

Appendix 30 B

With-profits governance arrangements

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

1.01. Objectives

The purpose of this Appendix is to comment on the approach of Aviva as set out in its governance appendix and to set out the views of the policyholder advocate on the appropriate structure for the governance of the with-profits funds under Aviva's scheme for the reattribution and transfer of certain of its long term insurance funds (the *Scheme*).

1.02. Conflicts of interest

The operation of with-profits business inevitably gives rise to conflicts of interest between policyholders and shareholders (and between different groups of policyholders). The reattribution will itself give rise to additional conflicts or exacerbate existing conflicts, including for example in relation to:

- (a) the availability of capital support from the non-profit sub-funds to support the with-profit sub-funds;
- (b) the release of reattributed inherited estate;
- (c) consistent management of the old with-profit sub-fund¹ and the new with-profit sub-fund; and
- (d) how expenses and other liabilities are allocated to the various sub-funds of Aviva Life & Pensions UK Limited (*AVLAP*).

Accordingly, given the potential for conflicts and the complexity of the reattribution and fund transfer arrangements for Aviva, it is clearly important that Aviva has a corporate governance framework that recognises and protects the interests of all interested parties.

¹ i.e. the sub-fund into which policyholders who do not elect to receive a reattribution policyholder incentive payment will be transferred.

2.00 Elements of a governance framework

The governance arrangements will in practice comprise a number of elements including the roles of various bodies (the Board, the With-Profits Actuary, the Actuarial Function Holder, the With-Profits Committee (*WPC*) and the Financial Services Authority (*FSA*)) as well as matters specified in certain documents (principally the Scheme and the applicable PPFM²). The policyholder advocate has commented separately on the relevant documents and this paper focuses on how the management of the with-profits business should be governed following the reattribution (including but not limited to compliance with the Scheme and the PPFM) to ensure that policyholders' rights, interests and reasonable expectations are protected and that policyholders are treated fairly.

2.01. Board of directors

Fundamentally, the governance of all of an insurer's funds is the responsibility of the board of directors of the company (the *Board*), subject to the requirements of applicable law and regulation. An insurer is subject to regulatory requirements under FSA rules including, for example, the obligation to treat customers fairly and a director must take reasonable steps to ensure that the business for which he is responsible complies with applicable regulatory requirements. There are also specific FSA requirements for the governance of with-profits business which are considered below. Under company law, however, the primary duty of the Board is to promote the success of the company for the benefit of its shareholders as a whole³ and it is therefore necessary to have a robust counter-balancing mechanism which ensures that policyholders' rights and interests are protected.

2.02. FSA

The FSA also has an indirect role in governance which is essentially to establish an appropriate regulatory framework. This is considered further in section 3.00 below.

² Principles and Practices of Financial Management.

³ Companies Act 2006, s172.

2.03. Actuaries

A life insurer is required under FSA rules to appoint an Actuarial Function Holder (*AFH*) and also (for with-profits business) a With-Profits Actuary (*WPA*). These actuaries are required to take steps to ensure that they are free from bias and they also have a statutory duty to report certain matters to the FSA. The actuaries also have a part to play in governance. The role of the AFH spans all of the long-term insurance business of an insurer and is primarily to advise the Board of the risks the firm runs in so far as they may have a material impact on the firm's liabilities to policyholders. The role of the WPA includes:

- (a) advising the firm's management on key aspects of the discretion to be exercised affecting those classes of the with-profits business of the firm in respect of which he has been appointed; and
- (b) preparing an annual report addressed to the relevant classes of the firm's with-profits policyholders as to whether, in his opinion and based on the information and explanations provided to him by the firm, and taking into account where relevant the rules and guidance in COBS 20, the discretion exercised by the firm in respect of the period covered by the report may be regarded as taking, or having taken, the interests of the relevant classes of the firm's with-profits policyholders into account in a reasonable and proportionate manner.

FSA guidance states that firms should normally obtain advice from the WPA whenever they are preparing to make key decisions based on the exercise of discretion affecting their with-profits business and in providing such advice the WPA should consider the implications for the fair treatment of the relevant classes of the firm's with-profits policyholders.

3.00 FSA requirements for governance of with-profits business

The primary requirement under FSA rules is in SYSC 3.2.6R which provides that "...a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system ...".

COBS 20.3.2G and 20.3.3G (summarised in Annexe 1 to this Appendix) provide guidance on

how a firm should discharge this requirement in relation to with-profits governance. They provide specifically that the governance arrangements should involve some independent judgment in the assessment of compliance with the PPFM and how any competing or conflicting rights and interests of policyholders and, if applicable, shareholders have been addressed.

