UNIT-LINKED FUNDS

YOUR GUIDE

Important information about investing in our unit-linked insurance funds using one of our unitised life or pension plans.
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INTRODUCTION

It’s important to understand your unit-linked investment. This guide gives you information about investing in our unit-linked insurance funds using the following types of products:

• Personal pensions
• Company and group pensions
• Investment bonds
• Savings plans (e.g. endowments)
• Investment-based protection plans (whole of life, fixed term & income protection plans)

Different types of products are sometimes referred to as policies, bonds, accounts or plans. For simplicity we’ll call them all plans in this guide. The type of plan you have will be detailed in the original documents we gave you when it started.

In this guide we’ll explain how the funds in which your plan is invested work, including how we set charges and manage the investments. Where a plan has a unitised with-profits option, the product charges information on page 4 will be relevant. But for details of how we manage your with-profits investment, please read the relevant ‘Your Guide to With-Profits’ booklet for your plan. You can find this on our website: www.scottishwidows.co.uk/existingcustomers/with-profits

This guide doesn’t change or replace any plan documentation we sent you when you took out your plan. If there are differences between your documentation and this guide, then the terms and conditions set out in your plan documentation will apply.

If you’d like detailed information on the aims, risks and composition of specific funds you can find it in our fund guides, and other related documentation, which you can find on our website www.scottishwidows.co.uk

We may change our approach to managing our unit-linked funds in the future, but we’ll contact you if there are any changes that affect your plan’s terms and conditions.
WHAT IS A UNIT-LINKED FUND?

A unit-linked fund is a pool of one or more types of assets in which your and other individuals’ plans can invest. The types of assets typically include:

- **Equities** (shares in companies);
- **Cash**;
- **Gilts** (a type of loan to the UK Government);
- **Bonds** (a type of loan to other Governments, organisations or companies);
- **Property**, either directly in land and buildings, or indirectly e.g. in our Property Authorised Contractual Scheme, and Real Estate Investment Trusts; and
- **Collective Investment Schemes**, for example Open Ended Investment Companies (OEICs) and Unit Trusts.

Unit-linked funds can allow your plan to invest in a wider range of investments than you’d normally be able to buy yourself.

Generally, each unit-linked fund will diversify its investments across different types of assets or within one asset type, depending on its objective. There are different merits and levels of risk associated with the various types of funds. Investment styles that spread money out widely or concentrate it in one area provide options to suit different investors, depending on their needs and appetite to risk. It’s important to remember that many factors affect the performance of an investment. These include the overall health of the economy at home and abroad, interest rates around the world, the effect of inflation and how world politics/events influence investor sentiment and financial markets.

The value of each unit-linked fund we offer can go down as well as up, depending on how the assets perform. You might not get back the amount you invested. Please remember that past performance is not a reliable indicator of future results.

Each fund is divided into units. The price of a unit depends on the total value of the assets of the unit-linked fund. The unit price determines how many units are allocated to your plan when it invests in a fund, and how much you get back when you cash in the units.

Your plan may be able to invest in:

- **Our funds** – for the majority of our funds we determine the objectives and how they should be run. We can delegate the day-to-day management of the funds to another firm. In some cases, the firm we delegate to may define the fund objectives and how the fund should be run.
- **Other externally-managed fund links** – each external fund manager defines the objectives for their funds, determines how they should be run and is responsible for their management.

HOW DO YOU CALCULATE THE VALUE OF THE FUND?

The value of a unit-linked fund is based on the total value of the assets held by the fund. For our funds, the assets are owned by Scottish Widows Limited.

Wherever possible, we use price information which is widely available to the market in order to value the assets we hold. For example, we use prices quoted on stock exchanges, such as the London Stock Exchange. Where prices are not widely available (e.g. for valuing land and property), we use independent valuations. To calculate the value of a fund we:

- add up the values of all assets in the fund;
- add any income which is due to the fund; and
- deduct any charges/expenses and tax (if applicable) payable from the fund.

Before finalising the value of a fund we also consider whether it’s expanding or contracting. In other words, whether more units are being bought by investors than are being sold (expanding), or whether more units are being sold by investors than are being bought (contracting).

