For customers

Our new generation with-profits funds

What’s this guide for?

You should read this guide if you’re invested in one or more of our new generation with-profits funds. You can find out more about how these funds work and what you can expect if you invest in them.

We have two new generation with-profits funds (the identifier in brackets after the fund name is how you might see it referred to in your yearly statement):

- With-Profits Pensions Growth fund (WGW)
- With-Profits Pensions Cautious fund (WCA)

We explain any investment terms as we go through the guide, but you can also find them listed in the ‘Definitions’ section.

Where can I find out more?

We’ve produced a detailed technical guide on our with-profits investment strategy: Principles and Practices of Financial Management of With-Profits Business (PPFM). This is available on our website at aegon.co.uk/with-profits or from us at the address opposite.

If, when you’ve read this guide, you still have questions about investing in new or existing with-profits funds, or are unsure if a fund is suitable for you, please speak to a financial adviser. If you don’t have an adviser, visit moneyhelper.org.uk/choosing-a-financial-adviser to find the right one for you. We can’t give you any advice, but if you’d like further information on the funds or how we run them, please contact us:

Aegon and Scottish Equitable Pensions and Bonds
Sunderland
SR43 4DS

03456 10 00 10

Call charges will vary.

If we change our with-profits principles or practices, we’ll let you know.

If your personal circumstances mean you need any additional support, or if you’d like a large print, Braille or audio version of this document please visit aegon.co.uk/additionalsupport or call 03456 10 00 10 (call charges will vary).

Definitions

Asset classes
What the funds can invest in, for example shares, bonds and property.

Contract charges
Charges as defined in your policy conditions booklet (for example the yearly charge we take from your fund). Smoothing reductions aren't included in these.

Expected growth rate (EGR)
The EGR for each fund is our estimate of the long-term rate of return for each fund's investment.

Smoothing
Returns are 'smoothed' over the investment's term. In other words, in good years some return is held back to be used for years when returns aren't so good. This gives the investor a return that changes less over the years. We explain this in more detail in the 'Smoothing' section.

Smoothing adjustment
This is an adjustment, which may be up or down, that we may apply to your payout when you leave the fund. This is in order to be fair to investors who are leaving the fund and to those who are staying.

Unit
Each of our new generation with-profits funds is made up of units and each payment you make buys a number of units in the funds you choose.

With-profits
A type of investment where the investor shares in the profits and losses of the fund.

New generation with-profits

What's a new generation with-profits investment?
In this type of investment you share, with the other fund investors, in the profits and losses of the fund you've invested in. Each fund makes profits and losses both from its investments and from investors leaving it.

Another key element of a new generation with-profits investment is smoothing and you can find more details of this in the 'Smoothing' section.

How does a new generation with-profit fund work?
If you invest in one of these funds, your money is put with that of other investors in that fund. This 'pooling' of investments generally means you have access to a better spread of assets (in other words what you can invest in, such as shares, bonds, and property) than if you'd invested on your own. It can also help spread the risk and the costs.

Each of our new generation with-profits funds are made up of units and each payment you make buys a number of units in the funds you choose. The value of your investment then depends on the price of the units you hold. We calculate the unit price daily (you can find more details on this in the section 'How we calculate the unit price').

We invest the funds in a mix of company shares (equities), fixed interest securities (for example loans to the government or large corporations), cash and potentially property. These different types of investment are known as classes of assets. You can find more details on this in the section 'Where are these new generation with-profits funds invested?'. The return on these investments is paid back into the funds.

Each of our new generation with-profits funds are ring-fenced. This means that all investment profits and losses, as well as profits and losses arising from investors leaving the fund, are shared within the fund and are reflected in payouts to investors.

Smoothing

What is smoothing?

Smoothing is a key part of how our with-profits funds work. The fund invests in shares (also known as equities) and fixed interest investments. Together these are known as the underlying investments. The value of these underlying investments changes every day — sometimes going up and sometimes going down. Which means that, in normal circumstances, the value of your investment would also rise and fall. But here's how your with-profits fund's smoothing helps cushion you from the worst of this.

When the value of the underlying investments rises more quickly than we expect, we keep some money back. We then use this to top up the value of the underlying investments when they fall (or rise less quickly than we expect). Using it means that the change in value of funds won't be as dramatic as that of the underlying investments.

Although smoothing can provide a certain amount of protection, it can't cancel out the impact of a sustained fall in investment returns.

How does smoothing work?

The expected growth rate (EGR)

We set an estimated growth rate — which is an estimate of how well we expect the underlying investments of the fund to grow over the long term. The EGR isn't guaranteed and may change in the future, and we only use it to calculate smoothing of unit prices. We show this rate as a yearly percentage but we divide it to give us a daily rate, which we then use to calculate the smoothed unit price.

