

Appendix 18 B

The With Profits Actuary's report

A report for the policyholder advocate in connection
with the reattribution of the inherited estates
of the CGNU Life and CULAC with-profits funds

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1.00 Introduction and summary

1.01 Context

This appendix has been prepared by KPMG LLP for the policyholder advocate and is a response to the with-profits actuary's (WPA) report. Whilst we have done our best within this appendix to explain technical terms and concepts, it remains the case that this is a technical report intended for readers who have some familiarity with the concepts involved.

The policyholder advocate has commented in appendices 26 ("FSA guidance letters and responses") and 39 ("Impact of FSA guidance on policyholders") on the FSA rules as they stand at the time of writing this appendix, and the views as expressed in these appendices have not been repeated here. The WPA is working within the current FSA framework and our comments similarly take the current FSA rules as given. Our comments in this appendix do not therefore extend to any views held by the policyholder advocate in relation to the FSA rules.

The policyholder advocate has commented separately on her views about how the role of the WPA should have been used to challenge the company's discretion further.

It is noted and accepted that no specific guidance from any source exists in relation to the role of the WPA in a reattribution situation, and that different WPAs will have different views as to how they should exercise their role in a reattribution.

1.02 Background

With effect from 31 December 2004, it became a statutory requirement for a life insurance company transacting long-term business to have an actuarial function holder (AFH), and for a company transacting with-profits business to have also a WPA. One of the main responsibilities of the WPA is to advise management and directors on key aspects of the exercise of discretion affecting with-profits business, and, in particular, the WPA is required to advise or report on whether a firm is treating its policyholders fairly. This report by the WPA is one of the key protections for policyholders.

Under FSA guidance (SUP 18.2.58G), the affidavit evidence to the court would normally include copies of a report on the transfer (for with-profits business) by the WPA of both firms, which should also be provided to the FSA at an early stage. SUP 4.3.17R(4) requires a firm to request the advice of its WPA about the likely effect of material changes in its business plans on the rights and reasonable expectations of the relevant classes of its with-profits policyholders. A transfer of business would usually be regarded as a material change. The advice on a transfer of business would normally be in the form of a formal report by the WPA. This appendix contains our views on the WPA's conclusions, as set out in his report to the governing body in relation to the reattribution.

Guidance Note 41 (GN41) provides guidance on the duties of the WPA. GN41 is a guidance note adopted by the Board for Actuarial Standards. It is normally applied in relation to the regular advice provided by the WPA in business as usual circumstances, but it is not dis-applied in a major change situation such as the one under consideration. Section 4 of GN41 sets out how, in formal advice to the firm's management, the WPA should include his or her interpretation of what constitutes fair treatment of policyholders, as well as an opinion on whether the asset share methodology or discretion applied in line with the provisions of the relevant transfer are in line with that interpretation. In addition, the WPA should consider whether the interests of the relevant classes of the firm's with-profits policyholders are taken into account in a fair and reasonable manner. These requirements are consistent with those set out in FSA's Conduct of Business Sourcebook Rules ("COBS").

Section 20.2.44G of COBS rules which sets out the role of the policyholder advocate with regard to the WPA, states that the policyholder advocate's scope should include comments to with-profits policyholders on:

“(d) the views expressed by the independent expert or the reattribution expert (as the case may be), and the firm's with-profits actuary on the allocation of any benefits amongst the relevant with-profits policyholders.”

1.03 Purpose of this report

It is part of the policyholder advocate's role to comment on the views expressed by the WPA on the allocation of any benefits amongst the relevant with-profits policyholders.

We have reviewed the WPA report prepared for the relevant Boards, and we have commented on the conclusions made by the WPA in his report. We also comment on other areas which are covered by the WPA report and which we consider relevant to policyholders' benefits. Finally we have considered all the areas in the WPA report where the Scheme relies on the WPA report for more detail.

1.04 The role of the WPA with regards to the reattribution of the inherited estates of the CGNU Life and CULAC with-profits funds

Whereas the primary role of the AFH is to consider whether the obligations to policyholders can be met now and in the future, it is the role of the WPA to consider the "fair treatment" of policyholders, and in this respect we consider that the role should encompass both the fairness of the policyholder incentive payment (PIP) offered (including comments on the process of the negotiations), as well as how the benefit expectations for the non-electors may change post reattribution.

1.05 Structure of this appendix

Section 2 gives KPMG's views on the conclusions reached in the WPA report. Section 3 goes on to discuss the few areas where the Scheme refers to the WPA report for more detail.

1.06 The WPA report on the Scheme

The WPA report is addressed to the Directors of CGNU Life, CULAC, AVLAP and NUL(RBS). A summary of the terms of the Scheme on which the report is based is given in Appendices 1 and 2 of the WPA report.

Section 1.5 of the WPA report states that the objective of the report is to consider the following:

- *“the likely effect of the Scheme’s proposals on the fair treatment of the with-profits policyholders of CGNU Life, CULAC, NUL(RBS) and NULAP, including their reasonable benefit expectations;*
- *the fairness of the reattribution proposals; and*
- *whether the governance arrangements are sufficient to ensure compliance with the detailed principles and practices following the implementation of the Scheme.”*

We agree with these objectives and note that the WPA’s conclusions set out in the summary (Sections 2.5.1 to 2.5.5) are as follows:

- *“with-profits policyholders as a whole have a right to receive a proportion (at least 90%) of the relevant Inherited Estate to the extent that it is distributed, but not otherwise and that individual policyholders have very little specific rights to participate in a future distribution from the Inherited Estate;*
- *there is no reason to believe that the current generation of with-profits policyholders have in aggregate contributed to the build up of the Inherited Estates;*
- *the Scheme is consistent with the fair treatment of the transferring with-profits policyholders of CGNU Life, CULAC and NUL(RBS) and that there will be no material adverse effect on their reasonable benefit expectations;*
- *the Scheme is consistent with the fair treatment of the existing with-profits policyholders of the NULAP WPSF and that there will be no material adverse effect on their reasonable benefit expectations;*
- *the Scheme is consistent with the fair treatment of the existing with-profits policyholders of the PM Sub-Fund and that there will be no material adverse effect on their reasonable benefit expectations;*
- *the Scheme is consistent with the fair treatment of the existing with-profits policyholders of the Belgian Sub-Fund and that there will be no adverse effect on their reasonable benefit expectations.”*

