

Appendix 41B

The Aviva Offer

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 Introduction

This appendix has been prepared by LECG Ltd. for the policyholder advocate, and is a response to Aviva's appendix on the same topic. While care has been taken to explain the technical terms and concepts contained in this appendix, the complex issues involved will be better understood by readers with some familiarity of the concepts involved.

The purpose of this appendix is to describe and to provide LECG's commentary on Aviva plc's (Aviva) offer to CGNU Life and CULAC with-profits policyholders in the context of the proposed reattribution of the funds' inherited estates. The offer is analysed and evaluated in detail in other appendices.

As part of the reattribution, Aviva intends to transfer the CGNU Life and CULAC with-profits funds into sub funds in the AVLAP fund, which in itself is not part of the reattribution. The inherited estates of the CGNU Life and CULAC with-profits sub funds will then be split between a with-profits sub fund created in AVLAP called the old with-profits sub fund (Old WPSF) and a reattributed inherited estate external support account (RIEESA) held within the non-profit sub fund. A further with-profit sub fund will be created in AVLAP called the new with-profits sub fund (New WPSF).

Aviva's offer is made to all eligible policyholders in the CGNU Life and CULAC with-profits funds and will take the form of a cash payment, save where Aviva considers that payment in cash would be disadvantageous to the policyholder. Policyholders choosing to accept Aviva's offer ("electors" or "electing policyholders") will receive a portion of the total cash amount offered by Aviva, the Policyholder Incentive Payment (PIP). In exchange, they will give up any interest they have in potential future special distributions from the inherited estates of the funds and will pass their interest to Aviva. The electing policyholders' policies will be placed in the separate New WPSF and their allocated portion of the inherited estates will be transferred to the RIEESA.

Those policyholders that choose not to accept the reattribution offer or make no choice at all (“non-electors” or “non-electing policyholders”) will not receive any allocation of the PIP and will have their policies placed in the separate Old WPSF along with their allocated portion of the inherited estates. The intention in respect of non-electing policyholders is to preserve their current position as far as practicable, including a similar probability of participating in any potential future special distributions from the inherited estates.

In general, any such benefits accruing to both policyholders and shareholders from the inherited estates may be modelled as a series of cash flows over time.

In the case of eligible policyholders, these cash flows may arise, without a reattribution, from their interest in special distributions of any excess surplus that builds up in the inherited estates; or with a reattribution, from the cash payment offered by Aviva for their interest in any potential future special distributions from the inherited estates.

In the case of shareholders, these cash flows may arise, without a reattribution, from shareholders’ share of potential future special distributions of excess surplus, the corporation tax payments arising from shareholders’ share of all distributions and indirectly, through a range of uses of the inherited estates permitted under current regulation and discussed in *Appendix 39: The Impact of FSA Guidance on Policyholders*; or, with a reattribution, from the receipt of the electing policyholders’ interests in any potential distributions of the inherited estates, subject to certain constraints on its future use.

In general terms, therefore, policyholders must choose between:

- accepting the reattribution offer, and receiving a known PIP payment from Aviva ; and
- not accepting the reattribution offer, and receiving potential future special distributions of excess surplus from the inherited estates, should any be made, with uncertain values, methods of distribution and timing.

On the basis of comparing the value of the Aviva offer with the potential future special distributions that they will forgo by accepting the offer, certain policyholders will, in

principle, be clearly better off by choosing one course over another. But there will be some policyholders for whom Aviva's reattribution offer is more finely balanced when set against the estimated value of potential future distributions from the inherited estates. In those cases, the policyholder advocate has sought to provide sufficient information for each policyholder to make a sound choice, in consultation with their financial advisor, as outlined in Appendix 45: *Formulation of Guidance to Policyholders*.

On an individual level, the policyholder advocate has sought to ensure that policyholders have a realistic choice between accepting Aviva's offer or choosing to remain in a fund that broadly preserves the scale and nature of their benefits (including potential special distributions) that they would have received if there were no reattribution. In other words, given a choice between accepting and not accepting the reattribution offer, the better of those two options for each policyholder should not leave them worse off, and in many cases may make them better off.