We review EGRs at least once a year and we may change them upwards or downwards in the future. EGRs don't show the impact inflation may have on the real return on your investment. Real return is the actual return on your investment after adjusting for the rate of inflation over the time you're invested.

How we calculate the unit price

Each day we compare the return earned on the underlying investments with the daily EGR.

- While the difference between these measures is within +/- 5%, we'll continue to operate our daily smoothing mechanism as illustrated in the smoothing mechanism chart on the next page. This is based on 50% of the actual investment return plus 50% of the expected growth rate (EGR).
- If the value of the actual fund assets is greater than the smooth unit value by more than 5% then we'll modify the formula to gradually increase the value of the smooth unit price with a view to returning the difference to within 5% over time.
- Alternatively, if the value of the actual fund assets is less than the value of the smooth unit value by more than 5% then we'll modify the formula to gradually decrease the value of the smooth unit price with a view to returning the difference to within 5% over time.

The approach we use in the second and third bullet points above will calculate the value of the daily smooth return as 45% of the actual investment return, 45% of the expected growth rate plus a further 10% of the higher (second bullet point above) or the lower (third bullet point above) of these two returns.

The price of your fund can still rise and fall each day, but not as much as it would without smoothing.

People leaving the fund can also affect its price. Half of the profits or losses created in the fund by those leaving are added by the smoothing process into the next day's unit price.

We also take the fund's annual management charge into account in our unit price calculation.

Let's look at an example.

While the calculation is actually done daily, we're showing it done yearly in the example to make the process easier to understand. So, say the actual return on the With-Profits Pensions Growth fund's investments was 7% and its EGR was 3%. We'd then calculate the change in the smoothed unit price as follows:

7 (actual)	– 3 (EGR)	=	4 (difference)
4 (difference)	÷ 2	=	2 (half of difference)
7 (actual)	– 2 (half of difference)	=	5 (used to calculate the smoothed unit price)

So the unit price growth would be 5% (before any charges are deducted).

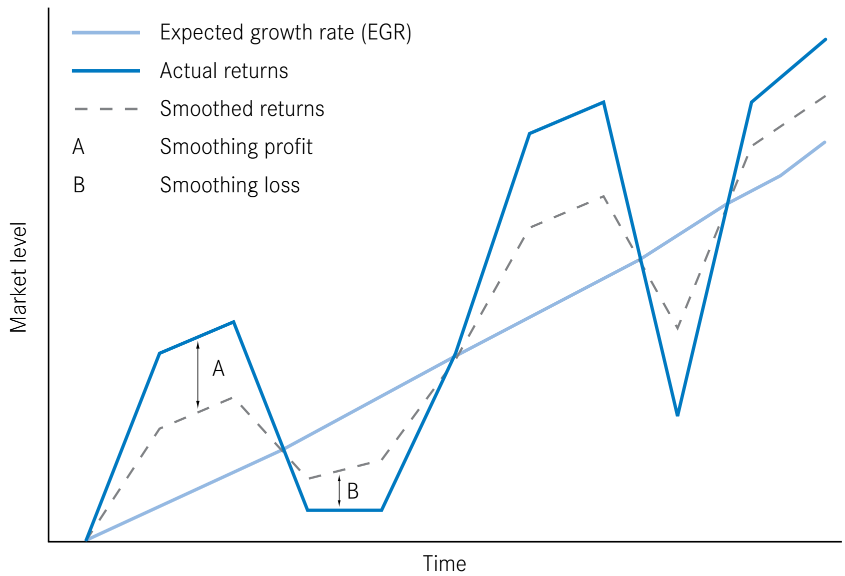
However, if the actual return was a fall of 7%, we'd calculate the change in the smoothed unit price as follows:

Rise of 3 (EGR) and a fall of 7 (actual)		=	10 (difference)
10 (difference)	÷ 2	=	5 (half of difference)
Fall of 7 (actual) +	5 (half of difference)	=	fall of 2 (used to calculate the smoothed unit price)

So the unit price would be reduced by 2% (before any charges are deducted).

In addition, whenever any investor takes money out of the fund, the fund makes a smoothing profit or loss:

- There's a smoothing profit when the growth in the smoothed unit price is less than the actual return on the fund's investments during the period the investor's been in the fund.
- There's a smoothing loss when the growth in the smoothed unit price is greater than the actual return during the period the investor's been in the fund.



The graph above shows how this works. For example, if an investor leaves the new generation with-profits fund at point A, the fund will actually have earned more from its investments over the time the investor has been in the fund than the investor will take out at the calculated smoothed return rate. This means a profit for the fund.

However, if the investor leaves at point B, the fund will actually have earned less on its investments than the investor could take out at the calculated smoothed return rate. This means a loss for the fund.