In relation to the fairness of the reattribution process the WPA concludes (Section 2.5.6):

- *“the reattribution process has been undertaken in line with regulatory requirements and provides eligible customers with a choice:*
 - *to accept the terms of the reattribution and receive a PIP; or*
 - *not to accept the terms of the reattribution and continue to be eligible to participate in any future Inherited Estate distributions;*
- *the negotiation process with the Policyholder Advocate has been robust with open access to information. Accordingly the Policyholder Advocate and the FSA have been able to properly assess, present and agree their respective positions and the Policyholder Advocate has been able to recommend the reattribution for the majority of eligible customers; and*
- *consequently, policyholders have been treated fairly in the reattribution process.”*

In the event that the Alternative Scheme is implemented the WPA concludes (Section 2.5.7):

- *“the Alternative Scheme is consistent with the fair treatment of the transferring with-profits policyholders of CGNU Life, CULAC and NUL(RBS) and that there will be no material adverse effect on their reasonable benefit expectations; and*
- *the Alternative Scheme is consistent with the fair treatment of the existing with-profits policyholders of the NULAP WPSF, the PM Sub-Fund and the Belgian Sub-Fund and that there will be no material adverse effect on their reasonable benefit expectations.”*

Finally, in the summary of the WPA report the WPA concludes (Section 2.5.8):

- *“the governance arrangements are appropriate and sufficient to facilitate compliance with the detailed principles and practices that apply to the management of the funds under the Scheme after the Effective Date.”*

Section 3 of the WPA report provides an outline of the current position concerning the fair treatment of with-profits policyholders including their reasonable benefit expectations

(including consideration of potential future distributions from the inherited estates of CGNU Life and CULAC), and whether the current generation of with-profits policyholders have contributed to the build-up of the inherited estate. Sections 4 to 6 consider the effect of the Scheme on the fair treatment and reasonable benefit expectations of the eligible with-profits policyholders. Section 8 considers the fairness of the reattribution process.

Section 9 of the WPA report considers the situation if the Alternative Scheme is implemented, and Section 10 covers the governance arrangements that will apply after the Effective Date of the Scheme, including the role of the WPC and the annual certification requirements.

We note that a further conclusion is made in Section 3.5.8:

“I conclude that the Inherited Estate is needed to provide security and investment freedom and the other purposes referred to in Paragraph 3.5.2 and that, only to the extent that it is considered by the Board to be excessive, is there any expectation of a direct benefit from the Inherited Estate to policyholders.”

We also note that throughout the WPA report there are references to viewpoints used in reaching the conclusions. These viewpoints are listed in Annex 1.

2.00 KPMG’s view of the WPA’s Conclusions

In this section we comment on the conclusions, and the basis for these conclusions as set out in the WPA report.

As a general point, there are a number of times when the WPA states that policyholders would not be “*materially adversely affected*”. We understand that it is not always possible to be definitive, but nevertheless it would have been helpful if the WPA could have given some indication of the degree of materiality he had in mind.

2.01 Fair treatment of with-profits policyholders

The WPA has concluded that with-profits policyholders as a whole have a right to receive a proportion (at least 90%) of the relevant inherited estate to the extent that it is distributed, but not otherwise, and that individual policyholders have very little specific rights to participate in

a distribution from the inherited estate. Section 3.2.3 of the WPA report expands on this, and goes on to say that this is because an inherited estate could stay in place for many years and accordingly fall to be distributed only to policyholders who survive to the end of the period when it starts to be distributed. The WPA also states that legally, policyholders as a whole do not have a right to participate in profits arising during a period that are not distributed nor do they have a right to participate in the undistributed profits of prior periods unless and until they are distributed. The WPA report also concludes that the inherited estate is needed to provide security and investment freedom and the other purposes referred to in Paragraph 3.5.2 of his report and that, only to the extent that it is considered by the Board to be excessive, is there any expectation of a direct benefit from the inherited estate to policyholders.

We acknowledge that under certain circumstances there will be future distributions of estate to current policyholders, and under other certain circumstances there will be no distribution. However, our perspective is different. We believe that the effect of the COBS rules and the fact that the PIP is being offered, must mean that, by definition, the combination of all these factors does lead to a material interest in the estate.

It is also the case that the current generation of policyholders' contingent interest in the inherited estate is directly dependent on the levels of future new business. If for example, in the extreme, there were no future new with-profits policies sold, then the full amount of the inherited estate would fall 90% to the current generation of policyholders. We believe that the WPA in his role could usefully have considered the range of possibilities that might arise. Clearly, given the presence of the policyholder advocate, we would not expect the WPA to act as a second advocate, or get involved in negotiations. Nevertheless, in our view, the WPA would need to have satisfied himself that the PIP is in the interests of policyholders under a plausible range of scenarios.

It is our view that the WPA should focus on issues primarily from the point of view of policyholders. Given that shareholders could not gain benefit from the inherited estates without either a distribution (where the shareholders would receive at most 10%) or a reattribution, we would expect the WPA not to be arguing that the policyholders have "very little specific rights" to participate in a future distribution from the inherited estate, but instead

to be discussing how any value placed on the potential future distributions which might be made in the absence of the reattribution is dependent *inter alia* upon the levels of future new business assumed, with lower volumes resulting in a higher estimate. Stating that the policyholders have “little specific rights” to participate in a future distribution from the inherited estate appears to give more emphasis to the shareholders’ position than we would expect from the WPA. Our view, which is shared by the WPA, is that the policyholders do clearly have an entitlement to participate in the inherited estates to the extent that such estates meet the “excess estate” rules set out within the COBS rules. It is also our view that these rights can vary enormously depending on factors such as new business and the company’s risk appetite.

We therefore believe that the WPA should have commented on Aviva’s forecasts for new business and his view of their appropriateness. The WPA does state that he believes that the risk appetite is in his view fully consistent with the expectations of policyholders, but we believe that he should also have commented on how the chosen risk appetite of the fund affects the amount forecast to go to future policyholders.

