

Appendix 19

The Independent Expert'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

June 2009

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1.00 Introduction and Summary

1.01 Context

This appendix has been prepared by KPMG LLP for the policyholder advocate in response to the views expressed by the Independent Expert on the allocation of benefits amongst the relevant with-profits policyholders as a result of implementation of the Scheme.

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.

1.02 Background

The Independent Expert was appointed in connection with the Schemes involving the transfer of the long term insurance business of CGNU Life Assurance Limited (CGNU Life), Commercial Union Life Assurance Company Limited (CULAC) and Norwich Union Life (RBS) Limited (NUL(RBS)) to Aviva Life & Pensions Limited (AVLAP). The with-profits benefits of policies of Norwich Union International Limited (“NUIL”) are currently reassured to CGNU Life and CULAC, and following implementation of the Scheme, will be reassured to AVLAP.

The transfer of the UK long term insurance business of CGNU Life, CULAC and NUL(RBS) will, subject to its sanction by the High Court of Justice in England and Wales, be implemented under the Main Scheme.

The scope of the Independent Expert’s work is set out in his report. It is to consider the consequences of the Schemes for the policyholders affected by those Schemes, including whether the Schemes provide sufficient protection for policyholders’ interests in the changed circumstances which will apply following their implementation. In addition, the scope is to consider any areas where there is potential for conflict between the interests of policyholders and those of the AVLAP shareholders, and the adequacy of the provisions designed to help manage such conflict (including the terms on which discretion may be exercised by the Board

and the With-Profits Committee of AVLAP, and other aspects of the governance arrangements applicable following implementation of the Schemes).

The scope of the Independent Expert's report includes the following areas considered by the Independent Expert:

- the likely effects of the Schemes on the security of guaranteed benefits of policies;
- the implications of the Schemes for the level of benefits which might be payable in the light of the current expectations of policyholders;
- the eligibility rules and the election process;
- the methodology applied by Aviva to determine the incentive payment to be offered to holders of individual Eligible Policies;
- the sources of the inherited estates of the CGNU Life WPSF and the CULAC WPSF, and the likelihood of future distributions from those inherited estates.

1.03 Purpose of this report

Section 20.2.44G(2)(d) of the COBS rules 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 actuary appointed by the firm to perform the with-profits actuary function on the allocation of any benefits amongst the relevant with-profits policyholders”

Appendix 28 B (“Policyholders’ future security and risk appetite”) sets out the policyholder advocate's views on many of the issues covered by the Independent Expert's report, and this appendix does not repeat these views.

We have reviewed the report of the Independent Expert and have commented on the views expressed by the Independent Expert on the allocation of any benefits amongst the relevant with-profits policyholders.

1.04 Structure of this appendix

Section 2 of this appendix sets out some of the key conclusions set out in the Independent Expert's report, along with KPMG's comments on these conclusions.

2.00 Summary of the key conclusions made in the Independent Expert's report, and KPMG's comments on these conclusions

In this section we comment on some of the conclusions set out in the Independent Expert's report, and those set out below in bold are direct extracts from the Independent Expert's report.

Conclusions around eligibility and communications to policyholders are not commented on in this report, neither are conclusions concerning the future governance, around the protection for policyholders (including future investment policies and management discretion), or the principles and practices set out in the Main Scheme. This report does not consider any conclusions of the Independent Expert on the Alternative Scheme.

The conclusions we comment on are grouped into two areas:

- Those aspects which directly form part of the policyholder advocate's role – i.e. the allocation of benefits amongst the relevant with-profits policyholders. We take this to mean the benefits surrounding the allocation of the inherited estates of CGNU Life and CULAC, and potential future distributions from those estates. In other words, we have considered the conclusions made around the derivation of the proportion of the combined inherited estates which will be allocated to the Old WPSF (and so form its inherited estate), the value of the aggregate amount of the PIP (in return for which the balance of the combined inherited estates will be allocated to the AVLAP shareholder) and the allocation of the aggregate amount of the PIP between eligible policyholders;

- those aspects which are more general conclusions around policyholders' benefits in future excluding any consideration of possible future special distributions from the former inherited estates of CGNU Life and CULAC.

We note here that, as set out above, part of the scope of the Independent Expert's work is to consider the consequences of the Schemes for the policyholders affected by those Schemes, including any areas where there is potential for conflict between the interests of policyholders and those of the AVLAP shareholders.

