A guide to how we manage our with-profits fund

Scottish Mutual International

You'll find important information about your policy and how it works in this guide. Please read this guide and then keep it safely with your other policy documents.

1. Who this guide is for and what you'll find in it

This guide is for you and the other policyholders who are invested in the with-profits fund of SMI. In this document 'we', 'us' and 'ours' refers to SMI. Policy benefits are expressed in 'units' which your policy bought. We own the assets in the with profits fund. A unit in a with-profits fund is a representative share in the assets of the fund. The guide explains:

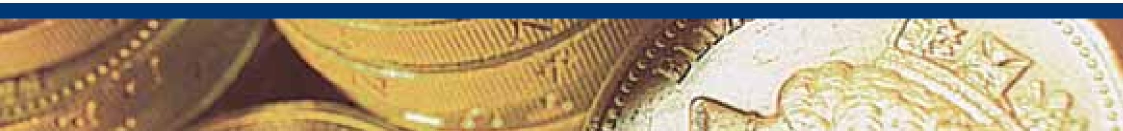
- How the fund works.
- What you should expect the fund to do for you.
- What affects the value of your investment when the time comes to cash it in.

2. What you'll find in the later sections

3. Your policy and our business

SMI is an Irish life assurance company ultimately owned by Resolution plc and regulated by the Financial Regulator in Ireland.

SMI was formed in 1996. We commenced writing with profits business in 1999 by reassuring such business into the with profits fund of Scottish Mutual Assurance plc (SMA) SMI's sister company in the UK. In 2000 SMI opened its own with-profits fund



and new business was kept within SMI, rather than being reassured into SMA. This guide describes the way in which the policies in SMI's own with-profits fund are managed.

Your policy is invested, either in whole or in part, in with-profit units in SMI's own fund. We have several different series of with profit units. The series all operate on similar principles but may be in different currencies and have different charges or bonus rates.

Like all insurance companies whose policies were sold to customers who live in the UK, we are regulated to some extent by the Financial Services Authority for sales in the UK and we always aim to operate within the relevant FSA requirements.

4. How we work out what to pay you when your policy is cashed in

When you invest in a policy you buy units which you then sell back to us when you want to cash-in your policy. This section explains how we manage the with-profits policies and policies invested in a with profits fund so that policyholders are treated fairly.

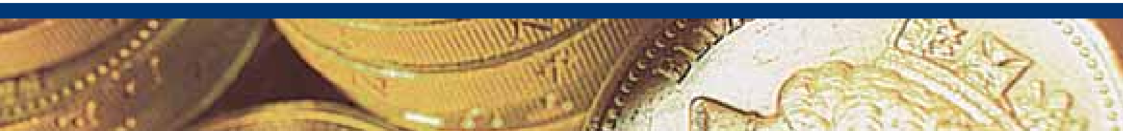
We'd like to explain a few technical terms first:

- Unit Price - This is the price we use when you are buying units from us or when cashing in your units. There may be adjustments for *Market Value Reductions* or for *Final Bonus*.

- Annual bonus - This tells you how fast the unit price increases. If there is an annual bonus for your units then you should expect to see the unit price going up over a year by the amount of the bonus rate. The annual bonus rate is usually declared in March of each year. Annual bonus is not guaranteed and could be declared at zero.

- Investment result - This is the amount we credit to the value of your units. The fund owns a variety of investments. These produce interest and dividends both of which are free of tax in the fund. The fund also sees the benefit, or the cost, of capital gains and losses as, for example, shares go up and down in value on the stock market. In some years the capital losses could be larger than the income, leaving an overall loss. Units have an annual management charge. Sometimes there may be other gains or charges arising from the smoothing of bonus rates or the cost of guarantees. There is more about annual management charges and smoothing later. All of these factors make up the investment result which we work out each year.

- Market Value Reduction or MVR (also referred to as Market Value Adjustment or MVA) - This is money we can take away from the value of your units in certain circumstances when you cash-in your policy or withdraw money from your policy.



- Final bonus (also referred to as terminal bonus) - This is an increase to the value of your units that we can give you when you cash in your policy.

