund would not receive their fair share. Please note that if an MVR is applied to your policy, the value of your plan would be reduced and you could get back less than you paid in. The MVR will not be applied if the policy is being cashed in on death or in certain other circumstances as set out in your policy documents.

There is more information on asset shares and how we decide annual and final bonus rates and MVRs in the leaflet 'A guide to how we manage our with profits fund'. We tell you how to get a copy at the end of this leaflet.

DEMUTUALISATION ENHANCEMENT

To help with the technical language used in this section the key terms are highlighted the first time they appear and explained clearly at the end of this section.

What is the demutualisation enhancement?

When Scottish Life demutualised and was acquired by Royal London in 2001 there was a commitment to distribute the **Estate** fairly over the expected lifetime of qualifying plans. The **demutualisation enhancement** was the process agreed to achieve that distribution.

The demutualisation enhancement was 0.75% for all years prior to 2008. From 2008 to 2011 the rates were 0.5%, 0.7%, 2.4% and 6.0%. However, from 2012 we changed our approach and stopped making enhancements to the asset shares themselves. Instead we aimed to distribute the Estate by paying an additional amount over and above the asset share as a final bonus. To achieve this aim we used the **target payout**.

Why did we change the approach?

The change of approach anticipated the introduction of the new Europe-wide regulations known as Solvency II, which all life and pension providers must follow. The new regulations came into force on 1 January 2016. Broadly the effect of the new regulations is that we need to hold more capital to protect against the risks within the fund. This reduces our ability to distribute the Estate.

The main risks within the fund are associated with guaranteed annuity options. These are provided in many of the pension policies held in the fund.

What is the target payout for 2017?

For claims during 2017 the target payout is 106% of asset share, down from 112% in the middle of 2016. This follows the continued falls in interest rates associated with the Brexit vote. The low interest rates require us to hold more capital.

Holding more capital affects the extent to which we can distribute the Estate. This is why we've had to reduce the target payout for claims during 2017.

We are doing all we can to reduce the level of risk in the fund so we can increase the level of Estate distribution again. We have a proposal that we are going to test with our pension planholders with guaranteed annuity options in the coming months. However if the proposal is not successful, or if the position of the fund deteriorates further then we may have to reduce Estate distribution to zero.

Estate

The amount by which the investments of the fund are greater than the benefits already promised to planholders. You might also think of it as the fund's available capital.

Demutualisation Enhancement

The process we previously used to distribute the estate to planholders. It involves increasing the investment returns applied to the asset shares over and above the returns actually achieved.

Target Payout

We currently aim to pay more than asset share to distribute the estate. The proportion of the asset share that we aim to pay is called the target payout.

WHERE CAN I FIND OUT MORE INFORMATION?

You can view and download the following documents from our website **royallondon.com**:

- **'Principles and Practices of Financial Management' (PPFM)** which is a technical document that explains the way in which we manage our with profits fund.
- **'A guide to how we manage our with profits fund'** which is a plain English guide to the key points of the PPFM. This includes more information on asset shares and how we decide annual and final bonus rates. The version that covers your policy is **Guide 5**.
- The Directors report on compliance which is the most recent report about how we have complied with the PPFM.

To find these documents please click on **'Welcome to Royal London'** then **'Corporate Governance'** then **'PPFM'**. If you prefer, or would like large print versions of these documents, you can ask us to send you copies by calling us on 0345 0502020.

PPFM CHANGES AT 31 DECEMBER 2016

We have made a change to the Practices to permit more freedom to invest in new asset types subject to following the standard approval process. there have been a few small updates to other PPFM Practices to update terminology.

Royal London
1 Thistle Street, Edinburgh EH2 1DG
royallondon.com

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