The Scheme does not require the With-Profits Committee to approve any charges to asset shares in respect of some or all of future industry levies. We believe it would be appropriate for such approval to be required. In this respect, the Independent Expert places reliance upon the Board taking action in line with the With-Profits Committee's recommendations, and, reliance on the With-Profits Committee whistle-blowing to the FSA if they feel the need to do so. In effect the Independent Expert is taking the view that such reliance can be placed on the Board and With-Profits Committee. We do not share the Independent Expert's view in this area, and would prefer approval for some or all of future industry levies being charged to asset shares to be subject to the approval of the With-Profits Committee.

An extract of relevant paragraphs from the Independent Expert Report is set out below:

Section 8.9.10 "As noted in the previous paragraph, a charge may be deducted from the asset shares of transferring with-profits policies in respect of industry levies in certain circumstances without the prior approval of the With-Profits Committee. Changes made to the Financial Services Compensation Scheme (FSCS) in April 2008 may lead to an increase in the likelihood of such levies being applied to insurance companies, and in the potential size of any levies. In particular, those changes permit costs arising under the FSCS in respect of the banking sector (for example) which exceed those which may be charged directly to companies operating within that sector to be charged to all financial services companies."

Section 8.9.11 "The draft PPFM for the Old WPSF and the New WPSF states that the current practice of charging industry levies to the inherited estates will be reviewed by

the [AVLAP] Board from time to time, and some or all of those levies may be charged to asset shares in the future. I understand from the Actuarial Function Holder that, in view of the potential for a significant increase in the amount of such levies resulting from the regulatory change, Aviva will amend the PPFM applicable to all of its UK with-profits policies to permit levies to be charged to asset shares regardless of whether either the Main Scheme or the Alternative Scheme is sanctioned.”

Section 8.9.12 “Through the operation of the RIEESA, the [AVLAP] shareholder will meet any industry levies which are to be charged to the New WPSF but not deducted from the asset shares of with-profits policies of the New WPSF. It is possible that implementation of the Main Scheme could lead to circumstances where industry levies referable to transferring with-profits policies will be charged to the asset shares of those policies, where in the absence of the reattribution they would have been charged to the inherited estates of the CGNU Life WPSF and the CULAC WPSF. The Main Scheme does not introduce any specific constraints to manage this potential conflict between the interests of holders of transferring with-profits policies allocated to the New WPSF and the [AVLAP] shareholder. However, the Actuarial Function Holder has informed me that the [AVLAP] Board has undertaken to consult with the With-Profits Committee and 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. This undertaking will be reflected in the PPFM for the New WPSF and the Old WPSF following the Effective Date. In forming its views, I would expect the With-Profits Committee to give particular consideration to the likelihood that corresponding charges would have been applied in the absence of the Main Scheme.”

The Independent Expert does comment that the With-Profits Committee when considering the issue should consider whether the charge would have been made before the Scheme was in place, and we agree with this. However, in our opinion we can see no justification for this area to be different from the process which has otherwise been agreed in relation to With-Profits Committee oversight in many areas. We thus believe that the Independent Expert could have considered the potential implications of this further, rather than placing reliance on

the Board and the With-Profits Committee's power to whistle-blow. We also note that the changes required to the PPFM in respect of these changes did not require approval by the With-Profits Committee, and we would have expected this to be the case.

We do note that the AFH report states:

Section 5.14.71 "Where a proposed policy for the management of with-profits business would give rise to a material benefit to shareholders and that benefit would not (in the reasonable opinion of the [AVLAP] Board) have arisen in the absence of the Scheme, the approval of the With-Profits Committee will be required to adopt the policy unless the [AVLAP] Board considers that it is needed to treat customers fairly."

Nevertheless we believe this to be an important enough area for the prior approval of the With-Profits Committee to be required (i.e. whether or not the AVLAP Board considers that the charge would have applied in the absence of the Scheme, or that it is needed in order to treat customers fairly).

2.01 Conclusions on the allocation of benefits amongst the relevant policyholders.

Section 1.2.18 "The basis for determining the aggregate amount of the incentive payments, and the way in which this amount will be allocated among holders of eligible policies, have been negotiated between Aviva and the Policyholder Advocate. I have reviewed the allocation approach and am satisfied that it is fair."