From a policyholder perspective, the policyholder advocate believes that the governance arrangements set out in the guidance in COBS should be regarded as minimum requirements and that tighter governance controls are likely to be appropriate in various respects.

3.01. The With-Profits Committee

A WPC is the common way of achieving this independent judgment in large life insurance companies - in his address to the Institute of Actuaries Annual General Meeting on 25 September 2006, Nick Dumbreck noted the move towards WPCs for larger companies but also stated that he was not convinced that the balance of committee membership is sufficient to ensure Treating Customers Fairly and advocated a majority of independent members on the WPC. The Financial Services Consumer Panel makes a similar point in its 2005/2006 Annual Report.

3.02. Alternative structures

However, as the FSA guidance in COBS 20.3 indicates, a WPC is not the only possible governance structure which can be used. Indeed, until July 2007, Aviva relied on an independent expert who reported to a WPC (which at that stage did not have independent members). In July 2007, a more independent WPC was introduced but still using the services of an independent expert to report to the WPC.

It would also be possible to establish mechanisms for more direct policyholder influence such as having a policyholder representative on the Board of directors. The FSA has also considered more fundamental changes to the structure of with-profits governance, including whether company law could be modified so that directors would have a statutory duty to have regard to policyholders' interests and whether policyholders could be given a beneficial

interest in the with-profits assets. These proposals are discussed in more detail in another Appendix⁴ and are not considered further here.

3.03. With-profits actuary

There is also clearly a significant overlap between the roles of a WPC and that of the WPA described above. In particular, both are required to consider the exercise of discretion by the firm in relation to its with-profits business and both must also have some degree of independence from the company's management. This gives rise to the question of the extent to which the WPA can be relied on to provide the necessary protection of policyholders' interests and by implication that the role of the WPC is arguably less important. However, since the WPA is an officer of the company and will generally provide an actuarial view of the management of the with-profits business, it would not in the policyholder advocate's view be appropriate to compromise the role of the WPC on the basis that the WPA can be regarded as providing a sufficiently broad and independent oversight.

3.04. Scope of the policyholder advocate's comments

The remainder of this Appendix focuses on how the constitution and role of a WPC can be optimised from the perspective of safeguarding policyholders' interests and also contains the policyholder advocate's comments on Aviva's governance proposals. The policyholder advocate has commented separately on governance matters to the extent that they are contained in Aviva's PPFM and in the Scheme effecting the transfer and reattribution of the relevant with-profits funds.

4.00 Aviva's proposals in relation to the With-Profits Committee

4.01. General

Aviva's governance proposals are summarized in its Governance appendix.

In the "Context" section of its paper, Aviva explains that a key consideration is that "the funds will continue to be run after implementation of the Scheme and reattribution in a way that is

⁴ Appendix 12: Economics, governance and regulation.

consistent with how they were run before the reattribution”. The policyholder advocate accepts that this approach is in principle appropriate but notes that:

- (a) it is subject to the changes which will be made under the Scheme (including, for example, specific matters prescribed under the Scheme for which WPC approval is required); and
- (b) the principle of carrying forward existing practices in relation to running the funds does not justify continuing practices which the policyholder advocate regards as unfair (and on which she has commented separately – see Appendix 26: FSA guidance letters and responses).

4.02. Aviva’s proposal for the role of the WPC

The Aviva appendix summarises the role of the WPC (at paragraph 6.02) which includes, among others, a requirement on the WPC to:

- (a) consider, and provide the AVLAP board with an independent assessment of AVLAP’s compliance with the relevant PPFM and how any competing rights and interests of policyholders and, if applicable, shareholders have been addressed; and
- (b) provide a formal response to any issue on which the AVLAP board has requested the view of the WPC and to report to the Board on any matters of significance arising from the WPC’s work.

For the reasons given by the policyholder advocate in section 5 below, the policyholder advocate considers that the role of the WPC may not have the right focus⁵. The policyholder advocate also notes that in a letter from the FSA to the CEOs of with-profits insurers⁶, the FSA states:

⁵ Aviva’s terms of reference for the WPC are not attached to its governance appendix; the policyholder advocate has based her comments on the most recent draft of the terms of reference provided to her by Aviva.

⁶ Letter from Sarah Wilson to the CEO’s of insurers that provide with-profits funds dated 19 September 2007.