The WPA in his report also concludes that there is no reason to believe that the current generation of with-profits policyholders has in aggregate contributed to the build up of the inherited estates. Provided there are no material errors in the calculation of the asset shares, we agree with this conclusion. It is worth noting here that there is protection for transferring policyholders where there may have been errors in the calculation of asset shares. Paragraph 2 of part 2B of Schedule 4 to the Scheme states that:

“Where any factual errors or errors in calculation have resulted in a material understatement of Asset Shares as at the Effective Date, such errors will be corrected.

Where any factual errors or errors in calculation have resulted in a material overstatement of Asset Shares of any Policies allocated to the New WPSF as at the Effective Date, the correction of such errors shall be limited to the aggregate amount of any corrections of understatement of Asset Shares in the New WPSF.

Any such correction of understatements in the New WPSF shall not be at the cost of the Core Assets Account but shall be funded from the RIEESA and shall result in a recalculation of the Core Assets Account at the date upon which the error is discovered.

Any overstatement of Asset Shares for Policies in the Old WPSF will be corrected to the extent overstatements on equivalent Policies in the New WPSF have been corrected.

Any such upward or downward corrections of Asset Shares in the Old WPSF shall be debited or credited respectively to the estate of the Old WPSF.”

With regard to the uses of the estate (section 3.5 of the WPA report), we would have expected the WPA in his report to have given more consideration to the existing rules around surplus distributions and, given the COBS rules, to have considered more fully the potential impact on the current generation of policyholders of the uses to which Aviva can put the estate.

Post reattribution, the risk appetite is important for the Old WPSF policyholders because it impacts the likelihood that they will participate in any future distributions from its inherited estate, and the amount of any such distributions. The risk appetite was important pre-reattribution because of the corresponding impact on the interests of holders of eligible policies in future potential distributions from the inherited estates of CGNU Life and CULAC in the absence of the reattribution, which formed a key part of the negotiations. We would have expected the WPA to have commented on the approach taken to risk appetite. In particular we would have expected him to have commented on the balance between a high level of security and the potential for future distributions from the inherited estate, and to have drawn out the advantages and disadvantages of the approach adopted by Aviva.

The risk appetite is particularly important when there is an expectation of a high level of future new business because new business serves to increase capital requirements and delay potential releases of surpluses, which has the effect of transferring a greater share of potential special distributions to future expected new business. This is because capital will be required to meet the resulting new business strain and new business will introduce additional risks against which capital must be held. In addition, new with-profits business would be expected

to be eligible to participate in any future distributions from the inherited estates, and so would act to dilute the interests of holders of existing with-profits policies in such distributions. All other things being equal, a more conservative risk appetite increases the deferral period.

2.02 Effect of the Scheme on the fair treatment of with-profits policyholders of CGNU Life, CULAC, NUL(RBS) and NUIL¹

The WPA report concludes that the Scheme is consistent with the fair treatment of the transferring with-profits policyholders of CGNU Life, CULAC, NUL(RBS) and NUIL and that there will be no material adverse effect on their reasonable benefit expectations. In coming to this conclusion, the WPA has taken into account the method used to allocate the inherited estates between the old with-profit sub-fund (Old WPSF), and new with-profit sub-fund (New WPSF). We note that the WPA has chosen to use the following reasons for concluding that it is justifiable that there is a possibility that the collective interests of holders of non-elected policies in future distributions from the inherited estate may not be fully preserved (Section 4.3.7):

- *“The primary purpose of the Inherited Estate is to provide security for policyholders’ benefits and investment freedom and (given my conclusions in Paragraph 4.3.8 below and Paragraph 4.3.3 above) in these respects the position of non electing policyholders is not materially affected;*
- *current policyholders have not in aggregate contributed to the build up of the Inherited Estate; and*
- *policyholders have very little specific rights to receive a distribution from the Inherited Estate except to the limited extent that an excess surplus arises under the COBS Rules and the Board decides to make a distribution in accordance with the COBS Rules.”*

¹ With-profits policies of NUIL are currently reassured to CGNU Life and CULAC. Following implementation of the Scheme such policies will be reassured to AVLAP.

We do not disagree with the WPA's final conclusions in this area, and in fact we also believe that Aviva has considered this issue in detail, and has addressed the issue to the best of its ability and in a way we believe is appropriate. In our opinion the above statements made by the WPA are irrelevant to the proportion of the combined inherited estates allocated to the Old WPSF on the Effective Date, and we fail to understand why the WPA is commenting again that policyholders have only "very little specific rights". It is our view that the WPA could have given a more positive comment on the approach that Aviva has taken to this issue as opposed to once again confirming his views on the lack of rights that policyholders have. We do believe that the WPA has a duty to consider the change in potential future distributions for non-elected policies carefully and to comment on the arrangements made to seek to protect them.

The WPA also considered the deferred special bonus which amounted to £2,363m at 1 January 2008 and is being made over three years with the first tranche having been distributed as a special bonus to eligible policyholders in 2008. Although we do not agree that this distribution should have been made over a three year period, we acknowledge that a different view could be taken and have no further comments.

The WPA also considers future releases from the Old WPSF, and concludes that the Scheme requirement to distribute capital is consistent with the maintenance of a strong financial position and a relatively high EBR for asset shares which is the basis on which CGNU Life and CULAC have sold with-profits business in the past. Although we believe that policyholders may prefer the fund to be managed in a less prudent way, we acknowledge that a different view could be taken and have no further comments.

2.03 Effect of the Scheme on the fair treatment of other relevant with-profits policyholders

The WPA report concludes that the Scheme is consistent with the fair treatment of the existing with-profits policyholders of the AVLAP WPSF, the PM Sub-Fund and the Belgian Sub-Fund and that there will be no material adverse effect on their reasonable benefit expectations.

We do not disagree with the WPA's conclusions.

2.04 The fairness of the reattribution process

The WPA report concludes that the negotiation process with the policyholder advocate has been robust with open access to information, and it goes on to say that accordingly the policyholder advocate and the FSA have been able to properly assess, present and agree their respective positions. We agree that the process has been open.

The WPA does not express an opinion in his report as to size of the aggregate PIP, and we would have expected the WPA to have done so. However, section 4.3.2 of the WPA report states:

“I have set out in Section 8 of this report my reasons for concluding that the outcome of the negotiations is fair to policyholders. Given that those negotiations also encompassed the approach to protecting the position of non-electors, my conclusion extends not just to the size and allocation of the PIP offer, but also to the allocation of the transferred Inherited Estates and the particular safeguards for non-electors contained in the Scheme...”