1.02 Components of the offer

Aviva's offer has six main components:

- an aggregate PIP that is offered to eligible policyholders who accept the reattribution offer;
- allocation mechanisms that set out, first, the division of the aggregate PIP between electing policyholders and, second, the division of the inherited estates between the RIEESA of the New WPSF and the inherited estate of the Old WPSF;
- a Benefit Security Factor test (BSF test) at the Effective Date of the reattribution (the Effective Date, currently assumed to be 1 October 2009), the intention of which is to ensure that policyholders' benefit security is not compromised by the reattribution and that benefit security is broadly equal for all policyholders, irrespective of whether they have accepted the offer;

- a safety net mechanism intended to “top up” the estimated future special distributions of non-electing policyholders in the event that the level of their potential future special distributions from the Old WPSF appear likely to fall below the level they would have enjoyed absent a reattribution;
- a defined process incorporating a number of milestones on which key events are planned to occur; and
- a set of rules restricting the manner in which Aviva may operate the funds following the conclusion of the reattribution process.

The next section of this report sets out each of the six components of the offer listed in the bullet points above. In Appendices 42 to 45, LECG analyses the terms of Aviva’s offer in aggregate and for individual policyholders. The aggregate analysis contained in Appendices 42 and 43 suggests that Aviva’s offer would serve to make most policyholders better off than they would be, absent a reattribution, for a broad range of potential outcomes for the funds. The offer also contains safeguards that may be expected to protect their interests both across the same set of potential outcomes for the funds and also for a broad range of potential outcomes of the reattribution election; these are described in *Appendix 44: The Position of Non-Electing Policyholders*. In Appendix 45, the policyholder advocate provides guidance to policyholders intended to support their decision-making in consultation with their financial advisor.

2.00 Aviva's PIP offer to policyholders

Aviva has contemplated a reattribution of the CULAC and CGNU Life with-profits funds for a number of years. Within Aviva, work on the reattribution process began in earnest in 2005. In November 2006, the policyholder advocate was appointed to conduct negotiations on behalf of eligible policyholders. Since then, Aviva and the policyholder advocate have analysed and discussed a wide range of issues surrounding the reattribution process and the content of Aviva's offer to policyholders. This section sets out the offer that has resulted from that process of analysis and negotiation.

2.01 The Aggregate Policyholder Incentive Payment

At the end of 2006, around the time that the policyholder advocate was appointed, the combined inherited estates of the CGNU Life and CULAC with-profits funds stood at approximately £5.2 billion, according to Aviva's annual accounts for the funds. Since that time, the size of the inherited estates has been reduced by two main factors:

- the special distribution announced in February 2008. By the beginning of 2008, Aviva had sought to de-risk policyholder guarantees covered by the estates, which resulted in excess surplus with a value of £2.3 billion at that time being announced in February 2008 as a special distribution from the funds.¹ This distribution will be divided 90:10 between policyholders and shareholders and distributed in equal tranches over three years to eligible policies in force at the date of each distribution. Policyholders will receive their distribution in the form of an enhancement to their asset share;² and
- the fall in the equity and property markets. Seventy per cent of the assets of the inherited estates were invested in equities and property, primarily in the

¹ In other appendices, this special distribution is referred to as the "pre-reattribution distribution", or "PRD".

² The total reduction in the estate as a result of the special distribution was expected to be £2,363 million in February 2008, including tax on the distribution to shareholders that is paid by the inherited estates; eligible policyholders' share was £2,080 million.

UK. Since 31 December 2006, stock markets and property values have fallen significantly around the globe. For instance, the FTSE 100 index in the UK fell from around 6,400 at the beginning of 2008 year to 4,434 by 31 December 2008.

All else being equal, the distribution of £2.3 billion from the inherited estates would have been expected, along with the associated shareholder tax, to reduce the value of the inherited estates by an equivalent amount. The fall in equity and property markets and reductions in interest rates further reduced the size of the inherited estates to approximately £2,100 million as at 30 June 2008³ and £1,570 million⁴ as at 31 December 2008.

The terms of the proposed reattribution offer reflect the uncertainty, in present market conditions, surrounding the value of the combined inherited estate at the Effective Date (expected to be 1 October 2009). In recognition of that uncertainty, the value of Aviva's offer to policyholders varies with the value of the inherited estates around that time.

