

## **Your guide to the Scottish Friendly with-profits fund**

### **Introduction**

Your policy is invested in the Scottish Friendly with-profits fund. This guide will provide you with an overview of how the fund works, how Scottish Friendly manages the fund and the risks and rewards you can expect from your policy.

### **PLEASE READ THIS GUIDE – IT GIVES IMPORTANT INFORMATION ABOUT HOW WITH-PROFITS POLICIES WORK**

#### **What is the with-profits fund?**

All payments into the with-profits fund are added together and invested in a range of different assets managed by Scottish Friendly after taking off expenses and payouts from the fund. The value of the with-profits fund rises and falls to reflect the underlying investment return on these assets. Scottish Friendly's expertly managed investments include stock market shares, bonds, property and cash assets and other assets.

As Scottish Friendly has no shareholders, after the deduction of expenses, the whole fund is used to provide benefits for investors in the with-profits fund.

The overall fund is expertly managed to meet all the legal and regulatory requirements in a sound, prudent and professional manner designed to treat all customers fairly. In addition the fund is managed to ensure it can meet the guarantees which are granted to with-profits policyholders, and these are explained below.

#### **Is there more than one with-profits fund?**

Scottish Friendly has a single with-profits fund, however part of the fund has been specifically earmarked to provide benefits for certain classes of policyholders. This document covers the operation of the part of the with-profits fund in respect of those policyholders who were transferred to Scottish Friendly from Rational Shelley Friendly Society Ltd on 31 December 2005. Therefore all further references to the with-profits fund within this document refer to the, separately identified, Rational Shelley with-profits fund which is within the Scottish Friendly fund but earmarked for Rational Shelley policyholders. Separate documents outline the operation of Industrial Branch policies (normally those where premiums were collected by a door-to-door salesperson), Ordinary Branch policies (set up directly with Scottish Friendly), unitised with-profits policies and any other policies which were transferred to Scottish Friendly where the terms of the transfer determined that these policies should be managed separately.

You should therefore ensure that this guide relates to your policy.

#### **What are the guarantees?**

Your with-profits policy will contain an element of capital security. All policies provide a guaranteed cash sum on a specified maturity date provided all premiums have been paid.

The guaranteed cash sum at maturity can grow in two ways. Firstly through the addition of *regular bonuses*, normally paid once a year. These bonuses increase the value of the guaranteed cash sum on maturity. Once the guaranteed cash sum on maturity has been increased it cannot fall provided all premiums continue to be paid. Secondly, a *final bonus* may be added to the guaranteed cash sum on maturity.

The level of bonuses that may be paid will depend principally on the long-term performance of the underlying investments in the with-profits fund and how Scottish Friendly decides to allocate those profits between regular and final bonuses. Bonuses will depend on legal and regulatory requirements, the prudent management of the business with a view to treating all customers fairly and obligations to meet the benefits and guarantees that have already been set.

Notwithstanding these principles, the following sections explain how Scottish Friendly goes about calculating the regular and final bonuses.

## **How does Scottish Friendly decide regular bonuses?**

Regular bonuses are normally decided annually although in extreme circumstances, such as during a severe stock market downturn, they may be changed more frequently.

When setting regular bonus rates Scottish Friendly starts from a rate that reflects the level of interest paid on the long term government bonds that are held within the with-profits fund. This is adjusted to allow for the effect of charges (and, where appropriate, tax).

In addition Scottish Friendly aims to ensure that the bonus level should not change dramatically from year to year.

In severe market circumstances, such as a significant and sustained fall in the stock market and/or interest rates, the regular bonus rate could fall to zero. It cannot however fall any further.

Every year you will receive a *bonus notice* statement which will provide you with details of the amount of bonus which Scottish Friendly has paid on your policy and its effect on your guaranteed cash sum at maturity.

## **How does Scottish Friendly decide final bonuses?**

Scottish Friendly sets final bonuses with the intention of ensuring that the value of your policy represents a fair return on the premiums you have paid bearing in mind the investment returns that have been available on the assets held in the with-profits fund during the period your policy has been in force. Final bonus rates are normally set once a year but can change more frequently if there are significant market movements.

Our preference is normally to pay the larger part of bonuses as final bonuses as this helps to reduce the cost of guarantees within the fund. This in turn provides some freedom to invest a proportion of the fund in assets with potentially higher long term returns but which also carry greater risk.

