



**Phoenix Life Limited  
Scottish Mutual With-Profits Fund**

**Annual report to with-profits policyholders by the Board of Phoenix Life Limited  
for the period 1 January 2009 to 31 December 2009**

**Purpose**

We set out how we manage the Phoenix Life Limited with-profits funds in our Principles and Practices of Financial Management (PPFM). In this report we give details of how we have complied with the PPFM for 2009 for our Scottish Mutual With-Profits Fund ('the fund').

Phoenix Life Limited has discretion in a number of areas, such as setting bonuses, policy payouts and surrender values, and in addressing any competing or conflicting rights of policyholders and shareholders. This report deals with how Phoenix Life Limited has exercised its discretion in these areas.

**Background**

The Phoenix Life Limited Scottish Mutual With-Profits Fund consists of former Scottish Mutual Assurance Limited With Profits Sub-Fund policies. These policies were transferred to Phoenix Life Limited on 6 February 2009 to the newly created Scottish Mutual With-Profits Fund as part of the 2009 Scheme.

For the period from 1 January 2009 to 6 February 2009, these policies were managed in accordance with the PPFM for the Scottish Mutual Assurance Limited With Profits Sub-Fund and this report also covers how we have complied with the PPFM for the Scottish Mutual Assurance Limited With Profits Sub-Fund PPFM over this short period.

The February 2009 PPFM for Phoenix Life Limited was updated to allow for this transfer. Changes were made to take account of the transfer, related events and to create a consistent style and presentation. Apart from these changes, the February 2009 Phoenix Life Limited PPFM reflected the existing Phoenix Life Limited PPFM and the PPFM of Scottish Mutual Assurance Limited.

Phoenix Life Limited has eight with-profits funds including the Scottish Mutual With-Profits Fund. We manage each with-profits fund in accordance with its own subset of our PPFM. The with-profits bonuses, policy returns and payouts for each with-profits fund reflect the financial position of that fund. The performance of each with-profits fund reflects the historic performance of the original with-profits funds and companies up to

their respective transfer to Phoenix Life Limited, and then their performance within Phoenix Life Limited since that time.

The Scottish Mutual With-Profits Fund is part of Phoenix Life Limited, along with seven other with-profits funds and a non-profit fund. The Scottish Mutual With-Profits Fund is run as a separate ring fenced fund within Phoenix Life Limited but with the additional security that comes from being part of a large well capitalised company. In extreme circumstances one fund may have to provide financial assistance to another. However there are internal arrangements to ensure that Phoenix Life Limited holds assets in excess of the requirements of our regulator and, because of this, it is extremely unlikely that a with-profits policy in one fund will be affected by losses from another fund.

We have produced separate reports for our other with-profits funds.

Our PPFM is available on our website at [www.phoenixlifegroup.co.uk](http://www.phoenixlifegroup.co.uk), or you can ask us for a copy. We have produced a shorter guide called 'How we manage the Phoenix Life Limited Scottish Mutual With-Profits Fund' and this can be obtained in the same way.

The with-profits policies fall into two main types. These are:

- traditional with-profits; and
- unitised with-profits.

### **Independent review**

The company formally consulted with, and took into account the opinions of the With-Profits Actuary and the With-Profits Committee (a committee which is independent by virtue of its majority of independent members) in respect of all material changes during 2009. This included consultation on the changes to bonus rates, surrender values and the estate.

The funds merger was subject to independent actuarial review and review by the Financial Services Authority. The funds merger was also subject to a court scheme.

### **Summary**

Payouts for with-profits policies depend on the discretion exercised by Phoenix Life Limited. The interests of with-profits policyholders are protected by the PPFM of the company.

Each year the Board will produce a report to you, the with-profits policyholders, summarising compliance with the PPFM and how any discretion has been used over the previous year.

The PPFM guiding principles cover the following areas:

- Legal requirements, that is, Phoenix Life Limited and its with-profits funds are managed in accordance with Phoenix Life Limited's then current understanding of all legal and regulatory requirements.
- Basic fund concept, that is, subject only to the legal requirements guiding principle, the interests of with-profits policyholders extend to, but are also limited to, the assets of the fund to which the policy belongs.
- Fair treatment, that is, Phoenix Life Limited aims to treat its with-profits policyholders fairly.