Aviva is offering eligible policyholders an aggregate PIP with a minimum value of £500 million for 100 per cent of the inherited estates of CGNU Life and CULAC, conditional upon the Reattribution Estate being valued at £1,200 million or more at the Effective Date; this condition can be waived by the Aviva plc Board, in which case the aggregate PIP offer would remain at £500 million.⁵ The aggregate PIP will be supplemented by what Aviva calls an 'Enhancement Factor', an additional aggregate sum that increases pro rata with any value the Reattribution Estate has in excess of £1,200 million. The Enhancement Factor added to the £500 million minimum value of the aggregate PIP offered will be calculated as 55 per cent of the value of the Reattribution Estate in excess of £1,200 million. The aggregate PIP will therefore scale with the movement in the Reattribution Estate.

³ Aviva's interim calculation of the financial position as at 30 June 2008 was reviewed by Ernst and Young.

⁴ Based on the year-end 2008 published estate value of £1,529 million, plus £41 million post year-end adjustments.

⁵ The Reattribution Estate is the inherited estate calculated in accordance with Aviva's annual audit and reporting procedures and does not include any of the adjustments considered appropriate by KPMG, nor any deductions for risks, costs and allowances, as discussed in Appendix 35: *Size of the Inherited Estates*, and Appendix 37: *Valuation of the Reattributed Estates*, respectively.

To protect policyholders and shareholders from sharp changes in financial market conditions, the value of the Reattribution Estate will not be calculated at a single date. Rather, the value used to calculate the Reattribution Estate will be calculated as the unweighted average of the unadjusted value of the combined CGNU Life and CULAC inherited estate at close of business on 30 June, 31 July and 28 August 2009. Each of the month-end valuations will involve an economic roll-forward of the prior “hard close” valuation, in this case at 31 May 2009. The June valuation will be audited as will the roll forward mechanism. The averaged estates will be increased by two months interest using LIBOR to cover the period to the Effective Date.

The value of the aggregate Aviva offer for a range of values of the Reattribution Estate is shown in Table 1 below.

Table 1 Value of aggregate PIP

Reattribution Estate (£m)	Aggregate PIP (£m)
1,200	500
1,300	555
1,400	610
1,500	665
1,570	704
1,600	720
1,700	775
1,800	830
1,900	885
2,000	940
2,100	995
2,200	1,050
2,300	1,105
2,400	1,160
2,500	1,215

Source: Aviva

The PIP will be paid in cash, unless Aviva considers that cash payment will disadvantage the policyholder, taking into account the nature of a particular policy, or if there are legal, regulatory, security or tax reasons why a cash payment should not be made. The PIP will be paid as a guaranteed bonus where it is not paid in cash. Examples of policies that may not receive a cash PIP include pension policies held in trusts or where the policyholder’s place of residence suggests that there may be disadvantages to cash payment. The full amount of the

aggregate PIP offered will only be paid if 100 per cent of policyholders still eligible at 1 October 2009 accept the reattribution offer.

Aviva's offer for 100 per cent of policyholders' interest in the inherited estates of the CGNU Life and CULAC with-profits funds is markedly lower than the market value of the inherited estate's assets but it should be noted that:

- shareholders would expect to receive 10 per cent of the value of the inherited estates in any event;
- the timing and value of future distributions to policyholders is uncertain and may ultimately turn out to be earlier or later and/or above or below the level anticipated at the Effective Date. Following the reattribution, Aviva bears the risk that future releases from the RIEESA will be lower or higher than anticipated at the Effective Date;
- any future distributions will likely be declared as bonuses, the value of which may not be received by policyholders until their policies mature or are surrendered;
- Aviva's shareholders will in future continue to bear ultimate responsibility for ensuring the security of policyholders' benefits. Prior to any reattribution, implicitly, 90 per cent of that risk is borne by policyholders via the inherited estates;
- electing policyholders resident in the UK, Jersey, Guernsey or the Isle of Man will receive their share of the PIP free of tax, but might have to pay tax on any future distributions from the inherited estates, depending on their individual tax status. Shareholders may also incur increased or decreased taxation on the income and capital releases from the RIE (for full details please see *Appendix 34: Tax Matters in relation to the Reattribution*); and
- shareholders must bear a range of other costs and risks associated with the reattribution and future ownership of electing policyholders' interests in the

inherited estates, as well as forgoing a number of benefits that the FSA has permitted the company to take from the inherited estates and which they must fund or bear themselves in future.

Aviva's offer is subject to approval by the boards of AVLAP and Aviva plc and High Court approval of Aviva's reattribution Scheme.

A detailed analysis of the aggregate offer is contained in *Appendix 42: Evaluation of the Aggregate PIP Offer*.

