

# ANNUAL REPORT

## SKANDIA LIFE GUARANTEED PENSION FUND

### Annual Report to With-Profits Policyholders from the Directors

Period: 1 January 2009 to 31 December 2009

#### 1. Introduction

**1.1** Our with-profits fund is called the Guaranteed Pension Fund. We manage this Fund by following the Principles and Practices set out in the document Principles and Practices of Financial Management (PPFM) [http://www.skandia.co.uk/funds/principles\\_practices.pdf](http://www.skandia.co.uk/funds/principles_practices.pdf). We do not expect to change the Principles often whereas Practices can change more frequently.

**1.2** The leaflet "A guide to how we manage our with-profits fund" (Guide) <http://www.skandia.co.uk/funds/CFPPFM.pdf> sets out the key points of the PPFM.

**1.3** All providers of with-profits funds are required to produce an Annual Report that explains the extent to which, throughout the year covered by the report, their fund has met its obligations as set out in the PPFM.

#### 2. How we manage the Guaranteed Pension Fund

**2.1** The governance arrangements for the Fund involve four parties:

- The Board of Directors of Skandia Life
- The With-Profits Committee
- The With-Profits Actuary
- The Investment Committee

The PPFM sets out the duties and responsibilities of each of these parties.

**2.2** The With-Profits Committee is a sub-committee of the Board of Directors and throughout 2009 comprised:

- A Director plus a number of other employees of Skandia Life
- The With-Profits Actuary who is independent

**2.3** The Committee met seven times during 2009 and is responsible for drawing any material issues to the attention of the Directors. The Committee also discussed various issues by conference call and e-mail throughout the year.

**2.4** The With-Profits Actuary also has a statutory obligation to ensure that the Directors exercise any discretion in respect of the Fund fairly in respect of investors and his Report is appended to this Annual Report.

### **3. Annual Report**

**3.1** As explained in the regular six-monthly Updates we have sent to you, following the severe and prolonged setbacks in investment markets that started at the beginning of 2000 the Guaranteed Pension Fund closed to further investments in October 2002. The Directors deemed that abnormal or extreme conditions applied to the Fund at this time.

**3.2** In November 2006 the discretion over bonus rates was replaced by a return to the fixed rules set out in the literature. The rules are documented in the PPFM and Guide both of which are available from our web site <http://www.skandia.co.uk/funds/gpf.asp>.

**3.3** As mentioned in the Annual Report and the With-Profits Actuary's Report for 2007, the global credit crunch had an impact on the Fund and, from the end of April 2008, the Fund returned to abnormal or extreme conditions.

**3.4** Throughout periods where abnormal or extreme conditions apply, the Directors exercise the discretion they have as set out in the literature to determine the bonus rates each month. In doing so the Directors adopt a prudent approach to bonus additions to protect the solvency of the Fund, while maintaining a balance between the interests of short term and long term investors and continuing to meet all guaranteed payments as they become due at their Selected Guarantee Date or earlier death.

**3.5** From April 2008 the bonus rates were reduced each month in the light of this prudent approach. In October 2008, when it was clear that the United Kingdom was heading into an officially recognised recession, the bonus rates were reduced to zero and have remained so. The Directors keep the situation under close review.

**3.6** The attached Report from the With-Profits Actuary explains the main areas where discretion exists in the management of the Fund and the way in which the Directors have considered the different rights and interests of relevant parties in exercising that discretion.

**3.7** The Fund is designed to ensure that Skandia Life is only able to take explicit charges (as specified in the literature) from the Fund and hence there are no conflicting interests between policyholders and shareholders of Skandia Life as may be the case for a more traditional form of with-profits fund.