We note that this conclusion does not give any indication as to the Independent Expert's views on the basis for the aggregate amount of the incentive payments. However we do note that in Section 1.2.24 the Independent Expert does consider the basis on which the negotiations were based.

Section 1.2.24 “Aviva and the PHA’s team have each calculated estimates of the value of potential special distributions to holders of Eligible Policies (which Aviva refers to as the “VPDP”) which might have been made from the inherited estates of the CGNU Life WPSF and the CULAC WPSF in the absence of the Proposed Schemes. Those calculations show that, for a range of possible aggregate amounts of the inherited estates (assuming all holders of Eligible Policies accept the incentive payments offered), the total amount of incentive payments appears favourable relative to the corresponding VPDP, based on alternative scenarios for possible new with-profits business volumes. It should be noted, however, that any estimate of the VPDP is heavily dependent upon the assumptions made.”

In his report, the Independent Expert describes the approach adopted by Aviva to allocate the aggregate amount of the incentive payments among individual policyholders, which has been to assign a weighting to each Eligible Policy in order to arrive at a uniform rate of incentive payment, whilst taking into consideration the minimum payment to be made. He states in Section 4.4.30 that a range of methods which would be considered fair could have been used so long as they were applied in a consistent manner. Section 4.4 of the Independent Expert’s report goes into detail on the method used to allocate the incentive payments for the various types of policyholders, and includes any approximations that were made. The analysis done by the Independent Expert is extensive and he states that, in his opinion, the allocation is fair.

Section 1.2.19 “For certain Eligible Policies (referred to in the Main Scheme as “Additional Benefit Policies”) the incentive payments will be in the form of additional policy benefits rather than paid in cash. I am satisfied that the basis applied by Aviva to determine which Eligible Policies are Additional Benefit Policies, and the methodology which will be applied to determine additional benefits from the amount of the offered incentive for Elected Policies, are reasonable.”

For certain policies (see the Independent Expert's report section 4.5.1), the PIP would be paid in the form of an additional benefit. Here the question is whether the policyholders' PIP is being diminished in value due to the fact that it is paid in the form of additional benefits as opposed to cash. This could happen if initial charges were to be applied to the additional benefit, or if guarantees were to be diluted, which could happen if the benefits were enhanced via an increase in asset shares with no increase in guarantees, making the value of those guarantees worth less to the policyholder (the additional benefits would end up paying for part of the guarantee).

Additional benefits are not to be diminished by initial charges and the value of any guarantees are not to be reduced.

We agree with the Independent Expert's conclusions in this area.

Section 1.2.20 “The [AVLAP] Board may proportionately reduce the incentive paid to the holders of Elected Policies to reflect reductions in the degree of investment in the with-profits sub-funds as a result of changes to individual policies during the period between 24 April 2009 (one week before the date on which information to be presented to the High Court at the first hearing of the Claim Form is to be sent to the Court) and the Effective Date. This is explained in the draft provided to me of the Election Mailing Pack prepared by Aviva. I am satisfied that it is reasonable for the [AVLAP] Board to have this power.”

We understand that this clause was incorporated in the Scheme to permit the AVLAP Board to reduce the PIP paid to policyholders who make large partial surrenders leading up to the effective date to reflect the amount part-surrendered. In the event that the Board were to exercise this right, PIPs not paid out due to this clause would be reflected through the uniform uplift which may be applied to the PIP initially offered to eligible policyholders. For practical reasons, the uplift would not reflect any reduction in PIP in the month prior to the effective date of the Scheme. We agree with the Independent Expert's conclusions in this area.

Section 1.2.22 “On the basis of the information provided to me by Aviva, and after allowing for the special distribution announced by Aviva in February 2008, I consider that it is extremely unlikely that in aggregate the current generation of with-profits policyholders of CGNU Life and CULAC has collectively contributed to the inherited estates of the CGNU Life WPSF and the CULAC WPSF.”

We agree it is unlikely that the current generation of policyholders have contributed to the inherited estates. The Independent Expert has considered how current asset shares are calculated and has considered information provided by Aviva. We have come to the same conclusion in appendix 21 B, (“Contributions to the inherited estates”).