2.02 The allocation mechanism for the inherited estates and PIP

Aviva's reattribution Scheme contains two distinct allocation mechanisms. The first sets out the manner in which the aggregate PIP will be divided among electing policyholders. The second describes how the inherited estates will be divided between the RIEESA and the inherited estate of the Old WPSF.

Aviva proposes to allocate the inherited estates between the RIEESA and the Old WPSF based on a proxy for the realistic liabilities of each policy on 21 November 2006 (the PIP Liability), the date on which the proposed reattribution was announced. The PIP Liability is calculated by means of a formula which uses the sum assured and reversionary bonuses (or their equivalent) attached to a policy and is intended to approximate to the larger of the policy's asset share or minimum guaranteed value. The data on individual policyholders will be refreshed at 28 August 2009, to remove policyholders that are no longer eligible due to voluntary discontinuance, and to speed up payments to policyholders after the Effective Date.

Aviva's proposed mechanism will allocate the aggregate PIP between policyholders pro rata to the PIP Liabilities of eligible policies, adjusted by a multiplier for policies in selected product groups, subject to a minimum payment per policy.⁶ The minimum payment will be £200 if the Reattribution Estate is valued at £1,200 million. The minimum PIP Payment will be increased by £22 for each additional £100 million of value in the Reattributed Estate above

⁶ Payments to other policyholders are scaled down to meet the cost of the application of the minimum payment.

the £1,200 million minimum. The relationship between the Reattribution Estate and minimum PIP is illustrated for a range of values of the Reattribution Estate in Table 2 below.

Table 2 Value of minimum PIP

Reattribution Estate (£m)	Minimum PIP (£)
1,200	200
1,300	222
1,400	244
1,500	266
1,570	282
1,600	288
1,700	310
1,800	332
1,900	354
2,000	376
2,100	398
2,200	420
2,300	442
2,400	464
2,500	486

Source: Aviva

The purpose of Aviva’s proposed multiplier is to improve the relationship between the PIP that is being paid and the potential future special distributions forgone by the policyholder. The multiplier will increase the weighting given to certain types of policy, in particular those with additional future premium payments due and long terms to run. The types of policy and outstanding terms of policies whose PIP Aviva proposes to adjust are set out in Table 3 below.

Table 3 Policies to which increased weightings will be applied

Policy type	Outstanding term					
	<=5 yrs	>5 <=10 yrs	>10 <=15 yrs	>15 <=20yrs	>20 <=25 yrs	>25 yrs
CWP regular premium	1	1.7	1.85	2	2	2
Defined benefit	1.7	1.7	1.7	1.7	1.7	1.7
Deposit administration	1.7	1.7	1.7	1.7	1.7	1.7
With-profits annuity	2	2	2	2	2	2
Unitised pensions	1	1.3	1.9	2.05	2.05	2.05

Source: Aviva

To illustrate how the allocation mechanism will be applied in practice, an example is shown below using simplified numbers. Let us say that there are 10 policies in a fund and that each policy has a PIP Liability of £10,000. The manner in which the allocation mechanism will divide up the PIP between each electing policy - and transfer inherited estate to the RIE - is shown in Table 4 below.

Table 4 Example of allocation mechanism

Policy type	No of policies	Outstanding term	PIP liability	% of unadjusted PIP Liability	Weighting	Weighted PIP Liability	% of adjusted PIP Liability
CWP regular premium	1	14	£10,000	10%	1.85	£18,500	12.9%
Defined benefit	1	10	£10,000	10%	1.7	£17,000	11.9%
Deposit administration	1	5	£10,000	10%	1.7	£17,000	11.9%
With-profits annuity	1	3	£10,000	10%	2.0	£20,000	14.0%
Unitised pension	1	21	£10,000	10%	2.05	£20,500	14.3%
Other policies	5	N/A	£50,000	50%	1.0	£50,000	35.0%
Totals			£100,000	100%		£143,000	100%

As expected, it may be seen that policies with increased weightings may expect to receive a higher share of the aggregate PIP than they would if no weighting were applied.⁷ In contrast, in this example, the five policies that have not had their weighting increased may expect to receive 35 per cent of the PIP allocated instead of the 50 per cent represented by their unweighted PIP liability.

⁷ The analysis assumes that each policy had the same share of weighted PIP liability on 21 November 2006 as on the Effective Date. In practice, eligible policies still in force on the Effective Date will have a higher share of the aggregate PIP liability than they would have had on 21 November 2006 because of surrenders and lapses between 21 November 2006 and the Effective Date of the reattribution.