Section 8 of the WPA report does not contain any statements regarding whether he believes the size of the aggregate PIP to be in policyholders' interests, and there is no mention of this in the summary. In addition to noting that the size of the aggregate PIP is the result of the negotiations, we believe the WPA should have commented upon whether he considers that that amount fairly reflects the interests of eligible policyholders, and we believe that the statement in section 4.3.2 is confusing.

2.05 Governance arrangements

The WPA report concludes that the governance arrangements are appropriate and sufficient to facilitate compliance with the detailed principles and practices that apply to the management of the funds under the Scheme after the Effective Date. In Section 10 of his report, the WPA discusses the role of the with-profits committee (WPC) and the WPA, as well as the internal documentation which exists. We do not disagree with the WPA's conclusions.

2.06 Other views and conclusions

The WPA report contains a number of other viewpoints which allow the WPA to reach his main conclusions. There are a number of conclusions throughout the report where the WPA concurs with the AFH around areas such as benefit security. We have considered these in our appendix on the AFH report (appendix 17 B) and do not consider them further here. There are also a number of areas where the WPA makes conclusions around the allocation of benefits. We have set out below where we have comments on these conclusions if they are not already covered above.

The key conclusions on which we have commented are set out below:

“4.3.6: ... The Actuarial Function Holder has concluded in Paragraph 7.6.7 of his report that it is not possible to place a value on an individual policyholders’ contingent interest in the Inherited Estate and I would agree with that assessment. ...”

“8.8: I conclude that:

- *the reattribution process has been undertaken in line with regulatory requirements and provides eligible customers with a choice:*
 - (a) *to accept the terms of the reattribution and receive a PIP; or*
 - (b) *not to accept the terms of the reattribution and continue to be eligible to participate in any future Inherited Estate distributions.*
- *the negotiation process with the Policyholder Advocate has been robust with open access to information. Accordingly the Policyholder Advocate and the FSA have been able to properly assess, present and agree their respective positions and the Policyholder Advocate has been able to recommend the reattribution for the majority of eligible customers; and*
- *consequently, policyholders have been treated fairly in the reattribution process.”*

We have mentioned above that we believe that the WPA should have given a reasoned view as to the overall fairness of the size of the aggregate PIP. In addition, although it is not possible to place an exact value on the contingent interest in the inherited estate, estimates using various assumptions can be and have been made. The report of the WPA contains no commentary or critique of the assumptions used to determine those estimates of with-profits policyholders' interests in the estate. We would have expected the report of the WPA to have included such consideration, and to have confirmed that the size of the aggregate PIP being offered corresponds to a scenario which the WPA regarded as being plausible. Assumptions such as the levels of new business, for example, are key to the calculation, yet we do not know whether the WPA considers the assumptions made by Aviva to be reasonable.

There is one potentially important area of the Scheme on which there is no conclusion or comment by the WPA. The power to allocate some or all of future industry levies to asset shares has been introduced, and is solely for the Board to determine. There is no right of veto from the WPC on the charging of such levies to asset shares. However, we do note that the draft PPFM for the Old WPSF and the New WPSF does state that the WPC will be made aware of and be consulted on such levies being charged to asset shares, and that the Board will properly consider the views of the Committee before reaching a decision on whether to introduce any charges to asset shares in respect of industry levies. We also note that the Independent Expert covers this matter in his report (section 8.9.12).

In its appendix on the AFH report (appendix 17 A), Aviva states that *“the facility to allocate industry levies to asset shares is not intended to be utilised in the normal course of events, but is intended to deal with a situation where, due to the current financial crisis and government bailouts, there is either a large levy or a number of levies adding up to a high amount on insurers”*. Aviva does not want to be in the position of not being able to make any charge to asset shares in respect of such levies, particularly if the rest of the industry is able to do so. The power to make such a charge will be subject to the terms of the policy and to treating customers fairly. Aviva states that a large levy on AVLAP could have implications for its financial security, and so it does not think it is appropriate for the WPC to have a veto. The WPC will of course have whistle-blowing rights if they consider the allocation of such

charges to asset shares, or the manner in which the charges are allocated between policyholders, is unfair.

We note the above, but remain of the view that it would be more appropriate for this power to be subject to the WPC approval process. The Scheme does not limit this power to periods where such a levy on AVLAP would otherwise have implications for its financial security. In addition, we would not expect the WPC to veto such a decision if the security of the company were at stake and so we do not agree with Aviva's reasoning for not making this power subject to WPC approval.

Such levies have not been significant in the past, and have not been charged to asset shares in the past. However, due to the regulations having changed to include levies in respect of the banking sector such levies could become large in the future.

Clearly what is important is whether the treatment of such levies after the Scheme is implemented is likely to be different from the treatment of such charges before the Scheme. We acknowledge that the amounts of such levies are impossible to predict and they could be classified as expenses incurred in running the business. However, we believe that the power to charge some or all of such levies to asset shares rather than the inherited estate means there is a very clear potential conflict of interest between the shareholders and policyholders.

We believe that the WPA should have considered this and commented on whether he believed that there being no requirement for WPC approval for charges to asset shares in respect of future industry levies is appropriate.

3.00 Summary of the areas where the Scheme relies on the WPA report

The WPA report is not referred to by the Scheme to the same degree as the AFH report and there are only two key areas where the Scheme relies on the detail in the WPA report. This section sets out the two areas where the Scheme depends on the WPA report for further detail.

3.01 Paragraph 5.7.4 of the Scheme

“As further described in Section 7 (Effect of the Scheme on the fair treatment of with-profits policyholders of the Belgian Sub-Fund) of the With-Profits Actuary's Report, the NULAP Board shall continue to apply the same policy (as that applied prior to the Effective Date) in respect of the declaration of bonuses on any Policies allocated to the Belgian Sub-Fund immediately prior to the Effective Date, (or any Policies issued pursuant to the exercise of an option in any such Policy), which confer on the holder a right to share in a bonus declared out of the excess of investment income on certain assets allocated to the Belgian Sub-Fund over a guaranteed tariff interest rate, after a deduction for expenses and profit (such deductions having been subject to a cap of 1.5% per annum to the end of 2007) and for Tax.”