There is more about how, why and when we use MVRs and final bonus later.

Smoothing

The investment result could be a gain or a loss. Smoothing can mean two things:

- Smoothing can mean not always allowing the value given for a policy to move up or down as quickly as changes in the investment result.
- Smoothing can also mean that if there are different investment results from one year to the next we may use an averaged investment result.

In either case the full effect on the investment results is allowed for over time.

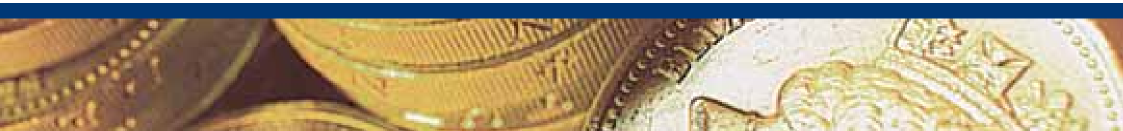
Market Value Reductions, or MVRs, and final bonuses

In most years, the investment result will be different to the annual bonus on your units. This could lead to unfairness with some policyholders getting too much and some not getting enough. We can take two steps:

- If the annual bonuses have been too low, we may add a final bonus when you cash-in the units in your policy.
- If the annual bonuses have been too high, we may take off an MVR when you cash-in the units in your policy.

The aim of either type of change is to match up your cash-in value with the investment results. We expect to check the final bonuses and change them if necessary at least twice a year and to check and change the MVRs more often so that the value of your units follows the fortunes of the fund. If an MVR reduces the value of your units, the amount of the MVR stays in the fund and does not go to SMI or Resolution plc. In the same way any final bonus is paid by the fund. At the date of this document, MVRs are being applied to some policies when they are cashed or withdrawals are taken.

Many policies will have certain times or conditions when we have promised that a minimum guarantee will apply, irrespective of any MVR. These guarantees can be valuable and if you are considering cashing-in your policy at a time when an MVR is



being charged it is always a good idea to check whether your policy has a guarantee date and how far away it is. You might want to take advice about whether it would be better for you to wait until you can claim the benefit from your guarantee.

An example

There is a simple example of how bonus, MVRs and smoothing might work in the box below.

A simple example of how annual bonus, MVRs and final bonus might work

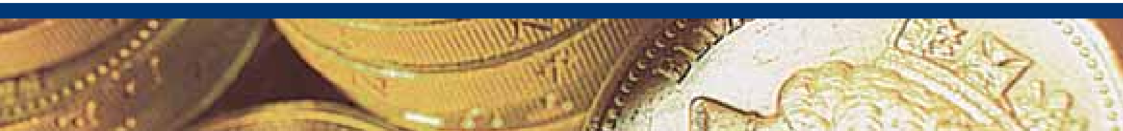
Here is a very simple example of what can happen and what we might do. It uses some imaginary units whose history is:

	Annual bonus	Investment result for year	Difference for year
First year	2%	4% loss	-4 - 2 = -6%
Second year	2%	7% gain	+7 - 2 = +5%

Let's suppose that the unit price was £1 at the start of the first year. In the first year we had a bonus of 2%, so the unit price at the end of the first year is £1.02. But the fund lost money and the £1 worth of investments we bought are now worth only 96 pence. If you cashed in now we would be likely to charge you an MVR. This might be the full 6% difference or there might be some smoothing and the charge could be, for example, 5 pence.

Despite the loss in the first year, we expect positive investment returns in year 2 and so declare an unchanged level of annual bonus of 2%. At the end of the second year the unit price has grown to £1.04. The investments which were worth 96 pence at the start of the year are now worth nearly £1.03, because the 96p has risen by 7%. We might be levying an MVR of 1 pence, or decide to levy no MVR at all.

Let's think now about a unit for a policy that began at the start of the second year. This would have quite a big difference between the annual bonus added (2%) and the investment result of 7%. We would be likely to have a final bonus for this newer policy. This is likely to be less than the full 5% suggested by the figures because the policy has only been running for one year.



