

# lifestyling?

As the Cautious, Moderate and Growth options are invested directly in equity funds (with the inherent risk that the value of members' account could go down in value as well as up), all such funds will be "lifestyled". If a member has many years before retirement, he or she may wish to maximise investment returns whilst there is still time to bear short term fluctuations in the equity markets. "Lifestyling" gradually reduces the exposure to equities as the member approaches retirement and switches funds progressively into cash and fixed interest or index linked bonds which move broadly in line with annuity rates.

With Lifestyling, the member's account will be automatically switched between the different asset classes during the five years leading up to the selected **Target Retirement Date**. This may be different from the member's actual or Normal Retirement Date. All the switching is done within the relevant option, which means that once the member has selected the appropriate option, he or she will normally have no further investment decisions to take. Members can change their Target Retirement Date at any time and their account will be rebalanced accordingly. **It is extremely important that members ensure that their Target Retirement Date reflects their retirement plans.**

## What is the change in policy for transfer values and early retirement for the With Profits option?

As mentioned above, financial conditions continue to be very difficult. As a result, the Committee is taking action to ensure that no members receive more than their fair share of the underlying investments and to protect the funding position for all members. Without the change in policy, members taking their benefits early would receive a disproportionate share of the Scheme assets, thus potentially disadvantaging those members who remain invested in the With Profits option. Previously, this issue was addressed through the final bonus mechanism. With the reduction of the final bonus to zero and the continuing deterioration in financial markets, the Committee has had to consider an additional approach in the interests of fairness.

In the past, transfer values and the

amount available for early retirement have been calculated to include the present value of future guaranteed interest together with an allowance for future bonuses. This normally resulted in the amount available being equal to the member's account at the date of transfer or early retirement together with any final bonus. Historically, therefore, the Committee has allowed members to take an amount which includes allowance for a significant level of future bonuses.

The revised policy, adopted in light of financial conditions, means little or no allowance is now being made for future bonuses. This means that the amount available for transfer or early retirement is currently less than the member's account. This does not mean that the value of accounts with Cheviot has been reduced. Account

values will be unaffected by this revised policy if they remain invested until the member's Normal Retirement Date.

This change parallels action taken by many insurance companies where "market value adjustments" have been introduced to achieve the same effect. The amount available is calculated on a "cash equivalent" basis. The cash equivalent is the amount required today to provide the member's account, including any future guaranteed returns, at Normal Retirement Date. The Scheme Actuary calculates this amount on the basis of assumptions about investment returns between the date of calculation and the member's Normal Retirement Date. This change in policy applies whatever the reason for taking the account before Normal Retirement.



# Important Announcement

## For members of the Money Purchase Scheme

Issued January 2003

The Money Purchase Scheme currently offers three investment options: With Profits, Moderate and Growth. The Moderate and Growth options invest directly in the stock market and movement in those markets determines their value. The With Profits option is different. Members' accounts are not directly invested in the stock market and the Committee seeks to smooth annual returns so that they do not vary greatly from year to year. This means that in good years, part of the investment return may be held back in order to help provide annual bonuses in bad years. The Committee's ability to provide and smooth returns is, nevertheless, still dependent on the underlying value of the Scheme's assets.

### REVISED VERSION

Issued 17th January 2003

Please discard previous version

Contributions made to the With Profits option attract different rates of return, depending on when the contributions were made. Contributions received prior to 1 January 1997 receive guaranteed interest of 5% per year (compound) and contributions received between 1 January 1997 and 31 December 1999 receive guaranteed interest of 3.5% per year (also compound). Contributions paid from 1 January 2000 currently receive no guaranteed rate of interest. In determining the level of bonuses to be awarded each year, the Committee has taken into account the differing levels of underlying guarantee to try to ensure fairness between the different groups. Consequently, in 2002, at a time of falling stock markets, the Committee continued to award a base bonus of 3% to contributions receiving no guaranteed interest whereas the other categories of contributions received no bonus.

Financial conditions last year proved exceptional. The main UK equity market fell by some 25% from the start of 2002, on top of significant falls

in the previous two years. In addition, interest rates and the yield available from government bonds have fallen to low levels. The Committee, with assistance from its professional advisers, has kept its investment strategy under close review, particularly in the light of lower than average investment returns and exceptional stock market volatility. The overall investment strategy of the With Profits option has never been to be wholly invested in equities. The Committee made some changes to the investment strategy in 1998 and 2001. It is currently implementing a further reduction in the proportion of the With Profit assets invested in equity type investments to around 40%. The effective equity allocation for members who have not yet retired, however, is significantly higher than this.

In light of changes in investment conditions, and as part of its ongoing review, the Committee has considered the structure of the With Profits option and is making some important changes to the Scheme as whole.