Section 7 of the WPA report considers the effect of the Scheme on the fair treatment of with-profits policyholders of the Belgian Sub-Fund, and describes the bonus declaration policy. We have no comments on this section of the report.

3.02 Paragraph 11 of Part 4 of Schedule 4 to the Scheme

“The costs of the With-Profits Committee shall be apportioned in accordance with Section 10.2 (With-Profits Committee) of the With-Profits Actuary's Report between the Sub-Funds as determined by the NULAP Board in accordance with its obligation to treat customers fairly and after consultation with the With-Profits Committee.”

The relevant section is 10.2.10 of the WPA report:

“It is anticipated that the apportionment of the costs of the WPC will be as follows:

- *The direct costs of the WPC will be apportioned between the With-Profits Sub-Funds of NULAP based on an appropriate measure of fund size;*
- *The costs of external advice, other than that which has been obtained in connection with the role of the WPC under the Scheme, will be apportioned based on the nature of the advice:*
 - *costs which relate to general advice that is relevant to all sub-funds will be apportioned as for direct costs;*

- *costs which are only relevant to the business carried on by particular sub-funds will be apportioned between those sub-funds based on the respective sizes of such business;*
- *The costs of external advice that has been obtained in connection with the role of the WPC under the Scheme (i.e. those costs which, in the opinion of the With-Profits Actuary, would not have arisen in the absence of the Scheme) will be apportioned between the New WPSF and the Old WPSF. It is envisaged that such costs will be allocated to the New WPSF unless there are clear reasons why a proportion of such costs should be borne by the Old WPSF.*

Any costs that are allocated to the New WPSF will be charged to the Core Assets Account of the New WPSF and any costs that are allocated to the Old WPSF will be charged to the Inherited Estate of the Old WPSF. The costs of the WPC will not be charged to asset shares. Any changes to the above framework for the allocation of the costs of the WPC will be subject to the approval of the WPC.”

We do not disagree with the above approach, although the approach does leave significant room for interpretation.

Annex 1 – List of other views and conclusions within the WPA report

Section 3	The fair treatment of with-profits policyholders
3.5.8	I conclude that the Inherited Estate is needed to provide security and investment freedom and the other purposes referred to in Paragraph 3.5.2 and that, only to the extent that it is considered by the Board to be excessive, is there any expectation of a direct benefit from the Inherited Estate to policyholders.
3.6.10	The method of determination of the preferred range of surplus, the wider acceptable range of surplus, and the manner in which these ranges are referenced for the purpose of determining management actions, including the scope for discretionary distributions (together the Risk Appetite Framework) is in my view fully consistent with the expectations of policyholders as described in Paragraph 3.5.7 above.
3.7.1	... I have concluded this section with a description of the Risk Appetite Framework focusing on the investment and bonus policy of the Funds. This articulates the views of the Boards on the circumstances in which future distributions might be made from the Inherited Estate and I have set out my view that this is fully consistent with the expectations of policyholders.

Section 4	Effect of the Scheme on the fair treatment of with-profits policyholders of CGNU Life, CULAC and NUL(RBS)
4.3.2	I have set out in Section 8 of this report my reasons for concluding that the outcome of the negotiations is fair to policyholders. Given that those negotiations also encompassed the approach to protecting the position of non-electors, my conclusion extends not just to the size and allocation of the PIP offer, but also to the allocation of the transferred Inherited Estates and the particular safeguards for non-electors contained in the Scheme ...

4.3.6	... The Actuarial Function Holder has concluded in Paragraph 7.6.7 of his report that it is not possible to place a value on an <u>individual</u> policyholders' contingent interest in the Inherited Estate and I would agree with that assessment.
4.3.7	<p>... In any event it is in my view unnecessary for the prospects to be identical in order to achieve a fair basis of apportionment given that:</p> <ul style="list-style-type: none"> • The primary purpose of the Inherited Estate is to provide security for policyholders' benefits and investment freedom and (given my conclusions in Paragraph 4.3.8 below and Paragraph 4.3.3 above) in these respects the position of non electing policyholders is not materially affected; • current policyholders have not in aggregate contributed to the build up of the Inherited Estate; and • policyholders have very little specific rights to receive a distribution from the Inherited Estate except to the limited extent that an excess surplus arises under the COBS Rules and the Board decides to make a distribution in accordance with the COBS Rules.
4.3.8	... If the BSF of the Old WPSF exceeds that of the New WPSF (including the RIEESA) by more than 0.5% the initial apportionment of the Inherited Estates will be adjusted to bring the difference down to 0.5%. I am satisfied that this test will ensure that the level of security for policy benefits in the Old WPSF and the New WPSF are sufficiently similar. ...
4.3.12	I am therefore satisfied that the apportionment of the Inherited Estates on the Effective Date as provided in the Scheme is fair to both electing and non-electing policyholders.
4.4.4	... I am satisfied therefore that the Scheme provisions in relation to the DSB are fair to both New WPSF and Old WPSF policyholders.
4.5.4	... I am satisfied that the Scheme requirement to distribute capital in excess of this level is consistent with the maintenance of a strong financial position and a relatively high EBR for asset shares which is the basis on which CGNU Life and CULAC have sold with-profits business in the past.
4.5.7	... In my view it is reasonable for the CRP to be set at a lower level than the MPC because:

	<ul style="list-style-type: none"> • There is no requirement to release surplus in the RIEESA above the level represented by the CRP and surplus could be retained if considered appropriate. This is in contrast to the position for the Old WPSF where surplus in excess of the level represented by the MPC must be distributed. • The company could make a distribution of surplus in the Old WPSF that would result in the AAA CT Coverage being less than the MPC whereas no releases can be made from the RIEESA if they would result in the AAA CT Coverage being less than the CRP.
4.5.8	The Actuarial Function Holder has stated (in Paragraph 6.6.15 of his report) that in his view a AAA CT Coverage of 110% currently provides a high level of security to current and future policyholders and I would agree with that view.
4.5.10	I am satisfied that the level at which the CRP has been set and the additional safeguards described above, will be sufficient to ensure that releases from the RIEESA will not have an adverse effect on the benefit security for transferring policyholders allocated to the New WPSF or (given that the AAA CT will be calculated based on the preferred management approach and strategy which is consistent with past management strategy) the benefit expectations of those policyholders.
4.5.11	... I am also satisfied that the requirements which must be met by any modified or replacement tests, including the requirement for the NULAP Board to have regard to actuarial advice and for any changes to be subject to the approval of the WPC, are appropriate and will not result in a material reduction in the protection provided by the Scheme.
4.5.12	I am satisfied that the Scheme provisions relating to future distributions from the Inherited Estate of the Old WPSF and releases from the RIEESA to the shareholders and the restrictions on future changes to the tests will not have an adverse effect on the benefit expectations of transferring policyholders and accordingly that they are consistent with the fair treatment of those policyholders.
4.6.3	... the NULAP Board may reduce the proportion of new with-profits policies which are reinsured to the Old WPSF so as to be less than the Old WPSF Proportion, subject to the approval of the With-Profits Committee. Such a reduction may be proposed by the NULAP Board if the Old WPSF becomes significantly weaker than the New WPSF