The guiding principles are presented here at a high level rather than in the full detail of the PPFM. These guiding principles are applied in managing Phoenix Life Limited and all of its with-profits funds. Guiding principles are considered when applying the other fund specific principles and practices set out in the PPFM. In the event of a conflict with other principles these guiding principles take priority.

In the Board's opinion, the guiding principles were applied in accordance with the PPFM.

The principles for the Scottish Mutual With-Profits Fund cover:

- Amounts payable under a with-profits policy
- Annual bonus rates
- Final bonus rates
- Smoothing
- Surrender values
- Investment strategy
- Business risks
- Expenses and charges
- Estate management
- New business
- Equity between the fund and shareholders

These are expanded on in the sections below. In addition, there is a commentary on any changes to the PPFM, other significant events and communications to with-profits policyholders during the year.

### **Amounts payable under a with-profits policy**

We aim to pay all policyholders their fair share of the profits which the fund has earned over the time they have held their policy. We pay the share of profits in the form of annual and final bonuses. When deciding what is a fair share we consider the underlying value of representative specimen policies (sometimes called the 'asset share') as a guide. The underlying value of policies reflects the premiums paid and the investment performance of the fund over the lifetime of the policies, after allowing for factors such as our costs, the tax we have to pay, the shareholders' share of profits, charges for death benefits, charges for guarantees and other profits and losses. This was the approach we used over 2009.

The outcomes we describe below relating to bonus rates, smoothing, surrender values and investment strategy are all measured by reference to representative specimen policies rather than to each actual policy.

For traditional pensions policies, when assessing the amount we pay we look at the current market value of the average mix of cash and pension benefit that we expect policyholders to choose.

In the Board's opinion, the methodology used to calculate the underlying value of policies has been in line with the PPFM. Further, in the Board's opinion, the discretion applied to the methods used to determine payouts on all policies during 2009 has been in line with the PPFM.

### **Annual bonus rates**

We generally declared nil annual bonus rates for 2008 in March 2009 as part of the 2008 year end valuation. We generally declared nil annual bonus rates for 2009 in March 2010 as part of the 2009 year end valuation. Where annual bonuses are declared in advance, the declared bonus rates applied from 2009 and 2010. The exceptions to the nil annual bonus are some of the older unitised with-profits policies which have a guaranteed minimum rate of annual bonus and with-profits annuities where there is no final bonus mechanism.

We reviewed our policy of concentrating on final bonuses (and market value reductions (MVRs)) before reintroducing or increasing annual bonuses. We continue to believe that this is the best and fairest way for all our policyholders to benefit from the returns of the fund.

The Board is satisfied that the approach taken in determining annual bonuses during the year was in line with the PPFM.

### **Final bonus rates**

We changed final bonuses on 1 January 2009, 1 July 2009 and, due to the unusual investment conditions, also on 1 October 2009.

We also reviewed final bonus rates to apply from 1 January 2010.

For some policies where the value of guaranteed benefits already exceeded the underlying value, we did not add any final bonus.

With-profits annuities and group deferred cash and group pension policies do not receive any final bonus.

The Board is satisfied that the changes to final bonus rates resulted in changes to payouts that were consistent with the PPFM and were consistent with treating customers fairly.

## **Smoothing**

We generally limit the changes in final bonuses to restrict differences in total maturity payouts (sum assured, annual bonus and final bonus) on similar maturing policies to 7.5% at each half yearly final bonus review and to 15% from one year to the next. However, for some policies where payout ratios were significantly out of line with 100% of asset share, we allowed larger differences.

However, due to the unusual investment conditions, for the January 2009 final bonus changes, we allowed an additional 5% reduction in total maturity payouts before smoothing applied. This meant that we generally limited reductions in total maturity payouts to 12.5% compared to similar maturity payouts in July 2008.

We also allowed an additional 5% reduction in total maturity payouts for the 1 July 2009 final bonus changes. This generally limited reductions in total maturity payouts to 12.5% compared to similar maturity payouts in January 2009.

