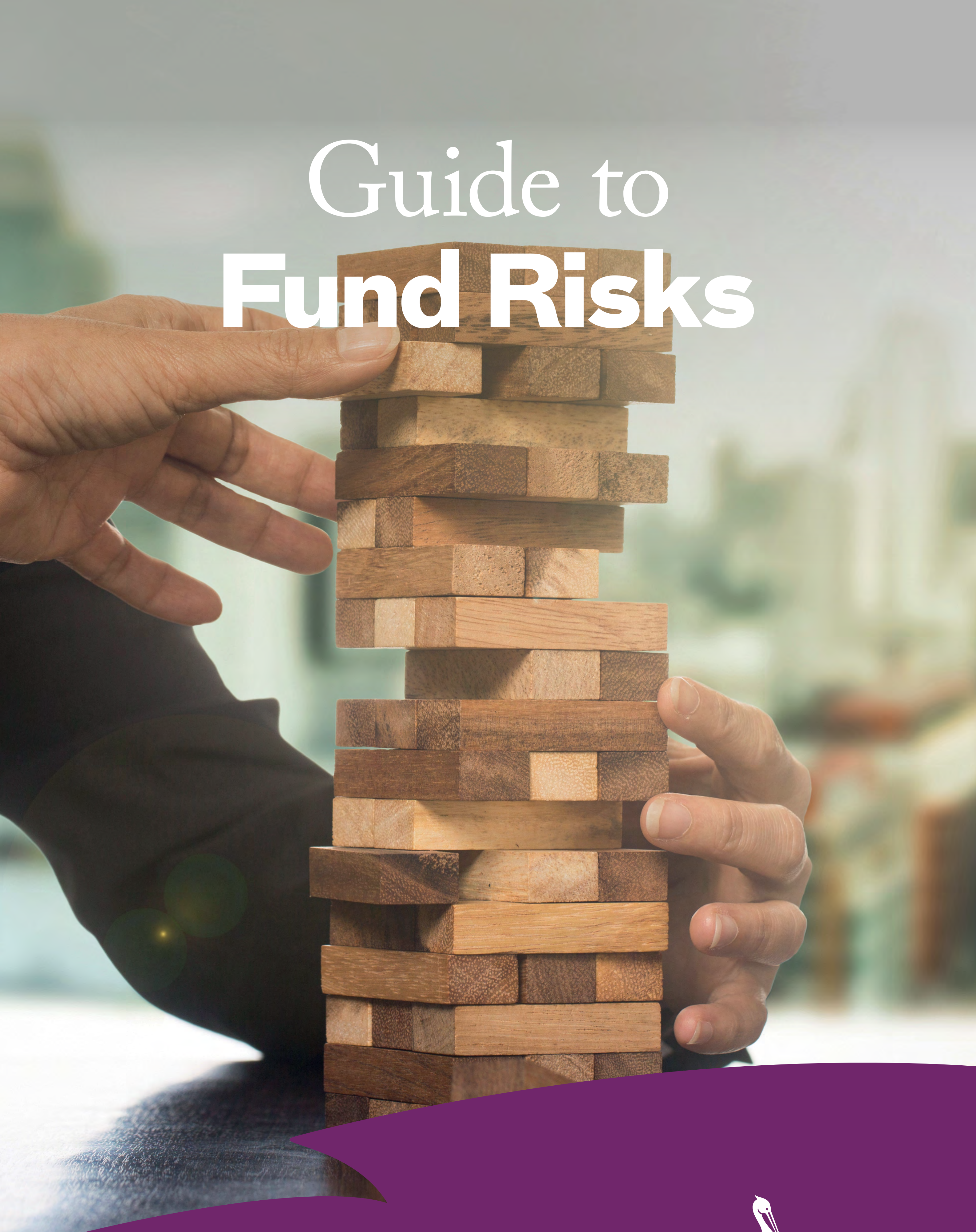
Guide to **Fund Risks**



ROYAL LONDON

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Making Sense **of Risk**

Understanding all the risks involved when selecting an investment fund can be a daunting and confusing experience for most people. To help you understand all the potential risks when investing in our funds we have created this guide which should be read in conjunction with the fund factsheets.