Section 1.2.23 “[The current generation of with-profits] policyholders may nevertheless expect to benefit from any distributions of the respective inherited estates which are made during the lifetime of their with-profits policies. Other than the special bonuses announced in February 2008, the amount and timing of such distributions will depend on the future experience of the funds, and the potential benefit to any individual policyholder is subject to a high degree of uncertainty.”

We agree with the Independent Expert’s conclusion, and analyses carried out by the policyholder advocate confirms that there is a positive VPDP under a wide range of possible scenarios, but that the value does clearly depend on the assumptions used.

Section 1.2.27 “In certain specified situations (see paragraph 1.3.20), aspects of the Proposed Schemes could potentially have a material adverse effect on the contingent interests in future distributions from the inherited estate of the CGNU Life WPSF and/or the inherited estate of the CULAC WPSF of those policies (wholly or partly) allocated, or

reassured, to the Old WPSF on the Effective Date. However, given the uncertainty surrounding such distributions in the absence of the reattribution, and having considered the circumstances which may give rise to these adverse effects, I do not consider that they are likely to result in material unfairness to any group of such policyholders.”

The Independent Expert is here considering whether holders of non-electing policies and ineligible policyholders of CGNU Life, CULAC and NUIL might be worse off with regards to the potential for future special distributions from the inherited estate of the Old WPSF than they would have been in the absence of the Scheme.

In Section 1.3.20 of his report, the Independent Expert has identified the aspects of the Main Scheme which could potentially diminish the interests of holders of certain policies (wholly or partly) allocated, or reassured, to the Old WPSF on the Effective Date in future special distributions from the former inherited estates of the CGNU Life WPSF and the CULAC WPSF as being:

1. the cap of £100 million applying to the reallocation of transferring assets from the RIEESA to the Old WPSF to preserve the assessed value of potential future special distributions;
2. the requirement to make a contingent loan of assets from the Old WPSF to the RIEESA if the financial strength of the Old WPSF exceeds that of the New WPSF on the Effective Date (in each case determined as specified in the Main Scheme) by more than a specified margin;
3. the provision which allows the AVLAP Board to change the allocation of future single premium with-profits increments and switches to with-profits investment under Eligible Policies so that the ‘New WPSF Proportion’ of such investments is allocated to the New WPSF and the balance is allocated to the Old WPSF, which could disadvantage holders of individual Non-Elected Policies who intend to effect such increments or switches;

4. the withdrawal of the right of transferring with-profits policies (other than Stakeholder pension policies), and existing with-profits policies of NUIL, that are not Eligible Policies, to participate in any future distributions from the inherited estate of the CGNU Life WPSF and/or the inherited estate of the CULAC WPSF (which was disclosed at the time those policies were sold), and its replacement by a corresponding right in relation to the inherited estate of the Old WPSF that is restricted to the 'Old WPSF Proportion' of the policy;
5. replacement of the contingent right of holders of hybrid policies of CGNU Life (other than Stakeholder pension policies), CULAC and NUIL which are not currently invested in with-profits to invest in with-profits under those policies, and thereby to become entitled to participate in any subsequent distributions from the inherited estate of the CGNU Life WPSF and/or the CULAC WPSF, by a corresponding contingent right in respect of the inherited estate of the Old WPSF which is restricted to the 'Old WPSF Proportion' of the policy.

On bullet point 1, the Independent Expert considers the situation where the £100million cap could make policyholders worse off and concludes that, for this to happen, the outcome of the election would need to be particularly skewed, and moreover subsequent circumstances would need to be sufficiently favourable that distributions would have been made from those inherited estates in the absence of the Main Scheme. Given the inherent uncertainty, he does not believe that with-profits policyholders invested in the CGNU Life WPSF and/or the CULAC WPSF have a concrete expectation in relation to such distributions.

We agree with the Independent Expert's conclusions, and would add that Aviva has gone to some length to ensure that the split of the inherited estate between the Old and New With-Profits sub-funds reflects as far as possible the potential distributions which transferring with-profits policyholders allocated, or reassured (to the extent that such policies are reassured), to the Old WPSF might have received in the absence of the Scheme, whilst taking security of benefits into consideration. In particular the calculations to determine the VPDP pre and post scheme for such policyholders are to be based on assumed new business volumes decreasing by 10% per annum after 2010 which would serve to increase the VPDP which would have

been calculated on the basis of Aviva's projection of growth of 5% per annum in new with-profits business volumes after 2010.