	<p>after the Effective Date. In my view it would be reasonable to reduce the proportion reinsured in these circumstances.</p>
4.6.6	<p>... The Norwich Union life company boards considered the capital support arrangements when the Stakeholder With-Profits Funds were launched in 2001. Those Boards concluded that those capital support arrangements would have no impact on the reasonable benefit expectations on the existing policyholders of the CGNU Life and CULAC With-Profits Funds. Having regard to the basis on which the Stakeholder WPSF is managed, I am satisfied that this will continue to be the case in relation to transferring with-profits policyholders immediately after the Effective Date. The position in the longer term will, as now, be subject to ongoing review.</p>
4.6.9	<p>I am satisfied that the allocation of future with-profits new business between the New WPSF, the Old WPSF and the Stakeholder WPSF has the effect of preserving the pre-Effective Date position (treating the CGNU Life and CULAC With-Profits Funds as having been merged for this purpose) for non electing policyholders and that it is fair to transferring with-profits policyholders.</p>
4.7.8	<p>... Unless the financial position of the New WPSF and the Old WPSF deteriorates to a significant extent, it seems likely that these constraints will result in a requirement to maintain a relatively high asset share EBR in the future. I am satisfied that the requirement to review the constraints in the event of extreme conditions as described in Paragraph 5.14.25 of the AFH report is sufficient to ensure that there will be no significant adverse impact on benefit security as a result of the application of those constraints.</p>
4.7.10	<p>... the Scheme does not prevent the NULAP Board from adopting different policies for different categories or durations of policy in the future. Such a change in approach could have the effect of reducing guarantee costs...In my view however it would not be reasonable in normal circumstances to change the approach with the sole objective of reducing the overall level of guarantee costs.</p>

4.7.12	... There is in my view no reason why the Scheme would give rise to a change in the investment strategy for the Remaining Assets of the Old WPSF given the continuing alignment between policyholder and shareholder interests. ...
4.7.15	The Actuarial Function Holder has considered the potential impact of the investment policy of the RIEESA in Paragraphs 6.6.2 to 6.6.10 of his report and has concluded that (having regard to the constraints and governance provisions) it will not have a material adverse effect on its ability to provide benefit security to policyholders of the New WPSF and the Old WPSF. I would agree with this conclusion.
4.7.18	... I consider that it is unlikely that the realistic financial position of the New WPSF (including the RIEESA) and the Old WPSF that is taken into account in the determination of the asset share EBR will be materially adversely affected by the investment policy for the Remaining Assets.
4.7.19	In my view, having regard to the considerations above, the investment strategy for the Return Assets is unlikely to be materially affected by the Scheme either as a consequence of a change in the exercise of management discretion or as a consequence of the investment policy for the Remaining Assets. As a result the investment return credited to asset shares is unlikely to be materially adversely affected by the Scheme.
4.7.24	... In my view, it seems unlikely that the implementation of the Scheme would result in a material increase in the fee rates charged when the MSAs are next renewed from 1 January 2019.
4.7.27	The allocation of investment and policy expenses and mis-selling expenses to the New WPSF and the Old WPSF is described in the Scheme PFM and a summary of the principal effects of these allocations is provided in Paragraphs 5.11.6 and 5.11.7 of the AFH report. The allocation of other expenses that do not relate to a particular policy or investment as between the NULAP Sub-Funds (treating the New WPSF the Old WPSF and the RIEESA as one NULAP sub-fund for this purpose) is described in Paragraphs 5.11.8 and 5.11.9 of the AFH report. The apportionment of the combined allocation of

	<p>such expenses between the New WPSF, the Old WPSF and the RIEESA is described in Paragraph 5.11.10 of the AFH report In my view these allocation bases are appropriate and would be consistent with the treatment of such expenses if the Scheme were not to proceed. The apportionment of expenses that do not relate to a particular policy or investment to the New WPSF, the Old WPSF and the RIEESA will be performed after taking into account the advice of the With-Profits Actuary and will be subject to the approval of the WPC. I consider that these governance arrangements will be sufficient to ensure the fair treatment of policyholders.</p>
4.7.30	<p>Having regard to the considerations above the charges that are made to asset shares in respect of expenses are, in my view, unlikely to be affected by the Scheme.</p>
4.7.32	<p>... Deferred tax assets consisting of unrelieved BLAGAB acquisition expenses and the remaining tax assets and provisions consisting of any losses carried forward, current tax assets and provisions and any tax contingency provisions will be allocated between the New WPSF and the Old WPSF based on the New WPSF Realistic Liability Proportion and the Old WPSF Realistic Liability Proportion respectively. Such a pro rata allocation of existing tax assets and liabilities is in my view appropriate.</p>
4.7.34	<p>The provisions [of the Scheme] for changing the basis of allocation [of tax to the Old WPSF, the New WPSF and the RIEESA set out in the Scheme] in the event of a change in tax regulations or to take account of tax synergies are in my view consistent with the fair treatment of policyholders.</p>
4.7.36	<p>... In my view the provisions above remove significant amounts of discretion and hence reduce the potential for conflicts of interest in relation to the determination of asset shares.</p>
4.7.37	<p>... I am satisfied that the reduction in flexibility [arising from the removal of the power to introduce guarantee charges to asset shares of transferring policies] will not have a material adverse effect on benefit expectations. I am also satisfied that the remaining</p>

