With profits changes explained

A leaflet for with profits policyholders of Scottish Mutual Assurance Limited

We have sent you this leaflet because you have a with profits policy which is currently in the With-Profits Sub-Fund of Scottish Mutual Assurance Limited (Scottish Mutual) or a unitised with profits (UWP) policy with Scottish Mutual or because you have a policy investing in the Smoothed Investment Funds.

In this leaflet we explain how our proposals will affect you. We recommend that you read the other material that we have sent you before reading this leaflet. The terms defined in the brochure have the same meanings in this leaflet.

Throughout this leaflet, reference to ‘policy’ includes UWP benefits on policies with such benefits.

Introduction

As part of our proposals, all policies within the With-Profits Sub-Fund of Scottish Mutual will be transferred to the Scottish Mutual With-Profits Fund (SM WPF) of Phoenix Life Limited (Phoenix).

The benefits under policies investing in the Smoothed Investment Funds will continue to be provided by way of a separate pool of assets and the sections below on Targeted Asset Allocation Strategies, Capital Support and the Scottish Mutual Demutualisation Scheme do not apply to such policies.

Your policy benefits

Your benefits will not change as a result of the transfer. We will continue to add annual and final bonuses when appropriate in the same way as before.

Future bonuses on Scottish Mutual with profits policies will take account of the assets underlying those policies that are transferred into the SM WPF of Phoenix and the net returns earned on them. Some changes may, however, occur in the future, as described in the section below headed “Targeted Asset Allocation Strategies”.

Targeted asset allocation strategies

As part of the Phoenix Scheme, it is proposed that in future the Board may decide that some or all of the returns on with profits policies allocated to the SM WPF will be determined for policies, particular policies or policy groups by reference to, or influenced by, particular assets or asset types within the SM WPF. At present, with some limited exceptions, it is considered that this cannot be done in the context of the With-

Profits Sub-Fund of Scottish Mutual and the returns on the with profits policies allocated to the With-Profits Sub-Fund of Scottish Mutual are determined by reference to the overall financial position of the fund.

The Phoenix Scheme provides for some formal safeguards before the Board can decide to make a change of this kind. Therefore, subject to these safeguards, it will be possible for the Board to make a change even if it is contrary to the terms of a policy or to commitments previously given to policyholders. The Board will be required by the Phoenix Scheme to take appropriate legal, actuarial and other advice and will not be allowed to make this sort of change unless it is satisfied that it is unlikely to have a material adverse effect on the with profits policies allocated to the SM WPF. This sort of change might be appropriate if, for example, the Board believes that it will improve policyholder returns or reduce the volatility of payouts for those policyholders near maturity.

Principles and Practices of Financial Management

Full details of how Scottish Mutual currently manages the fund have been published in its Principles and Practices of Financial Management (PPFM). This document goes into a large amount of detail regarding the management of the fund and how benefits are determined. We also produce a quick guide for different types of products which contain less detail and which will already have been sent to you.

As a result of the transfer, the PPFM of Phoenix will apply in relation to the management of the SM WPF. A draft version of the PPFM of Phoenix, including the SM WPF, has been prepared. It reflects the changes noted in this document. It is available on our website. You can also phone our helpline number or write to us to request a copy.

Drafts of the quick guide have also been prepared and are available in the same way. In addition, if our proposals are approved you will be sent a copy of the new version with your 2009 annual statement.

You will notice that the format of the documents has changed. This is to bring them in line with the format used elsewhere in Phoenix. However, apart from the changes described in this leaflet, no material changes are proposed to the way we are going to manage the fund.

Capital policy and support arrangements

Currently, the fund has adequate assets to cover its liabilities and this will not be changed by the transfer to the SM WPF of Phoenix. However, the fund does not have sufficient excess capital to cover the additional capital requirements of our regulator, the Financial Services Authority (FSA). As a result, the fund currently relies on the Scottish Mutual Shareholder Fund and Other Business Sub-Fund holding additional capital. After the transfer to Phoenix, this additional support will continue at its current level but will be provided by the Non-Profit Fund of Phoenix.

In addition, the current PPFM specifies certain actions that will be taken if at any time the fund does not have enough money to cover its liabilities. These include a limit on any extra amount that will be provided to the fund if it does not have enough assets to cover its liabilities.

Following the transfer to Phoenix, we will:

- change the way in which asset shares, which are used to guide payout amounts, can be reduced if a deficit does arise; and
- remove the limit on the maximum amount that can be provided to the SM WPF if its assets are insufficient to cover its liabilities.

In addition, under the Phoenix Scheme, we will implement the Phoenix Capital Policy (PCP). The PCP is part of the Phoenix Scheme and requires Phoenix to hold additional capital for all of its operations in excess of the normal regulatory requirements. This is intended to help Phoenix withstand conditions of excessive financial stress.

Under the PCP, the Non-Profit Fund or Shareholder Fund of Phoenix will make a loan (provided they have sufficient resources) to the SM WPF if its assets are insufficient to cover its liabilities. Further, where the SM WPF is unable to cover the additional capital requirements of the FSA, then, subject to the agreement of the Board, the SM WPF will be able to rely on the Non-Profit Fund and Shareholder Fund.

In extreme circumstances the SM WPF may have to provide financial assistance to another fund within Phoenix. However, our proposals mean that the PCP should ensure that Phoenix holds assets in excess of the requirements of the FSA in relation to each of its funds, including the SM WPF. Because of this it will be extremely unlikely that a with profits policy in the SM WPF will be affected by losses from another fund within Phoenix.

Closure of the fund

If the statutory value of the with profits liabilities in the SM WPF falls below a certain level in the future, our proposals will require us to convert all the with profits policies that then exist in the fund to non profit policies and transfer them into the Non-Profit Fund.
If the conversion happens, policyholders will be given guaranteed bonuses at a guaranteed rate which will be calculated in a way that is fair to them.

Closure would only occur with the approval of our regulator the FSA. It is not expected that this would occur until around 2035.

Scottish Mutual Demutualisation Scheme

There are a number of other requirements included in the Scottish Mutual Demutualisation Scheme, which currently apply to the policies then in-force or to the way Scottish Mutual is run.
The Phoenix Scheme reflects these to the extent that they still remain relevant or are not now covered by regulation or unless they are reflected in the new PPFM. Whilst the provisions of the Scottish Mutual Demutualisation Scheme cannot be changed without an application to the Court of Session in Scotland, the PPFM can be amended without Phoenix having to apply to court.
However, there are safeguards built into the rules of our regulator, the FSA, that mean that changes to the PPFM can only be made if they are fair to policyholders.

Conclusion of Independent Expert

The Independent Expert has concluded that the proposals do not have a material adverse effect on either the security of the affected policyholders' benefits or on their benefit expectations.

Further information

If you have any questions or require further information please call our helpline. You will find the number on the letter enclosed with this leaflet.