

# *Saunderson House Limited*

## Crystallisation of Terminal Bonuses

### in Standard Life's With Profits Pension Fund

#### Background

A with profits fund is intended to provide a smoothed return and certain guarantees. It comprises a spread of assets which include equity, property, fixed interest and cash investments. Strong with profits funds like that of Standard Life hold a high proportion of equity and property investments. These asset classes have in the past provided most of the long-term growth associated with such investment funds.

Smoothing arises when part of the profit made by the fund in good investment years is held back for release in poorer years. The investment return is distributed through annual (or reversionary) and terminal bonuses.

Guarantees arise because annual bonuses attach irrevocably to the policy and when there is a minimum guaranteed rate of bonus.

The trend has been to reduce annual bonuses which are guaranteed in favour of terminal bonuses which are not. Whilst this enables life offices to adopt higher equity and property weightings to maximise the long-term returns from their with profits funds it reduces the guaranteed element of the portfolio making with profits funds higher risk investments than they used to be.

#### Terminal Bonus Ratios

The terminal bonus in many clients' Standard Life with profits policies accounts for 25-50% of the total value of the with profits fund. The value of terminal bonus is not included in our half yearly valuations.

#### Crystallising the terminal bonus

Since terminal bonus is not guaranteed and may be reduced or removed at any time and because Standard Life have not currently reduced terminal bonuses nor applied "market value adjusters" as have other life offices, it may be sensible to crystallise terminal bonuses at their present levels.

This can be achieved by:

- Switching out of the with profits fund;
- Transferring to another retirement annuity policy or personal pension plan;
- For those over age 50, taking pension benefits.

#### Potential Demutualisation Benefits

Standard Life remains a Mutual Office having rebuffed the attempt of some members to force them to demutualise. In our view further attempts will be made and it is likely that at some stage demutualisation will take place, which could provide substantial demutualisation benefits.

It is possible to crystallise the terminal bonus whilst preserving potential demutualisation benefits by:

1. Transferring to a new Standard Life personal pension plan, invested in the With Profit fund, or
2. Taking benefits in the form of a with profit annuity (if over age 50)

#### Transferring to a new Standard Life Personal Pension Plan

Clients not wishing or able to take immediate benefit may prefer this option. The following points should be noted:

1. Retirement annuity policyholders who did not elect to transfer to Standard Life's new Millennium With Profits Fund enjoy a minimum guaranteed bonus rate of 4% per annum. Investments in the With Profits Fund via a personal pension plan have no minimum rate of bonus;
2. To maximise the guarantees in any replacement policy, the selected retirement age should be that at which you expect to take benefit because the fund is then available without risk of any market value adjuster;
3. Retirement annuity policyholders should retain sufficient retirement annuity policies to accept uncapped contributions. Standard Life retirement annuity policies are normally segmented. It may be appropriate to retain one or more segments enabling a high proportion of the terminal bonus to be crystallised, retaining the ability to:
  - (a) pay RAP contributions into the remaining segments; and
  - (b) take benefits in stages if more than one segment is retained;
4. We are able to arrange the new personal pension plan at no initial charge/bid-offer spread and with ongoing charges similar to transferring policies;
5. Under existing retirement annuity policies, the cash commutation is three times the residual single life annuity. Under a personal pension policy, 25% of the fund can be taken as cash commutation. At current annuity rates, the RAP will only provide higher cash if benefits are taken after approximately age 70.

#### Taking Benefits in the form of a Standard Life With Profits Annuity

This may appeal to those over age 50 who were planning to take their benefits in the near future.

For those who wish to take benefits via the income drawdown route there is currently no way of doing so whilst preserving membership rights but we expect a facility to be available before the end of the year. Those wishing to crystallise terminal bonuses now could transfer to a Standard Life personal pension plan as an intermediate step.

It should be noted that whilst the options outlined above provide continuous membership rights, the basis on which any demutualisation bonus is calculated may not be as generous as if the policy had not been transferred.

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**Regulated by the Personal Investment Authority**

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