	<p>safeguards described in Paragraph 4.7.36 will not have a significant impact on benefit expectations.</p>
4.7.38	<p>As stated in Paragraph 2.2.11 above, 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. This assessment, which I will review, will be determined taking into account both recent and projected future experience for the business concerned. 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. ... I am satisfied that the proposed approach is reasonable and is unlikely to result in a material adverse effect on benefit expectations.</p>
4.7.39	<p>For classes of transferred non-profit business where it has not been the practice of CGNU Life and CULAC to allocate profits or losses to asset shares, the New WPSF Proportion of those profits or losses will accrue to the Non-Core Amount of the New WPSF (and therefore ultimately to the shareholders) and the Old WPSF Proportion will accrue to the Inherited Estate of the Old WPSF. The most significant classes of non-profit business concerned are immediate annuities and deferred annuities. Given the significant longevity risk associated with this business it is not in my view an appropriate policyholder investment and it seems reasonable therefore that the New WPSF Proportion of such risks should be borne by the shareholders and that there should be no future discretion to charge the Old WPSF Proportion to the asset shares of policies allocated to the Old WPSF.</p>
4.7.40	<p>... The 'MVR-free roll over' concession can be withdrawn for policies which have not yet passed their MVR free anniversary. However the Actuarial Function Holder has informed me that the concession will not be withdrawn whilst the surplus position is positioned within or above the preferred range under the Risk Appetite Framework.</p>

4.7.42	... Given that the AAA CT Coverage will be calculated assuming the continuation of the preferred management approach and strategy, I am satisfied that this requirement [to make distributions when the AAA CT Coverage of the Old WPSF exceeds the MPC] will not have an adverse effect on future bonus policy.
4.7.49	... In my view the degree to which the internal governance and guidance documentation describes the current policy together with the role of the WPC in assessing compliance with that policy, provides a high level of comfort that the benefit expectations of transferring with-profits policyholders will not be adversely affected by a future change in bonus policy as a result of the implementation of the Scheme. ...
4.7.55	Given the operation of the New WPSF and in particular the provisions governing the Core Assets Account, it seems unlikely that an ‘estate’ (meaning an excess of the value of Core Assets Account over the Enhanced Aggregate Asset Shares) would build up within the Core Assets Account of the New WPSF. However in the event that such an estate did arise then, to the extent that it was unlikely to be utilised in meeting future claims and expenses on with-profits policies, it would in my view be appropriate for it to be distributed to the with-profits policyholders allocated to the New WPSF and to shareholders in line with participation rights described in Paragraph 4.7.50 above. ...
4.7.57	Having regard to the above considerations, the participation rights of transferring with-profits policyholders are in my view consistent with the fair treatment of such policyholders.
4.7.59	In order to eliminate the mismatching risks described in Paragraph 4.7.58 the Scheme allows the investments of the New WPSF, the Stakeholder WPSF and the Old WPSF to be pooled. In my view such pooling of investments is a desirable feature of the Scheme. ... I have considered the consequences of these pooling arrangements as described in Paragraph 5.14.49 of the AFH report and I am satisfied that these are appropriate. ...

4.7.62	Transfer payments will be required between the New WPSF and the Old WPSF (in relation to the Return Assets CGT pool) and between the RIEESA and the Old WPSF (in relation to the strategic assets CGT pool) in the event that their respective interests change over the year. These payments are necessary in order to take account of the transfer of part of the deferred tax liability for unrealised chargeable gains from one sub-fund to another which is not taken into account in the operation of the pooling arrangements (as described in Paragraph 5.14.53 of the AFH report). ... I am satisfied that the formula used to determine the transfer payments will provide a fair outcome.
4.7.63	... I am satisfied that the pooling arrangements, including the allocation of realised chargeable gains and the transfer payments in respect of unrealised chargeable gains are likely to be materially fair to both policyholders and shareholders over time. ...
4.7.68	... The amendment to the [Mortgage Endowment] Promise described in Paragraph 4.7.67 will in my view address this concern by removing the discretion that would otherwise be available under the Affordability Condition.
4.7.76	In my view the above provisions [relating to the eventual merger of the Old WPSF and the New WPSF] are sufficient to ensure that the reasonable benefit expectations of with-profits policyholders will not be materially adversely affected by the merger provisions of the Scheme.
4.8.1	I conclude that the Scheme is consistent with the fair treatment of the transferring with-profits policyholders of CGNU Life, CULAC and NUL(RBS) and that there will be no material adverse effect on their reasonable benefit expectations.

Section 5	Effects of the Scheme on the fair treatment of with-profits policyholders of the NULAP WPSF
5.3.3	... I am satisfied that the risk of the NULAP long term fund as a whole being unable to meet its solvency requirements will not be increased as a result of the Scheme and

	consequently the likelihood of the NULAP WPSF investment policy being constrained will not be increased.
5.3.4	On the Effective Date the investments of the NULAP WPSF will continue to be managed separately from the investments of the other sub-funds. The NULAP Board may determine, having regard to appropriate actuarial advice, that part of the investments of the NULAP WPSF may be pooled with those of the New WPSF (including the RIEESA), the Old WPSF and the Stakeholder WPSF at any time after the Effective Date. In this event the pooling arrangements that are described in Paragraphs 5.14.46 to 5.14.61 of the AFH report will be extended in an appropriate manner. I am satisfied that the requirement for the NULAP Board to have regard to appropriate actuarial advice and the arrangements for determining the respective interests of each sub-fund in each asset pool will be sufficient to ensure that the investment return that is allocated to the NULAP WPSF will not be adversely affected by such pooling arrangements.
5.3.5	Having regard to the considerations above the investment return that is credited to asset shares and the future bonus policy for the NULAP WPSF is in my view, unlikely to be affected by the Scheme.
5.4.3	In my view, it seems unlikely that the implementation of the Scheme would result in a material increase in the fee rates charged to the NULAP WPSF when the MSAs are next renewed from 1 January 2019.
5.4.7	Having regard to the considerations above the charges that are made to asset shares in respect of expenses and taxation are, in my view, unlikely to be affected by the Scheme.
5.6.1	I conclude that the Scheme is consistent with the fair treatment of the existing with-profits policyholders of the NULAP WPSF and that there will be no material adverse effect on their reasonable benefit expectations.