**3.8** There were two changes in the operation of the Fund during 2009. The first took place at the beginning of the year. Skandia Life had a reinsurance agreement with another company in the Old Mutual Group to help support the guarantee value. The Directors decided to end this arrangement and Skandia Life took over the responsibility for covering the guarantee from its own resources without charge. As a result the cost of the reinsurance agreement ceased to be deducted from the Fund's assets. The PPFM and Guide were amended to reflect this change. The second change took place in May and was designed to provide greater flexibility in the way the Fund invests in overseas equities. The separate geographical sector funds were replaced by the Skandia Global Dynamic Equity Fund.

**3.9** The PPFM was also amended during the year to clarify the description of how we manage the Fund although there were no actual changes in the way the Fund was managed.

**3.10** In preparing this Annual Report for the Guaranteed Pension Fund the Directors arranged for the independent With-Profits Actuary to review the operation of the Fund. He carried out a similar review last year. The Directors are pleased to report that this Review identified no material concerns and the With-Profits Actuary confirmed to the Directors that the Fund had operated in accordance with the PPFM.

**3.11** In the light of the above, the Directors believe that the Guaranteed Pension Fund has operated in accordance with the PPFM during the year.

#### **4. How to find out more**

**4.1** Please read the Update letter and accompanying questions and answers document that is normally sent to you around January and July each year.

**4.2** Full information on the Fund and its progress is available on the website: <http://www.skandia.co.uk/funds/gpf.asp>. This information includes the PPFM, the Guide, bonus rates, the discounted value of units on leaving the Fund before your Selected Guarantee Date and the proportion of the Fund invested in equities.

**4.3** If you have any other enquiries, please telephone 02380 916 624.



Nick Poyntz Wright  
Skandia UK Director



Michelle Cracknell  
Skandia UK Director

28 June 2010

# **ANNUAL WITH-PROFITS ACTUARY REPORT**

**N.H. Taylor FIA, ASA**

## **GUARANTEED PENSION FUND**

**Annual Report to With-Profits Policyholders from the With-Profits Actuary**

**Period: 1 January 2009 to 31 December 2009**

### **1. Introduction**

**1.1** This report accompanies the Annual Report prepared by the Directors of Skandia Life into the management of the with-profits fund called the Guaranteed Pension Fund (Fund).

**1.2** It is required under Financial Services Authority (FSA) Rules.

**1.3** This Report complies with Technical Actuarial Standards R: Reporting Actuarial Information issued by the Board for Actuarial Standards.

**1.4** The purpose of the report is to give you an independent view on the main areas where discretion exists in the management of the Fund and the way in which the Directors have considered the different rights and interests of relevant parties in exercising that discretion.

**1.5** The description of the way the Fund is managed is documented in Skandia Life's Principles and Practices of Financial Management (PPFM). Information is also contained in the leaflet "a guide to how we manage our with-profits fund" (Guide).

**1.6** Both these documents were amended during the year to reflect the cessation of a reinsurance agreement within the Old Mutual Group which is referred to later in this report. In addition the opportunity was taken to clarify the description in the PPFM of how Skandia Life managed the Fund although there was no actual change in practice.

**1.7** In May a decision was taken to change the way the Fund invested in overseas equities in order to provide greater flexibility. Rather than making investments in separate geographical sector funds exposure to overseas equities was amended to making investments in the Skandia Global Dynamic Equity Fund.

**1.8** I became the With-Profits Actuary in January 2007. I am an independent consulting actuary in private practice.

**1.9** I attended all seven meetings of the With-Profits Committee during 2009 and was party to discussions during the year by conference call and e-mail on various issues.

**1.10** I confirm that, where necessary, I had, or was furnished with, such information as was necessary for the compilation of this report.

## **2. Discretion in the Fund**

**2.1** The Fund was closed to further investments in October 2002.

**2.2** The Fund is designed to operate as much as possible with very limited discretion. The principal areas where discretion can be exercised are:-

- In deciding whether or not the Fund is experiencing “abnormal or extreme” conditions and hence whether or not to override the Rules for bonus rate calculations.
- In deciding the proportion of equity investments the Fund should hold.
- In selecting in which equity and fixed interest investments the Fund will invest.
- In setting the scale of discount factors to be applied to units on leaving the Fund before the .Selected Guarantee Date.
- In deciding what level of fees should be charged to the Fund for external investment management.
- In deciding the amount to include in the fund charge in respect of administration costs directly associated with the management of the Fund.

