

**SCOTTISH WIDOWS**  
preparation is everything  
*official pensions and investment provider*



# Your guide to with-profits

Important information about  
investing in our With-Profits  
Income Fund using one of our  
Flexible Options Bonds.



We have written this guide to give you more information about investing in our With-Profits Income Fund through one of our Flexible Options Bonds.

This guide explains how the With-Profits Income Fund works. You should read through all of this document as it contains important information about your bond, but here is a brief summary.

When you invest your money, it is pooled with the money invested by other investors in part of our with-profits fund. We expect to add bonuses to your bond, though you may choose to cash in these bonuses regularly to provide an income.

The bonuses will depend on the fortunes of the with-profits fund, and in particular on the returns from the investments in the relevant part of the fund. The cash-in value of your bond will go up or down depending on these investments, and on the income you take. However, a guaranteed minimum value is paid if you die.

After meeting its obligations, the with-profits fund will over time be distributed in full to with-profits investors. Our aim is that different groups of investors receive their fair share of the fund.

This guide is a summary of a longer, more detailed, document called our Principles and Practices of Financial Management ('PPFM'). We have tried to make sure that this guide accurately reflects the PPFM. But the PPFM will apply if there is any difference between the information in it and the information in this guide.

The full PPFM is on our website at **[www.scottishwidows.co.uk/PPFM](http://www.scottishwidows.co.uk/PPFM)**, or you can ask us to send you a copy. Our address is given at the end of this guide in the section "How can I get more information?"

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We've set out the information in this guide as answers to the questions above.

The With-Profits Income Fund is just one of the investment choices we offer. It is possible that only some of your money is invested in the With-Profits Income Fund. This guide only covers the With-Profits Income Fund part of your investment.

## What is meant by With-Profits Income?

In return for your investment in the With-Profits Income Fund we add With-Profits Income units to your bond. The units we add to your bond have a guaranteed minimum value in some circumstances. A description of this guarantee and the circumstances when it applies is given in “What are the guarantees?” on page 5. Your units will stay With-Profits Income units until they are cashed in when one of the following happens:

- you cash in all or part of your bond;
- we cash in units to pay any fixed regular withdrawals you make;
- you die; or
- you change from the With-Profits Income Fund by switching all or part of your investment to other funds.

Each month we add new bonus units to your With-Profits Income investment (see “Regular bonus” on page 6). You can cash in bonus units regularly to provide what we call ‘natural income withdrawals’.

We may also add final bonus to your bond when your With-Profits Income units are cashed in. Further information on bonuses is given in “What types of bonus may be added to my bond?” on page 5. When guarantees do not apply we may make a ‘market value reduction’ (see page 8).

Your money less any initial charges is pooled with the money invested by other investors. While you have With-Profits Income units, it is pooled in part of our with-profits fund called the With-Profits Income Fund. Our approach to managing our with-profits fund as a whole and the With-Profits Income Fund can change from time to time.



## The With-Profits Income Fund

The With-Profits Income Fund invests mainly in a mix of ‘corporate bonds’ and some property. Corporate bonds are a type of loan made to companies. While corporate bonds have not provided returns as good as those from shares and property over long periods such as 20 years, their value has not been as variable. Still, one year the investment may do well but the next year could see a fall in value – this is often called ‘investment risk’.

The proportion of the With-Profits Income Fund that is put into each of these different types of asset will vary over time. The mix of assets is different to other parts of the with-profits fund. We may use different types of asset in the future.

Part of the With-Profits Income Fund will be used as part of a process of providing the guarantees that apply to With-Profits Income units. See “Guarantees” on page 11.

## Your group

When managing the With-Profits Income Fund we often look separately at different groups of investors. The group you’ll be in will depend when you started to invest in the With-Profits Income Fund. If you invest in the With-Profits Income Fund at different times using your bond, each of those investments could be in a different group.

In addition your bonus units are likely to be in different groups. Which group depends on when you started to invest in the With-Profits Income Fund and when we paid the bonus units. In particular, bonus units added to bonds that started investing in the With-Profits Income Fund on or after 23 March 2005 will belong to different groups from bonus units added to bonds started earlier.

## The shareholders

Scottish Widows plc is a ‘proprietary company’. This means that we have shareholders. Our shareholders receive the charges that we make on bonds like yours and in return meet the cost of looking after your bond.

## What are the guarantees?

We guarantee that each With-Profits Income unit added to your bond will have a minimum value of £1 in the following circumstances:

- if you die while you still have With-Profits Income units; and
- if we cash in units to pay for either:
  - fixed regular withdrawals (unless the exceptions listed below apply); or
  - natural income withdrawals (see “What is meant by With-Profits Income?” on page 3).

For simplicity in this guide we will refer to all of these circumstances with the phrase ‘when guarantees apply’.

The guarantees do not apply at other times and the guarantee on fixed regular withdrawals may not apply if you:

- chose them after the start of your bond;
- started them after the first year of your bond; or
- changed their level.