“We found that some firms’ arrangements aim to comply with our guidance (i.e. monitoring compliance with the PPFM) rather than thinking about the broader outcome that the governance arrangements are intended to achieve in terms of Principle 6 (treating customers fairly) and Principle 8 (managing conflicts of interest). As a result, in some firms the range of issues referred is more limited than we would expect it to be.”

There are certain other matters relating to the operation of the WPC in respect of which Aviva has declined to adopt the policyholder advocate’s suggestions and these are noted in the text below and summarized in Annexe 2.

It is also noted that there are a number of respects in which the terms of reference proposed for the WPC are broader than the role of the WPC contemplated under Aviva’s Scheme⁷ and the policyholder advocate is unclear as to the reason for this. Aviva’s view is that the Scheme is not intended to replicate the terms of reference.

5.00 Role of the With-Profits Committee

The governance arrangements for with-profits business contemplated by the guidance in the FSA rules at COBS 20.3 focus on an assessment of the firm’s compliance with the PPFM and how any competing rights and interests of policyholders and, if applicable, shareholders, have been addressed.

Limiting the role of the WPC to considering compliance with the PPFM (and the Scheme) and how competing interests have been addressed does not in the policyholder advocate’s view go far enough to address the conflicts inherent in the management of with-profits business or to ensure that policyholders are treated fairly (and the FSA letter referred to in paragraph 4.02 above suggests that the FSA now takes this view). This is because in considering an exercise of discretion in the context of compliance with the PPFM, the WPC would only have to consider whether the exercise of discretion was reasonable in the circumstances and there may well be a range of such decisions. The WPC would not, either

⁷ See Scheme Schedule 4, Part 4.

in this respect or in a consideration of how competing interests have been addressed, necessarily be testing whether the exercise of discretion was fair from the perspective of the interests of with-profits policyholders.

The policyholder advocate believes that the remit of the WPC should therefore include the consideration of policyholders' rights and interests and exercises of discretion by AVLAP more generally and a requirement to regard themselves as the policyholders' representatives in this respect, and not, in contrast to the AVLAP Board, as representatives of the company. That is not to say they should ignore the existence of the shareholders' rights and interests, but in making judgments as to whether shareholders' and policyholders' rights and interests have been properly weighed, as against each other, they should see themselves accountable only to policyholders and not to shareholders.

Accordingly:

- (a) the primary role of the WPC should be generally to monitor the management by the Board of the relevant with-profits funds to determine whether or not in the opinion of the WPC:
 - (i) the funds are managed in a way which is consistent with the rights, interests and reasonable expectations of with-profits policyholders; and
 - (ii) with-profits policyholders are treated fairly;
- (b) in carrying out its role, including considering how any competing interests of policyholders and shareholders have been addressed, the WPC's role should be only to ensure that the rights, interests and reasonable expectations of with-profits policyholders are met and that they are treated fairly, in contrast to the broader remit of the AVLAP Board⁸.

⁸ There are in fact precedents for committees being established to consider only the interests of policyholders. For example, the Monitoring Board established under the AXA reattribution scheme (which is required to have regard solely to the interests and reasonable expectations of the holders of "Monitored Policies") and the supervisory boards established

Aviva does contemplate the role of its WPC will extend beyond the guidance in COBS 20.3 and in particular the WPC terms of reference provide that the WPC can report to the FSA if it believes that the Board is not treating with-profits policyholders fairly. The WPC terms of reference also provide that the WPC will report to the Board on compliance with the Scheme. Since the application of various provisions of the Scheme is expressly stated (in the Scheme itself) to be subject to the fair treatment of policyholders, the WPC does therefore in this respect have a remit to review fairness. However, Aviva's WPC terms of reference do not reflect the proposals set out above relating to the accountability and focus of the WPC.

The policyholder advocate notes that the Treasury Select Committee also supports a wider role for the WPC. In its report on inherited estates the Committee stated⁹ that:

“We see a good deal of merit in the proposal that With-Profits Committees consider the principle of Treating Customers Fairly as well as checking the firm's compliance with its own Principles and Policies [sic] of Financial Management. It is important that With-Profits Committees have such a strong, clear commitment to protecting and promoting policyholder interests, so the Financial Services Authority should consider consulting on whether such a role should be granted to With-Profits Committees. Efforts must also be made by firms to raise the visibility of With-Profits Committees, to reassure policyholders that their interests are being represented and protected. This could mean, for example, With-Profits Committees having their own dedicated website, linked to the relevant firm. We will continue to monitor the performance of With-Profits Committees during our ongoing scrutiny of the Financial Services Authority.”

