

Report Number 17 A

Actuarial Function Holder's Report

A summary of Aviva's proposals 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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Appendix by: Aviva UK Life – June 2009

Aviva Life Services UK Limited. Registered in England No 2403746. 2 Rougier Street, York, YO90 1UU.

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1.00 Context

Aviva is proposing to make changes to three of its funds:

- CGNU Life with-profits fund.
- Commercial Union Life Assurance Company (CULAC) with-profits fund
- NUL (RBS) Limited

These changes affect a large number of our policyholders.

Our proposed changes are a reorganisation: consisting of a reattribution and a fund transfer.

In accordance with SUP 18.2.58(G) of the Financial Services Authority (FSA) Conduct of Business Sourcebook (COBS) rules, the Actuarial Function Holder for CGNU Life, CULAC, Aviva Life and Pensions (AVLAP) and NUL (RBS) has produced a report to the Board of Directors for these companies. The objective of the report is to consider:

- The effect of the Scheme's proposals on the benefit security of policyholders of CGNU Life, CULAC, NUL (RBS) and AVLAP
- The effect of the Scheme on the fair treatment of non-profit policyholders of CGNU Life, CULAC and AVLAP, including their reasonable benefit expectations
- Whether it is likely to be in the interests of holders of Eligible Policies to elect; and
- Whether the holders of Non Elected Policies are treated fairly in relation to their interests in future distributions from the Inherited Estates.

In addition, the report provides further detail on how the Scheme provisions will be implemented on the Effective Date and the ongoing management of the transferred business after the Effective Date.

With that in mind, this paper shares some background information on the role of the Actuarial Function Holder and provides a summary of his comments and conclusions in relation to the reorganisation proposals.

Copies of the full Actuarial Function Holder's report have been made available to:

- The FSA
- The Independent Expert
- The Policyholder Advocate

A copy of the full Actuarial Function Holder's report will be presented to the Court so that it can be taken into consideration in the decision on whether or not to approve the transfer.

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You will also find the Policyholder Advocate's and the Independent Expert's complete reports and the reports of the Actuarial Function Holder and the With-Profits Actuary on the website www.aviva.co.uk/fundtransfer as well as more information from the Policyholder Advocate on our website and her own. These reports and their appendices are very large documents, so in an effort to minimise the environmental impact of issuing printed copies of these publications they will only be available on-line or on request by writing to us at:

Aviva Fund Transfer Support Team, P.O. Box 3312, Surrey Street, Norwich, NR1 3FE.

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2.00 Introduction

2.01 What is an Actuarial Function Holder?

The role of the Actuarial Function Holder was introduced in 2005 following the FSA's With-Profits review. As part of its with-profits governance arrangements an insurer must appoint an Actuarial Function Holder to perform the role set out in SUP4, and in particular SUP 4.3.13R, of the FSA handbook.

The appointed Actuarial Function Holder must have the required skills and experience to perform the role and be a Fellow of the Faculty of Actuaries or of the Institute of Actuaries.

In brief, the role of the Actuarial Function Holder is to advise about:

- The risks that the funds run and their impact on the firm's ability to meet its liabilities to policyholders as they fall due
- The capital needed to support the business, including the regulatory capital requirements¹.

It is the Actuarial Function Holder's role to monitor these risks².

2.02 Who is the Actuarial Function Holder?

The Actuarial Function Holder for CGNU Life, CULAC, AVLAP and NUL (RBS) is John Lister; he has held this role since June 2005.

John is the Chief Actuary for Aviva UK Life and a member of the Board. In his role as Chief Actuary he is responsible for all actuarial matters, capital and balance sheet management, investments, tax and legal.

He is also responsible for Aviva's commercial mortgage business that has some £126m under management.

John is a Council Member of the Institute of Actuaries.