Special payout situations where MVRs may not apply in full

Guaranteed With Profit Bond policies have up to two special guaranteed dates depending on which series you invested in, and which fall on:

(i) any one anniversary of the commencement date between the 8th and 13th anniversaries, which you selected at the start of the policy and the 15th anniversary.

(ii) any one anniversary of the commencement date between the 8th and the 15th anniversary which you selected at the start of the policy.

Many policies will also not levy an MVR, or will provide a guaranteed benefit, upon death. You should refer to the policy documents we gave you at the start of the policy, or when you switched in to the with profits fund, to find out exactly what guaranteed benefits apply to your particular policy.

All these guarantees can cost the fund money and there is more about how we manage this risk in section 6.

What happens if you cash-in, or ‘surrender’ your policy early

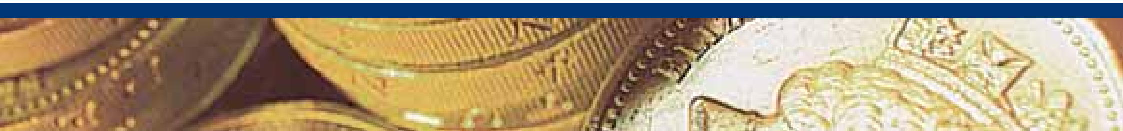
If you cash-in your policy early, you will be doing so at a time when there is no guarantee. We will work out the value of the units which have already been bought for your policy. The value of your units may be changed because an MVR or a final bonus has been used.

There may also be an early surrender charge taken off the value of the units. This happens because we have quite heavy costs when your policy starts. If the policy runs for its full normal life then we recover these early costs from the annual management charges we mentioned earlier and establishment charges. If you cash-in your policy early we will not have had long enough to get our costs back and we have to take back the outstanding cost from the cash-in value. As with other product features mentioned in this document, we told you about any early surrender charge on your policy in the papers you were given when you took out the policy.

Cashing-in early may mean you get back less than you have paid in.

What happens if you cash-in your policy on a guarantee date

If you are cashing-in your policy on a date when a guarantee applies, we will work out the value of your units using the normal price, including potentially, any MVR. You will still be entitled to any final bonus. There will never be an early surrender charge on a guarantee date, and you will receive the higher of either the value of the units plus any final bonus or the guarantee amount applying at that time.



Our right to share in bonuses

If there are any annual or final bonuses, we may, depending on the type of policy you invested in, be entitled to a share of the profits: slightly less than 18% of the amount of bonuses that are added to policies.

5. How the money in the fund is invested

At the date of this document there are three currency sub-funds; Euro, US Dollar and Sterling, and each sub-fund will have its own investment result. The fund may use any of the usual types of investments. These include stocks and shares which are bought and sold on the stock markets, unit trusts, fixed interest loans to local or national governments or to companies, and bank deposits.

History shows that company shares tend to do better than fixed interest loans in the long run, but the value of shares can go up and down quite a lot, with losses in some years. Because of the guarantees in the fund we are careful not to put too much into the type of stocks whose value might fall over short periods. We aim for a balance between choosing types of stocks that we think have a good chance of growing in value on one hand and not risking too great a loss on the other.

A typical mix of investments in the Sterling with-profits fund might be to have about half of the fund in fixed interest loans and between about a third and a half in shares on UK and overseas stock markets with the rest in a wider variety of investments. The actual mix at any time might be different. Our usual aim is to share in the overall movement of the market, rather than to try and choose individual stocks.

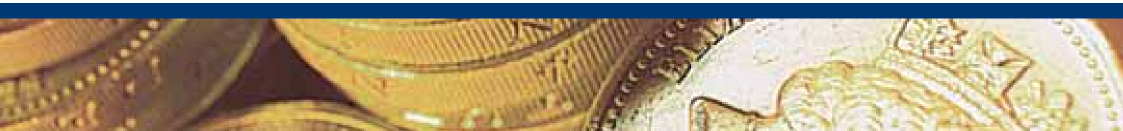
Similarly in the Euro fund, the majority of equities are from the Euro zone. For the US fund the majority of equities are US based equities.

6. How we manage risk

This section tells you a little more about the main risks in the fund, how these might affect you and how we try to manage the risks.