## Important changes

- **Contributions received in the With Profits option from 1 January 2000 to 31 December 2002 will in future receive a guaranteed rate of interest of 3% per year compound, in line with the non guaranteed base bonus currently being paid. This guarantee does not apply to the annual bonuses awarded since January 2000.**
- **No transfers in from other pension arrangements have been accepted into the With Profits option since November 2002. In addition, no future contributions will be accepted after 31 December 2002.**
- **The range of investment options in the Money Purchase Scheme generally is being extended. It is hoped that these new options will be available from April 2003.**
- **The Committee has changed its policy in relation to the calculation of transfer values and the amount available on early retirement from the With Profits option. Little or no allowance is now being made for future bonuses. This means that if a member takes his or her benefits early, the amount available is currently less than the member's account. This does not mean that the value of accounts with Cheviot has been reduced. Account values will be unaffected by this revised policy if members remain invested until Normal Retirement Date. See below for more details of this change in policy.**

There are two main reasons for these decisions. First, the Committee is seeking to avoid the possibility of unfair cross subsidy between the different categories of contributions. Second, the continuing uncertainty in the markets and the very volatile returns experienced during the last five years have led the Committee to question, along with many others in the pensions industry, the long term concept of mutuality which underpins with profits arrangements.

### Future investment options

The Committee and its advisers have been considering a future range of investment options which will invest directly in a variety of funds including UK equities, overseas equities, fixed interest bonds, index linked bonds and cash funds. These funds will track various stock market indices and therefore gains and losses in fund values will be in line with overall market movements. As such, the value of funds can go down as well as up.

The range of options which should be available from 1 April 2003 are

### Cautious

Invests 50% in equities and 50% in bonds until five years before your Target Retirement Date, following which "Lifestyling" will come into effect (see below). This approach may suit people who wish to reduce their exposure to volatile equity markets whilst still retaining some opportunity for long term growth balanced by the more stable returns associated with bonds.

### Growth

Invests entirely in equities until five years before your Target Retirement Date, following which Lifestyling will come into effect (see below). This approach may suit people who are prepared to take more risk to achieve higher growth over the long term. This may include people at younger ages who have a longer term investment horizon.

### Moderate

Invests 75% in equities and 25% in bonds until five years before your Target Retirement Date, following which Lifestyling will come into effect (see below). This approach may suit people who feel uncomfortable about being invested solely in equities. They may be seeking reasonable opportunities for long term growth, partly balanced by the more stable returns associated with bonds.

### Retirement Protection

The Committee is introducing another option for all members who are within five years of their Target Retirement Date (see below). If members want to remove all equity exposure from their account at this stage, they can do so by taking a transfer value to the Retirement Protection option, which invests in cash and (primarily index linked) bonds (which move broadly in line with annuity rates).

described in this announcement. Members can switch any part of their account which is invested in the Moderate and Growth options to one of the new options. As has always been the case, members may not normally change the basis on which their With Profits account is invested. The Retirement Protection Fund described in this announcement, however, will be available for those within five years of Target Retirement Date who wish to reduce their exposure to annuity rate fluctuation. The value available for switching will be the amount available for transfer to another provider (see below for more details).

### Future investment returns for the With Profits option

The Committee expects to honour all guaranteed returns as they fall due at Normal Retirement Date. The prolonged adverse investment conditions mean, however, that it is unlikely that contributions eligible for 5% per year compound interest will receive any bonuses for the foreseeable future. This reflects the significant falls in the markets during the last three years (UK equity markets have fallen by 40% since the start of 2000) and the current investment returns available, particularly in relation to the yield available from government bonds. This should be considered against the background of the consistent returns provided in the past. For example, a contribution of £1,000 paid in 1992 would now be worth £2,080 on normal retirement, representing a total return of 7.6% per year, including both guaranteed interest and annual bonuses. Contributions eligible for 3.5% and 3% per year compound interest are more likely to

In the short term, equities can fall as well as rise but over the long term they have historically outperformed all other major classes of investment. The Committee's advisers will monitor the above fund mixes and they may be changed from time to time if necessary so that the risk and return objectives of all of the options are maintained. The

receive future bonuses but this will depend on the prevailing investment conditions.

### At retirement

The option to set up an annuity on a with profits basis at retirement has been withdrawn.

### What to do now

If a member wishes to switch their investments, they should write to the Pension Administration Department. Please note, only members within five years of their Target Retirement Date can switch from the With Profits option and only to the Retirement Protection option. If a member does not wish to switch investments, no further action is necessary. A revised Members' Booklet will be issued in early 2003 to reflect these changes.

## Further questions

If you have any further questions regarding the changes set out in this announcement please contact the Chief Executive's Office at:

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70 Baxter Avenue,  
Southend-on-Sea, Essex, SS2 6JA  
dx: 2818 Southend

or email [CEO@cheviottrust.com](mailto:CEO@cheviottrust.com).

*No further action is necessary unless you wish to switch your investments or change your Target Retirement Date*

underlying equity funds for the Cautious, Moderate and Growth options are currently invested in index tracking funds. The Committee can change investment managers if it thinks it is appropriate. Investment performance of all the funds is actively monitored on a regular basis against appropriate benchmarks on behalf of employers and members.