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With Profits Update – Scottish Mutual International (“SMA”) With Profits Series I Fund

I’m writing to let you know that Scottish Mutual Assurance (“SMA”) has now concluded the review of its With Profits Fund (the “SMA Fund”) and discussions with the UK Financial Services Authority on realistic reporting and capital requirements and to update you on what the review means for SMI With Profits Series I policyholders.

The outcome of this review is as follows:

- The SMA Fund, in which the SMI With Profits Series 1 Fund is reassured, now fully meets the new UK regulatory requirements, which are expected to come into force soon.
- The SMA Fund is stable and in a well risk-managed capital position, with a statutory solvency margin of 170% for SMA as at 31 May 2004.
- SMA is now in a position to increase the SMA Fund’s target level of equities to 35% (Sterling, with an additional 5% property) or 40% (US Dollar and Euro, with no property) (in each case excluding the hedge asset) - which is broadly in line with industry averages. This will help the SMA Fund take advantage of potential stock market growth - although the aim is still to produce steady returns with moderate risk over the long term.
- There is now greater clarity on the future management of the SMI With Profits Series 1 Fund as published in our updated Principles and Practices of Financial Management.

In arriving at these outcomes, Abbey has confirmed significant financial support to the SMA Fund from provisioning previously disclosed in Abbey's 2002 and 2003 year-end accounts. The hedging measures used by the SMA Fund over the last 18 months have been extended and improved, and will now be held within the SMA Fund. This is to help protect against negative movements in both the stock market and interest rates impacting fund realistic solvency in the future.

The conclusion of the review generally has no impact on the appropriateness of the current levels of MVRs applicable to SMI With Profits Series 1 policies as established earlier this year, apart from a small number which are being slightly reduced. The MVR levels now reflect the new realistic position of the SMA Fund. MVRs will continue to be reviewed regularly to reflect stock market conditions and other relevant factors.

Going forward, the plan is to use future growth from net investment returns to reduce MVRs and increase terminal bonus levels, in priority to declaring annual bonus. This means that the benefits of future net investment returns can be passed on to policyholders through improved bonuses on policy maturities or higher values on surrender. This allows the SMA Fund to provide all policyholders, including SMI With Profits Series 1 policyholders, with a fairer share of available assets.

We believe it is fairer to all policyholders to re-introduce annual bonuses only after MVRs have been substantially reduced, although this does not necessarily mean that they would need to be completely removed. Before we would apply annual bonus our investment managers would also have to be confident that the investment outlook was stable and sustainable and that the SMA Fund was likely to remain in a position to meet its increased liabilities following an annual bonus declaration.


We would also ensure that any payment of annual bonus was fair to all policyholders and did not favour any one set of policyholders over others.

We appreciate that this has been an uncertain time, however, we believe that Abbey's contribution along with the above measures will have a positive effect on the SMA Fund in the future. We can also assure you that any guarantees that apply to your clients' policies are not affected and currently there is no explicit future annual charge against policy values for guarantees.

We have updated our Principles and Practices of Financial Management (PPFM) to reflect the changes I have discussed. This remains the definitive document which sets out how the SMI With Profits Series 1 Fund will be managed in the future. If you would like a copy please email us at info@smi.ie.

If you have any more questions please have a look at the enclosed 'Questions and Answers' document, email us at info@smi.ie or call our helpline on +353 1 8044000.

Yours faithfully

A handwritten signature in black ink, appearing to read 'Anthony Haynes', written in a cursive style.

Anthony Haynes
Managing Director