

## With Profits Update 2006

### Your Questions Answered

Aimed at intermediaries and investment professionals



### How does this With profits announcement impact my clients?

**Q1** What contracts are affected by this update?

**A** Any contracts invested in the SMI With Profits funds – either the Series 1 Fund which is reinvested into the Scottish Mutual Assurance With Profits Fund under OLAB rules or the SMI Dublin With Profits Fund.

Contracts invested in the SMI With Profits Series 1 Fund include the International With Profit Investment Bond, International With Profit Redemption Bond, and SMI VIP Plan.

Contracts investing in the SMI Dublin With Profits Fund include the Guaranteed With Profits Bond (and Controlled Capital Plan) and policyholders invested in the SMI Dublin With Profits Fund via a fund-link.

**Q2** What is the fund performance announcement for 2006?

**A** We have announced improved investment returns in 2005 for the SMI With Profits funds, and in line with our stated policy, we have announced more improvements to Final Bonuses and reductions in MVRs.

**Q3** When will you be contacting my clients?

**A** During April and May we will be writing to all SMI With Profits policyholders. We will give them details of the annual bonus, final bonus and an update on the fund returns for 2005. Copies of sample policyholder letters will be available on our website [www.smi.ie](http://www.smi.ie) from mid April 2006. Annual plan statements will continue to be issued on the policy anniversary which will detail the current nominal value of the investment (i.e. any potential Final Bonus or MVR will not be included).

### With Profits Funds

**Q4** What is the value of each of the With Profits funds now?

**A** The Scottish Mutual Assurance With Profits Fund is valued at £7.8 billion as at 31/12/2005 while the SMI Dublin With Profits Fund is valued at £0.9 billion as at 31/12/2005.

**Q5** What have your With Profits funds returned from 1 January 2005 to 31 December 2005?

**A** Details of the funds' performance and bonus history from January 2000 to December 2005 will be available shortly on our website ([www.smi.ie](http://www.smi.ie)) – however the returns for 2005 are as below:

#### SMI Series 1 With Profits Fund

£: 12.25%

€: 12.50%

\$: 3.50%

#### SMI Dublin With Profits Fund

£: 11.5%

€: 13.25%

\$: 4.25%

HK\$: 2.75%

#### Q6 How do you use these returns to the benefit of policyholders?

A We use annual and final bonuses and MVRs as the mechanisms to translate the above investment returns to the benefit of our investors.

When setting bonuses, we calculate an 'asset share'. This is an accumulation of the amount invested at the actual rates of return earned on the fund, after allowing for charges and expenses, and any withholding tax. In a sense, this can be viewed as the investors' 'fair share' of the with profits fund. This calculation is done for groups of policies rather than every single policy.

#### Q7 What changes have you made over the last year to the asset split of the funds?

A We continued with our prudent approach to asset allocation with a focus on achieving sustainable growth coupled with a sensible attitude to risk. We maintained our target equity backing ratio of 40% for the funds, and in respect of the Series 1 sterling sub fund, we disposed of our commercial property holding in what we viewed as an over-valued market.

#### Q8 What is the current asset allocation of each fund?

A These approximate splits represent the total With Profits funds at 28 February 2006:

SMI Series 1 With Profits Fund		SMI Dublin With Profits Fund	
Equity	37%	Equity	44%
Property	1%	Property	0%
Fixed Interest/Cash	62%	Fixed Interest/ Cash	56%

#### Q9 What was the asset allocation of the fund 12 months ago?

A

These approximate splits represent the total With Profits funds as at 28 February 2005:

SMI Series 1 With Profits Fund		SMI Dublin With Profits Fund	
Equity	32%	Equity	40%
Property	9%	Property	0%
Fixed Interest / Cash	59%	Fixed Interest / Cash	60%

## Final Bonus

#### Q10 What are the Final Bonus scales?

A Full details of the final bonus scales are detailed in the fund performance announcement. Final bonus for the Series 1 Fund range from 0% to 21% and 0% to 9% for the SMI Dublin Fund. Final bonus may be varied or withdrawn at any time without notice. The new final bonus scales apply from 1 March for the SMI Dublin Fund and 29 March 2006 for the Series 1 Fund.

**Q11** Why is it fairer to look at improving final bonus before applying an annual bonus?

A Many investors have asset shares below their guaranteed values. This has happened because the stockmarket, as measured by the FTSE 100 Index, lost around 50% of its value from the beginning of 2000 until March 2003. An annual bonus continued to be paid on the Series 1 Fund during some of this period, and throughout the period in the case of SMI Dublin Fund, in an attempt to 'smooth out' these losses. However three consecutive years of losses had not been experienced since the 1940's, and so was particularly unusual. This resulted in the declaration of zero annual bonus for the Series 1 Fund from March 2003, and the reduction in the annual bonus rate to the current level for the Dublin Fund. MVRs began to be introduced from July 2001, although in practice the first application of an MVR to an SMI policy was some months later.

We are committed to paying the guaranteed benefits. Paying an annual bonus can disproportionately benefit those policyholders whose guaranteed benefit exceeds the asset share as opposed to those where asset share exceeds the guaranteed benefits. By paying a final bonus we do not increase the guaranteed benefits and so this is the fairest to all groups of policyholders.