**2.3** The Directors have in certain circumstances delegated its discretionary powers to the With-Profits Committee, of which I am the independent member alongside members of Skandia Life’s management. I set out below my observations on the factors that have been taken into account in each of the following areas.

### **3. Abnormal or Extreme Conditions**

**3.1** As I mentioned in the last section of my Report for 2007, the With-Profits Committee has been monitoring the economic situation carefully since the decision made by the Directors in November 2006 that abnormal or extreme conditions no longer applied. In April 2008 the Committee recommended to the Directors that such conditions should, once again, apply and the Directors agreed to this recommendation.

**3.2** Skandia Life documents whether or not it considers the Fund continues to experience abnormal or extreme conditions and the reasons for that belief. It does this each time a bonus is declared which is prior to the end of each calendar month. When abnormal or extreme conditions apply then the bonus Rules may be over-ridden.

**3.3** From April 2008 the bonus rates were reduced each month. In October 2008, just ahead of official recognition that the United Kingdom was in a recession, the bonus rates were reduced to zero and have remained so.

**3.4** In my opinion the Directors will continue to exercise discretion over bonus declarations for the foreseeable future taking advice from the With-Profits Committee, such advice including that which I have given to the Committee.

**3.5** The United Kingdom has recently made a technical exit from recession but the economy remains fragile and there continues to be uncertainty about the intentions of the new coalition government. The equity market continues to be volatile. The Bank of England's quantitative easing programme is currently on hold and this also adds to uncertainty particularly in the fixed interest market. Further there is concern over sovereign debt particularly with the problems in Greece making headlines but Spain, Portugal and Ireland also have problems and the United Kingdom is not in a strong position. Concern has also been expressed about whether the problems in the Eurozone countries may cause the demise of the Euro as a viable currency

**3.6** The Directors and the With Profits Committee keep the situation under close review. The new Chancellor of the Exchequer, George Osborne, produced an austerity Budget on 22 June 2010 on behalf of the new coalition government with the intention of cutting the United Kingdom's budget deficit but, at the same time, encouraging economic growth. It is his intention that there should be no return to recession but his growth forecast for this year is only 1.2% with that for 2011 being 2.3%. Initial reaction to his Budget by experienced commentators has been that he has got the balancing act about right but only time will tell whether this is correct and what impact it will have on the coalition going forward. In the meantime the Directors and the With Profits Committee believe that abnormal or extreme conditions continue to apply.

**3.7** The fact that the Directors consider abnormal or extreme conditions continue to apply allows them to decide the bonus rates each month. Thus the Directors could decide to reinstate bonus payments when they consider that market conditions are such as to minimise any threat to the long term solvency of the Fund, or they could decide to make one-off bonus additions. The Fund will always distribute all the available investment growth each month so, regardless of conditions, a bonus will always be added when the average value of units exceeds £1.00 per unit.

#### **4. Equity Investments**

**4.1** As documented in the PPFM, the With-Profits Actuary is responsible for advising the Directors on the proportion of Fund assets that should be invested in equities. This is referred to as the Equity Backing Ratio (EBR). The EBR is limited to a maximum of 40%, this limit having been set in 2006 following a full review by the then With-Profits Actuary.

**4.2** Over 2009 the EBR varied between 24% and 38% and ended the year at 30%. These figures reflect the combined effect of movements in equity and gilt edged markets. As I mentioned in my Report last year the With-Profits Committee believes that the investment portfolio should not be rebalanced to achieve the 40% maximum level at this time with markets remaining volatile. However this decision is kept under regular review. When in my judgment, markets have become less volatile I will carry out a formal review of the EBR and make appropriate recommendations.