To establish if a fund is expanding or contracting we review net cash flows of the fund over a period of time (as a guide) and consider our expectations for the future.

If a fund is expanding, we need to create additional units and buy additional assets. In this case, the value of the fund will be influenced by the price we pay to buy the assets, including any associated costs and taxes.

If a fund is contracting, more units are being sold by investors than bought. To meet demand we cancel units, which requires assets to be sold. In this case, the value of the fund will be influenced by the selling price of the assets sold, including any associated costs and taxes.

We’ll value a fund higher if it’s expanding (i.e. we’re valuing the fund on a creation or offer basis) than if it’s contracting (i.e. we’re valuing the fund on a cancellation or bid basis).
HOW DO YOU DETERMINE THE UNIT PRICE?

We determine the price of a unit by dividing the total value of the fund (as described in page 2) by the number of units allocated to plans invested in that fund. In most cases, our unit prices are rounded up or down to the nearest 0.1p. We determine the value of funds at a fixed time on each working day (the valuation point) unless otherwise disclosed to planholders.

Where assets are quoted on foreign markets in foreign currencies, they are converted to their Sterling equivalent using the exchange rate at the time of valuation. For markets in other parts of the world which are closed at the time we establish asset prices, the value is based on the prices when the markets close.

The unit price for your plan’s investment in a fund can differ depending on the charges that apply to your plan. For example, your plan may have different unit types which are subject to different annual management charges. The underlying assets are the same but any change to the unit price would be at different rates as a result of the charges that apply to them.

For some plans each fund has only one price quoted for that fund. This single price is the price your plan can buy or sell units at in that fund on a given day. However, for other plans, for each fund we will quote both an offer price which is the price at which your plan can buy units in the fund, and a bid price which is the price at which your plan can sell units in the fund. The offer price is higher than the bid price and the difference is a charge. Please refer to your plan documents for details on the unit types you hold and how they are priced. Unit prices are published on our website the working day after they have been calculated.

HOW DO YOU DETERMINE THE VALUE OF MY INVESTMENT?

The value of your investment on a given date is the number of units allocated to your plan, multiplied by the price of those units on that date.

Buying and selling units

Typically, when your plan buys or sells units in a fund, the amount paid or received for each unit will be calculated using the next available unit price. This is referred to as forward pricing. This means that you won’t know the price in advance of your transaction. The next available unit price we use will depend on the date and time we receive the instruction, and the type of transaction you are carrying out.

Different valuation points and pricing approaches can apply to the different products we provide. Please contact us if you would like specific details for your particular type of plan. Unless your plan documents state otherwise, we will use forward pricing.

Exceptional situations

We aim to calculate prices in a timely, accurate, fair and transparent manner. In certain circumstances, and in the interest of being fair to all investors, this can mean we need to delay selling your plan’s units. This delay can typically be up to one month, but could be up to six months where a fund invests directly or indirectly in property or land. Some examples of the circumstances which might trigger a delay can include:

- Market conditions which make it difficult to buy or sell assets at a suitable price.
- Closure of stock exchanges or markets, such as those which closed after the 9/11 attacks on the World Trade Center.
- Extraordinary events, such as the failure of computer systems.

The price that applies to units following a delay will be the price at the end of the delay period.

Checking the value of your investment

To get a valuation you should contact the servicing team that looks after your plan – you can find the contact details in your plan documents. (Older plan documentation may contain out-of-date contact details – so please see “How can I get more information?” on page 7.) Please have your plan number to hand if you do call.

We administer a variety of contracts and in most cases we’ll issue you an annual statement. A statement will normally detail the value of your investment, the funds your plan is invested in and the number of units in your plan at the date of the statement.

Depending on the type of plan you have, it might be possible to see the valuation of your investment online. If you’d like to access your value online, please contact us and we’ll let you know if your plan has this option.
WHAT ARE THE RISKS OF INVESTING IN UNIT-LINKED FUNDS?

Please remember that the value of unit-linked funds can go down as well as up, and you might not get back the amount you originally invested.