¹ SUP 4.3.13(1)R

² SUP 4.3.13(2)R

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2.03 Structure of this Paper

Sections 3.00 to 7.00 of this paper have been extracted from the Summary section³ of the Actuarial Function Holder's report to the directors of CGNU Life, CULAC, AVLAP and NUL(RBS) in connection with the proposed reorganisation of the CGNU Life and CULAC funds. As a result, the numbering sequence used in these sections corresponds with those used in the Actuarial Function Holder's Report.

As a result, any references made in the text of these sections are to the main content sections of the Actuarial Function Holders Report and not replicated in this document.

Section 8 of this paper provides Aviva's view of the Office of the Policyholder Advocate's commentary in relation to the Actuarial Function Holder's report.

Where technical terms are used in the text, they are not explained further in this document. The other Aviva appendices accompanying the Policyholder Advocate's Report explain the concepts summarised in this appendix.

³ Section 2 of the Actuarial Function Holder's Report dated 30/04/2009

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3.00 The Scheme (Section 2.1)

2.1.1 In summary the transfer and financial reorganisation being proposed under the Scheme comprises:

- (a) A merger of the businesses of CGNU Life and CULAC
- (b) The establishment of two new With-Profits Sub-Funds in AVLAP (the New WPSF and the Old WPSF)
- (c) A transfer of the policies of CGNU Life, CULAC and NUL(RBS) and the associated assets and liabilities into the New WPSF and the Old WPSF
- (d) An election by eligible with-profits policyholders to accept the reattribution proposals (as described below) and be transferred into the New WPSF, or not to elect to accept the reattribution proposals and be transferred into the Old WPSF
- (e) The transfer of ineligible with-profits policies and non-profit policies (including the unit-linked part of hybrid linked policies) partly to the New WPSF and partly to the Old WPSF based on the outcome of the election
- (f) The apportionment of the transferred Inherited Estates of the CGNU Life and CULAC With-Profits Funds between the Non-Profit Sub-Funds of AVLAP (the Reattributed Inherited Estate External Support Account or RIEESA) and the Old WPSF based on the outcome of the election
- (g) Ancillary provisions governing:
 - The investment and bonus policy for the transferred business
 - Requirements relating to the RIEESA concerning its investment, its use to provide capital support to the New WPSF and the Old WPSF and its future release to shareholders
 - The efficiency of the investment process including the pooling of assets
 - Future new business arrangements
 - Other changes aimed at providing greater clarity on the exercise of management discretion following the reattribution
 - Governance arrangements appropriate to the changed circumstances following the reattribution, designed to ensure compliance with the Principles of the Scheme.

4.00 The Reattribution Proposals (Section 2.2)

Overview

2.2.1 Under the reattribution proposals, eligible with-profits policyholders of CGNU Life, CULAC (including for this purpose the with-profits policyholders of Aviva Life International Limited whose benefits are wholly reinsured to CGNU Life and CULAC) and NUL (RBS) will be offered a choice. They can elect to accept certain reattribution benefits (Policyholder Incentive Payments (PIPs)) and if their policy remains in force on the Effective Date, have their policy transferred to (or reassured to in the case of Aviva Life International Limited) a newly established sub-fund of AVLAP (the New WPSF). Such policies will no longer be eligible to participate in any future Inherited Estate distributions. Eligible with-profits policyholders who do not so elect (including those who fail to respond) will, if their policy remains in force on the Effective Date, have their policies transferred (or reassured) to another newly established sub-fund of AVLAP (the Old WPSF). Such policies will be eligible to participate in any future Inherited Estate distributions from that fund whilst they remain in force and invested in with-profits. It is intended that the reattribution proposals will not be implemented unless a minimum proportion of eligible policyholders elect to accept the proposals (Election Threshold). The AVLAP Board does have the ability to waive this condition although the Election Threshold has been set at a very low level as described in Section 21 of Appendix 1.