As for the second of the allocation mechanisms in the reattribution Scheme, Aviva proposes to divide the inherited estates valued at the Effective Date between the RIEESA and Old WPSF pro rata to the aggregate PIP accepted by electing policyholders (for the RIEESA) and PIP declined by non-electing policyholders (for the Old WPSF). If, for instance, 80 per cent of the aggregate PIP is accepted by electing policyholders, then 80 per cent of the inherited estates will be transferred to the RIEESA and 20 per cent to the Old WPSF.

The proportion of the inherited estates transferred will reflect the adjusted PIP Liabilities, similar to those shown in Table 4 above. To extend that example to the division of the inherited estates, the CWP regular premium policy would transfer 12.9 per cent of the inherited estates to the RIEESA, if it accepted the reattribution offer, rather than 10 per cent; while the five policies that have not had their weight increased would transfer 35 per cent of the inherited estates rather than 50 per cent if all accepted the reattribution offer.

LECG has analysed the impact of Aviva's proposed allocation mechanism for the inherited estates and the PIP. The results of that analysis are set out in *Appendix 43: Allocation of the Aggregate PIP between Policyholders*.

2.03 Assessing the financial strength of the New WPSF and Old WPSF (the BSF Test)

The allocation of the inherited estates between the RIEESA and the Old WPSF is subject to a "true-up" adjustment that is designed to ensure that the financial strength of the New WPSF and Old WPSF are broadly similar at the Effective Date. At that date, Aviva will calculate the Effective Date Benefit Security Factor (BSF) for each sub-fund, which is the probability of the fund being able to meet its obligations to eligible policyholders as they fall due.

The funds will be deemed to be of equivalent financial strength if their BSFs are within 0.5% of one another. If the financial strength of one of the sub-funds exceeds that of the other by more than a margin of 0.5%, a portion of the inherited estates sufficient to equalise the financial strength of the sub-funds will be transferred from the stronger sub-fund to the weaker one. LECG's analysis suggests that any transfer is more likely to occur from the Old WPSF to the New WPSF.

In response to the policyholder advocate's concerns, Aviva has agreed that any transfer will take the form of a contingent loan, rather than a transfer of assets. The loan will be repaid once the financial strength of the fund receiving the transfer exceeds the level consistent with a credit rating of AAA. If the loan is made from the Old WPSF to the New WPSF, shareholders may not receive any releases of capital from the RIEESA until the loan has been repaid.

2.04 Safeguards for non-electors

A primary interest of the policyholder advocate throughout the negotiation of the offer with Aviva has been to safeguard the level of future benefits to non-electing policyholders. Of particular concern to the policyholder advocate has been the possibility that non-electors may not carry enough of the inherited estates with them to the Old WPSF to offer a similar level of potential future special distributions as the non-electors could have received without a reattribution. Such a situation might arise, for instance, if policyholders with regular premium policies and long outstanding terms were to choose not to accept the reattribution offer in large numbers. As at 21 November 2006, such policies would have relatively small PIP liabilities in proportion to the special distributions that they might expect to receive over the course of, perhaps, the next 15 years or more.

In response to the policyholder advocate's concern, Aviva has proposed a "safety net" mechanism for non-electing policyholders whose policies will be transferred to the Old WPSF. Once the number and nature of non-electing policies is known, Aviva will make a calculation of the future special distributions that those policies would have reasonably expected to receive from the inherited estates absent a reattribution. Aviva refers to this as the value of potential distributions to policyholders (VPDP). Aviva and the policyholder advocate have agreed that the VPDP will be calculated under the assumption that new business amounts decline by 10 per cent per annum from 2011 onwards. If the aggregate VPDP for non-electing policyholders is lower after the reattribution, compared to Aviva's calculation of non-electors' aggregate VPDP absent a reattribution, the safety net mechanism will be applied.

The safety net mechanism will operate by providing additional capital of up to £100 million to “top up” the inherited estate of the Old WPSF. If required, the additional capital will be transferred from the RIEESA to the inherited estate of the Old WPSF. The Effective Date BSF test described above will be calculated after any transfer of the safety net amount from the RIEESA to the Old WPSF to ensure that the benefit security of policyholders in the New WPSF and Old WPSF is broadly maintained. The transfer of the safety net amount will not be affected by the BSF test.

