

2008 annual report to with-profits investors

For the year to 31 December 2008

May 2009

AEGON Scottish Equitable and with-profits

In this report you can find details of how we managed our with-profits business in 2008 and how we took account of our with-profits investors' interests.

About this report

The Financial Services Authority (FSA) requires us to produce a report each year for our with-profits investors stating whether or not, during the financial year in question, we believe we've complied with our stated Principles and Practices of Financial Management of With-Profits Business (PPFM).

But it's not just our word on it. The independent Scottish Equitable Policyholders Trust Ltd is involved in the ongoing assessment of our compliance with the PPFM, providing an element of independent judgement throughout the process. (You can find more details on this in the section 'How we make sure we're compliant with the PPFM' below.)

Our PPFM

Our PPFM sets out in detail our with-profits management strategy and processes. You can view it on our website at www.aegonse.co.uk or write to us at AEGON Scottish Equitable, Edinburgh Park, Edinburgh EH12 9SE for a copy.

Our PPFM is split into two sections: Principles and Practices. The Principles set out our general approach to the management of with-profits business and we don't expect these to change often. The Practices cover the day-to-day operation of our with-profits business within the Principles framework.

Our with-profits contracts and funds

Scottish Equitable plc used to be Scottish Equitable Life Assurance Society, which was a mutual company, and you may have invested in your with-profits contract or fund with us then. On 31 December 1993 the business and assets of Scottish Equitable Life Assurance Society were transferred to Scottish Equitable plc as part of the demutualisation process as we became a public limited company. AEGON Scottish Equitable is the trading name of Scottish Equitable plc.

We have three types of with-profits contracts/funds:

- traditional with-profits
- unitised with-profits
- new generation with-profits

We generally offered traditional with-profits contracts up to 1984 for pensions business (for example retirement annuities) and 1991 for life business (for example endowments). We then had unitised with-profits funds available under contracts taken out after these dates up to 30 September 2002. Since then we've offered our new generation with-profits funds.

We included minimum pension guarantees (including guaranteed annuity options) in a number of contracts mainly in the 1970s and 1980s. As people are now on average living longer and interest rates have fallen over time, the cost of meeting these minimum guarantees has increased. While we've made investments that provide some protection against the impact of future interest rate falls, these guarantees still have an effect on the bonuses paid out to our with-profits investors, except for those invested in the new generation with-profits funds.

Apart from ongoing regular contributions, increments and new entrants into existing occupational pension schemes, we stopped offering with-profits business with investment guarantees on 30 September 2002. Since then, any new with-profits investments have been into our range of new generation with-profits funds. These have no investment guarantees and each is ring-fenced, which means that all investment profits and losses stay in the fund and are reflected in payouts to investors.

How we make sure we're compliant with the PPFM

We take advice from the With-Profits Actuary on all aspects of the operation of our with-profits business. This ranges from bonus declarations to the systems and procedures needed to treat with-profits investors fairly. The With-Profits Actuary advises us on whether any changes we make are consistent with our PPFM and produces routine reports for us. One of these is a detailed report explicitly covering compliance with the PPFM during the previous financial year.

Also, the Scottish Equitable Policyholders Trust Ltd provides an element of independent judgement on compliance with the PPFM. Its board (which is independent of Scottish Equitable plc) meets regularly throughout the year and its directors take advice from an independent actuarial adviser (who also sits on the board of Scottish Equitable Policyholders Trust Ltd). The independent actuarial adviser and the With-Profits Actuary are present at these regular meetings, as well as certain directors and management of Scottish Equitable plc. All reports from the With-Profits Actuary to Scottish Equitable plc's directors are also given to Scottish Equitable Policyholders Trust Ltd. As a matter of course during the year, the With-Profits Actuary routinely discusses matters with the independent actuarial adviser.