Section 6	Effects of the Scheme on the fair treatment of with-profits policyholders of the PM
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	Sub-Fund
6.3.3	... I am satisfied that the risk of the NULAP long term fund as a whole being unable to meet its solvency requirements will not be increased as a result of the Scheme and consequently the likelihood of the PM Sub-Fund investment policy being constrained will not be increased. The scope for any further constraints on the investment policy of the PM Sub-Fund is in any event very limited.
6.3.5	Having regard to the considerations above the investment return that is credited to asset shares and the future bonus policy for the PM Sub-Fund is in my view, unlikely to be affected by the Scheme.
6.4.4	In my view it is unlikely that the implementation of the Scheme will affect the expenses incurred by NULS in respect of the Scale business and its expenses in respect of retained services, overhead activities and migration costs in respect of the Heritage business. Given that the charges under the outsourcing agreement with the external service provider will not be affected by the Scheme I therefore consider that there is no reason why the Scheme should give rise to an increase in the level of charges to be made to the PM Sub-Fund when the MSAs are next renewed from 1 January 2019.
6.4.5	Currently (and in line with the NULAP Scheme) the service standards for policies allocated to the PM Sub-Fund are the same as those for policies allocated to other long term insurance funds in the UK. The Scheme will however permit the scope and/or level of services provided to the PM Sub-Fund to differ from those provided to other long term insurance funds of NULAP or to any other company in the Aviva Group which carries on long term insurance business in the UK, subject to the prior approval of the WPC. ... I am satisfied therefore that this change to the NULAP Scheme is consistent with the fair treatment of policyholders.
6.4.8	... I am satisfied that the change in reference date [described in paragraph 6.4.7] will not affect the tax that is charged to the PM Sub-Fund.
6.4.9	Having regard to the considerations above the charges that are made to asset shares in respect of expenses and taxation are, in my view, unlikely to be affected by the Scheme.

6.6.1	I conclude that the Scheme is consistent with the fair treatment of the existing with-profits policyholders of the PM Sub-Fund and that there will be no material adverse effect on their reasonable benefit expectations.
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Section 7	Effects of the Scheme on the fair treatment of with-profits policyholders of the Belgian Sub-Fund
7.6.1	I conclude that the Scheme is consistent with the fair treatment of the existing with-profits policyholders of the Belgian Sub-Fund and that there will be no adverse effect on their reasonable benefit expectations.

Section 8	The fairness of the reattribution process
8.3.7	... I am satisfied that the process which has been followed satisfies the FSA rules and guidance relating to the process for reattribution of inherited estates.
8.4.10	... I am satisfied that the Policyholder Advocate has been provided with open access to all relevant information, that she has carried out her role in a diligent manner and that there has been a full and fair negotiation in relation to the matters described in Paragraph 8.4.1 above.
8.5.1	In my view, Norwich Union has provided a great deal of assistance to the Policyholder Advocate both prior to the start of the negotiations and throughout the period of the negotiations. ...

8.8	<p>I conclude that:</p> <ul style="list-style-type: none"> • the reattribution process has been undertaken in line with regulatory requirements and provides eligible customers with a choice: <ul style="list-style-type: none"> (a) to accept the terms of the reattribution and receive a PIP; or (b) not to accept the terms of the reattribution and continue to be eligible to participate in any future Inherited Estate distributions. • the negotiation process with the Policyholder Advocate has been robust with open access to information. Accordingly the Policyholder Advocate and the FSA have been able to properly assess, present and agree their respective positions and the Policyholder Advocate has been able to recommend the reattribution for the majority of eligible customers; and • consequently, policyholders have been treated fairly in the reattribution process.
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Section 9	The Alternative Scheme
9.2.4	In the event that the Alternative Scheme is implemented the C&C WPSF will be managed as a separate sub-fund of NULAP. ... There is in my view no reason why the NULAP Board would have an incentive to manage the C&C WPSF in a different way to the With-Profits Funds of CGNU Life and CULAC.
9.2.5	... In my view therefore, having regard to the considerations in Paragraph 9.2.4 above, there is no reason why the fund transfers under the Alternative Scheme should give rise to a change in benefit expectations.
9.2.7	I conclude that the Alternative Scheme is consistent with the fair treatment of the transferring with-profits policyholders of CGNU Life, CULAC and NUL(RBS) and that there will be no material adverse effect on their reasonable benefit expectations.
9.4	I conclude that the Alternative Scheme is consistent with the fair treatment of the existing with-profits policyholders of the NULAP WPSF, the PM Sub-Fund and the

	Belgian Sub-Fund and that there will be no material adverse effect on their reasonable benefit expectations.
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Section 10	Governance arrangements
10.2.3	The WPC consists of five members, three of whom (including the chairman) are independent. ... In my view such a degree of independence is appropriate to the changed circumstances following the implementation of the Scheme and in any event it is consistent with current best practice.
10.2.4	... I am satisfied that the selection process [for the independent members of the WPC] has been suitably rigorous and objective and that, in combination with the knowledge of the business which has been brought about through the inclusion of the non independent members, it has resulted in a membership which contains a balance of skills and experience which is appropriate to the role of the WPC.
10.2.6	. The responsibilities of the WPC under the Scheme are set out in the internal governance and guidance documentation which I comment on in Paragraph 10.3 below. I have considered the specific responsibilities of the WPC under the Scheme as set out in that documentation. I am satisfied that these encompass the most important aspects of the management of the with-profits funds. I am also satisfied that the responsibilities of the WPC in reviewing, approving or in providing the required confirmation in relation to those aspects of management are appropriate to the changed circumstances following the implementation of the Scheme. Provided that the WPC is able to carry out its role effectively these should ensure that the interests of with-profits policyholders are adequately protected.
10.2.7	In my view these provisions [of its terms of reference] will enable the WPC to carry out its role effectively.

10.3.6	The exercise of management discretion is fundamental to the operation of with-profits business. In my view the description of how that discretion will be exercised and the role of the WPC in that process as laid out in the internal governance and guidance documentation provides an appropriate balance between the requirement for policyholder protection and the continuing need for management discretion.
10.6.1	I conclude that the governance arrangements are appropriate and sufficient to facilitate compliance with the detailed principles and practices that apply to the management of the funds under the Scheme after the Effective Date.