If, following the transfer, the inherited estate of the Old WPSF exceeds 100% of the capital required to maintain an AAA credit rating for the fund, any excess amount will be set aside in a separate account in the Old WPSF for distribution to policyholders at a later date. Any such excess cannot be distributed for at least 3 years after the Effective Date, after which it will be paid out to policyholders. After the 3-year period, the With-Profits Committee must consider annually whether some or all of the excess should be distributed to policyholders. The timing and allocation of any such distributions will be decided by the boards of AVLAP, taking into account the views of the With-Profits Committee.

LECG’s analysis of Aviva’s proposed safety net mechanism is described in *Appendix 44: The Position of Non-Electing Policyholders*.

2.05 The reattribution process

Over the period prior to the Effective Date, the reattribution will proceed in accordance with an agreed timetable. Aviva reserves the right to withdraw its offer to policyholders and either to abandon the Scheme or put a revised offer to policyholders if the value of the Reattribution Estate is below £1,200 million at the Effective Date.

2.06 Future operation of the funds

The final part of Aviva’s reattribution offer to policyholders concerns the future operation of the New WPSF, RIEESA and Old WPSF following a reattribution. Aviva and the policyholder advocate have been concerned to ensure that policyholders are fairly treated after a reattribution, whether they accept Aviva’s offer or not.

These restrictions are required as a result of the transfer to shareholders of electing eligible policyholders' interests in potential special distributions from the inherited estates and the alteration of incentives to shareholders that arises, in part, from shareholders' interests in releases of capital from the RIEESA after a reattribution. Potentially, either of those factors could encourage shareholders to take actions that could be detrimental to policyholders' interests, or which could be perceived as being in shareholders' interests without being in policyholders' interests.

Accordingly, a number of safeguards have been placed within the Scheme that will restrict the future operation of the funds by Aviva following a reattribution. The most important of the safeguards offered by Aviva are that:

- the operation of the New WPSF and Old WPSF should be the same, to the extent possible. The investment strategy will be the same in New WPSF and Old WPSF and both funds will invest in the same asset classes in broadly the same proportions. Similarly management actions, for instance in terms of bonus allocations, will be broadly consistent across both funds;
- Aviva aims to maintain the capital strength of both the New WPSF and Old WPSF in a range equivalent to a credit rating of between AA and AAA, the intention being to offer similar levels of benefit security to policyholders in each fund;
- new business will be reinsured into the Old WPSF in proportion to the inherited estate transferred to the Old WPSF; and
- there will be restrictions on Aviva's ability to release capital from the RIEESA to shareholders. For Aviva to release capital from the RIEESA, there must be sufficient capital in the RIEESA to provide the New WPSF and Old WPSF with security equivalent to 110% of an AAA credit rating. In addition, the capital adequacy of the New WPSF must have exceeded 100% of an AAA credit rating for three consecutive years prior to release. As noted above, no release of capital can occur until any contingent loan from the Old WPSF to the

New WPSF has been repaid in full. Finally, no capital may be released from the RIEESA to shareholders until six years after the Effective Date.

Between them, these restrictions are intended to ensure that all policyholders are treated fairly after a reattribution and that the security of their future benefits is maintained at a high level. A detailed discussion of the future management of the funds is contained in Appendices 28 to 32.

As has been analysed in *Appendix 38: Aviva's New With-Profits Business Assumptions*, the potential future special distributions that eligible policyholders receive, absent a reattribution, are heavily dependent on the level of new business that Aviva writes in the future. The more new business written, the less the special distributions to eligible policyholders will be. Aviva has agreed with the FSA that if they do write less new business than they forecast then eligible policyholders will receive additional potential future special distributions. Aviva has confirmed that if much less new business is written than expected (i.e. if the amount of new business written in any year from 2009 to 2013 is less than 10 per cent of Aviva's new business projection used in the negotiation on the reattribution⁸), Aviva has agreed to transfer an amount of up to £120 million to the New WPSF for the benefit of eligible policyholders.

The value of the payment made to the New WPSF depends on the year in which new business first falls below 10% of Aviva's projection, as set out in the table below. Aviva defines the New WPSF proportion as the proportion of the combined Inherited Estates of CGNU Life and CULAC on the date of reattribution which is deemed to relate to policyholders who have received a PIP.

⁸ For more information on Aviva's new business assumptions, please refer to *Appendix 38: Aviva's New With-Profits Business Assumptions*.