There are some risks that all funds carry but there are specific risks depending on a particular funds theme or investment policy. We've detailed the general risks applicable to all our funds below. We've also detailed the specific risks associated with our funds and have labelled these on each of our factsheets. You should remember that with all our funds there is potential for you to receive less than what you have paid in.

There are useful definitions at the back of this guide to help you with any of the terminology used throughout

General **Risks**

There are certain risks that apply to all funds and we have detailed these below.

Deferrals

A deferral is when we have to delay switching in or out of funds. We will delay switching units only in exceptional circumstances such as:

- when we are unable to buy or sell assets in a fund because of acts of violence, flood, fire, extreme weather, pandemic or failure of computer systems;
- where we are unable to buy or sell assets of an external fund that are held in a linked fund;
- where we reasonably consider that there is no suitable market in which we can sell assets in a fund; or
- where we reasonably consider that if we sell assets in a fund it will lead to some unit holders being treated unfairly.

When we do switch the units we will calculate their value using the first unit price that we calculate after the delay ends.

Charges may change

The charges on our funds may change from time to time. The Total Expense Ratios (TER) may fluctuate. We may also, on occasion, change the Fund Management Charges (FMC), but we will write to you before the change takes place. If any of the charges on your funds change this will affect the value of your investment.

Risk and return

Funds which invest in higher risk asset classes such equities, property and corporate bonds would be expected to have more extreme movements in price than funds which invest in lower risk assets such as UK government bonds and cash. But over the long term higher risk funds would be expected to produce better returns than lower risk funds, although this is not guaranteed.

Long-term investments

Funds which invest in higher risk asset classes such equities, property and corporate bonds are intended to be long-term investments for investors with a time horizon of at least 5 years. Investing in these funds for shorter periods could increase the volatility of your returns and potential losses are less likely to be recovered.

Tax – life funds

We are liable to tax on the investments backing your plan. This is allowed for when calculating unit prices.

Tax – pension funds

Income and capital gains arising on holdings in our pension investment funds are generally free of UK income and capital gains tax. Where funds buy UK shares they will be liable to UK stamp duty. In addition funds that own shares in overseas companies may also suffer some irrecoverable foreign tax on dividend income. This is reflected in the unit prices of the funds.

Fund Specific **Risks**

The following risks are specific to funds depending on their particular theme or investment policy. We have detailed which of these risks are applicable on the individual factsheet available for each fund.

Exchange rate

This fund invests in investments outside the UK. This means that the value of these investments will decrease or increase as a result of changes in exchange rates between currencies.

Emerging markets

This fund invests predominantly in Emerging markets. Emerging markets can offer attractive investment opportunities, but they are generally less well regulated than the UK and it can sometimes be difficult to buy and sell investments in these areas. There is also a greater chance of political and economic instability and so these funds carry higher risks than those investing in larger, more established markets.

Concentrated portfolio

This fund invests in a relatively small number of holdings – usually less than 25. This means that changes in the value of each investment can have a significant effect on the value of the fund. Funds with concentrated portfolios can produce higher returns than funds which are more diversified, but they also carry more risk as there is less diversification.

Smaller companies

This fund invests in smaller companies, which can experience bigger price movements than larger companies and can sometimes be more difficult to buy and sell. Funds which invest in smaller companies can produce higher returns than funds which are more diversified, but they also carry more risk.

High yield bonds

This fund invests in high yield bonds which can experience bigger price movements than investment grade bonds. High yield bonds pay a higher level of interest than some other bonds which can result in higher returns, but it is also more likely that the issuer of the bond will fail to re-pay the loan which would affect the value of investments in the fund.

Sector specific

This fund invests in specific market sectors, such as technology or pharmaceuticals. The value of the fund will be closely linked to the performance of the specific sectors it invests in. Sector funds can produce higher returns than funds which are diversified across a number of different sectors, but they also carry more risk.