2.2.2 Eligible with-profits policyholders whose policies terminate before the Effective Date as a result of the occurrence of an insured event such as death, maturity or normal retirement, will receive a PIP (unless they have elected not to accept the reattribution benefits). With-profits policyholders whose policies terminate before the Effective Date as a result of voluntary actions (such as surrender, transfer or early retirement) will not be eligible to receive a PIP.

2.2.3 Where the with-profits investment of an Elected Policy is voluntarily reduced between the Qualifying Date and the Effective Date, the AVLAP Board may proportionately reduce the PIP. No such reduction will be applied in respect of the continuation of automatic partial withdrawals that were being made on the Qualifying Date or, for pension policies, from the 'lifestyling' option of automatic switches out of with-profits as the normal retirement date in the contract approaches. Furthermore, no such reductions will be applied in respect of any reduction in the with-profits investment which took place prior to 24 April 2009

Determination of the PIPs

2.2.4 The PIPs offered to Eligible Policyholders (calculated as described in Section 23 of Appendix 1) will be based on an assumed value of the combined Inherited Estates of CGNU Life and CULAC of £1,200m and in this event an aggregate PIP of £500m (the Minimum Aggregate Policyholder Incentive Payment) will be made if all Eligible Policyholders elect to accept the proposals. The combined Inherited Estates will however be valued as at the Effective Date (the Estate Value as described in Paragraph 2.2.5 below) and the aggregate PIP will be enhanced in the event that the Estate Value exceeds £1,200m. The enhanced value (Final Aggregate Policyholder Incentive Payment) will then be apportioned between those policyholders who remain Eligible Policyholders one month and one day

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prior to the Effective Date. This will be achieved by enhancing the PIPs offered to the remaining Eligible Policyholders by a uniform percentage (after allowing for any proportionate reduction in the payments to be made in the circumstances described in Paragraph 2.2.3 above). Through this mechanism, the payments made to holders of Elected Policies will reflect an allowance for the PIPs which would have been paid to potentially Eligible Policyholders who have voluntarily terminated their policy prior to the date one month and one day before the Effective Date (and reflect any reduction in payments in the circumstances described in Paragraph 2.2.3 above). In the event that the Estate Value would be less than £1,200m (before the application of the £1,200m minimum value) the AVLAP Board and the Aviva Board will consider whether or not to waive the Estate Condition and if not, the Scheme will not proceed.

2.2.5 The Scheme requires that the Estate Value used for the purpose of calculating the Final Aggregate Policyholder Incentive Payment will be calculated using the average of three values of the combined Inherited Estates of CGNU Life and CULAC. For this purpose the values will be determined at the three consecutive month ends which are three calendar months, two calendar months and one calendar month prior to the day which is one day prior to the Effective Date. The average value so obtained will be increased to allow for two months interest at an appropriate risk free rate. The approach to the Estate Value calculation has been chosen so as to protect both policyholders and shareholders from sharp market movements on any particular day whilst enabling the PIP payments to be made as quickly as possible after the Effective Date. The approach adopted is the same as that used to produce half-year results for Aviva plc. The calculation of the Estate Value is described in Appendix 5.

Financing arrangements for the PIPs

2.2.6 Electing policyholders and those eligible with-profits policyholders whose policies terminate before the Effective Date who are deemed to have elected, will receive a PIP which, in most cases, will take the form of a cash payment. For certain categories of contract however the PIP will take the form of an additional benefit. The AVLAP Board will determine whether any part of the PIP that takes the form of an additional benefit should be financed from the surplus assets in NPSF1 and NPSF2 (prior to the transfers, but after allowing for any expenses arising in respect of the transfers which are to be charged to these sub-funds). The balance of the cost of such PIPs, together with the whole of the cost of any PIP that takes the form of a cash payment will be financed by Aviva from resources outside the long-term business funds but may take the form of a contingent loan to AVLAP which is subordinated to policyholder liabilities (although at the date of this report this option is not being proposed).