Each unit-linked fund can be exposed to a range of different investment risks. These can include market risk, credit risk, counterparty risk, liquidity risk, and/or currency risk. There may be other investment risks.

The actual risks that apply, the levels of those risks, and how they affect the value of a fund over time, depends in part on what asset types a fund invests in, and how the fund is managed. Some asset types are relatively higher risk than others, and some assets can be more susceptible to changes in value in the short term (i.e. are more volatile).

Detailed information on the specific risks of each fund can be found in our fund guides and other related documentation, which you can find on our website www.scottishwidows.co.uk.

We aim to manage investment risks by agreeing clear aims and risk thresholds for each fund, and reflecting these in the mandates and instructions we provide to fund managers. We then monitor fund managers to ensure they are managing the funds in accordance with our instructions.

The assets of each of our unit-linked funds are owned by us. As such, you are also exposed to the risk that we are unable to meet our liabilities to you under your plan. In the highly unlikely event that we defaulted on paying out the proceeds of your plan, you could claim compensation from the Financial Services Compensation Scheme (FSCS). Our unit-linked life and pensions products are covered by the FSCS for 100% of their value.

CHARGES

Why do we deduct charges?

We deduct charges to cover:

- administration and servicing costs
- investment management costs
- charges made by other companies for advice or related services
- where applicable, the cost of providing life insurance or other cover (e.g. critical illness, waiver of premium)
- profit

Charges will affect the value of your plan over time. We may vary the rates of charges where we consider this to be necessary and in line with the product terms.

What are our product charges?

Our product charges break down into three main groups, which we call initial, ongoing and fund switching charges. Your plan may have one or more of these types of charges, and we have summarised each of them below.

INITIAL CHARGES

We may deduct initial charges when you make a payment to us, depending on your type of plan. They reduce the amount which is invested in your plan. Initial charges can apply in three ways:

1. An allocation rate, whereby we allocate a reduced proportion of your payment to buy units. If the allocation rate was 98%, for example, it means that we take 2% of what you pay to us as a charge and use the rest to buy units in your chosen fund(s).
2. A fixed bid-offer spread, whereby the price for selling units in a fund is typically 5% lower than the price for buying units – effectively a 5% charge.
3. An adviser charge, which is an amount agreed by you and your financial adviser, which you ask us to deduct from the money you pay to us to cover the cost of financial advice and any related services you have received.

ONGOING CHARGES

We deduct ongoing charges from your plan regularly during its lifetime. These can take several forms and one or more could apply to your plan:

- Annual Management Charges for managing your plan and the funds it invests in. These are normally deducted from the funds at a rate of 1/365th of the annual percentage rate each day. The effect of the AMC reduction is reflected in the fund prices calculated for each day. For some plans, if the overall yearly fund charge is different from the annual management charge, we will regularly add units or sell units to get to the correct charge.
- There may be a monthly plan fee or administration charge, which is a deducted by selling some of your plan's units to meet the fee. The deduction may be a fixed amount of money (for example, £2 per month), which in some cases may increase each year in line with a financial index.
- We may make monthly or yearly deductions to cover payments made to your financial adviser for the advice and services they provided to you, or are continuing to provide.
We may deduct a charge for any life insurance, critical illness cover or waiver of premium benefit (insurance to allow contributions to continue if you are ill for an extended period), depending on your type of plan and any optional benefits you have selected. These are normally deducted by selling units in your plan each month.

Ongoing adviser charges. These can be fixed monetary amounts and/or a percentage of your plan value. They’re amounts you agree with your adviser to pay for any ongoing advice or related services being provided.

FUND SWITCHING CHARGES

These sorts of charges are made when you request a change to the funds your plan is invested in. Typically, a fixed level of monetary charge or a percentage of the value being switched is deducted from your plan’s value to cover our costs in administering the changes. We do not deduct charges for routine changes to your plan, such as a change of address.

TRANSACTION COSTS

In addition to the charges outlined above, each fund will incur transaction costs when buying and selling assets. The costs incurred by each fund will depend on how often the fund manager buys and sells assets; the types of assets being transacted; and where the transactions take place. Transaction costs reduce the value of the fund by increasing the costs when buying assets, and reducing the value received when selling assets. They can include broker commissions and taxes e.g. stamp duty is payable when buying UK equities.