We made an interim review to generally increase final bonuses from October 2009. We generally allowed an increase in total maturity payments of up to 12.5% compared to similar payouts in July 2009.

We allowed an additional 5% increase in total maturity payouts for the 1 January 2010 final bonus changes. This generally limited increases in total maturity payouts to 12.5% compared to similar maturity payouts in July 2009.

For with-profits annuities and group deferred cash and group pension policies we smooth the actual investment return when reviewing annual bonuses.

The Board is satisfied that these movements in final bonuses and maturity payouts in 2009, were necessary to keep payouts reasonably in line with the underlying value of policies, to ensure fairness between groups of policyholders and to protect the financial position of the fund, and were in line with the PPFM.

## **Surrender values**

- For traditional business, during 2009, we broadly set surrender values by adjusting the expected value of the cash payout at maturity to allow for the early payment of the benefit and for the non-payment of future premiums. There is an overall check that surrender values are broadly in line with the target proportion of the underlying value.

For pension policies, early transfer values were based on adjusting the cash option that would be available at normal retirement to allow for the early payment and for the non-payment of any future premiums.

We reviewed the way we calculate surrender values at the end of 2009 with revised surrender values applying from 1 January 2010. Surrender values include an allowance for final bonus and these final bonus allowances were revised from 1 January 2009, 1 July 2009, 1 October 2009 and 1 January 2010 in line with changes in final bonus rates.

- For unitised with-profits business, we based surrender values on the value of the with-profits units and final bonus, subject to the potential application of a market value reduction. If the underlying value was less than the value of the with-profits units, then no final bonus was added and we applied a market value reduction which reduced the value of the with-profits units, so that the surrender value reflected the underlying value. We apply market value reductions to ensure fairness to all with-profits policyholders, so that surrender values are not unfairly higher than the policies' share of the underlying value of the fund's assets.

We changed market value reductions at the same time we changed final bonus rates. In addition, we normally reviewed market value reductions each month and changed them if necessary.

In the Board's opinion, the methodology used to determine surrender values has been in line with the PPFM.

### **Investment strategy**

During 2009, we invested the fund in a mix of higher risk assets such as company shares (equities) and lower risk assets such as fixed interest stocks (bonds, types of loan usually issued by the Government or companies) and cash deposits. We had the following asset mix for with-profits policies on 31 December 2009.

<b>Asset type</b>	
Company shares (equities)	39%
Fixed interest stocks - issued by the UK government (gilts)	16%
Fixed interest stocks - other (including corporate bonds)	34%
Property	0%
Cash and Other	11%

The mix of assets is broadly the same as that on 31 December 2008, although the proportion for company shares (equities) has increased slightly.

The above asset mix applies to the main with-profits business. For euro and US \$ denominated policies different asset mixes apply.

The yearly statement that we send to with-profits policyholders includes information about the mix of assets for with-profits policies.

The fund also contains investments which back the cost of guarantees, the cost of smoothing and the estate.

We reviewed the investment strategy during 2009 and from 2010 onwards, for with-profits policies, we expect to make changes. These generally include having a wider spread of investments including property and reducing the proportion invested in fixed interest stocks issued by the UK government (gilts). We also intend that in future, the

mix of assets will vary for different groups of policies, with policies with higher guaranteed benefits having fewer higher risk investments. The yearly statement that we send to with-profits policyholders includes further information on the investment strategy.

The Board is satisfied that the approach taken in following the investment strategy during the year was broadly in line with the PPFM.

### **Business risks**

There was an annual review by the Board of existing business risk exposure. In the opinion of the Board, appropriate measures were taken to limit the with-profits business exposure to risk to amounts which are fair.

The Board is satisfied that it has managed its business in line with the PPFM, that is, in a prudent manner, having regard to both the risks and rewards of which it is aware.

### **Expenses and charges**

During 2009, we charged a fair share of our expenses to the fund and we made an appropriate allocation to the underlying value of with-profits policies in the fund. The main expenses we charged to the fund in 2009 were due to:

- Management services

During 2009, Pearl Group Management Services provided all the services required to operate the fund apart from investment management services. The charges are mainly expressed as an annual amount per policy which increases each year linked to the increase in the Retail Prices Index.