The transferred Inherited Estates

2.2.7 The proportion of the combined Inherited Estates of CGNU Life and CULAC on the Effective Date which is deemed to relate to policyholders who have received a PIP (the New WPSF Proportion as described in Paragraph 3.4 of Appendix 1) will be transferred to the Non-Profit Sub-Funds of AVLAP. The balance of the Inherited Estates of CGNU Life and CULAC will be transferred to the Old WPSF..

2.2.8 That part of the Inherited Estates of CGNU Life and CULAC which is transferred to the Non-Profit Sub-Funds of AVLAP (the RIEESA) will not be immediately available for distribution to shareholders. The RIEESA will instead be 'locked-in' until it is no longer needed to provide support for the transferring with-profits policies, so that in this respect the security for policyholder benefits and the

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freedom to manage the business of the transferring funds is not diminished by the Scheme. The RIEESA will, subject to the limitations specified in the Scheme, be available to write non-profit new business for the benefit of shareholders and to provide capital to support with-profits new business.

Associated changes

2.2.9 A distribution of part of the Inherited Estates of the CGNU Life and CULAC with-profits funds is being made to certain with-profits policyholders whose policies are invested in those funds (including NUL (RBS) policyholders and Aviva Life International Limited policyholders who are invested in with-profits). This distribution (being the Deferred Special Bonus which is described in Paragraph 5.14.97 below) is being made to all with-profits policies of CGNU Life, CULAC, NUL (RBS) and Aviva Life International Limited (other than Stakeholder Pension Policies) that were in force and invested in with-profits on 1 January 2008. Part of the Deferred Special Bonus distribution was made in 2008 and the remainder will be distributed by way of further distributions in 2009 and 2010 to the same policyholders, provided that their policies remain in force and invested in with-profits at the relevant time. The Deferred Special Bonus, including the element which is deferred, has been facilitated by the strategy of hedging some of the investment risks to which the Inherited Estates are exposed ('de-risking' - as described in Paragraph 7.4.3 below) and it has been taken into account as part of the negotiations with the Policyholder Advocate who has been appointed in connection with the reattribution proposals (see Paragraph 2.4.3 below). Such a distribution demonstrates Aviva's commitment to treating its customers fairly and it means that the likelihood of a further sizeable distribution from the Inherited Estate of the Old WPSF in the short to medium term is low.

2.2.10 As part of the reattribution, and conditional upon it taking effect, the Affordability Condition in relation to the application of the Mortgage Endowment Promise provided by CGNU Life and CULAC will be removed (although the other conditions applying to the Promise will continue to apply). The removal of this condition (whereby top-up payments can be reduced or withdrawn in certain adverse circumstances) will provide greater clarity on the application of shareholder discretion in the post reattribution environment and will, in certain circumstances, be of direct financial benefit to some policyholders. The greater clarity is considered desirable in view of the increased potential for conflicts of interest between policyholders and shareholders generated by the reattribution. The removal of the Affordability Condition would apply to all relevant policyholders in CGNU Life and CULAC who benefit from the Mortgage Endowment Promise irrespective of whether or not they elect to receive a PIP. There will be no change to the terms of the Mortgage Endowment Promise in relation to policies currently allocated to the existing sub-funds of AVLAP.

2.2.11 As a further part of the reattribution proposals and in order to provide greater clarity to policyholders on the application of discretion in the post reattribution environment:

- the ability of the AVLAP Board to apply charges to the asset shares of Transferred Policies for guarantees will be restricted after the Effective Date. Such charges will only be made in respect of transferring policies where an explicit charge was being applied under the terms of the policy prior to the Effective Date. Furthermore, no additional charges will be made for guarantees in the period prior to the Effective Date unless the application of such charges is explicitly specified in the product terms and conditions. Charges for guarantees may be made to new policies effected after the Effective Date provided such charges are clearly permitted under the terms of the policy; and