## Market Value Reductions

**Q12** Why do you apply MVRs?

A

MVRs are applied to make sure that those who cash-in don't receive more than their fair share of the With Profits fund. This ensures that those policyholders who remain invested in the fund are not disadvantaged by people cashing in early.

The level of MVR depends on:

- How long the customer has been invested in the fund
- What the investment market conditions have been like over that time
- What bonuses have been declared
- The actual return on the fund
- The benefits payable under the customers policy
- Any relevant tax or charges

**Q13** When is a MVR applied?

A A MVR may be applied when a policyholder takes money out of their policy, or if there is an Annual MVR-free Allowance, when withdrawals in that policy year exceed the MVR-free Allowance. Please refer to the policy terms and conditions for information specific to any particular policy type.

**Q14** Given you have not paid any return on policyholders money in the SMI With Profits Series I Fund in the last 4 years, how can you still justify large MVRs on surrender?

A The net returns over the last six years (after tax and charges) are less than the bonuses added over the period January 2000 – March 2003. The MVRs reflect the shortfall.

With improving conditions we have reduced all MVRs since April 2005, but are not yet able to reduce all of these further or remove all of them. If we were to pay more on surrender than has been earned it would adversely affect returns for those policyholders who do not exit. On the other hand we reintroduced final bonus for certain policies in October 2005 and have now announced increased and extended final bonuses.

**Q15** Have your Market Value Reduction (MVR) rates been reviewed?

A Since April 2005 we have revised the illustrative MVR scales on six separate occasions, which have resulted in improvements in MVR rates for all our policyholders. We also reintroduced Final Bonus in October 2005.

Individual Final Bonuses and MVRs depend upon the fund in which the policy is invested, the fund currency, the period of investment, general investment conditions and the performance of the underlying assets within the fund compared to the value of the units purchased and any bonus arising over the period.

Please remember that MVR-free guarantees, or absolute guarantees, still apply where appropriate. Individual policy MVR rates or surrender illustrations are available on request to [info@smi.ie](mailto:info@smi.ie).

## Annual Bonus

**Q16** What are the annual bonus rates for 2006?

A We have decided to maintain the 0% bonus for the SMI With Profits Series 1 Fund (which is reassured into the Scottish Mutual Assurance With Profits Fund), and for the SMI Dublin With Profits Fund we have declared annual bonus rates of either 2% or 2.5% (depending on the fund currency) with effect from 1 March 2006.

**Q17** Your funds had positive returns last year - why are you not paying a bonus on both funds?

A Our priority is always to protect the long-term interests of all investors in the funds. In line with our stated policy, we have announced more improvements to final bonuses and reductions in MVRs so that policyholders leaving the fund will receive their fair share of the returns.

Paying annual bonus could disproportionately benefit both maturing policyholders and policyholders with guarantees as opposed to policyholders who remain invested in the funds without guarantees. This is particularly the case for the Series 1 Fund, where there are MVR free guarantees, as opposed to the Dublin Fund where guarantees are based on a minimum percentage return.

**Q18** What effect will the zero annual bonus rate on the Series 1 Fund have on bond clients taking withdrawals?

A Policyholders who want to take withdrawals can do so but should take your advice as this will erode their capital and an MVR may be applied on any amount taken as a withdrawal.

**Q19** What about contracts invested in the SMI Dublin With Profits Fund where withdrawals are being taken?

A That will depend on the type of contract and the product terms and conditions. For example, MVRs are potentially applicable to all withdrawals from the Guaranteed With Profit Bond product, whereas policies invested in the SMI Dublin With Profits Fund via a fund link may withdraw up to the Annual MVR-Free Allowance (which is based on a percentage of the value of units held at the start of the bond year) without imposition of an MVR. The current Annual MVR-Free Allowance is the same as the bonus rate for 2006.

**Q20** How often do you review the position?

A MVRs are reviewed monthly with changes normally applying every 2 to 3 months if the change is sufficient to move MVRs. MVRs may be reviewed more frequently in line with market fluctuations. Bonuses are reviewed at least twice a year.

## What is going to happen in the future?

**Q21** Have the charges increased?

A No, the same Annual Management Charge rates that you were told when your client took out their contract still apply. Any bonuses on the With Profit Series 1 Fund are declared net of charges; the charges for the majority of policies invested in the SMI Dublin With Profits Fund are related to the bonus rate and have therefore reduced in line with the reductions in bonus declared in recent years.

**Q22** What is the long-term plan for the With Profits funds?

A The funds are closed to new business and will be retained and managed by Abbey. The long-term plan is to share the available assets fairly amongst the existing policyholders.

## Next Steps

**Q23** I would like a copy of Principles and Practices of Financial Management (PPFM)

A The following PPFMs are available

- SMI Dublin With Profits Fund
- SMI With Profits Series 1 Fund

If you would like a copy download from [www.smi.ie](http://www.smi.ie), email us on [info@smi.ie](mailto:info@smi.ie) or call us on +353 1 8044000 (10:00 to 16:00 local time). The PPFM sets out strategy for management of the With Profits funds including bonuses, smoothing, the funds' exposure to business risks, and fund charges and expenses.

**Q24** Who should I contact if I have further queries?

A Please email us at [info@smi.ie](mailto:info@smi.ie) or contact our helpline on +353 1 804 4000 (10:00 to 16:00 local time).