On bullet point 2, the Independent Expert notes in his report that, if the Scheme requires the contingent loan to be made, then future adverse experience of the business of the New WPSF and the RIEESA could result in the contingent loan not being repaid in full to the Old WPSF, thereby reducing the potential for future special distributions from the sub-fund. However the Independent Expert states that comparable risks exist within the CGNU Life WPSF and the CULAC WPSF at present, and does not believe this to be an issue. We agree with this conclusion and would add that if the future experience were bad enough for the loan never to be repaid then it is unlikely that policyholders would have received much in terms of future special distributions anyway.

On bullet point 3, the Independent Expert notes that the AVLAP Board may change the allocation between sub-funds of future single premium with-profits increments and switches to with-profits investment under Eligible Policies so that the 'New WPSF Proportion' of such investments is allocated to the New WPSF and the balance is allocated to the Old WPSF. He notes that it would be possible for such a change to be disadvantageous to holders of individual Non-Elected Policies who intend to effect single premium increments to, or switches to with-profits under, those policies, since this would dilute the interest which those policyholders might otherwise have had in future distributions of 'excess surplus' from the inherited estate of the CGNU Life WPSF and/or of the CULAC WPSF in the absence of the Main Scheme.

The Independent Expert goes on to state that, in his opinion, the AVLAP Board would need to consider the potential impact of any reallocation of future single premium increments and switches to with-profits in the light of the likelihood of future distributions from the inherited estate of the Old WPSF, taking into account the respective interests of policyholders who effect increments and switches and those who do not.

We agree with the conclusions made since there is no advantage or disadvantage to the shareholders to making this change, but, the power to make such a change potentially

provides protection for the interests of policyholders who do not have the option to make additional increments and switches.

On bullet point 4, the Independent Expert considers the disclosures made to the holders of transferring with-profits policies (other than Stakeholder pension policies) that are not Eligible Policies, and existing with-profits policies of NUIL that are not Eligible Policies in coming to his conclusions in this area and we agree with his conclusions.

On bullet point 5, it would be possible for this reduction in contingent right to be disadvantageous to relevant policyholders in certain circumstances. The Independent Expert bases his conclusions on the fact that potential distributions are uncertain. Given there is no advantage to shareholders either way, we agree that the replacement of this contingent right is not unfair.

Section 1.3.2 **“I am satisfied that the proposed allocation of transferring policies and transferring long term insurance liabilities between the Old WPSF, the New WPSF and the RIEESA is reasonable. I am also satisfied that the allocation of transferring long term insurance assets between the Old WPSF on the one hand, and the New WPSF and the RIEESA on the other hand, is fair. In the light of the current role of the inherited estates of the CGNU Life WPSF and the CULAC WPSF, I consider the requirements under the Main Scheme regarding the provision of capital support by the RIEESA to the Old WPSF and the New WPSF to be appropriate.”**

In arriving at the conclusions set out above, the Independent Expert considers in detail (in sections 5, 8 and 9) how the transferring policies, assets and liabilities are to be allocated. The Independent Expert considers the consistency between the liabilities transferred and the assets being transferred to ensure fairness. He has placed reliance upon the effective operation of the governance arrangements set out in the Main Scheme, the AFH report and the WPA report in coming to his conclusions.

We agree with the Independent Expert's conclusions in this area and this is considered in more detail in our comments on the AFH report.

Section 9.6.21 “I am satisfied that it is reasonable for the distribution of the Old WPSF Bonus Amount to be at the discretion of the [AVLAP] Board.”

This conclusion is not repeated in the summary as it is not viewed by the Independent Expert as a key conclusion. We disagree with his conclusion: we believe that the distribution methodology should be set out in the Scheme and, subject to the level of solvency in the Old WPSF being sufficient, should be paid out in line with a pre-determined formula. This is to ensure that, if the experience turned out as expected, the policyholders who under those circumstances would have received a certain distribution pattern would be in broadly the same position as if the reattribution had not happened. Clearly this cannot be guaranteed, but it avoids the situation of the distribution being potentially delayed. Given that there is no advantage to shareholders either way, we see no reason for there not to be a more formal process. We do however believe that it is highly unlikely (given current market conditions) that there will be a need for a Old WPSF bonus amount to be set up since the inherited estates would need to increase significantly for this to be an issue. We therefore agree that this is not a key conclusion for the Independent Expert.