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- prior to the Effective Date a final assessment will be made of the profits that are expected to arise under certain classes of non-profit business where it has been the practice of CGNU Life and CULAC to allocate such profits to asset shares. The non-profit business concerned is that described in Paragraph 4.5.1 below. The purpose of that assessment will be to establish whether the previous allocations to asset shares in respect of such profits should be adjusted in the light of any differences between the future experience (in relation to mortality and policy lapses for example) which was anticipated when those allocations were made and the subsequent experience up to the date of the assessment. Our current expectation is that the previous allocations to asset shares will exceed the profits that are expected to arise under those classes of non-profit business and in these circumstances no further adjustments will be made to asset shares. After the Effective Date no further adjustments will be made to asset shares in respect of the profits or losses on non-profit business written prior to the Effective Date (except to correct any factual errors as described in Paragraph 5.14.104(d) below).

2.2.12 Stakeholder Pension policyholders with investments in the Stakeholder With-Profits Fund will not be affected by the reattribution proposals. They will, as currently, only be entitled to participate in distributions from a Stakeholder With-Profits Fund which, after transfer, will be the AVLAP Stakeholder WPSF.

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5.00 Implications for Policyholders (Section 2.3)

2.3.1 From a with-profits policyholder perspective, the terms of the reattribution under the Scheme are designed to:

- Ensure that the security of policyholder benefits for all with-profits policyholders will not be materially adversely affected
- Ensure that, as far as possible, policy benefits will be no different from those that would have been provided in the absence of the Scheme (disregarding for this purpose the benefits that might have been paid to electing policyholders and non eligible policyholders in the event of further distributions from the Inherited Estates and the Additional Benefits that will be provided to certain categories of policyholder under the incentive arrangements in lieu of a cash payment);
- Ensure that the implementation of the Scheme will not lead to a change in the investment policy for assets backing the asset shares;
- Provide eligible policyholders the opportunity to access the value (through the payment of a PIP) of their contingent eligibility to participate in any future distributions from the Inherited Estates should any be made. Following the allocation of the Deferred Special Bonus, the likelihood of further sizeable additional distributions in the short to medium term is relatively low. Consequently, for many policyholders who are currently entitled to participate in such distributions should they be made, this eligibility would more than likely be given up to future generations of policyholders on exit and generate no significant value to them;
- For eligible policyholders who choose to elect, provide clarity as to the ownership of the Inherited Estates, their entitlements under their policies and the responsibilities of shareholders and management;
- Give eligible policyholders who choose not to elect the option to retain their eligibility to participate in future distributions of Inherited Estate if they so wish, whilst maintaining the value of their collective interests at the Effective Date in future distributions from the Inherited Estate; and
- Provide greater clarity in the operation of management discretion (as outlined in Paragraphs 2.2.10, 2.2.11 and 2.3.2).

2.3.2 The exercise of Board discretion in the management of with-profits business can give rise to a potential for conflicts between the interests of policyholders and shareholders. This potential conflict is already recognised in the existing governance arrangements for the With-Profits Funds. These include the publication of detailed Principles and Practices of Financial Management (PPFM), the role of the With-Profits Actuary (as described in Paragraph 10.4 of the WPA Report) and the With-Profits Committee (as described in Paragraph 10.2 of the WPA Report) in advising the Board and reporting on the exercise of discretion and compliance with the PPFM. The reattribution would however give rise

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to a greater potential for conflicts between the interests of policyholders and shareholders and this has been recognised in designing the proposals. In particular, the Scheme specifies detailed principles of financial management which will be supplemented by additional practices set out in this report, the report prepared by the With-Profits Actuary, and recorded in the PPFM for the New WPSF and Old WPSF. These principles and practices (which include those described in Paragraphs 2.2.10 and 2.2.11 above) will impose limitations on the exercise of discretion by the Board and management of the company. There will be a further strengthening of the governance arrangements in respect of compliance with, and future changes to, these principles and practices which will provide an appropriate level of protection for the interests of policyholders after the Scheme takes effect. In particular, internal governance and guidance documentation provides greater codification of these principles and practices and whereas future changes to principles and practices will continue to be subject to review by the With-Profits Committee (WPC), any material changes will require its prior confirmation or approval.