Investment risk

The fund is not limited to investments guaranteed by big banks and governments. We aim to earn a higher return than deposits would earn, but you don't usually get offered a higher return unless there is also some risk of loss attached. We aim to limit the risk in two main ways:



- We put only part of the fund into shares on the stock-market and keep quite a large part in safer fixed interest loans.
- We don't put too much money into any one stock or company. We spread the fund over a large number of separate investments.

Even so, the fund performance will be different from year to year and may be a profit or a loss.

Guarantee risk

Many policies will have some dates when there are guarantees which means that the fund will have a minimum amount that has to be paid out if you cash in your policy. If these guarantees mean we are not charging an MVR (or charging a reduced MVR), when we normally would, then the guarantee is costing the fund money. This could mean there is less left in the fund for other policyholders.

Since 2004, we have been managing these guarantee costs through a complex set of 'fund protection assets'. These are special investments whose value changes with the overall level of the stock market and as interest rates change. SMI bought the fund protection assets from its own resources to match what we expected the current guarantees to cost. The value of these assets is designed to rise at times when other stocks are falling and the guarantees are more likely to cost more. The overall effect is that we have insured the fund against most of the guarantee costs, but the actual guarantee costs may turn out to be more or less than the fund protection assets. We will check and revise the position from time to time. In normal circumstances, the costs or gains arising from such changes in position would not show up in the investment result.

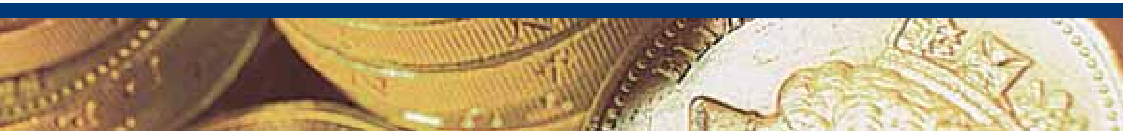
7. Charges and expenses

Different types of policy will levy different types of policy charges. There are two main types of charge – charges based on the fund and charges based on the policy. The type of charge based on the fund and the units is:

- An annual management charge based upon the price of your units. Different series of units can have different levels of charge.

The charge based on the policy is:

- An establishment charge – this is a start up fee. It is applied by reducing the number of units on your policy over the initial years, but we stop charging it once the policy reaches a certain age.



8. Our approach to new business

Our with-profits fund is closed to new business and SMI has no current plans to change this.

9. What happens if the fund has too much, or too little, money

At the time of writing (September 2006) our best estimate was that the fund had a small surplus of money to settle all our policyholders' claims. We check the position at least twice a year. However, we can't be sure what will happen in the future and the balance could be upset.

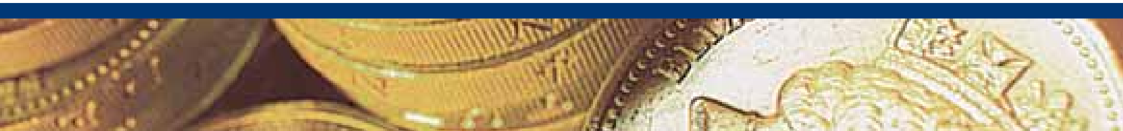
If there is extra, then we expect to add this in when we work out the investment result that we use when deciding whether we can afford to pay final bonuses or whether we need to charge MVRs. In the same way, if there is not enough then this is likely to show up as a lower investment result, making final bonuses lower or MVRs higher.

10. How to find out more

We hope this guide has been helpful, but remember you need to look at your other policy papers and your regular statements as well.

This is a short version of our full Principles and Practices document. Some of the more technical details have been left out. This summary version tells you about the main points in the full Principles and Practices document dated September 2006. If we change the full document, we will tell you and if the change is an important one that affects your policy we will send you a revised guide like this one. If you want more details about the fund you can ask for a copy of the full Principles and Practices document or you can download it from our website. If you need more information about your own policy then you can phone us or write to us.

This guide aims only to help you understand your policy. It does not aim to change the contract between us or to give you advice.



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