5.01. Company law considerations

A WPC is often constituted as a sub-committee of the Board which in practice means that it should have at least one member who is a director¹⁰. However, in the context of the role the

to consider matters relating to the former mutual businesses of Scottish Amicable, National Provident Institution and National Mutual.

⁹ House of Commons Treasury Committee, Twelfth Report of Session 2007-08, Inherited Estates at paragraph 101.

¹⁰ This is the common law position as reflected in Article 72 of the Table A articles of association.

policyholder advocate envisages for the Aviva WPC, the policyholder advocate's view is that it will not be appropriate for AVLAP directors to sit on the WPC and therefore that the WPC should be independent of the Board; this is indeed what Aviva propose¹¹. The reason the policyholder advocate considers it inappropriate for a director to sit on the WPC is that the director would be exposed to acute (and apparently irreconcilable) conflicts of interest since:

- (a) in the capacity of director the person would be bound to comply with his/her statutory duties as a director of AVLAP to act in the best interests of the shareholders of AVLAP as a whole; whereas
- (b) in the capacity of WPC member he/she would be required to safeguard the interests of policyholders.

These conflicts would not however arise in relation to the appointment to the WPC of an officer of AVLAP who was not a director. The policyholder advocate assumes that in practice AVLAP would in any event generally not appoint board directors to the WPC but would instead appoint other senior officers of the company. At the date of this report, no member of the WPC is a director of AVLAP.

We note that the FSA did consider the possibility of an independent WPC in the context of its with-profits review, but its guidance now contemplates that the WPC will be a committee of the board. However, that does not mean that a company cannot establish a WPC which is independent of the board – particularly where this leads, through more robust governance, to greater protection of policyholder interests.

We have also considered, from AVLAP's perspective, whether it is appropriate for the Board to restrict its freedom of manoeuvre by delegating any of its powers to an independent body. We think this must depend on the extent of the delegation and it would in our view be open to directors in the context of a with-profits business to delegate a power of veto to such a body in respect of matters which may have a material impact on with-profits policyholders. We note in this respect that in carrying out his/her duty under section 172 of the Companies Act 2006

¹¹ See Scheme Schedule 4, Part 4, paragraph 3.

(to act in the way he/she considers would be most likely to promote the success of the company for the benefit of its members as a whole) a director is required to have regard to “the need to foster the company’s business relationships with suppliers, customers and others....” (which would of course include the policyholders of AVLAP).

The position might well be different if the Board sought to delegate executive authority to a WPC, but the policyholder advocate does not advocate that the WPC should have the power to take executive decisions on behalf of the Board. The primary responsibility for the management of the business should properly remain vested in the Board and it is unlikely to be appropriate (or acceptable to the FSA) for this responsibility to be delegated to an independent committee. We also suspect that prospective independent committee members may be reluctant to assume an executive role in the management of the with-profits business.

5.02. Veto rights

WPCs do not invariably enjoy a power of veto over Board proposals relating to the with-profits business – for example, it would appear from the published terms of reference for the Friends Provident and Standard Life WPCs that they do not have a veto¹². The policyholder advocate notes that Aviva has specified certain matters under the Scheme for which WPC approval is required¹³. Aside from these specific matters, the policyholder advocate does not believe that the WPC should, as a general matter, be required to approve the exercise of discretion by the Board in relation to the management of with-profits funds; rather its role should in essence be as a reviewing body coupled with a power to “whistle blow” to policyholders and the FSA in appropriate circumstances.

WPC approval should however be required in the view of the policyholder advocate in relation to changes proposed by the Board to the with-profits governance structure and in particular:

¹² Friends Provident - <http://www.friendsprovident.co.uk/common/layouts/subSectionLayout.jhtml?pageId=fpcouk%2FSitePageSiuple%3Awith+profits+au#f1f>
Standard Life - <http://www.standardlife.co.uk/content/policy/withprofits/index.html>.

¹³ Comments on specific matters requiring WPC approval have been made to Aviva by the policyholder advocate and her advisers in the context of her comments on the Scheme and the PPFM.

- (a) changes to the WPC terms of reference (as to which see section 7.00 below); or
- (b) material changes to the PPFM (i.e. approval not for the exercise of Board discretions contemplated in the PPFM but for changes to the PPFM itself).