If you decide to start or change the withdrawals please let us know shortly before you want the change to happen. We will then tell you whether the guarantee will apply or not. There are limits on the levels of fixed regular withdrawals you are allowed to take.

If only some of your money is invested in the With-Profits Income Fund, the guarantee only applies to the With-Profits Income units.

## What types of bonus may be added to my bond?

Two types of bonus may be added to your With-Profits Income units:

- regular bonus, which we may add each month by the addition of extra (‘bonus’) units to your bond; and
- final bonus, which we may add when you cash in With-Profits Income units or if you die.

We usually decide levels of regular and final bonus twice a year, but we may sometimes change them at other times. Future rates of bonus are not guaranteed.

Different groups of investors may have different levels of each type of bonus. Different levels will also apply to With-Profits Income units added to your bond in different periods (usually six-month periods). This means different rates may apply to units in your bond that we added at different times. The yearly statement we send you includes information about the current bonus rates for your group.

## How do you decide the bonuses?

Regular bonuses and final bonuses have different purposes, and we decide them differently.

### Regular bonus

Details on how we set regular bonus rates are given in our PPFM but, very broadly, we use the following approach.

The regular bonus is based on the investment return we expect from the core assets (see “Investment Performance” on page 10). For each different level of regular bonus this value is adjusted for:

- taxation;
- the charges we expect to make to cover the cost of managing your bond;
- the deductions we expect to make as part of the process of paying for guarantees;
- the profits and losses arising from this process; and
- any differences between past actual investment returns and the investment returns we expected when we set past regular bonus.

Overall, we expect regular bonuses to provide a return that does not change sharply from year to year. We normally aim to limit any change in the regular bonus to a maximum of 0.5% over 6 months. However, over many years regular bonuses will inevitably rise or fall to fully reflect changes in the return available on investments.

## Final bonus

We apply different levels of final bonus for With-Profits Income units bought in different periods. We take 'sample units' added in each of these different periods. The sample units are chosen to be representative of the units of the bonds in your group. We pay a final bonus if the asset share (see "Asset shares" on page 9) of the sample unit is bigger than its face value of £1. In other words, we aim to 'top up' what investors get from each unit to reflect the sample unit's asset share.

Overall, we aim that the total payouts over many years are equal to the asset shares. The extra that we sometimes pay out because of guarantees would be on top of this.

We constantly monitor the market value of the core assets (see "Investment performance" on page 10), and may change levels of final bonus at any time. For instance, we'd consider a change if asset shares move more than 2.5% from the values used to set the current bonus rates. We'd also consider a change if it was necessary to limit losses to the with-profits fund. Final bonuses can sometimes change very significantly, even within a few months.

## What if I decide to cash in my With-Profits Income units when guarantees don't apply?

Normally, if you choose to cash in With-Profits Income units then guarantees won't apply. This may happen because you decide to:

- switch out of the With-Profits Income Fund into another investment fund;
- take fixed regular withdrawals that don't qualify for the guarantees (see page 5); or
- cash in all or part of your bond.

Whatever the reason, we will still aim to give you fair value for your investment. However, there is no minimum guarantee of what your bond will pay and you will not get anything for the guarantees you are giving up. In fact, it is possible that you could get back less than you invested if markets are low enough.

How much you get back from each of your With-Profits Income units will be:

- the £1 face value of the unit;
- plus any final bonus that we add;
- less any 'market value reduction'.

There may be a charge if you transfer your investment out of your bond early.

This charge helps us to recover costs and is not covered in this guide. It will be described in the Key Features that we gave you at the start of your bond.

## Market value reductions

Different levels of market value reduction apply for different groups of investors and for With-Profits Income units bought in different periods (usually 6-month periods).

We take the same representative sample units we use to set final bonuses. We may apply a market value reduction if the asset shares of the sample units are lower than their £1 face value. Market value reductions are sometimes referred to as 'market level adjustments'.

Our aim is to maintain a fair level of payouts to everyone investing in the With-Profits Income Fund. We constantly monitor the market value of the core assets (see "Investment performance" on page 10), and may change or apply market value reductions at any time. For instance, we'd consider a change if the difference between payouts and asset shares is more than 2.5%. We'd also consider a change if it was necessary to avoid excessive profits or losses to the With-Profits Income Fund.

The size of the reduction is restricted by the terms of your bond. We will not set a reduction such that it takes the sample unit's payout below its asset share. If we introduce a market value reduction, we'll check after not more than three months to see if it should still apply. We'll also check whenever rates of final bonus change.

Market value reductions are likely to be quite common for With-Profits Income units. This is because we try to adjust levels of regular bonus to keep asset shares close to the £1 face values. This increases the chances of them sometimes being below face values.

## What affects how much I might get back?

### Asset shares

Asset shares help us decide the bonuses and market value reductions. The way this works is described earlier in this guide.

Very broadly, asset shares are an accumulation of the amounts invested, less the value of any bonus units already added. So when deciding what an asset share would be, we look at the following four main factors:

- the amounts invested in sample With-Profits Income units (see below);
- when they were invested;
- the past investment performance of the 'core assets' (see "Investment performance" opposite); and
- how much of that performance has already been passed on through the addition of bonus units.