#### **5. Fixed Interest Investments**

**5.1** There has been no change to the practice of wholly investing the fixed interest proportion of the Fund assets in UK Gilt-Edged securities.

**5.2** Advice on a suitable portfolio of Gilts to match the term of the liabilities was provided in formal reports to the With-Profits Committee during 2009.

**5.3** In addition, the extent to which the expected income from the Gilt portfolio matches the guaranteed benefit profile is reviewed each month.

## **6. Average Value of Units**

**6.1** The average value of units started 2009 at 89.9p per unit and ended the year at 96.2p per unit. The absence of bonuses contributed to this increase and means the Fund can maintain its investment in equities for a longer period. It is my view, and that of the Directors, that aiming to increase the average value of the units during this period balances the interests of different investors in the Fund when considered over longer periods of time.

**6.2** For those policyholders who choose to switch out of the Fund before their Selected Guarantee Date, the closer the average value of units is to £1.00 the closer the value of their units will be to £1.00 each.

## **7. Discount Rates**

**7.1** Section 1.1 of the PPFM sets out the amount payable on the Selected Guarantee Date, death or on leaving the Fund before the Selected Guarantee Date. In particular a discount may be applied to the guaranteed value of units on leaving the Fund before the Selected Guarantee Date. The maximum such discount rate is equal to the yield of a medium-term Gilt. Throughout 2009, the FTSE 15 year Gilt Index was used to define this yield.

**7.2** The approach to setting discount rates was last reviewed following the closure of the Fund in 2002 to new money. The With-Profits Committee can direct the With-Profits Actuary to review this if there is a material change in circumstances. No such review was carried out in 2009. However I recently carried out a review with the Actuarial Function Holder of Skandia Life and we both considered no change was necessary.

## **8. Charges**

**8.1** The charges that are documented in Section 4 of the PPFM applied throughout the year. As a result of switching overseas equity investments into the Skandia Global Dynamic Equity Fund there was a small increase in the fees charged for external management which was offset by a reduction in the charge for administration costs for the management of the Fund. As a result the Fund charge remained at 0.35% per annum of the value of the assets throughout the year.


**8.2** I mentioned last year that Skandia Life had a reinsurance agreement with another company in the Old Mutual Group to help support the guarantee value in the Fund. The Directors decided to end this arrangement with effect from the beginning of 2009 with Skandia Life covering the guarantee from its own resources without charge. As a result the cost of the reinsurance agreement ceased to be deducted from the Fund's assets.

## **9. Controls**

**9.1** During the year a number of measures were introduced to strengthen the controls placed on the management of the Fund. The With-Profits Committee receives detailed reports on these controls at each of its meetings. I note that all the controls worked satisfactorily during 2009 and the results met the laid down criteria.

## **10. Conclusion**

**10.1** Over the last two years we have experienced exceptional market conditions since the global credit crisis was triggered by the sub-prime lenders. For many countries, including the UK, the credit crunch has caused a recession and, for those who have emerged from the recession, the exit has been fragile. There has been an unprecedented period of low interest rates and, more recently, unparalleled concerns over a sovereign debt crisis – the risk that countries will default on their debts. It has been a huge challenge to manage a Fund that provides guarantees during these turbulent times while also balancing the interests of the many different types of investor in the Fund. Despite these abnormal and extreme conditions, while the value of your units will vary according to the period remaining to the guarantee date you have selected, it is pleasing to report that the average value of units is close to their guaranteed value of £1.00 per unit. However the continuing challenge to manage the Fund is likely to continue for the foreseeable future. Information is updated monthly on the website and you will continue to be kept informed of how these challenges are being managed via the Updates that are sent to you around January and July each year.



**N H Taylor**  
**With-Profits Actuary**

28 June 2010

### **Further Information**

Please refer to the section in the Directors' Report for contact details.