Our with-profits decisions

Within our with-profits business, we have discretion (in other words we make all the decisions as to what to do) in the following key areas:

Traditional and unitised with-profits business

- Investment policy
- The calculation of yearly bonus rates, final bonus rates and market value reductions
- The calculation of surrender values (for traditional with-profits contracts only)
- Deductions for meeting part of the expected future costs of guarantees within the calculation of asset shares (we calculate an asset share for each policy and it's basically the income (for example the contributions paid in) less the outgoings (for example contract charges) plus the underlying investment return)
- How much is added to the asset shares from the estate (which is the excess assets over and above the amount required to meet liabilities to investors)

New generation with-profits business

- Investment policy
- The calculation of expected growth rates (which is what we expect the long-term return on the investments for each fund to be)
- The calculation of smoothing adjustments (which are adjustments, upwards or downwards, that may apply to your payout when you leave the fund)

In accordance with the demutualisation process, as described in the 'Our with-profits contracts and funds' section above, the expenses or charges allocated to asset shares are set at specific levels. If you've invested in unitised or new generation with-profits funds, you can find details of the charges in your illustration and policy conditions booklet. If you've invested in traditional with-profits contracts, details of the expenses are in our Scheme of Demutualisation.

Investment policy

You can find the target investment ranges for traditional, unitised and new generation with-profits business, which have remained unchanged since the end of 2003, in the PPFM (and listed below). The target ranges specify how much of each fund is to be invested in a combination of equities (company shares) and property, with the balance to be invested in fixed interest securities and cash. Throughout 2008 with-profits investment mixes were within these target investment ranges.

Traditional and unitised with-profits contracts/funds

Target amounts to be invested in equities and property:

Traditional With-Profits	15%-20%
Unitised With-Profits – WPE, WPC and WWP Funds	15%-20%
Unitised With-Profits – WP1, DAF and DA2 Funds	17.5%-22.5%
Unitised With-Profits – WP2 and WPB Funds	52.5%-57.5%
Unitised With-Profits – Deposit Administration Funds	0%

Under these funds, the higher the level of guarantees for investors, the lower the target equity/property range generally.

New generation with-profits funds

Life Growth, Pensions Growth and Pensions

Stakeholder Growth

UK and overseas equities	60%-90%
UK and overseas fixed interest	10%-40%
Cash and others	0%-5%

Life Cautious, Pensions Cautious and Pensions Stakeholder Cautious

UK and overseas equities	20%-50%
UK and overseas fixed interest	30%-70%
Property	0%-25%
Cash and others	0%-5%

The gross investment returns (before deducting tax and expenses/charges and before adding an amount from the estate) over the last two years under the traditional and unitised with-profits contracts/funds are as follows. These investment returns feed directly into the calculation of asset shares. Note that these returns don't represent changes in the value of with-profits plans to investors. When we set bonus rates and market value reductions, asset shares are smoothed.

Contract/Fund	2008 returns	2007 returns
Traditional Life and Pensions; Unitised Pensions WPE, Life WPC, Life WWP	-7.3%	3.3%
Unitised Pensions WP1	-7.2%	3.3%
Unitised Pensions WP2	-15.5%	5.0%
Unitised Pensions DAF	-7.1%	3.2%
Unitised Pensions DA2	-7.1%	3.2%
Unitised Pensions Deposit Administration	-3.2%	2.3%
Unitised Life WPB	-15.9%	4.9%

Low investment returns were experienced in all funds during 2008, consistent with the significant economic downturn. The lowest returns were in the funds with the highest equity contents (WP2 and WPB).

The new generation with-profits funds use a smoothed unit price to share out their profits and losses to investors, unlike traditional with-profits contracts and unitised with-profits funds, which use a system of yearly bonuses and final bonuses or reductions. The change in smoothed unit price for the new generation with-profits funds over the last two years is shown below.

	2008 unit price change	2007 unit price change
Life Growth Fund	-6.8%	6.1%
Life Cautious Fund	-2.5%	4.6%
Pensions Growth Fund	-8.3%	6.7%
Pensions Cautious Fund	-3.7%	4.8%
Pensions Stakeholder Growth Fund	-8.2%	6.6%
Pensions Stakeholder Cautious Fund	-3.6%	4.5%

The unit price changes in all new generation with-profits funds during 2008 substantially reflect the average of the underlying asset returns and the expected growth rates, which are detailed later in this report.

Yearly bonus rates, final bonus rates and market value reductions (MVRs)

Asset shares are fundamental to the calculation of yearly bonus rates, final bonus rates and MVRs. You can find details of how we'll calculate asset shares in the PPFM, which we followed during 2008.