We note that in his report the Independent Expert confirms that the statements which appear in bold in this report apply in particular (and where relevant) to the French, German and Irish branch business of CGNU Life, and for the Jersey and Guernsey business of CGNU Life, CULAC, NUL(RBS), NUIL, AVLAP and NUA. We agree that similar considerations apply.

2.02 Comments on other conclusions.

Section 1.3.15 “The Main Scheme, the AFH’s report and the WPA’s report set out principles and practices applying to the future investment policy of the assets backing the Non-Core Amount¹ and the RIEESA. These

¹ The Non-Core Amount represents those assets of the RIEESA which have been loaned to the New WPSF on a contingent basis in accordance with the Main Scheme. Such assets will ultimately be repaid to the RIEESA to the extent to which they are not required to meet liabilities of the New WPSF.

require the [AVLAP] Board to give due consideration to the risk that the investment policy could be detrimental to the expectations of holders of policies allocated, or reassured, to the Old WPSF, the New WPSF or the Stakeholder WPSF, by reducing the available capital support. Investment in most types of asset involves risk and, as is currently the case, there can be no guarantee that adverse outcomes will be avoided. However, I consider the restrictions applying to investment of the assets backing the Non-Core Amount and the RIEESA in non-profit business, Aviva Group companies and strategic assets to be appropriate in order to limit the concentration of risk in these specific areas.”

We agree with the conclusion that the restrictions applying to the investment of the assets backing the Non-Core Amount and the RIEESA in non-profit business, Aviva Group companies and strategic assets are appropriate. We do however believe that there should be no investments of strategic assets in the Old WPSF.

Section 1.2.4 “Based on the financial position of the companies as at 31 December 2008, in my opinion current policyholders of CGNU Life, CULAC, NUL(RBS), NUIL, [AVLAP] and NUA will not experience a significant reduction in the level of security for their guaranteed benefits as a result of the Schemes.”

Here, the Independent Expert is considering the effect of the Scheme on policyholders’ guaranteed benefits, rather than whether the *total* expected benefits will differ before and after the Scheme. The Independent Expert is, amongst other things, therefore considering whether the excess assets in the long term insurance fund and shareholder net assets are affected by the Scheme.

The principal consequences of the Proposed Schemes which may impact security and which are highlighted by the Independent Expert’s report will be:

- to incorporate and combine the with-profits sub-funds of CGNU Life and CULAC into [AVLAP] and to allocate transferring policies between the Old WPSF and the New WPSF;
- to effect a reattribution of a proportion of the inherited estates of the CGNU Life WPSF and the CULAC WPSF to the RIEESA and of particular concern is the potential for shareholders to reduce the security of the funds over time via distributions from the RIEESA;
- to affect the amount of free assets available to support the solvency of [AVLAP].

The Independent Expert makes specific reference to the financial position as at 31 December 2008 and will update his conclusions when further data is available. Given the current volatility of the market, and since the investigations that are required to assess the impact on security would use the most current financial position as a starting point, it is appropriate for the Independent Expert to reference the date on which the conclusion was based.

Although the conclusion stated in section 1.2.4 of the Independent Expert's report does not directly concern the allocation of benefits between with-profits policyholders, it does refer to whether the implementation of the Scheme might adversely impact the guaranteed benefits of policyholders in a material way, and therefore we include our comments on the Independent Expert's conclusions here.

In arriving at his conclusions, the Independent Expert has placed reliance upon the effective operation of the governance arrangements which will be in place. In particular the Independent Expert has placed reliance on the fact that the Main Scheme requires the AVLAP Board to manage the Old WPSF, the New WPSF and the RIEESA with the objective of maintaining adequate financial strength for these subfunds, and this includes restrictions around the releases of capital to the AVLAP shareholder from the RIEESA. In addition, the FSA regulations on statutory solvency requirements must be adhered to.

Section 7 of the Independent Expert's report sets out the basis for his conclusion in detail.

