

Report Number 22 A

## Qualification for the Pre-Reattribution Distribution

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

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

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Appendix by: Aviva UK Life – June 2009

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## 1.00 Context

As part of the operation of the risk appetite framework (RAF) for the CGNU Life and Commercial Union Life Assurance Company (CULAC) with-profits funds, the Board periodically considers whether there is excess capital in the funds, by reference to the RAF. If there is, it then considers what actions it should take with the excess capital in the circumstances. One of those actions could be a special distribution to policyholders and shareholders. This is viewed as a 'business as usual' process and therefore independent of the policyholder incentive payment (PIP) negotiations.

In February 2008 Aviva announced that over the next three years they would be awarding special bonuses worth an estimated £2.1 billion to qualifying with-profits policyholders.

This became possible as a result of changes made in the way Aviva manages the with-profits funds. These changes reduced some of the investment risks, which resulted in less money needing to be set aside to cover such risks.<sup>1</sup>

As a result of the special bonus announced in February 2008, at the time of the reattribution offer, the Board (in consultation with the majority independent With-Profits Committee) considers that the funds do not have excess capital.

Special distributions (also sometimes referred to as special bonuses) are only awarded in exceptional circumstances. The qualification criteria are determined based on the circumstances at the time of announcement. As a result it should not be assumed that qualification criteria for any special distributions in the future will be the same as those set out in this paper.

A sample copy of the leaflet "Special bonus – your questions answered" dated February 2008 is included in Annexe A to this document.

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<sup>1</sup> The change in investment strategy is an aspect which could be viewed as blurring the boundary between the reattribution and distribution, since the decision to change investment strategy and its effect on the amount of money which needed to be set aside in the fund could be perceived as being a consequence of the method of assessing fairness planned by the FSA for the reattribution. Nevertheless, the assessment of the excess surplus – in line with Conduct of Business Sourcebook (COBS) rules – is a business as usual process which, in early 2008, following the change to investment strategy, brought about the announcement of the special bonus.

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## 2.00 Qualification for the Special Distribution

The key value in our thinking is that all Aviva customers are treated in a fair and open fashion. We also take into account any legal constraints. On this basis, qualification for the announced special distribution was defined as:

- Any with-profits policy within the CGNU Life and CULAC funds which was in force on 1<sup>st</sup> January 2008 qualifies for the first special distribution payment
- With-profits policies in the CGNU Life and CULAC funds which were in force on 1<sup>st</sup> January 2008, and remain invested in the same fund until 1<sup>st</sup> January 2009<sup>2</sup> qualify for the second special distribution payment
- With-profits policies in the CGNU Life and CULAC funds which were in force on 1<sup>st</sup> January 2008, and remain invested in the same fund until 1<sup>st</sup> January 2010<sup>3</sup> qualify for the third special distribution payment
- If the policy ends for any reason, or is switched to another fund before any of these qualification dates, qualification ceases
- The special distribution qualification criteria take no account of policyholders' eligibility for the reattribution
- As any decision to distribute a part or all of the inherited estate is taken based on the risk appetite for the funds with the full involvement of the With-Profits Committee, it is not contingent on the reattribution going ahead

Further detail is given in the leaflet "Special bonus – your questions answered" dated February 2008, a copy of which can be found in Annexe A.

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<sup>2</sup> For the avoidance of doubt, this is unaffected by the proposed Part VII fund transfer to AVLAP

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### 3.00 Special Distribution Allocation

Special distributions cannot in practice be paid in cash to policyholders (because of practical considerations including legal and tax constraints). Depending on the type of policy, the special distribution will be added as follows:

- Unitised investments in the with-profit fund and with-profit income fund (e.g. investment bonds) - added to eligible policies and converted into extra units
- Other investments in the with-profit fund, (e.g. most endowment policies) - added to total annual bonus for the year in which it is applied

Further detail is given in the leaflet "Special bonus – your questions answered" dated February 2008, a copy of which can be found in Annexe A.