Once we've calculated the asset shares, they're then smoothed, using a process described in the PPFM, to arrive at smoothed asset shares. We calculated smoothed asset shares in accordance with the PPFM throughout 2008.

The PPFM details the circumstances in which final bonus rates and MVRs might be based on something other than 100% of smoothed asset shares. During 2008 final bonus rates and MVRs were based on around 105% of smoothed asset shares during the first six months of 2008 and on 100% of smoothed asset shares thereafter. Every 3 months we update final bonus rates and MVRs on our website.

We declared yearly bonus rates on 1 April 2008 for those funds where the bonus is declared in advance and on 31 December 2008 for those funds where the bonus is declared in arrears. This was done in line with the PPFM. You can find the declared yearly bonus rates below, with the previous year's rates for comparison.

Yearly bonus declared in advance	1 April 2008	1 April 2007
Unitised with-profits pension funds:		
WP2	2.50%	1.25%
DAF	4.00%	3.00%
DA2	0.50%	nil
Unitised with-profits pension deposit administration funds:		
SE Funding (premium paying)	2.00%	4.50%
SE Funding (paid-up)	1.25%	3.75%
Barclays Retirement Accumulator Plan	1.00%	3.50%
Money Plus (accumulation units)	3.50%	3.50%
Money Plus (initial units)	nil	1.00%
Money Purchase Plan (accumulation units)	2.00%	4.50%
Money Purchase Plan (initial units)	nil	2.50%
Unitised with-profits life funds:		
WPB (1.0% annual management charge)	0.25%	0.25%
WPB (1.5% annual management charge)	nil	nil

Yearly bonus declared in arrears	31 December 2008	31 December 2007
Traditional with-profits:		
Life	3.00%	3.00%
Pensions	1.50%	1.00%
Unitised With-Profits:		
Pensions WPE Fund	Nil	Nil
Pensions WP1 Fund	Nil	Nil
Pensions Reflex Deposit Administration Fund	Nil	Nil
Life WPC Fund	Nil	Nil
Life WWP Fund	Nil	Nil

Yearly bonus rates are in addition to any guaranteed growth rates, which are as follows:

Fund	Guaranteed growth rate each year
Traditional With-Profits	In the range 2%–5.5%
Unitised Pensions WPE	Around 5.5%
Unitised Pensions WP1	4.0%
Unitised Pensions WP2 and DAF; Unitised Life WPB	0.0% (in other words the unit price can't fall)
Unitised Pensions DA2	3.0%
Unitised Pensions Reflex Deposit Administration	5.0%
Unitised Pensions Deposit Administration (other)	0.0% (in other words the accumulated fund can't fall)
Unitised Life WPC	3.9%
Unitised Life WWP	2.7%
All new generation with-profits funds	No guarantees

Guaranteed growth rates may only apply if you stay invested to a date specified in your policy documents (for example a specified maturity or retirement date or on earlier death).

While some increases in yearly bonus rates took place in 2008, rates remained at low levels under many funds. It's important to view this in the context of the additions and guarantees over the whole investment term. We have to make sure that guarantees to our investors can be met. Once a yearly bonus is added to an investment, it increases the guarantees under that investment. If we build up guarantee levels that are too high, our financial position may be adversely affected and this may mean changes in investment mix and in payouts to investors.

This is particularly relevant at the moment because of the following:

- Many with-profits funds have high rates of future guaranteed growth on top of any yearly bonus additions (see the table on guaranteed growth rates on the previous page).
- Guaranteed benefits continue to remain high relative to asset shares under a number of funds.
- We expect future investment returns to be relatively low, consistent with a continued low inflationary environment.

Because of all these factors, we believe the 2008 yearly bonus declaration represents a sensible strategy to protect the long-term interests of all with-profits investors.

Guaranteed benefits and yearly bonuses represent only a part of the ultimate payout under a with-profits investment. There are also final bonuses and market value reductions (MVRs) under unitised with-profits funds and final bonuses and surrender value bases under traditional with-profits contracts. We amended final bonus rates and MVRs every three months during 2008. All our final bonus and MVR calculations in 2008 were in line with the PPFM.

Deductions for guarantee costs and estate distribution

The PPFM states that we intend to make a regular deduction from asset shares to meet some of the expected future guarantee costs, including guaranteed annuity option costs. The rest of the expected future guarantee costs will be met from the estate.