HOW ARE UNIT-LINKED FUNDS TAXED?

This section covers how tax applies to unit-linked funds and how it’s allowed for in the pricing of unit-linked funds. It doesn’t cover any personal taxation you may incur on your plan, since that will be dependent on the type of plan you have, and on your individual circumstances.

The principles that we apply when allowing for taxation in the pricing of unit-linked funds are intended to ensure fairness between:

- different generations of planholders;
- different unit-linked funds; and
- planholders and shareholders.

We take account of UK tax legislation and, where relevant for the assets of the fund, any overseas tax regimes. The information below is based on our understanding of current tax legislation and HM Revenue & Customs practice as at the date of publication. However, please note that tax rules can change and our processes may be updated accordingly. Any assumptions we make about the charges for tax in pricing are reviewed on a regular basis to ensure they remain appropriate and fair.

The way we allow for tax when we value a fund depends on whether it is a pensions unit-linked fund or a life unit-linked fund. Life funds are subject to more complex rules.

Pension funds

UK pension funds are generally exempt from paying tax on any income and gains earned on the assets held by the fund. However, income earned on overseas assets might be liable to taxation by foreign governments and the tax will be reflected in the valuation of the fund. If it is cost effective to reclaim tax, the reclaim (net of any costs we incur) will be added to the fund. The value of pension funds will also reflect their liability to pay any taxes, for example transaction taxes, on the purchase or sale of assets.

Life funds

We treat each fund as if it is a stand-alone entity – ignoring any offset with other funds. The amounts charged in respect of tax to each fund reflect the tax the fund would have paid on the income and gains from its assets if it were a stand-alone fund.

Income and expenses

A charge is made in respect of tax at the Policyholder Tax Rate (currently 20%) on all income unless the income is exempt under UK tax rules (for example, income derived from UK and most overseas equities) or is exempt under plan terms (for example, some rebates of charges). Income earned on overseas assets may be liable to tax by foreign governments. If the tax cannot be offset against the UK tax liability or reclaimed, it will be treated as a reduction in the fund. If it’s cost effective to reclaim the tax, the reclaim (net of any costs we incur) will be added to the fund. The Annual Management Charge applied to the fund already includes an allowance for tax relief and so no further relief is provided within the funds. However, other costs incurred by the fund may be subject to tax relief and the value of the fund is increased by this tax relief where available. On some investment properties there may be a tax allowance available. Where it is cost effective, the tax allowances, net of any costs, may be claimed.
Gains and losses on equities, properties and collective investment schemes such as OEICs substantially investing in equities and/or properties

A charge in respect of tax is levied at the Policyholder Tax Rate where the value of the assets exceeds tax base cost plus any allowance for inflation – the indexation relief (note indexation is not available for gains arising after 1st January 2018). However, if the expected tax is not payable on a stand-alone basis immediately, we may reduce the tax rate to reflect when we would expect the fund to pay the tax. The reduced tax rate is regularly reviewed to ensure it remains appropriate and fair. Where a fund has more losses than gains, no value is given to the fund. However the losses are carried forward and can be offset against future gains.

Changes to funds

We may decide to launch a new fund, close a fund or merge an existing fund with another fund. Changes will be driven by investor, commercial, practical or market considerations. Some examples of when we might make a change include:

- where funds have similar investment objectives and approach to risk;
- if the value of a fund falls to a level that makes its management inefficient and expensive.

WHERE A CHANGE IS SIGNIFICANT WE WILL WRITE TO YOU IN ADVANCE TO DETAIL THE REASONS FOR THE CHANGE AND THE OPTIONS AVAILABLE TO YOU.

If, for example, we decide to close a fund, we will do so in a fair way. We’ll give you as much notice as possible, with at least the minimum period applicable to your plan. We’ll make you aware of the options available to you (including a default option if appropriate) and give you an opportunity to tell us your preferred choice.

Following the change, we will write to you to confirm how many units your plan holds in the new fund. Under these circumstances, we wouldn’t charge you for this change. We would write to you to explain the change, and the options you have.