Final bonuses can be substantial but can fall to zero if the performance of the with-profits fund is particularly poor for a sustained period of time. If at maturity the value of the guaranteed cash sum plus any regular bonuses that have been added is greater than the value which would have been received had premiums been directly invested in the underlying assets then it is likely that no final bonus will be payable.

All bonus payouts are also subject to smoothing and this is explained in the next section.

## **What is smoothing?**

Scottish Friendly aims for a smooth progression of policy returns by varying the regular bonus rates relatively infrequently and making gradual adjustments to the final bonus rates on an annual basis

## **What are the charges?**

The charges under the fund cover the expense of investing the premiums, the cost of ongoing administration and life insurance. These charges are passed directly to the with-profits fund but Scottish Friendly aims to ensure fairness between different policies and classes of policies. The expenses that may be charged to the fund are specifically limited by the terms upon which the business was transferred.

## **What happens if I leave the fund early?**

The guaranteed cash sum assumes that payments will be made for the full policy term so if a plan is cashed-in before the maturity date the guaranteed cash sum will not be paid. Instead Scottish Friendly will aim to pay a value which is consistent with what you would have received had you invested directly in the underlying investments within the with-profits fund.

## **What happens if I die before the end of the policy term?**

In the event of your death Scottish Friendly will pay out the full value of your guaranteed cash sum plus any bonuses that have been added and this may include a final bonus. Any final bonus will be

added at a rate that will ensure the total amount payable is similar to policies maturing with the same term as your investment.

### **Why does the fund hold more assets than it needs?**

The with-profits fund will always hold more assets than it needs to meet every individual policyholder's plan benefits. These support assets provide additional security to policyholders by being the first call on any unforeseen risks which may potentially impact policyholder returns (see "*What risk is the with-profits fund exposed to*"). They are also used to sustain the smoothing policy and are designed to meet the cost of guarantees granted to with-profits policyholders.

Ultimately all of the assets within the Rational Shelley fund will be distributed to the Rational Shelley policyholders.

### **What determines what the with-profits fund invests in?**

The underlying investments of the with-profits fund were broadly determined at the time of transfer and are aimed at ensuring an orderly winding down of the Rational Shelley book of business. These are formally reviewed at least once a year, more frequently during times of market turbulence. Scottish Friendly closely monitors the value of guarantees that are provided to with-profits policyholders and keeps a close eye on the proportion of the fund that is invested in more volatile shares and property investments.

It is of paramount importance to Scottish Friendly that the fund can meet all the guaranteed benefits provided to policyholders within the fund. Therefore should the value of the fund fall close to the value of the guarantees provided to policyholders, Scottish Friendly is likely to significantly restrict the scope for the fund to invest in shares and property.

Subject to this and depending on Scottish Friendly's judgement of current market conditions and growth opportunities the fund will normally expect to hold around 40% of the assets in shares and property with the balance invested in fixed interest investments made up of gilts and corporate bonds. This figure is expected to drop by 2% each year as the policies within the fund mature.

### **How long with the fund be managed?**

The with-profits fund is expected to be managed until 2020 or until the fund asset value falls below £5 million or 500 policies when bonus rates will be frozen and all the remaining assets of the fund will be distributed to the remaining policyholders.

### **What risks are the with-profits fund exposed to?**

The main risk within the with-profits fund is that associated with investment management. Whilst the fund is managed to ensure that Scottish Friendly can continually meet guarantees provided to policyholders, the growth potential of the fund depends on Scottish Friendly's investment management decisions and the performance of the assets within the fund.

In addition the fund accepts the risks and rewards of the guarantees within the fund. These risks are initially met from the support capital within the with-profits fund; thereafter they will impact on with-profits fund returns.

### **Governance of the with profits fund**

The fund will be managed according to the principles and practices set out in the full Principles and Practices of Financial Management which is available on the Scottish Friendly website or on request. You will be notified three months in advance of any changes to the principles governing this fund.

The fund is overseen by the Board of Scottish Friendly and every year they will report to policyholders confirming that the fund has been managed in accordance with the principles and practices of the fund and also noting any discretion which they have exercised under advice from the fund's With-Profits Actuary.

**Where can I get more detailed information?**

You can find additional information about the way in which your individual policy will invest in the with-profits fund in the Key Features document for your policy.

This document is a summary of the more detailed Principles and Practices of Financial Management for Scottish Friendly's with-profits fund. Copies of this document are available on request from Scottish Friendly or simply by downloading it from the Scottish Friendly website.