Geared investments

Funds which focus on geared investments such as warrants or options carry higher risks because the risk of the underlying investments could be very high. Geared investments can produce high returns, but losses could even equal the amount invested, in which case you would get nothing back.

Property

This fund invests in property. Property can reduce the risk profile of a portfolio as it can behave differently to other asset classes, but the value of the properties held in the fund is based on the subjective opinions of independent agents. Buying and selling property is usually more expensive and more difficult than trading other types of assets. This means that, in exceptional circumstances, withdrawals from property funds may delayed.

Higher risk funds

This fund concentrates in an investment area that may be exposed to unusual political or economic risks. You should only invest if you are comfortable with the specific risks pertaining to this fund.

Derivatives

This fund invests in derivatives as part of its investment strategy. Investing in derivatives can, under certain circumstances, result in bigger movements in price which produce higher levels of growth or greater losses. There is also the risk that the company issuing the derivative may not honour their obligations which could result in losses and affect the value of investments in the fund.

Equities

This fund invests in equities. Equities are shares in companies and can experience bigger movements in price than other types of investment. Funds which invest in equities can produce higher returns than other funds but they also carry more risk.

Bonds

This fund invests in bonds. Bonds are loans to governments and companies and their value can go up and down. If the issuer of a bond held within the fund fails to repay the loan this would affect the value of investments in the fund.

Money market

This fund invests in money market instruments. These are typically lower risk investments, but their value is not guaranteed and may fall. Money market instruments would usually be expected to produce lower returns than other asset classes over the long-term.

Stock lending

The fund may lend the stocks and shares it holds to other funds in return for a fee. This can help fund performance as at least part of this fee will be added to the value of the fund. There are also risks to the fund from lending stock. One is borrower risk as the borrower may not repay the loan – for example if they become insolvent. Another is collateral risk – lenders often request that the borrower commits a specific asset to cover the loan. If the borrower was unable to re-pay the loan, ownership of this asset would transfer to the lender. This reduces the risk of stock lending, but there is still the risk that the value of the asset isn't enough to replace the stocks and shares which have been borrowed. Any losses due to stock lending could affect the value of investments in the fund.

Useful **Definitions**

Deposits

This term is used to describe investments such as cash. They work in much the same way as a bank or building society account. Investments are put on deposit with a financial institution where they earn interest. Deposits are generally considered safer than other asset classes; however, over the longer term they are likely to provide lower returns.

Corporate bonds and gilts

Corporate bonds are loans to companies for a set period. During this period the company pays interest and eventually returns the original amount.

The main risk with a corporate bond is that the company to which the loan has been made might go bankrupt and fail to pay it back. Corporate bonds tend to be less volatile investments than company shares, but provide the opportunity for higher growth than deposits.

Gilts are loans to the Government and work in much the same way as corporate bonds. However, gilts are considered very safe investments, since the Government is unlikely to go bankrupt.

To date, the British Government has never defaulted on a gilts issue. Like corporate bonds, gilts tend to be less volatile than company shares but provide greater opportunities for growth than deposits. The value of bond funds will fluctuate, as bond funds tend to buy and sell bonds rather than hold them to maturity. These fluctuations will affect the value of your fund.

Property

There are two main types of property fund:

Direct property funds invest in bricks and mortar properties such as retail outlets, industrial sites and office buildings. One proviso: because the property in a fund may not be readily saleable, it's possible that you might not be able to cash in your investment in a property fund when you want to. Also the value of property is generally a matter of a valuer's opinion rather than fact.

Property security funds invest in Real Estate Investment Trusts and shares in property companies. These funds typically experience short-term price movements similar to equity funds but would be expected to have characteristics similar to direct property funds over the longer term. They are also less likely to place restrictions on cashing in your investment than direct property funds.