HOW DO YOU ENSURE MY INVESTMENT IS MANAGED FAIRLY?

We manage our unit-linked funds in accordance with the rules and principles of our regulators, the Prudential Regulation Authority and the Financial Conduct Authority. We also adhere to the Association of British Insurers Guide to Good Practice for Unit-Linked Funds.

Our senior management team has put in place a variety of controls and measures to ensure our funds are managed in line with their stated aims, the investment mandates, and industry best practice. They also ensure your plan operates in accordance with its terms and conditions, and that we treat our customers fairly.

A governance committee has been set up which has specific responsibilities in respect of the oversight of the pricing of our unit-linked funds. It’s advised by appropriately qualified experts, and ensures areas of risk are monitored and controlled, and where discretion is applied to the management of our unit-linked funds, it is done so fairly.

In summary, we are committed to ensuring that:

- unit prices properly represent the investment experience of each unit fund, making appropriate allowance for charges, costs and taxes;
- our unit pricing principles and practices will take account of policy terms and conditions, recognised industry good practice, regulations and guidance, and policyholders’ reasonable expectations;
- unit pricing will be carried out in a properly documented and controlled environment, and shall be performed diligently by suitably qualified members of staff;
- where any issues are identified, they are addressed promptly and appropriately; and
- policyholders are treated fairly.
HOW DO WE INVEST IN FUNDS?

We will hold sufficient units in the funds so that we can meet customer claims in line with our expectations. The number of units we hold may be more or less than the number of units allocated to planholders. This will not be to the detriment of plans. We do this to:

- aid the day-to-day management of the fund, for example to increase the range of investment opportunities or reduce the dealing costs;
- ensure fund managers have sufficient money to invest efficiently when a new fund is launched. This is known as a seeding investment and our stake will reduce as more customers invest;
- manage risk more efficiently for the benefit of our planholders and shareholders;
- recognise the expected future income from Annual Management Charges.

Where we hold units in a fund, we will be subject to the same deductions and earn the same return on our investment as your plan would receive. There are maximum and minimum limits on the number of units that we can hold in the funds, and we review these limits regularly.

Stock lending

In some instances, we may lend assets held by a fund to other financial institutions, with the objective of enhancing investment returns to the fund; this is called stock lending. While this can be an effective part of an investment strategy, stock lending carries certain risks which could result in losses (for example, if a borrower of the assets runs into financial difficulties and becomes unable to return the assets to us). To limit this risk, we apply stringent controls to the stock lending process including monitoring the borrowers’ credit ratings and obtaining security (referred to as collateral, which can include cash and/or assets) from each of the borrowers which we could claim if the borrowers could not return the assets borrowed.

Pricing errors

We make every effort to ensure accurate unit pricing, and aim to minimise the impact of any pricing errors through a robust control and governance environment. Should we identify an error, we will review the root cause and look at the financial impact. We will take corrective action as soon as it is practical to do so where a fund has experienced a material loss due to a pricing error. The action we take will depend on the specific circumstances of the error. (An error is generally deemed to be material if it is 0.5% or more of the unit price). We’ll also implement appropriate changes to reduce the risk of similar errors occurring in the future.

HOW CAN I GET MORE INFORMATION?

If you want more information about your unit-linked investment, you should speak to your financial adviser or contact us. Please note that your financial adviser will charge you for any advice given.

If you wish to contact us, you can write to:
Scottish Widows, PO Box 902, 15 Dalkeith Road
Edinburgh, EH16 5BU
Call us on 0345 716 6777

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.

Complaints

We hope you are and remain satisfied with how we manage and operate our unit-linked funds. If there’s a problem please let us know and we’ll try to provide a solution as quickly as possible.
If you would like a Braille, large print or audio version of this document, please contact us.

We work hard to keep your personal data secure, which includes regularly reviewing our privacy notice. When there’s an important change we’ll remind you to take a look, so you’re aware how we use your data and what your options are. Please review the latest privacy notice at www.scottishwidows.co.uk/legalprivacy or ask for a copy on 0345 300 2244.