ROYAL LONDON

A CLOSER LOOK AT **YOUR FUND**

Annual Update for the Scottish Life Fund
June 2018

Investments

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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 2017 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.

We were able to increase payouts this year. We encourage you to read the details about this on pages 7 & 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 for traditional with profits plans and how we have changed the mix of the investments backing the asset shares of traditional with profits plans in the fund since 2013.

We have now moved away from varying the asset mix by outstanding term. We mentioned that this had started to happen last year. Your policy is still invested in a wide range of assets, but the investment mix will no longer change as you approach the end of your policy. The asset mix now depends on the type of plan you have. Those policies with higher levels of guarantees are invested more conservatively.

Table 1 — Investment Mix

	Company shares %	Property %	Government and other bonds %	Cash and other investments %
31.12.2017	21	0	53	26
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

There has been a movement from short-dated bonds to cash assets in 2017. However, the economic exposure of the fund is relatively unchanged.

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.

INVESTMENT PERFORMANCE

What was the average investment return of the with profits plans in the fund for 2017?

The fund's overall 2017 investment return, before tax and charges, was +4.1%.

Table 2 below shows the average investment return, before tax and charges, on the investments backing the asset shares of traditional with profits policies in the fund from 2013 to 2017.

Table 2 – Investment Return

	Investment return before tax and charges %
2017	+4.1
2016	+6.2
2015	+1.8
2014	+6.3
2013	+4.2

Shares and property performed very well during 2017 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 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 increases 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 2017 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

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.

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.

What is the target payout for 2018?

For claims during 2018 the target payout is 118% of asset share, up from 106% in 2017. This is due to a more positive outlook for the fund.

We are doing all we can to reduce the level of risk in the fund and hence we have been able to increase the level of Estate distribution. At the end of 2017, we updated our assumptions to reflect the recent industry experience that life expectancy isn't increasing as fast as we had previously thought. This has reduced the cost of guaranteed annuity options in the fund and means that we can distribute more of the capital in the fund sooner.

We have recently asked planholders with guaranteed annuity options whether they would be interested in us making them a formal offer later this year. That offer would see planholders who want it, receive an increase to their fund value in exchange for giving up their guaranteed annuity option. We are making good progress with this proposal and have received positive feedback from the majority of these planholders. If the proposal is successful we hope to be able to keep the current level of Estate distribution or even increase it further.

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)** – Former Chief Actuary for Scottish Widows and other Lloyds Banking Group life companies with extensive experience in the life insurance and pensions sectors
- **Michael Livingston** – Partner at law firm Dentons with considerable practice experience in the life insurance sector
- **Stuart Purdy** – Former Products and Investment Director of Aviva Europe with significant life insurance and pensions experience
- **Tim Harris** – Deputy Chief Executive and Group Finance Director of Royal London
- **Martin Lewis** – Finance Chief Operating Officer of Royal London

It was with great shock and sadness that we learned of the death of Dick Barfield on 8 November 2017. Dick had served on the Supervisory Committee for a number of years giving valuable insight into investment matters. He will be sadly missed.

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'** which is the most recent report about how we have complied with the PPFM.

To find these documents please click on **'About 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

There are no changes to the PPFM in 2017.

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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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