The Independent Expert considers the impact of transferring the with-profits sub-funds of

CGNU Life and CULAC to AVLAP, which will expose the business of each of those sub-funds to the risks arising from the existing business of AVLAP and vice versa. He considers the strength of the with-profits sub-funds of CGNU Life and CULAC, and the with-profits sub-funds and non-profit sub-funds of AVLAP, as at 31 December 2008, based on statutory solvency positions and on their ICA. He also considers the nature of the assets backing the capital position, the risk of AVLAP security reducing through a variety of reasons including the sale of non-profit business and shareholders extracting money. In concluding that the risk of AVLAP security reducing materially as a result of the implementation of the Scheme is not an issue, the Independent Expert considers, amongst other things, the operational requirements for the existing sub-funds of AVLAP and concludes that they are in all material respects incorporated into the Main Scheme.

We agree with the Independent Expert's conclusions and have no additional comments to add.

Section 1.2.10 “No group of policyholders transferring to [AVLAP] or group of existing policyholders of NUIL will experience a material reduction in reasonable benefit expectations as a result of the Schemes. This does not take into account the scope for future special distributions from the inherited estates of CGNU Life and/or CULAC. I consider that there are no aspects of the Main Scheme which would be likely to result in material unfairness to any group of policyholders”

Here, the Independent Expert is considering the effect of the Scheme on policyholders' total expected benefits excluding any potential benefit from distributions from the inherited estates of the CGNU Life WPSF and the CULAC WPSF. Broadly, the Independent Expert is concerned that the approach to determining asset shares is not impacted (since most with-profits payouts are determined by reference to asset shares), and the Independent Expert considers, amongst other things, the approach to investment and smoothing.

Although this conclusion does not directly concern the allocation of benefits between with-profits policyholders, it does refer to whether implementation of the Scheme is expected to have a material adverse effect on the expected total benefits of policyholders, and this is an

area the policyholder advocate has considered herself. Therefore we are including our comments on the Independent Expert's conclusions here.

In coming to his conclusions, the Independent Expert explains that in most respects the Old WPSF will operate in the same way as the CGNU Life WPSF and the CULAC WPSF currently operate, but that a different structure will apply to the New WPSF. The reattributed inherited estate will be allocated to the RIEESA and will be available to meet liabilities of the New WPSF, and in certain adverse circumstances those of the Old WPSF, but any amount not required to meet those liabilities will eventually be paid to the AVLAP shareholders.

Where payouts under with-profits policies of the New WPSF exceed the corresponding asset shares because of the applicable guarantees, that excess will be met from shareholder resources.

In coming to his conclusions, the Independent Expert notes that the structure of the New WPSF gives rise to greater potential for conflict between the interests of with-profits policyholders and the interests of shareholders than currently exists within the CGNU Life WPSF and the CULAC WPSF, and it is these conflicts of interest which could have an impact on the total expected benefits for policyholders. We agree with this assessment.

The Independent Expert has stated that, in order to manage this potential conflict, and to protect the interests of transferring with-profits policyholders, the Main Scheme, the AFH report and the WPA report specify principles and practices relating to:

- the investment policy to be adopted for the assets backing asset shares, the future calculation of asset shares and the determination of payouts for transferring with-profits policies allocated to the New WPSF (which also apply to corresponding policies of the Old WPSF);
- the investment policy that may be adopted for the reattributed inherited estate, and
- the determination of amounts in the RIEESA that can be released to the AVLAP shareholder.

The Independent Expert has also reviewed the governance arrangements around the above principles and practices. Sections 6, 8, 9 and 10 of the Independent Expert's report considers the governance arrangements in detail, both internal (such as the PPFM, with-profits reference documents), and external (such as FSA rules), around the asset share calculations and the investment strategy, including management actions. The Independent Expert bases his conclusions on these governance arrangements.

We agree with the Independent Expert's conclusions set out above in terms of policyholders' reasonable benefit expectations (excluding potential distributions from the inherited estates).

Section 1.3.3 “On the basis of the financial strength of the CGNU Life WPSF and the CULAC WPSF at 31 December 2008, and the requirement under the Main Scheme to manage the with-profits business of the Old WPSF and the New WPSF as if those sub-funds and the RIEESA formed part of one with-profits sub-fund, I am satisfied that the benefit expectations of holders of with-profits policies allocated, or reassured, to those subfunds will not be materially adversely affected by the combination and subdivision of the two sub-funds as effected by the Proposed Schemes.”

This conclusion logically follows on from the other conclusions set out by the Independent Expert and we are in agreement with these conclusions.