Pearl Group Management Services made additional charges for certain one-off activities and developments and we generally apportioned such costs in a fair and reasonable manner, taking into account the beneficiaries of the activity.

- Investment management services

During 2009, investment management services for the fund were provided by Ignis Asset Management. The charges made by Ignis Asset Management in respect of the fund's investments were attributed to the fund.

- Direct and other costs

The Board is satisfied that we apportioned a fair share of the direct and other costs we incurred to the fund and that these were in line with the PPFM.

## **Allocation of taxation**

We allocated a share of the provisional amount of tax we incurred to the fund, in line with the PPFM. We calculated this by treating the fund as though it was our only fund and as though it was a mutual fund. Once we have agreed our tax charge with HM Revenue & Customs (HMRC), we will review the amount of tax we have allocated to the fund to ensure it is fair.

We made an appropriate allocation of tax to the underlying value of with-profits policies in the fund.

## **Cost of guarantees**

The policies in the fund provide a number of guarantees. We do not currently make any charges for the cost of guarantees, though the cost of rebalancing the assets backing the cost of guarantees may be charged to the underlying value of policies. The rebalancing costs incurred in 2009 were charged to the underlying value of policies.

The cost of guarantees is currently borne by the estate.

The Board is satisfied that we apportioned a fair share of the cost of guarantees in line with the PPFM.

## **Estate management**

The fund's estate provides working capital for the fund and supports the running of the fund. The estate is the excess assets that are not needed to support the fund's current and future liabilities. Profits and losses arising from policies in the fund affect the estate.

As the fund is closed, we aim to ensure a fair and orderly distribution of all of the fund's assets including the estate, over the remaining lifetime of the policies in force. While making sure that we have enough working capital to cover the risks in the fund, we expect the estate to run down to zero over time, broadly in line with the remaining lifetime of the policies in the fund.

We are pleased to advise that since July 2009, we have started making distributions of the estate. For the July 2009 final bonus review, we included a temporary distribution of the estate by increasing the underlying value of policies that we use to determine final bonus rates by 6.1%. We made a distribution of the estate by increasing the underlying value of policies by 1.1% from January 2010. For the January 2010 final bonus review, we included a temporary distribution of the estate by increasing the underlying value of policies that we use to determine final bonus rates by 6.5%. We review the level of the estate distributions following each half yearly valuation.

In the Board's opinion, the methodology used to calculate the estate has been in line with the PPFM. Furthermore, in the Board's opinion, the distribution of the estate has been in line with the PPFM.

## **New business**

The fund is no longer actively seeking new business. The Board is satisfied that this is in line with the PPFM.

## **Equity between the fund and shareholders**

Our shareholders received a share of the distributed profits. For traditional with-profits policies, this was equal to one ninth of the value of bonuses we distributed to with-profits policyholders. The shareholders' share of distributed profits for 2009 was £2.1m. For unitised with-profits policies, the shareholders receive the annual management charges.

The Board is satisfied that the shareholders' share of the distributed profits for 2009 is in line with the PPFM.

When Scottish Mutual With-Profits Fund pension policyholders retire, the pension is set up in, and then paid from, the company's non-profit fund. The with-profits fund pays the non-profit fund a fair value representing the cost of setting up the pension payments. The Board reviewed the terms for the cost of setting up the pension payments in March 2009, July 2009 and November 2009. The Board is satisfied that the terms agreed were in line with the requirements of the PPFM.

## **Changes to the PPFM during 2009**

We include a description of the recent changes to the PPFM with the annual statement we issue to with-profits policyholders.