The PPFM also states that we expect to make a regular addition to asset shares from the estate, although this isn't guaranteed.

The same rate of deduction for guarantee costs and addition from the estate applies to all our with-profits contracts except for new generation with-profits funds, where we make no such deductions or additions. This is consistent with the PPFM.

During 2008 we made monthly deductions for guarantee costs equivalent to 0.25% a year from asset share investment returns. Also, we enhanced the asset shares of those contracts in force at 31 December 2008 by 1.00%, resulting in a net asset share enhancement over 2008 of 0.75%.

Calculation of surrender values (traditional with-profits)

During 2008 we checked that the surrender values of traditional with-profits contracts were consistent with asset shares, which they were. As a result, no changes were made to the underlying bases.

New generation with-profits: expected growth rates

We reviewed the yearly expected growth rates (EGRs) for the new generation with-profits funds during 2008 against our expected future rates of return on equities and fixed interest securities. As a result, the yearly EGRs applying during 2008 were:

	From 1 January 2008 – 31 March 2008	From 1 April 2008 – 31 December 2008
Life Growth	7%	8%
Life Cautious	6%	7%
Pensions Growth (including stakeholder)	8%	9%
Pensions Cautious (including stakeholder)	7%	8%

The EGRs are before annual management charge deductions.

New generation with-profits: smoothing adjustments

In line with the PPFM, we currently don't apply smoothing adjustments to payouts to investors leaving the new generation with-profits funds as long as the ratio of the smoothed fund value to the actual value of the backing investments is in the range 80% to 130%. During 2008, there were no claims under investments where the ratio was outside this range, so we didn't apply any smoothing adjustments.

Changes to the PPFM during 2008

We made a number of changes to the PPFM on 1 January 2008. Most of these changes were simply to clarify existing wording. The others were as follows:

Smoothing of final bonus rates

When we calculate the final bonus rates for our traditional with-profits contracts we now include a further element of smoothing. This is in addition to smoothing changes made in 2006 and means the final bonus rates are now likely to fluctuate less than before. We've added some information about this into our PPFM. This change may well affect you if you took out a pension contract with us before 1984 or a life contract before 1992.

Interest rate protection

In June 2007 we bought some interest rate derivatives (which are financial instruments that enable us to exchange unknown future income for more certain future income). These provide protection against interest rates falling and help bolster payouts to our with-profits investors if this happens. We've added in some new wording to reflect this.

Smoothing adjustments

For our new generation with-profits funds, the PPFM used to have details of a 'priority order' we would aim to follow if smoothing adjustments were required on claims. The 'priority order' treated one-off withdrawals and switches less favourably than other claim types and is no longer appropriate given changes to FSA rules. So we've deleted the wording about this from the PPFM.

Our directors' opinion on our with-profits management in 2008

We can confirm that, throughout 2008, we have met the requirements of the PPFM and we have exercised our judgement fairly, taking into account the interests of with-profits investors in a fair and reasonable manner. Our governance arrangements involve Scottish Equitable Policyholders Trust Ltd providing some independent judgement in the assessment of our compliance with the PPFM. We continue to be satisfied with the operation of these arrangements (and the judgement exercised) throughout 2008.

The directors of Scottish Equitable plc
May 2009

We're not allowed to give you advice, but if you'd like any further information on our with-profits contracts or funds and how we run them, please contact us:

AEGON Scottish Equitable
Edinburgh Park
Edinburgh
EH12 9SE

Telephone: 0870 242 6789

Statement by the With-Profits Actuary

I can confirm that, in my opinion, the firm's 2008 annual report to with-profits investors and the discretion exercised by the firm's directors during 2008 have taken the interests of with-profits investors into account in a reasonable and proportionate manner. In reaching this conclusion, I have taken account of the information and explanations provided to me by the firm, as well as the relevant rules and guidance of the Financial Services Authority, the Board for Actuarial Standards and the Actuarial Profession.

Craig Murison
With-Profits Actuary
Scottish Equitable plc
May 2009



AEGON is proud to be the first ever Lead Partner of British Tennis. From grass roots to Centre Court, we'll be investing at every level of the game to help build a brighter future for British tennis. Find out more at www.aegon.co.uk/tennis