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## 4.00 Aviva's View of the Policyholder Advocate's Approach

### 4.01 Alignment of Eligibility Criteria

The appendix "Qualification for Pre-Reattribution Distribution" drafted by the Office of the Policyholder Advocate suggests that the distribution and reattribution are in substance part of the same transaction for Aviva and that accordingly there would have been merit in aligning the eligibility criteria for a special distribution and the reattribution.

Aviva does not concur with this statement for the reasons set out below:

- Very different principles and processes are involved in a special distribution and a reattribution
- In accordance with COBS, special distributions are part of the annual bonus review process as part of business as usual practice. A reattribution is a one-off, discretionary transaction
- Unlike a reattribution, a special distribution involves monies leaving the inherited estate with consequent potential impact on both fund security and investment flexibility, as well as on the funds' Risk Appetite Framework (RAF). Accordingly the two processes are managed and governed differently.

Some of those eligible for the reattribution may no longer have been policyholders at the time of declaring the special distribution. The Board is unable to make a distribution to this group of customers because distributions from the with-profits funds can in practice only be made to policyholders in that fund. As a result eligibility for the reattribution and a special distribution cannot be aligned.

Section 4.05 of the paper titled "The Pre-Reattribution Distribution" drafted by Aviva provides further explanation on why the special bonus could not be backdated to the reattribution announcement date.

#### 4.01.01 Board discretion

Decisions on whether it is appropriate to distribute any excess surplus, or not, are based on the RAF and taken by the Boards following regular reviews, discussion and advice from the With-Profits Committee.

If a decision is taken, any such special distribution can only be allocated to policyholders in the fund at the time. This has been confirmed by legal advice taken by the Boards.

The Boards announced the timing of the special distribution payments and consequent qualification in February 2008.

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#### **4.01.02 Alternative approaches to achieve alignment**

The Office of the Policyholder Advocate suggested that provision could be made in the Scheme to enable those eligible for the reattribution but who do not qualify for the special distribution to become eligible for the special distribution. This group would be those policyholders whose policies terminated prior to 1<sup>st</sup> January 2008. From a reattribution perspective, these policyholders will benefit from the reattribution offer even though they have no rights to potential future distributions to give up in return for the PIP. They could therefore be viewed as receiving a special bonus. In addition, since consideration of surplus for distribution is an annual, 'business as usual' process in accordance with COBS, asking the Court to change this is not an approach which Aviva accepts.

An alternative suggestion from the Office of the Policyholder Advocate was that part of the aggregate level PIP could be set aside to redress the balance and in effect pay an increased proportion of the PIP to those policyholders falling into this category. Whilst this sentiment is laudable, Aviva is concerned that such an approach would unfairly reduce the amount of PIP available to remaining policyholders. Such an approach would also increase the risk of misalignment of the allocation of the inherited estate between the Old With-Profits Sub-Fund (OWPSF) and Reattributed Inherited Estate External Support Account (RIEESA); and the allocation of the PIP, which would be unacceptable to shareholders. Reattribution and special distribution are two distinct and separate processes that are applied to the with-profits fund, although the impact of any distributions have to be taken into account as part of the reattribution.

At the time of writing this appendix there is no excess surplus in the funds of CGNU Life and CULAC and this was also the case at the reattribution announcement day in November 2006 (A-day). As a consequence there is no justification for allocating any part of the special distribution to policies that have terminated since A-day, and no need to align the eligibility of the distribution and reattribution.

Section 4.05 of the appendix titled "The Pre-Reattribution Distribution" prepared by Aviva provides further clarification on reasons for and timing of the emergence of the excess surplus. This appendix also explains why the special bonus could not be backdated to the reattribution announcement date.

#### **4.02 Phasing of the Distribution**

The Office of the Policyholder Advocate has challenged the fairness of phasing the special distribution over three years. The arguments are also repeated in their appendix titled "The Pre-Reattribution Distribution".

Aviva's rationale for the phasing of the announced special distribution has been explained through a number of media, including policyholder communications and submissions to the Treasury Select Committee inquiry on inherited estates. Our views on the Policyholder Advocate's approach to this topic are covered in our own appendix on the subject of "The Pre-Reattribution Distribution" and not here.

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## **Annexe A – “Special bonus – your questions answered” leaflet and covering letters to policyholders**