Table 5 Value of payment to the New WPSF

Year in which new business is first lower than expected	Payment to New WPSF
2009	£120 million x NWPSF proportion
2010	£100 million x NWPSF proportion
2011	£80 million x NWPSF proportion
2012	£50 million x NWPSF proportion
2013	£25 million x NWPSF proportion

Source: The Scheme

3.00 Conclusions

Aviva's reattribution proposals offer each policyholder the opportunity to exchange his or her interest in the inherited estates of the CGNU Life and CULAC with-profits funds for an immediate payment of known value. The value of each policy's interest in the inherited estates is equal to the value of special distributions that may potentially accrue to that policy over its remaining duration in force. The Scheme is designed to ensure that, to the extent possible, all other policyholder benefits are preserved as they would be absent a reattribution. Eligible policyholders have a choice between accepting their individual PIP offer from Aviva, the value of which is certain, or choosing not to accept the offer and instead retaining the right to receive future special distributions whose value and time is unknown today.

Aviva's reattribution offer is in addition to the special distribution announced by Aviva in February 2008. In recognition of recent financial market volatility, the aggregate PIP offered by Aviva varies with the size of the estates at the Effective Date (called the Reattribution Estate), to be measured as an average of the value on three dates, 30 June, 31 July and 28 August 2009, rolled forward to the Effective Date at a risk-free interest rate. The payment to policyholders will be made in cash except where to do so is expected to be against the interest of the policyholder.

Each policy whose owner chooses to accept the reattribution offer will be transferred to the New WPSF and a portion of the inherited estates corresponding to the policy's share of the aggregate PIP will be transferred to a separate account within the AVLAP funds. Subject to certain safeguards contained in the Scheme, the ultimate ownership of that account (the Reattributed Inherited Estate External Support Account, or RIEESA) resides with shareholders. Each policy whose owner chooses not to accept the reattribution offer will be transferred to the Old WPSF along with a portion of the inherited estates corresponding to that policy's share of the aggregate PIP.

In broad terms, the policyholder advocate has evaluated Aviva's reattribution offer to determine whether and to what extent it exceeds the aggregate value of eligible policyholders' potential future special distributions from the inherited estates. Further, she has encouraged

Aviva to adopt an allocation mechanism that, to the extent possible, translates the aggregate value offered into individual PIP allocations that exceed the value of the possible future special distributions that the policyholder would forgo if he or she accepts the reattribution offer. Finally, she has sought to protect the interests of non-electing policyholders so that, in the event that they choose not to accept Aviva's PIP offer, the approximate nature and scale of benefits, including future special distributions, that they would potentially have received, absent a reattribution, is preserved. The policyholder advocate's analysis of Aviva's offer is set out in subsequent appendices.

In *Appendix 42: Evaluation of the Aggregate PIP Offer*, the value of the aggregate offer is compared to a range of potential outcomes that might arise absent a reattribution. The purpose of the analysis is to assess whether the aggregate value of the Aviva offer exceeds the aggregate value of policyholders' interest in the inherited estates for a reasonable range of scenarios. The potential value of policyholders' interest in the estates is also considered in *Appendix 40: Analysis of Potential Future Special Distributions to Policyholders & Shareholders*.

The two subsequent appendices (43 and 44) assess, in broad terms, whether the terms of the reattribution offer afford eligible policyholders a realistic choice between accepting or rejecting Aviva's offer and, in so doing, being made either better off or no worse off as compared with the possible future special distributions they might have received in the absence of a reattribution and would forgo if the offer is accepted. *Appendix 43: Allocation of the Aggregate PIP between Policyholders* considers the extent to which Aviva's proposed allocation mechanism translates the aggregate PIP into individual offers that exceed the potential value of individual policyholders' interests in the inherited estates absent a reattribution. *Appendix 44: The Position of Non-Electing Policyholders* assesses Aviva's proposed safeguards, including the offer to "top up" the Old WPSF inherited estate with up to £100 million of capital from the RIEESA.

In *Appendix 45: Formulation of Guidance to Policyholders*, LECG segments eligible policyholders into groups based on policy characteristics and evaluates whether or not Aviva's offer is likely to be higher than the value of their possible future special distributions



from the inherited estates. The policyholder advocate recommends that all policyholders lacking a clear and obvious choice should seek financial advice to ensure that they make the decision best suited to their own situation.