We include a proportion of these daily smoothing profits and losses, currently 50%, in our calculation of the next day's unit prices.

Our new generation with-profits funds

How do the funds share out profits and losses?

Traditional and unitised with-profits funds share out their profits and losses to investors through a system of yearly bonuses with final bonuses or reductions. Under many of these funds there may be some guarantees of what you'd get back.

However, new generation with-profits funds work in a different way. Instead of using bonuses or reductions, we calculate a smoothed unit price daily for each fund (as explained in the previous 'Smoothing' section). There are no guarantees under this type of with-profits fund (so the unit price can fall).

We may apply a smoothing adjustment, upwards or downwards, to your payout when you leave the fund. This is to make sure you get your fair share and to protect the interests of our remaining investors. You can find more on this in the section 'What if I decide to cash in my investment?'.

What affects how much I might get?

Various factors affect how much you'll get. These include:

- the performance of the fund's investments – this is the biggest factor;
- the effect of taxation;
- the smoothing of investment returns (see the 'Smoothing' section);
- smoothing profits and losses (see the 'Smoothing' section);
- the yearly charge (called the annual management charge) we take from your fund (you can find details of this in your personal illustration, which you get when you first invest), and
- smoothing adjustments (see the section 'What if I decide to cash in my investment?')

You also need to consider inflation. While it won't affect the actual amount you'll get back, it can have an impact on that amount's buying power. The real return to you is the actual return on your investment after adjusting for the rate of inflation over the time you're invested. If actual returns don't keep pace with inflation, your real return will reduce, and vice versa.

Where are these new generation with-profits funds invested?

Our With-Profits Pensions Growth fund invest a relatively large proportion in equities (company shares), with the balance in fixed interest securities. The With-Profits Pensions Cautious fund invest a relatively high proportion in fixed interest securities, with the balance in equities and potentially in property. A financial adviser will be able to advise you if these funds are suitable for you.

Each fund has a target range for the percentage it invests in each of the main asset classes. The current target ranges are:

With-Profits Pensions Growth fund

UK and overseas equities: 80% to 90%

UK and overseas fixed interest securities: 10% to 20%

Cash and others: 0% to 5%

With-Profits Pensions Cautious fund

UK and overseas equities: 35% to 45%

UK and overseas fixed interest securities: 55% to 65%

Cash and others: 0% to 5%

Within these target ranges, we hold a mix of assets to reduce risk. We may vary these ranges in future.

The value of an investment can fall as well as rise for a number of reasons, for example market and currency movements. You could get back less than originally invested.

What are the guarantees?

There are no guarantees with these funds.

Are there any expense risks associated with investing in the funds?

There are no expense risks for you.

We deduct an agreed charge, designed to cover our running costs, from the fund on a daily basis. If our running costs are higher than expected, we cover the shortfall. You won't pay extra, so there's no risk to you.

What if I decide to cash in my investment?

If you decide to cash in your investment, we may adjust your payout by a smoothing adjustment, which may be up or down. This is in order to be fair to investors who are leaving the fund and those who are staying.

As we explained in the 'Smoothing' section, investors leaving the fund can generate a smoothing profit or loss. And when, for example, a large number of investors withdraw from the fund when the smoothed return is much greater than the actual return (as at point B on the graph shown earlier), this might generate a large smoothing loss and would pay out too much to the leaving investors. If they took the full amount of their investment at the smoothed value out, this would unfairly penalise the investors who were staying in the fund. In such cases, we may apply a smoothing reduction, which reduces the value of each leaving investor's payout.

In different market conditions we could see the reverse of this.
For example, if a large number of investors withdrew from the fund when the smoothed return was much less than the actual return (as at point A on the graph), this might generate a large smoothing profit and we could pay out too little to the leaving investors. In such cases, we may apply a smoothing increase, which increases the value of each leaving investor's payout, as otherwise the investors remaining in the fund would receive more than their fair share of the smoothing profits over the whole investment period.

We won't currently apply smoothing adjustments to any claims as long as the ratio of smoothed fund value to the actual value of the fund's assets is in the range 80% to 130%. We may alter this range in the future and we don't do this calculation at individual policy level. For example, we may group together all investments made in a particular year and month.

Given that with-profits investment is considered a long-term investment, it may not be in your best interests to cash in your investment early.

What discretion does the company have?

The directors of Scottish Equitable plc have discretion over the key aspects of the operation of new generation with-profits funds, in particular the investment policy, expected growth rates and smoothing adjustments. However, the Principles and Practices of Financial Management of With-Profits Business (PPFM) tell you how the directors expect to exercise this discretion. If we make any changes to the PPFM, we'll let you know.

If you're unclear on whether with-profits investment is right for you, you should ask a financial adviser for advice.

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