6.00 Fund Transfer and Reattribution Process (Section 2.4)

2.4.1 The Scheme is subject to the provisions of Part VII of the Financial Services and Markets Act 2000 and regulations made under it. It is also subject to the detailed guidance regarding transfers of insurance business as laid out in SUP 18.2. In addition, the process for reattribution of the Inherited Estates is subject to the rules and guidance laid out in COBS 20.2.42 to 20.2.52 inclusive.

2.4.2 The Scheme, this report and the report by the With-Profits Actuary will be reviewed by the Independent Expert appointed (with the approval of the FSA) in connection with the Scheme. The Independent Expert has in addition carried out an extensive due diligence exercise and will provide a report on the Scheme to the Court. His report covers (amongst other things):

- the likely effects of the Scheme on long-term policyholders including, but not limited to, their security and benefit expectations
- the approach applied to determining the allocation of PIP between relevant policyholders; and
- the effect of the Alternative Scheme where the transfer becomes effective without the reattribution proposals being implemented

2.4.3 The reattribution proposals have been considered by a Policyholder Advocate who has been appointed in accordance with the provisions of COBS 20.2.42 to 20.2.46 inclusive. The role of the Policyholder Advocate is (inter alia):

- negotiating with the firm the benefits to be offered to policyholders (i.e. the policyholder incentive payments) in exchange for the rights and interests that they would be giving up
- to explain to eligible with-profits policyholders the rights and interests that they would be giving up in exchange for the incentive payment
- to comment to with-profits policyholders on:
 - the methodology used in allocating the policyholder incentive payments amongst the eligible with-profits policyholders, or groups of such policyholders, and the form of those payments
 - the criteria used for determining the eligibility of with-profits policyholders to elect
 - the terms and conditions of the proposals; and
 - the views expressed by the With-Profits Actuary and the Independent Expert on the allocation of the policyholder incentive payments amongst the eligible with-profits policyholders
- to advise with-profits policyholders or each group of with-profits policyholders, with reasons, whether in her view the proposals are in their interests.

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2.4.4 Aviva's website will be updated to include this report and the full reports of the With-Profits Actuary, the Independent Expert and the Policyholder Advocate (subject to the removal of any price sensitive information). Aviva's website will also include summaries of the Scheme and the Independent Expert's report together with the executive summary of the Policyholder Advocate's report and her Guide. Paper copies of these reports, the summary of the Scheme (and the full Scheme) will be sent to policyholders free of charge upon request. Policyholders will have the right to raise questions, concerns or objections to the proposals. The Court will be informed of the number of such questions or complaints and any substantive questions or complaints will be notified to the Court.

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7.00 Outline of the Report (Section 2.5)

2.5.1 Section 3 of this report provides a summary of the historic development of the business, the current financial position and the rationale for the Scheme.

2.5.2 In Section 4 I describe the current structure and operation of the Funds of the companies involved in the Scheme, including any constraints imposed by previous schemes.

2.5.3 Section 5 details the proposed structure and operation of the Funds of AVLAP after the Scheme takes effect. This section includes the detailed controls around the exercise of discretion after the Effective Date and the governance arrangements applying to compliance with the Scheme and future changes in the principles and practices.

2.5.4 In Section 6 I consider the impact on benefit security of merging the CGNU Life and CULAC With-Profits Funds and the effect of the Scheme on the benefit security for existing policyholders of AVLAP and the Transferring Policyholders.