Equities

Equities are company shares. Limited companies can sell their shares to raise capital, paying a share of their profit (known as a dividend) to the buyer in return. Shares are bought and sold on the stock market, and their prices fluctuate based on a number of factors including the company's potential profitability. As a result, they tend to be too volatile for short-term investors. However, it's widely accepted that equities have the potential for better returns over medium and longer terms. It's also worth bearing in mind that equities traded on some overseas stock exchanges can be more volatile than UK equities. They are also affected by fluctuations in currency exchange rates.

Warrants

A warrant is a security that entitles the holder to buy a stock at a fixed price until an expiry date. It's essentially a promise you will be able to buy at set price up until the date of expiry.

Option

An option is a contract which gives the buyer (the owner) the right, but not the obligation, to buy or sell an underlying asset or instrument at a specified price on or before a specified date. The seller has the corresponding obligation to fulfil the transaction – that is to sell or buy – if the buyer (owner) "exercises" the option.

Derivatives

Derivatives is the collective name for financial contracts such as warrants and options. Derivatives can be used for a number of purposes – including insuring against price movements (hedging), increasing exposure to price movements for speculation or getting access to otherwise hard to trade assets or markets.

Investment Grade bonds

'Investment grade' bonds are bonds that are highly ranked by rating agencies. Rating agencies will rate each new bond issue based on its security and likelihood to default, i.e. not pay what was promised. Bond rating firms, such as Standard & Poor's, use different designations consisting of upper- and lower-case letters 'A' and 'B' to identify a bond's credit quality rating. 'AAA' and 'AA' (high credit quality) and 'A' and 'BBB' (medium credit quality) are considered investment grade. Credit ratings for bonds below these designations ('BB', 'B', 'CCC', etc.) are considered low credit quality, and are commonly referred to as "junk bonds" or "high yield bonds".

High Yields bonds

Commonly referred to as "junk bonds", high yield bonds are bonds on the opposite side of the rating scale to "investment grade bonds". These bonds are rated lower by rating agencies and are considered low credit quality. Because of this these bonds will usually provide a higher rate of return however there is a greater chance that these bonds will default.

Holdings

Holdings is the name given to different investments within a fund. The number of holdings a fund contains depends on the particular theme or investment policy of a fund. Some funds for example will invest in a concentrated portfolio of 25 or less holdings.

Diversification

The process by which a fund manager spreads the risk within a fund by investing in different asset classes or areas of investment. The old saying goes 'you shouldn't keep all your eggs in one basket'.

Emerging markets

An emerging market is a country that is experiencing rapid growth and industrialization. Investment in these countries has the potential to deliver greater growth but with additional risk.

Geared investments

This is when a fund manager borrows money, through the use of derivatives, in order to buy new holdings within a fund, with the hope of enhancing returns. It gives the fund managers freedom to take advantage of a opportunities, without having to sell existing investments to raise the necessary cash. There is potential for higher losses if things go badly as any borrowings will have to be repaid even if the investment performs poorly.

Money market

Money market is the name used to describe cash (deposits), or near cash investments. Typically such investments produce a lower return with lower volatility than other asset classes. However, some money market investments are higher risk than a deposit investment. Money market investments include:

Call deposits: A short-term deposit facility offered through banking institutions allowing investors immediate access to an interest-earning account.

Time deposits: An interest-bearing savings account held at a financial institution for a fixed period of time. The depositor can only legally withdraw their funds by giving written notice, and may be liable for a penalty payment as a result. Also known as 'Fixed Deposits'.

Certificates of Deposit: A low risk money market instrument purchased through a bank. The issued certificate is evidence that the investor has deposited a sum of money for a specified fixed rate of interest, redeemable on a specified maturity date.

UK Treasury Bills: A short-term promissory note obligation issued by the UK Treasury (therefore backed by the UK government) that is not interest-bearing, but which trades at a discount to its face value. The investor earns the difference between the face value and the discounted purchase value at maturity, typically being for a period of three months. Also known as 'T-bills'.

Short dated Gilts: UK government bonds with very short time to maturity; generally less than 2 years.

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