In default of such approval, the Board should not be permitted to carry out or otherwise proceed with the relevant proposal. Aviva has not adopted this suggestion generally (although the policyholder advocate does acknowledge that in relation to changes to the PPFM, the PPFM provides that where PPFM practices (rather than principles) “reflect principles in the Scheme no changes will be made to those Practices unless the With-Profits Committee has confirmed that the revised PPFM does not materially and adversely change the effect of the Scheme on policyholders and that it is in conformity with the Scheme Principles of Financial Management”).

The WPC should not of course withhold its approval unreasonably (but it would have reasonable grounds where it reasonably believes that the Board’s proposal is not consistent with the rights, interests, reasonable expectations and fair treatment of policyholders). Since the WPC would in respect of at least some matters enjoy a power of veto, a dispute resolution mechanism should be incorporated to deal with disputes between the WPC and the AVLAP Board. The policyholder advocate notes that Aviva proposes a mediation and arbitration mechanism and that this seems appropriate.

5.03. Power of WPC to make recommendations

The WPC should have the power to initiate its own reviews of the management of the with-profits business (including changes to the PPFM and the Scheme) and to make related recommendations to the Board. If the Board declines to follow any such recommendation, the Board should be required to give a reasonable written explanation to the WPC as to why it has not done so. This proposal is not fully reflected in Aviva’s WPC terms of reference although it is stated that the WPC can report to the Board on “any matters of significance arising from its work”.

5.04. Is one WPC appropriate?

Given the complexity of the AVLAP fund structure following the reattribution it might be appropriate to have more than one WPC (e.g. one WPC for each with-profits sub-fund). However, given the inevitable overlaps which would then arise between the roles of the different committees (and the potential practical difficulties and costs of staffing multiple committees) the single WPC model proposed by Aviva seems on balance the most appropriate structure. However, given that conflicts may arise between policyholders in different sub-funds, it will also be important that the committee is required and permitted to take such measures it considers appropriate (including seeking external advice in appropriate circumstances) to manage any conflict which may arise as between the interests of the policyholders in different funds.

6.00 Composition of With-Profits Committee

6.01. Independent vs. non-independent members

The WPC should have an element of independence. While it would be possible to have a WPC comprised solely of individuals who are independent of the Aviva group, such a committee may have insufficient knowledge of AVLAP's business to be able to function effectively. It is likely to be more appropriate to achieve a balance between independent members (who though independent will have, at least initially, a limited knowledge of AVLAP's business) and non-independent members (who will have a detailed knowledge of the business). In the policyholder advocate's view the appropriate balance is achieved by requiring that the WPC has a majority of independent members as Aviva proposes.

Independent members should not hold any office within the Aviva group nor should they have acted recently in any executive, non-executive or management capacity for any group company. The policyholder advocate notes that Aviva's eligibility criteria do not expressly exclude the appointment of a former Aviva group non-executive director as an independent member of the WPC.

It would be possible to require policyholder representation on the WPC although that may give rise to significant practical difficulties around selection and appointment of a suitable policyholder and it may be difficult for a policyholder to represent all policyholders given that there are different classes of policyholder with different, and sometimes competing, interests.

6.02. Number of members

Some WPCs are quite small – for example, the terms of reference for the Standard Life WPC contemplate 3 or 4 members. A WPC with 3 members is arguably too small given the size and complexity of the relevant Aviva funds and the complexity of the reattribution. A committee with a minimum of five members (of which at least three would be independent) as Aviva proposes would seem more appropriate. The ability to appoint deputies is arguably not appropriate in the context of a WPC although a member should be permitted to appoint another member as his proxy. The WPC chairman should be an independent member elected to the office of chairman by the WPC itself. Neither the proxy voting nor election of chairman proposal has been adopted by Aviva.

6.03. Appointment and removal of members

It may be appropriate for the WPC to have the power to require the Board to appoint additional independent members where the WPC believes on reasonable grounds that additional expertise is required and that it is appropriate in the circumstances to appoint a new member for these purposes rather than seeking outside professional advice on an ad hoc basis. However, since this may give the WPC an inappropriate degree of control over the size of the WPC, a requirement could be imposed that in any resolution the WPC passes on the appointment of an additional independent member, at least one of the non-independent WPC members must vote in favour.

The process for selecting independent members (other than the initial independent members) either as replacement or as additional members should ideally be within the control of the WPC itself voting on a simple majority basis¹⁴ although it may be appropriate to require the

¹⁴ For additional members, once it has been determined that an additional independent member is required (either by the Board on its own initiative or where the Board is in principle required to appoint an additional member by a resolution of

WPC to engage recruitment consultants for this purpose. The Board should have only limited rights to veto the appointment of any candidate recommended by the WPC and if the Board does veto a candidate then it should have no right to veto any subsequent recommendation made by the WPC of a candidate selected from a further shortlist.