I conclude that on the basis of the financial position at 31 December 2008:

- the effect of merging the CGNU Life and CULAC With-Profits Funds will be unlikely to have a material impact on the benefit security for policyholders in either fund;
- the benefit security for AVLAP policyholders will be increased as a consequence of the transfer
- the transfers will not have any material adverse effect on the benefit security for the Transferred Policies or the with-profits policies of Aviva Life International Limited;
- the reattribution proposals will not have a material adverse effect on the benefit security for the Transferred Policies, the with-profits policies of Aviva Life International Limited and the existing policies of AVLAP.

2.5.5 In Section 7 I consider the management of the Inherited Estate and the prospects for future distributions from the Inherited Estate. This section includes some background to the Deferred Special Bonus and the calibration of the Scheme trigger points for future distributions and releases from the Inherited Estate and the RIE. I then consider whether the PIP offered to eligible policyholders should be considered to be attractive to them and whether the allocation of the transferred Inherited Estates is fair. In this context I consider the value of the interests of with-profits policyholders in any potential future distributions from the Inherited Estate (VPDP) and the effect of the VPDP Adjustment (as described in Paragraph 5.3.13 below). I conclude this section by considering the provisions applying to the eventual merger of the Old WPSF and the New WPSF.

I conclude that:

- The initial allocation of the Inherited Estates under the reattribution is expected to preserve the collective contingent interest of holders of Non Elected Policies and the Old WPSF Proportion of Pipeline Policies in the Inherited Estate;

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- It seems likely that in nearly all cases it will be in the financial interests of eligible policyholders to elect. Even in cases where the projected value of potential future distributions from the Inherited Estate of the Old WPSF exceeds the value of the PIP, an election will result in the certainty and immediacy of the PIP rather than the uncertainty of Inherited Estate distributions that might be made a number of years into the future to holders of with-profits policies then invested in the Old WPSF using an allocation basis to be decided at that time;
- Based on the above conclusions, the respective Boards would be fully justified in making a recommendation to eligible policyholders that they elect to accept the PIP offered to them;
- The basis of allocation of a proportion of the combined Inherited Estates of CGNU Life and CULAC to the Old WPSF (after allowing for the effect, if any, of the Value of Potential Future Distributions (VPDP) Adjustment and the Effective Date Benefit Security Factor (BSF) Test) is sufficient to ensure that in relation to their interests in potential future distributions from those Inherited Estates and their future benefit security, the holders of Non Elected Policies are treated fairly.
- It is likely to be many years before a merger of the New WPSF and the Old WPSF can take place under the terms of the Scheme, but there is no reason why a merger should not take place once there are no longer any transferred policies left in force (other than Stakeholder Pension policies) invested in with-profits, or retaining the option to invest in with-profits. I also conclude that the security for policyholder benefits will continue to be adequately protected following such a merger.

2.5.6 In Section 8 I consider the impact of the Scheme on the fair treatment of holders of non-profit policies including their reasonable benefit expectations (the impact of the Scheme on the fair treatment and reasonable benefit expectations of holders of with-profit policies is considered in the report of the With-Profits Actuary).

I conclude that the Scheme will have no material adverse impact on the expected benefits of holders of non-profit policies in the Transferor Companies and AVLAP and that the Scheme will have no impact on the fair treatment of such policyholders.

2.5.7 Section 9 covers the financing arrangements for the Policyholder Incentive Payments and the implications for benefit security.

I conclude that the proposed financing arrangements for the Policyholder Incentive Payments will have no material adverse impact on benefit security for the existing policyholders of AVLAP and the holders of Transferred Policies.

2.5.8 Sections 5 to 9 consider the future operation of AVLAP if the Scheme and reattribution proposals contained therein are sanctioned by the Court, the Threshold Condition and the Estate Condition are met (or waived) and Aviva decides to go ahead with the reattribution. Section 10 outlines the impact on benefit security and the fair treatment of holders of non-profit policies in the event that the reattribution proposals are not accepted by the Court, or the Board decides not to proceed with the reattribution, and the Alternative Scheme is implemented.

