

ANNUAL WITH-PROFITS ACTUARY REPORT

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GUARANTEED PENSION FUND

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

Period: 1 January 2010 to 31 December 2010

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 Standard 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 The PPFM and Guide were amended during the year to clarify the description of how Skandia Life manage the Fund although there was no actual change in practice. Revised versions were issued in August 2010.

1.7 During 2010 the With-Profits Committee changed from being a sub-committee of the Board of Directors with a Director chairing it to being a Committee reporting directly to the Directors and continuing to be responsible for the day to day management of the Fund. The Committee is required to provide a full Annual Report to the Directors for the first Board Meeting in each calendar year and a brief written Report for each quarterly meeting thereafter. The required quorum for meetings of the Committee is now that three members of the Committee be present including one of the Chair, the Actuarial Function Holder or the With-Profits Actuary. Bearing in mind the size of the Fund I see no reason for a Director to be a member of the Committee. I am comfortable with the change in structure, the reporting requirements to the Directors and the quorum for meetings.

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 2010 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 fixed rules for bonus rate calculations
- In deciding the proportion of equity investments the Fund should hold
- In selecting 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 when the value of the assets in the Fund is less than the number of units in issue.
- 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 their 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 previous Reports 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. The With-Profits Committee and the Directors remain of the opinion that the economic situation is such that abnormal or extreme conditions continue to apply. I support this position.

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 fixed rules may be over-ridden.

3.3 The strong growth in equity markets in the second half of 2010 enabled the Fund to return to parity . the point where the value of the assets in the Fund equals the number of units in issue so all units are valued at £1.00 each - and to allow bonuses to be allocated for the first time since October 2008. In addition, when the Fund is at parity, investors can switch out of the Fund into other unit linked funds at £1.00 per unit regardless of how far they are from their Selected Guarantee Date.

3.4 At the end of August, September and December bonuses were determined by the fixed rules but, at the end of October and November, asset values had fallen and the Fund was below parity. As such the Directors determined bonuses at their discretion, taking advice from the With-Profits Committee, such advice including that which I have given to the Committee. The Fund will always distribute all the available investment growth in excess of a unit value of £1.00 each month so, regardless of conditions, a bonus will always be allocated when the average value of units exceeds £1.00 per unit.

3.5 Although the United Kingdom economy is no longer technically in recession it remains fragile. On a broader base the sovereign debt crisis has hit Greece and Ireland both of whom have needed support from other Eurozone countries and the International Monetary Fund. Portugal may well need such support. It is possible that these three countries will need to restructure their sovereign debt. The Netherlands, Italy and Spain also have problems but may be able to manage these without outside help.

3.6 The Directors and the With-Profits Committee keep the situation under close review. As I mentioned in my last Report the Chancellor of the Exchequer presented an austerity Budget in June 2010 with the intention of cutting the United Kingdom's budget deficit but, at the same time, encouraging economic growth. Reaction to his Budget by experienced commentators was that he had got the balancing act about right but, in practice, only time will tell whether this is correct.

3.7 With the difficult economic situation likely to continue for the foreseeable future the prospects for bonuses will depend mainly on whether the recent rally in equities continues coupled with any changes in the interest rates which will impact on the value of gilts.

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 currently 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 2010 the EBR varied between 29.0% and 40.7% and ended the year at exactly 40.0%. These figures reflect the combined effect of movements in equity and gilt edged markets. As I mentioned in my Report last year, when the EBR had varied between 24% and 38% over the year, the With-Profits Committee believed that the investment portfolio should not be rebalanced to achieve the 40% maximum level. The Committee do not intend to rebalance the portfolio if the EBR exceeds 40% noting that markets remain volatile and considerable costs would be incurred in rebalancing the portfolio. I support this decision which is kept under regular review. However when, in my judgment, markets have become less volatile I will carry out a formal review of the EBR and make 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 2010.

5.3 In addition, the extent to which the expected income from the Gilt portfolio matches the major part of the guaranteed benefit profile by amount and term is reviewed each month.

5.4 It needs to be noted that an increase in interest rates will reduce the value of the gilts. With 60% of the assets of the Fund invested in gilts, and an expectation that the low interest regime may not be maintained for much longer, such an increase could represent a key challenge to the management of the Fund this year.

6. Average Value of Units

6.1 The average value of units started 2010 at 96.2p per unit, reached £1.00 per unit in the middle of August and ended the year at £1.00 per unit. The absence of bonuses until August contributed to this increase which enabled the Fund to maintain its investment in equities for a longer period, a point I made in my Report last year. It remains my view, and that of the Directors, that aiming to increase the average value of the units to £1.00 per unit balances the interests of different investors in the Fund when considered over longer periods of time.

6.2 For those investors who choose to switch out of the Fund before their Selected Guarantee Date the closer they are to their Selected Guarantee Date the closer the value of their units will be to £1.00 each. The return of the average value of units to £1.00 per unit triggered the Special Switch Service. This allows investors to record, at any time, their desire to switch out of the Fund the next time they will receive an encashment price of £1.00 per unit. The return to parity in August led to 7% of the Fund being switched out. In my view this Service, which continues to be available, allows investors to meet their investment objectives.

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 will be applied to the guaranteed value of units on leaving the Fund before the Selected Guarantee Date when the value of the assets in the Fund is less than the number of units in issue. The maximum such discount rate is equal to the yield of a medium-term Gilt. Throughout 2010, the FTSE 15 year Gilt Index was used to define this yield.

7.2 The approach to setting discount rates was last formerly considered following the closure of the Fund in 2002 to further investments. However I carried out a review with the Actuarial Function Holder of Skandia Life in the first half of 2010 and we both considered no change was necessary, a view supported by the With-Profits Committee.

8. Charges

8.1 The charges that are documented in Section 4 of the PPFM applied throughout the year. The Fund charge remained at 0.35% per annum of the value of the assets.

9. Controls

9.1 The With-Profits Committee receives detailed reports on the controls placed on the management of the Fund at each of its meetings. I note that all the controls worked satisfactorily during 2010 and the results met the laid down criteria.

10. FSA Review of the With-Profits Regime

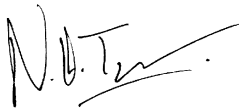
10.1 The Annual Report from the Directors mentions the FSA's review of the with-profits regime and mentions that the With-Profits Committee carried out a full audit and concluded that the Fund operates with due regard to the interests of policyholders.

11. Conclusion

11.1 As I mentioned in my last Report we have experienced exceptional market conditions over the last few years. For many countries, including the UK, the credit crunch caused a recession and, for those, like the UK, who have emerged from recession, the exit has been fragile. There has been an unprecedented period of low interest rates and, over the last year, concern over sovereign debt in a number of countries with Greece and Ireland requiring financial support; other countries also have problems and may need such support

11.2 It remains a challenge to manage a Fund that provides guarantees during the continuing difficult economic times coupled with volatile markets. Despite these abnormal and extreme conditions, while the value of your units will vary, it is pleasing to report that bonuses have been allocated since the end of August. However I must stress that it is not possible to predict for how long bonuses will continue to be allocated. This will depend on the economic situation as well as equity and interest rate market movements.

11.3 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 regularly twice a year.

A handwritten signature in black ink, appearing to read 'N. Taylor', with a stylized flourish extending to the right.

Nick Taylor

With-Profits Actuary

31 January 2011

Further Information

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