These suggestions have not been adopted by Aviva – under its arrangements for the WPC, the AVLAP Board would remain responsible for the appointment of all WPC members, which, along with its right to appoint the chairman, may give the Board an inappropriate level of control over the composition of the WPC.

The appointment of non-independent members either as replacement or as additional members can be a matter for the Board provided that reasonable notice is given to the WPC (and provided that the majority of the WPC members at any time are independent members).

It would in theory be possible to include the FSA in the WPC appointment process to give a further degree of independence, but this would not be necessary provided that the WPC itself has sufficient control and it is also questionable whether the FSA would be prepared to accept such a role.

Membership should cease automatically in the event of bankruptcy or if a member is no longer considered fit and proper by the FSA and a member may of course resign. Otherwise, it would seem appropriate that a termination of membership should require a unanimous resolution of the other members of the WPC (although the Board should be free to remove non-independent members at its discretion). The Aviva proposals do not refer to termination otherwise than for lack of fitness and propriety, bankruptcy or death/incapacity and it is unclear whether the AVLAP Board in practice reserves a right to terminate the appointment of an independent WPC member for other reasons (e.g. in the event of a dispute between the Board and a member of the WPC). In the policyholder advocate's view it would not be appropriate for the Board to have that right, again because it may give the Board an inappropriate level of control over the composition of the WPC.

the WPC on which at least one non-independent member voted in favour), the selection of the new member should be within the control of the WPC voting on a simple majority basis.

7.00 Changes to the constitution of the With-Profits Committee

Since the WPC performs an important role in the governance of with-profits funds, it is clearly also important to have controls around changes to its terms of reference.

Minor amendments to the WPC's terms of reference (e.g. to update the list of members, standard agenda items or to correct minor typographical errors) could be made subject only to the prior approval of the chairman of the WPC.

It would be possible to require that any material change to the terms of reference set out in the Scheme would require a formal amendment to the Scheme although this would be very inflexible and arguably unnecessary if:

- (a) the WPC has a majority of independent members who would be able to veto any proposed change of which they did not approve; and
- (b) the FSA does not object to the proposed change.

The Aviva proposals do provide that amendments that “relate to the Reattribution Scheme” should be subject (effectively) to WPC and FSA approval. It may not always be clear when an amendment does “relate to the Reattribution Scheme” but in any event the policyholder advocate believes that other material changes should also be subject to WPC approval; Aviva proposes that they be subject to the approval only of the WPC chairman and not the WPC itself.

8.00 General conduct of business considerations

8.01. Meetings

Given the nature of the WPC's role, quarterly meetings as Aviva proposes may be sufficient subject to the Board or the chairman of the WPC convening more frequent meetings where required. The WPC should be able to require any employee (including non-executive directors) to attend WPC meetings (see “Access to information and people” below). It also seems appropriate, as Aviva propose, that certain non-members may attend as a matter of

course (for instance the Actuarial Function Holder). However, a person who is not a member should not have a right to attend where the WPC wish to sit in private and this is reflected in Aviva's terms of reference for the WPC. The chairman of the WPC should also be entitled to attend meetings of the AVLAP Board at which issues relevant to the responsibilities of the WPC are to be considered.

Aviva's proposals do not expressly contemplate ad hoc meetings being convened by the WPC chairman or that he is entitled to attend any relevant AVLAP Board meetings (although it is stated that he will, after a WPC meeting, report to the Board at its next meeting and that he can request a meeting with the Board).

8.02. Access to information and people

The WPC should have access to all relevant information and people including the With-Profits Actuary and AVLAP's external advisers. Aviva's terms of reference provide for the WPC to have access to "individuals and all information as the WPC reasonably considers necessary..." which the policyholder advocate assumes would include access to AVLAP's external advisers. The Board should also have a positive duty to provide the WPC with all such information that it would reasonably require to fulfil its role without requiring a specific request by the WPC – Aviva's proposals are not expressed so as to effectively impose such a positive obligation on the Board and give rise to a risk that the WPC will not see all relevant information.

8.03. Obtaining external advice

In the policyholder advocate's view, the WPC should be able to obtain external professional advice where it is reasonable for it to do so, at AVLAP's expense, without requiring the approval of the Board. Aviva proposes that Board approval would be required (albeit that it could not unreasonably be withheld) which bears the risk that the Board will have an inappropriate level of control over the WPC.