I conclude that if the Alternative Scheme is implemented:

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- the effect of merging the CGNU Life and CULAC With-Profits Funds will be unlikely to have a material impact on the benefit security for policyholders in either fund
- the benefit security for AVLAP policyholders will be increased as a consequence of the transfer
- the transfers will not have any material adverse effect on the benefit security for the Transferred Policies or the with-profits policies of Aviva Life International Limited
- there will be no material adverse impact on the expected benefits of holders of non-profit policies in the Transferor Companies and AVLAP and that the Alternative Scheme will have no impact on the fair treatment of such policyholders

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8.00 Aviva's View of the Policyholder Advocate's Approach

8.01 Materiality

The Office of the Policyholder Advocate has suggested that "it would have been helpful if the AFH could have given some indication of the degree of materiality he has in mind." As the Office of the Policyholder Advocate acknowledges, it is difficult to provide a precise definition of this term.

The use of such terminology in the context of a Part VII Fund Transfer (and reattribution) is commonplace and represents a professional and expert opinion of the effects of the proposals without being able to provide absolute assurances due to the uncertain nature of future events.

8.02 Old With-Profits Sub-Fund (OWPSF) Bonus Amount

The Office of the Policyholder Advocate has commented that the terms for the distribution of any OWPSF Bonus Amount (OBA) should be specified in more detail in the Actuarial Function Holder's report.

When looking at whether to make a distribution, the Board is required to take account of the reason the OBA is there (including those policyholders who should benefit). The current fund strength and prevailing market conditions will be crucial factors in deciding when to actually distribute the OBA and it is therefore not possible at this stage to be more precise over exactly when the distributions will occur, save to say that the With-Profits Committee will be required to regularly consider whether it is appropriate to distribute.

8.03 Strategic Assets

In their paper on this topic, the Office of the Policyholder Advocate have commented that they would prefer the basis for allocation of existing strategic assets to be more formally documented. As set out in our paper titled "Investment Policy, Smoothing and Bonus Policy" this isn't possible before the election results are known.

The basis for allocation of existing strategic investments following the reattribution will largely depend on the number and types of policies that vote to accept or reject the reattribution offer – since the Effective Date benefit security of the policies in the OWPSF and New With-Profits Sub-Fund (NWPSF) (plus RIEESA) need to be broadly similar. This necessarily means that careful matching of the assets and liabilities of each group will have to take place.

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At this stage it is difficult to rule out the need to allocate strategic investments in the OWPSF Inherited Estate – this is something that will need to be considered, in conjunction with the WPC, once the reattribution voting patterns are known. Any decisions taken will adhere to the principles outlined in the Scheme, requirements of COBS and treating customers fairly.

8.04 Industry Levies

Aviva notes that the Office of the Policyholder Advocate has commented on the provisions in the scheme which address the facility to charge industry levies and the governance of those provisions. From Aviva's perspective, the inclusion of the facility to charge industry levies is a response to regulatory change and is not a consequence of either the reattribution or fund transfer. Transferring policyholders will benefit from restrictions, which are introduced in the scheme, on certain new charges to asset share, and it was therefore necessary to document an exception (noted in paragraph 1 (c) of Part 2C of Schedule 4 of the scheme) to deal with industry levies as a contingency measure against potential financial security issues.

The facility to allocate industry levies to asset share is not intended to be utilised in the normal course of events, but is intended to deal with a situation where there is either a large levy or number of levies imposed on insurers. Any ability to make such a charge will be subject to the terms of the policy and to TCF. The Principles and Practices of Financial Management (PPFM) make it clear that in considering whether or not to make such a charge the AVLAP Board will have regard to appropriate actuarial advice and the views of the With-Profits Committee. Aviva has considered the policyholder advocate's comments and remains satisfied that an appropriate combination of governance controls has been put in place to deal with this potential financial security issue.