We also make adjustments for:

- the regular deductions that we have made from asset shares as part of the process of paying for the guarantees we make to With-Profits Income Fund investors (see page 11);
- the With-Profits Income Fund's profits and losses from that process of paying for guarantees or from differences between actual investment returns and the investment returns we expected when we set past levels of final bonus;
- the charges we have made to cover the cost of managing your bond;
- any profits and losses from 'business risks' (see "What are the risks of investing in the With-Profits Income Fund?" on page 12); and
- taxation.

We track asset shares of the With-Profits Income Fund for sample With-Profits Income units. We track them separately for the different groups of investors, including your group, and for units that were started at different times.



## Investment performance

This guide sometimes refers to the 'core assets'. These are part of the With-Profits Income Fund. They aren't the only part of the With-Profits Income Fund that will affect what you and the other investors in your group get back, but they will have the most effect.

The investment performance of the core assets will depend on, among other things, the mix of the types of asset. We currently aim to hold a mix of corporate bonds and some property in the core assets. Corporate bonds are loans to companies, who pay us interest in return. The market value of these core assets can change very significantly even over a few months. However, we expect the longer-term investment return from the core assets to be more stable.

Returns from corporate bonds rely on the companies continuing to be able to make their loan repayments as they fall due. Some companies are more at risk of failing to make these payments than others. Independent experts have assessed this risk. We aim to invest half the core assets in what these experts think are lower-risk corporate bonds.

We aim to invest a quarter of the core assets in higher-risk corporate bonds. These offer a higher return but have a higher risk of not meeting the payments to give that higher return. Most of the remaining core assets are invested in business property from which we receive rent.

We would change the types of asset we use if we felt they were no longer suitable for the With-Profits Income Fund.

A small part of the core assets may be invested in cash deposits that earn interest. Or we may borrow a small amount in order to invest more in the other asset types.

Over ten years or so, the return available from the corporate bonds we invest in can change considerably as company loan repayments are made and new loans started. So your regular bonus, and any 'natural income' you may be taking, can also change. This reflects changing rates of inflation and other factors.

We may change the mix of the assets with the aim of:

- getting the best possible long-term investment income, avoiding large changes in asset shares over time; and
- making sure that the With-Profits Income Fund can always meet its obligations.

We include information about the mix of core assets in the yearly statement we send you. It is also in the PPFM section of the Scottish Widows website. You'll therefore be able to see any change in the mix of the assets over time.

## Guarantees

We regularly deduct small amounts from the asset shares to pay for the guarantees. These deductions are added to an account in the With-Profits Income Fund that is separate from the core assets. The account is used to help pay for any payments made that are greater than asset shares.

We set the deductions at a level we expect to cover the cost of paying for the guarantees. The size rises or falls as the expected cost changes and we use modern investment methods to reduce the variability. The cost of the guarantees is likely to increase when there's been poor investment performance. So these modern methods increase the money available to support guarantees at these times. This lessens the need to increase the deductions from asset shares. The methods reduce the money available when the investment performance is good and little support is needed.

The whole approach sometimes leads to profits and losses in the account. So from time to time we value the account to judge whether we expect there to be too little, enough or too much money in it. To balance the account we may adjust the asset shares and the future level of deductions.

## What are the risks of investing in the With-Profits Income Fund?

Your With-Profits Income investment, by being part of our With-Profits Income Fund, is exposed to 'investment risk'. This is the risk that the value of the core assets can fall as well as rise. There are other risks known as 'business risks'.

The main business risks for your bond come from the process of paying for the guarantees that we make to other With-Profits Income investors. The profits and losses from this process can increase or decrease the asset share for your group. This could increase or decrease the bonuses you receive.

With-Profits Income units are unlikely to share in the profits and losses from policies in other parts of the with-profits fund, and vice versa.

There are naturally risks associated with your bond that apply to other sorts of investment and not just our With-Profits Income Fund. Those other risks, such as the risk that the taxation may change, would also apply to other ways of investing your bond. This guide deals only with risks that are directly associated with your bond being invested in our With-Profits Income Fund. You can find out about the other risks in the Key Features document you were given at the start of your bond.

## How can I get more information?

If you're still not sure about your with-profits investment, you should speak to your financial adviser or contact us direct. If you wish to contact us you can write to us at:

**Scottish Widows**  
**PO Box 902**  
**15 Dalkeith Road**  
**Edinburgh**  
**EH16 5BU**

Or you can call us on **0845 845 0845**. We're open from 8am to 6pm Monday to Friday and from 9am to 12.30pm on Saturday. We may record and monitor calls to help us improve our service.

We'll write to you if we make a change to our approach to managing our with-profits fund that might have a significant effect on your plan. We'll also write if we change any of the 'Principles' in our PPFM. We'll normally include a replacement guide.

If you've any other with-profits investments with us that aren't covered by this guide, we'll send out your guide or guides for them.



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44621 08/08