8.04. Consultation and reporting

The WPC should be free to consult with and report to the FSA. The WPC should also be able to report to the Board (and ultimately to “whistle blow” to the FSA and to policyholders) if it considers that the management of the with-profits funds is in any respect inappropriate or contrary to the interests of policyholders. It may also be appropriate for the WPC to be free to consult directly with policyholders. Aviva’s proposed WPC terms of reference are essentially consistent with the views of the policyholder advocate in this respect save that the right to communicate with policyholders is limited to communications “to enhance policyholder understanding of the role of the WPC”. The policyholder advocate believes that this is too narrow since it would appear not to permit the WPC to consult with policyholders more generally or indeed to allow the WPC to “whistle blow” to policyholders.

The Aviva terms of reference for the WPC require the WPC to provide an annual report to the Board and (as contemplated in the FSA rules) state that the company will at the request of the WPC facilitate the issue of the report (or a representative summary) to policyholders. While the WPC is therefore given certain rights to communicate with policyholders, the policyholder advocate also believes that the WPC should be under a positive duty to communicate with policyholders annually. This could for example take the form of a consumer friendly version of the WPC’s annual report to the Board.

8.05. Costs

The Aviva WPC terms of reference provide that the costs of the WPC are to be borne by the with-profits funds. The policyholder advocate takes the view that these are business costs and are appropriately recharged to the with-profits funds. As has been noted in paragraph 2.01, in a with-profits business it is necessary to have a robust counter-balancing mechanism to the Board to ensure that policyholders’ rights and interests are protected.

8.06. Changes in the inherited estate

One matter which the policyholder advocate has not had the opportunity to discuss with Aviva before the publication of her report, but which she intends to address in a

supplementary report, concerns disclosure of changes in the inherited estate. The policyholder advocate believes that further disclosure on the change in the inherited estate over the year, over and above that already disclosed in FSA returns, should be made available to policyholders. Specifically she believes that there should be a flow of funds report which details movements in the estate which would explicitly include uses of the estate over the year and that the WPC should assure policyholders that the flow of funds report fully reflects how the estate has been used during the year.

Annexe 1: Summary of requirements under FSA rules

SYSC 3.2.6R - a firm must take reasonable care to establish and maintain effective systems and controls for compliance with applicable requirements and standards under the regulatory system and for countering the risk that the firm might be used to further financial crime.

COB 20.3.2G - in complying with SYSC 3.2.6, a firm should maintain governance arrangements designed to ensure that in the conduct of with-profits business it complies with, maintains and records any applicable PPFM.

The governance arrangements referred to in COBS 20.3.2G should:

- (1) be appropriate to the scale and complexity of a firm's with-profits business;
- (2) involve the approval of the firm's PPFM by its governing body; and
- (3) involve some independent judgment in the assessment of compliance with PPFM and how any competing or conflicting rights and interests of policyholders and, if applicable, shareholders have been addressed.

The independent judgment referred to in COBS 20.3.2G(3) can be provided in different ways. These may include but are not confined to:

- (a) establishing a with-profits committee (a committee of the governing body, including non-executive members of the governing body and possibly some external non-directors with appropriate skills and experience);
- (b) asking an independent person with appropriate skills and experience to report on these matters to the governing body or to any with-profits committee; or
- (c) for small firms, asking one or more non-executive members of the governing body to report to the governing body on these matters.

COB 20.3.3G provides that if a person or committee who provides the independent judgment under COBS 20.3.2G wishes to make a statement or report to with-profits policyholders, in



addition to any annual report made by the firm to those policyholders, a firm should facilitate this.

Annexe 2: Summary of policyholder advocate proposals not adopted by Aviva

The policyholder advocate notes that Aviva has passed a number of her suggestions relating to the WPC to the WPC itself for review. A summary of the policyholder advocate's proposals not adopted by Aviva is set out below. (References below in brackets to paragraph numbers are to paragraphs above in this Appendix 30.)

Role of WPC

Aviva has not adopted the policyholder advocate's proposal that the WPC terms of reference should make it clear that, in making judgments as to whether shareholders' and policyholders' rights and interests have been properly weighed, as against each other, the WPC should see themselves accountable only to policyholders and not to shareholders (paragraph 5.00).

