

Annexe Number 3A

## Safeguarding the Value of Potential Special Distributions to Non-Electing Policyholders

A summary of Aviva's perspective in connection with the reattribution of the inherited estates of CGNU Life and CULAC with-profits funds

Norwich Union rebranded as Aviva in the UK on 1 June 2009. Where an historical position or events prior to 1 June 2009 are described in this appendix, 'Aviva' and associated naming conventions have been used. Financial information has not been updated and remains as at the time of the report date.

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Annexe by: Aviva UK Life – 1<sup>st</sup> September 2009

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## 1.00 Context

Aviva's stated intention throughout the reattribution process has been to treat customers fairly, in developing the proposals Aviva's aim has been to ensure that the Value of Potential Distributions to Policyholders (VPDP) for non-electing policyholders as a group is broadly preserved by the reattribution when tested under a wide range of take-up scenarios.

VPDP is viewed as giving an estimate of the amount which groups of customers might potentially receive as future special bonuses. It is calculated using assumptions that Aviva consider to be reasonable assessments of what might happen over the next 25 years, although inevitably unforeseen circumstance (both beneficial and detrimental) in the future could, with the benefit of hindsight, make these assumptions look unrealistic.

As VPDP is an average of values determined across a wide range of possible scenarios it is not a suitable basis for individual customer decisions or for individual PIP allocation. Its value is in providing management with a useful tool to help them – as part of a range of considerations – to ensure that their proposals and recommendations are fair.

In the annexe "Aviva's 2008 data update" Aviva concluded that, based on the evaluation approach adopted for the negotiations, in the vast majority of situations the aggregate VPDP for non-electors as a group continued to be adequately protected. In addition, the analysis showed that benefit security of non-electors is also protected across all tested scenarios.

In this annexe Aviva considers whether the VPDP Adjustments described in the AFH report should be amended to allow for the possibility that the lapse rates in respect of Non-Elected Bond policies may be lower after the reattribution to those of Elected Bond policies.

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## 2.00 Possible Future Lapse Rates

The policyholder advocate has recently expressed concern regarding the calculation of the VPDP Adjustments (as described in Paragraph 5.3.13 of the Actuarial Function Holders report (AFH)). The policyholder advocate has shared some analysis with Aviva which concludes that the calculation of the VPDP Adjustment should allow for the possibility that the lapse rates in respect of Non-Elected Bond policies may be lower after the reattribution to those of Elected Bond policies.

In assessing the implications of the policyholder advocate's conclusions, Aviva has considered whether lapse rates are likely to depend on the prospects for future inherited estate distributions.

From Aviva's perspective, it seems more likely that future lapse rates will depend on other factors, such as future investment performance (and in particular whether MVRs are being applied) and the future cash needs of the policyholders concerned.

Although Aviva does recognise that the lapse rates for electors may increase to some extent as a result of the reattribution (as they would no longer benefit from future inherited estate distributions) there is no evidence to suggest that the lapse rates for non-electors will change as a result of the reattribution.

Having said this, it is conceivable that policyholders who intended to surrender their policies in the short term would choose to elect, whereas those policyholders who intend to hold their policies for the longer term would choose not to elect. In these circumstances it is possible that, in the absence of the reattribution, the lapse rates for those who have chosen to elect would have been higher than those who have chosen not to elect.

Although the overall lapse rates experienced before the reattribution are known, it is not possible to predict with any degree of certainty what the difference in lapse rates of policies in the Old and New With-Profit Sub Funds might be in the future.

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## **2.01 Analysis of Election Information**

Based on analysis of the votes received to 21<sup>st</sup> August 2009, it seems likely that a significant proportion of the non-electors will consist of policyholders who have received a voting pack but who have not returned a valid election form. In these circumstances it is difficult to conclude categorically that the non-electors will generally consist of policyholders who intend to maintain their policies over the longer term and who are therefore likely to exhibit a lower than average lapse rate.

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### 3.00 Aviva's Conclusions

Recognising that it is impossible for anyone to accurately predict the future, and that the open-maturity policies by their nature are investments that are held or surrendered based on the policyholders immediate need for the proceeds, it is feasible, although not certain, that the persistency levels for non-electing policyholders could be higher than that implied by the recent aggregate lapse experience of CGNU Life and CULAC policies.

Having agreed that different lapse experience (both negative and positive) is a possibility for non electors (and electors) post election. The question then is how much should be allowed for in the assessment of non electors VPDP pre and post reattribution. The fact that some policyholders say they are going to retain their policies for longer doesn't necessarily mean that all non electors will and therefore, from Aviva's perspective, it is going to be the average of these assumptions that matter.

On this basis, further analysis of the voting experience to 21<sup>st</sup> August 2009 has been undertaken of and the Aviva Board agreed to alter the negotiated terms of the reattribution offer. At the time of writing the supplementary AFH report the detail of the adjustment had not been finalised, a further letter will therefore be produced and published to document the revised proposals and will be presented in an additional witness statement to the High Court Hearing starting on 14<sup>th</sup> September 2009.

#### 3.01 Aviva's Proposed Solution

There is very little information available to guide an appropriate assessment of the lapse rates for non-electors after the reattribution. One source is the analysis of the AXA FSA returns:

Surrender rates			
	Old With Profits Fund	New With Profits Fund	Ratio
2004	5.0%	5.9%	86%
2005	7.8%	9.6%	81%
2006	15.1%	15.8%	95%
2007	17.3%	20.4%	85%

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The applicability of this information is clearly limited by the relative lack of information available to policyholder under this exercise, but in the absence of any other information this would suggest that 80% to 95% would be reasonable.

The policyholder advocate suggested that the voting patterns for fixed maturity policies may be a useful indicator of the relative lapse experience of non-electing policies without fixed maturity dates.

It is acknowledged that the voting patterns are one of the few available sources of data, although Aviva has concerns regarding making inferences from one set of products to be applied to a different set of products.

In particular, a number of factors influence both the lapse and election decisions. The thoughts and behaviours of one group of policyholders are not necessarily the same as those of another group of policyholders, so any method applied mechanistically can only be regarded as approximate. In Aviva's opinion this means that, at most, the voting patterns on products with maturity dates could only be used as a crude guide.

Nevertheless Aviva considered the approach suggested by the policyholder advocate to consider the results it would give.

Aviva concluded that the implied profiles could be quite unstable from year to year. In addition, in the first few years before distributions were projected it would only be the average rates, rather than the year-on-year rates, which would be relevant.

Aviva therefore suggested smoothing out the profile as follows:

- 60% for the first six years
- increase at 5% per annum until reaches 90% in year 12
- remain at 90% until year 14
- decrease at 5% per annum thereafter, reaching 35% in year 25

This approach will produce a differential in lapse rates in excess of that implied by the AXA experience. Aviva has therefore concluded that this approach errs on the prudent side and favours non-electors.