## **Funds merger**

We wrote to policyholders in August / September 2008 about our proposal to transfer certain Scottish Mutual Assurance Limited policies and certain policies of our sister company Scottish Provident Limited to Phoenix Life Limited. This transfer took place on 6 February 2009 as a result of schemes approved by the UK High Court, the Royal Court of Jersey and the Royal Court of Guernsey. The Scottish Mutual Assurance with-profits policies were transferred to the newly created Phoenix Life Limited Scottish Mutual With-Profits Fund. The Scottish Provident with-profits policies were transferred to the newly created Phoenix Life Limited SPI With-Profits Fund. The remaining policies were transferred to the existing Non-Profit Fund in Phoenix Life Limited.

The transfer did not lead to any change in the way in which we manage the fund.

Former Scottish Mutual Assurance Limited with-profits policies are now invested in the Phoenix Life Limited Scottish Mutual With-Profits Fund.

The funds merger was subject to reports by the Head of Actuarial Function and the With-Profits Actuary. It was also subject to a report by an independent actuary and the Financial Services Authority did not object.

The February 2009 PPFM for Phoenix Life Limited was updated to allow for this transfer. Changes were made to take account of the transfer, related events and to create a consistent style and presentation. Apart from these changes, the February 2009 Phoenix Life Limited PPFM reflected the existing Phoenix Life Limited PPFM and the PPFMs of Scottish Mutual Assurance Limited and Scottish Provident Limited.

### **Communications to with-profits policyholders**

During 2009, we provided with-profits policyholders with key information concerning annual bonuses, investment mixes and changes to the PPFM with their annual statement.

In 2009, we sent with-profits policyholders revised guides to how we manage the with-profits funds to reflect the transfer to Phoenix Life Limited.

### **Conclusion**

It is the opinion of the company that Phoenix Life Limited including the Scottish Mutual With-Profits Fund was, in all material respects, managed in accordance with the PPFM over 2009 (including the period from 1 January 2009 to 6 February 2009 prior to the transfer to Phoenix Life Limited).

The With-Profits Committee has reviewed this annual report to with-profits policyholders and does not wish to make any additional or separate reports.

### **The Directors of Phoenix Life Limited**

June 2010

**Report to with-profits policyholders by the With-Profits Actuary of the Phoenix Life Limited Scottish Mutual With-Profits Fund for the period 6 February 2009 to 31 December 2009 and by the With-Profits Actuary of the Scottish Mutual Assurance Limited With Profits Sub-Fund for the period 1 January 2009 to 6 February 2009**

**Purpose**

The Principles and Practices of Financial Management (PPFM) for Phoenix Life Limited and, prior to 6 February 2009, for Scottish Mutual Assurance Limited (both referred to as 'the company') is a detailed document which sets out how the company manages its with-profits business.

The company has discretion in a number of areas, such as setting bonuses, policy payouts and surrender values, and in addressing any competing or conflicting rights of policyholders and shareholders.

The purpose of this report to the company's with-profits policyholders in the Scottish Mutual With-Profits Fund and, prior to 6 February 2009, in the Scottish Mutual Assurance Limited With Profits Sub-Fund, is to give our opinion, as required by the rules of the Financial Services Authority, as to whether the company has taken the interests of these with-profits policyholders into account in a reasonable and proportionate manner in exercising this discretion during 2009.

**Conclusion**

In our opinion, the company has taken the interests of the Scottish Mutual With-Profits Fund and the Scottish Mutual Assurance Limited With Profits Sub-Fund with-profits policyholders into account in a reasonable and proportionate manner in exercising this discretion during 2009.

Our opinion is based on the information which the company provided to us during the year.

The Board for Actuarial Standards has issued a Technical Actuarial Standard on Reporting ('TAS R') which applies to reports produced by actuaries. Our report, when considered alongside the information in the company's own report to which this report is annexed, together with the other information provided to policyholders in relation to 2009, is intended to comply with TAS R.

Geoffrey Ross

Fellow of the Institute of Actuaries

With-Profits Actuary for the Phoenix Life Limited Scottish Mutual With-Profits Fund from 6 February 2009 to 1 April 2009

With-Profits Actuary for Scottish Mutual Assurance Limited from 1 January 2009 to 6 February 2009

Andrew Burke

Fellow of the Institute of Actuaries  
With-Profits Actuary for the Phoenix Life Limited Scottish Mutual With-Profits Fund from  
1 April 2009

June 2010