Matters for which WPC approval is required (veto rights)

WPC approval should in the view of the policyholder advocate be required in relation to changes proposed by the Board to the with-profits governance structure and in particular material changes to (a) the WPC terms of reference and (b) the PPFM. Aviva has not adopted this proposal (although on (a), material changes to the terms of reference are subject to the approval of the WPC chairman) (paragraph 5.02).

Power of WPC to make recommendations

The policyholder advocate proposed that the WPC should have the power to initiate its own reviews of the management of the with-profits business (including changes to the PPFM and the Scheme) and to make related recommendations to the Board and that if the Board declines to follow any such recommendation, the Board should be required to give a reasonable written explanation to the WPC as to why it has not done so. This proposal is not fully reflected in Aviva's WPC terms of reference although it is stated that the WPC can report to the Board on "any matters of significance arising from its work" (paragraph 5.03).

Composition of WPC

The policyholder advocate believes that a WPC member should be permitted to appoint another member as his proxy and that the WPC chairman should be an independent member elected to the office of chairman by the WPC itself. Neither the proxy voting nor election of chairman proposal has been adopted by Aviva (paragraph 6.02).

The policyholder advocate has also proposed that the WPC should be able to require the Board to appoint an additional member (provided that in any resolution the WPC passes on the appointment of an additional independent member, at least one of the non-independent WPC members must vote in favour). The policyholder advocate has also proposed that the WPC should itself be in control of the selection of new members (either as replacement or additional members). These suggestions have not been adopted by Aviva – under its arrangements for the WPC, the AVLAP Board would remain responsible for the appointment of all WPC members which, along with its right to appoint the chairman, may give the Board an inappropriate level of control over the composition of the WPC (paragraph 6.03).

Termination of WPC membership

It is unclear from Aviva’s proposals whether the AVLAP Board in practice reserves a right to terminate the appointment of an independent WPC member for reasons other than lack of fitness and propriety, bankruptcy or death/incapacity (e.g. in the event of a dispute between the Board and a member of the WPC). In the policyholder advocate’s view it would not be appropriate for the Board to have that right, again because it may give the Board an inappropriate level of control over the composition of the WPC (paragraph 6.03).

Changes to the WPC constitution (terms of reference)

While the Aviva proposals provide that amendments that “relate to the Reattribution Scheme” should be subject (effectively) to WPC and FSA approval, it may not always be clear when an amendment does “relate to the Reattribution Scheme” and in any event the policyholder advocate believes that other material changes should also be subject to WPC approval; Aviva

proposes that they be subject to the approval of the WPC chairman and not the WPC itself (paragraph 7.00).

General conduct of business considerations

Aviva's proposals do not expressly contemplate ad hoc meetings being convened by the WPC chairman or that he is entitled to attend any relevant AVLAP Board meetings (although it is stated that he will, after a WPC meeting, report to the Board at its next meeting and that he can request a meeting with the Board) (paragraph 8.01).

In the policyholder advocate's view, the Board should have a positive duty to provide the WPC with all such information that it would reasonably require to fulfil its role without requiring a specific request by the WPC – Aviva's proposals are not expressed so as to effectively impose such a positive obligation on the Board and give rise to a risk that the WPC will not see all relevant information (paragraph 8.02).

In the policyholder advocate's view, the WPC should be able to obtain external professional advice where it is reasonable for it to do so, at AVLAP's expense, without requiring the approval of the Board. Aviva proposes that Board approval would be required (albeit that it could not unreasonably be withheld) which bears the risk that the Board will have an inappropriate level of control over the WPC (paragraph 8.03).

The WPC should be free to consult with and report to the FSA. The WPC should also be able to report to the AVLAP Board (and ultimately to "whistle blow" to the FSA and to policyholders). It may also be appropriate for the WPC to be free to consult directly with policyholders. Aviva's proposed WPC terms of reference are essentially consistent with the views of policyholder advocate in this respect save that the right to communicate with policyholders is limited to communications "to enhance policyholder understanding of the role of the WPC". The policyholder advocate believes that this is too narrow since it would appear not to permit the WPC to consult with policyholders more generally or indeed to allow the WPC to "whistle blow" to policyholders (paragraph 8.04).

The Aviva terms of reference for the WPC require the WPC will provide an annual report to the Board and (as contemplated in the FSA rules) state that the company will at the request of the WPC facilitate the issue of the report (or a representative summary) to policyholders.

While the WPC is therefore given certain rights to communicate with policyholders, the policyholder advocate also believes that the WPC should be under a positive duty to communicate with policyholders annually. This could for example take the form of a consumer friendly version of the WPC's annual report to the Board (paragraph 8.04).