ROYAL LONDON

A CLOSER LOOK AT YOUR FUND

Annual Update for the Scottish Life fund
June 2016

Investments

CONTENTS

Welcome to your annual update	3
Investment mix	4
Investment performance	5
How do I share in the profits and losses of the fund?	6
Demutualisation enhancement	7
Supervisory Committee	9
Committee members	10
How can I find out more?	11

WELCOME TO YOUR **ANNUAL UPDATE**

This update is to keep you informed of the investment performance of the **Scottish Life Fund** in the year ending 31 December 2015 and the benefits under your with profits plan.

We will refer to '**the Scottish Life fund**' as 'the fund' throughout the rest of this update.

New solvency rules came into effect on 1 January 2016. In addition there are legislative changes to annuities that come into effect from 6 April 2017. These changes in combination reduce the level of Estate distribution the fund can afford in the short term. This means it is likely that we will have to reduce payouts. We encourage you to read the details about why this is the case on pages 7 and 8 of this booklet.

INVESTMENT **MIX**

What is the investment mix of the fund?

The fund is invested in a mixed portfolio of assets 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 planholders whilst recognising the need for the fund to meet the guarantees provided to planholders.

Table 1 shows the current investment mix of the fund as a whole and how we have changed the mix of the investments backing the asset shares of with profits policies in the fund since 2011.

By **asset share** we mean the accumulation of premiums paid into a with profits plan after taking off expenses and charges and allowing for the profits and losses earned by the investments backing the policies each year.

The asset mix for an individual policy depends on its outstanding term and the level of guarantees. We are considering changing this approach to make it easier for planholders to understand the actual asset mix for their own policy. We will keep you updated with progress on this.

Table 1 — Investment Mix

	Company shares %	Property %	Government and other bonds %	Cash and other investments %
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
31.12.2011	22	2	74	2

INVESTMENT PERFORMANCE

What was the average investment return of the with profits plans in the fund for 2015?

The fund's overall 2015 investment return, before tax and charges, was +1.8%.

Table 2 below shows the average investment return, before tax and charges, on the investments backing the asset shares of with profits policies in the fund from 2011 to 2015.

Table 2 – Investment Return

	Investment return before tax charges %
2015	+1.8
2014	+6.3
2013	+4.2
2012	+6.6
2011	+7.5

Property and overseas company shares were the investment assets that performed well and helped to provide the best investment return in 2015, while UK company shares, government and other bonds and cash provided more modest positive returns.

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 of the fund is appropriate in the current economic conditions.

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

Any profits or losses in the fund are shared out to the relevant planholders through a system of bonuses. There are two types of bonus that may be added to your plan:

- **annual bonuses**, which we may add during the lifetime of your plan and which increase the guaranteed amount payable when your plan matures or when the life assured dies, and
- **final bonuses**, which we may add on maturity or when a death claim is made. Final bonuses are not guaranteed and may go up or down.

The annual bonus rate for 2015 was 0.1% for traditional with profits plans.

There is more information on asset shares and how we decide annual and final bonus rates 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 and explained clearly at the bottom of this page.

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 for the liabilities in the fund.

What is the target payout for 2016?

For claims from the start of 2016 the initial **target payout** was 118% of asset share.

Estate
The amount by which the investments of the fund are greater than the guaranteed benefits and bonuses already promised to planholders.

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.

The position of the fund under the new regulation is now clearer and we need to hold more capital to protect against the risks within the fund. This affects the extent to which we can distribute the **Estate** and therefore the **target payout**.

The main risks within the fund which impact on the size of the **Estate** are associated with guaranteed annuity options which are provided in many of the pension policies held in the fund. Pension legislation changes come into force in April 2017 to introduce a secondary market in annuities. This may increase the cost of guaranteed annuity options in the fund.

We are currently considering options to manage this situation fairly and effectively. However, it is likely that from the middle of the year we will have to reduce payouts by around 4%-6% (i.e. reduce the target payout to around 112%-114% of asset share) unless we can reduce the level of risk that the fund is exposed to.

We have discussed these issues with our With Profits Committee and the Scottish Life Supervisory Committee and will do so again before we take any significant action. There are important matters of fairness between planholders to consider and so we plan to ask a range of planholders for their views over the coming months as we consider the most appropriate way forward.

If you would be interested in being involved in discussions then please contact us on **0345 60 50 050**.

SUPERVISORY **COMMITTEE**

One of the ways in which planholders' interests are protected is through the Supervisory Committee which was set up to monitor the management of the fund, including the investment and bonus plan. It also monitors compliance with the terms of the Scheme – the detailed principles and arrangements that governed the transfer of Scottish Life's business to Royal London and the way the fund is then managed. The Committee has again not raised any concerns about the way the fund is being operated.

COMMITTEE MEMBERS

Supervisory Committee members

The Supervisory Committee has five members. A majority, including the Chairman, is required to be wholly independent of Royal London's Board and Management. In carrying out their duties, the members of the Committee are required to have regard solely to the interests and reasonable expectations of the planholders in the fund. The Chairman has a casting vote if necessary.

The current members of the Supervisory Committee are:

- **Adrian Eastwood (Chair)** – Independent Consultant and a former Chief Actuary for Scottish Widows and other Lloyds Banking Group life companies
- **Michael Livingston** – A Senior Partner and Chairman Elect of Maclay Murray & Spens LLP with considerable practice experience in the life insurance sector
- **Dick Barfield** – Former Chief Investment Manager at Standard Life with extensive experience in the life insurance and pensions sectors
- **Tim Harris** – Group Finance Director of Royal London
- **Rachel Elwell** – Investment Office and Staff Pension Director of Royal London whose role includes overseeing the performance of the Group's asset managers

Patrick Gifford stepped down as Chair of the Committee during 2015 and I would like to express my sincere thanks to Patrick for his service on behalf of the planholders in the fund.

Brian Murray
With Profits Actuary

HOW CAN I FIND **OUT MORE?**

More information about the fund

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 the fund.
- '**A guide to how we manage our with profits fund**' which is a plain English guide to the key points of the PPFM. The version that covers your plan is **'Guide 5'**.
- The Directors report on compliance with 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, you can ask us to send you copies by calling us on **0345 05 02 020**.

If you need any more information or have any questions on the **Scottish Life fund** or your with profits plan please call us on **0345 60 50 050** between 8.00am and 6.00pm Monday to Friday, except bank holidays or visit **royallondon.com/SLbonus**.

PPFM Changes

We have made a number of changes to the PPFM to reflect the introduction of the new regulations known as Solvency II.

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All literature about products that carry the Royal London brand is available in large print format on request to the Marketing Department at Royal London, 1 Thistle Street, Edinburgh EH2 1DG.
All of our printed products are produced on stock which is from FSC® certified forests.

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