Annexe 2: to Clare Spottiswoode Witness Statement

UPDATE ON RECENT DEVELOPMENTS

1. Below I provide a brief update on recent developments. The Supplemental Report deals comprehensively with material developments since the Report. However, it may be of assistance, if I comment briefly on three main developments, namely:

   (a) new business assumptions;

   (b) the value of the inherited estates; and

   (c) investment in strategic assets

New business assumptions

2. As stated in the Supplemental Report (paragraph 7 of Chapter 2) LECG has analysed Aviva's PIP offer using four new business assumptions, three of which rely on Aviva's forecasts until the end of 2010, applying the following assumptions thereafter: (i) a 5 per cent increase per annum (Aviva's assumption); (ii) a 5 per cent decrease per annum; and (iii) a 15 per cent decrease per annum. Aviva has provided actual new business sales for the first half of 2009 and forecasts for the remainder of the year. These figures show that in the first half of 2009, Aviva withdrew its Inflation Protected Guarantee bond option (***IPG bond***), which accounts for a significant portion of the annual projected sales in 2009. Additionally, to meet Aviva's new business assumption for 2009, remaining sales of other bonds and pensions would have (and Aviva projects them) to be significantly higher than in the first half of the year. Aviva has not provided any rationale for why the sales of pensions and other bonds are forecast to significantly increase in the second half of 2009. Therefore, LECG's position is that Aviva should review its new business assumptions for 2009 and 2010 and adjust them based on actual experience. Aviva has stated it is not revising those assumptions. LECG has therefore

considered an additional new business sensitivity beginning with 50 per cent of Aviva's new business assumption in 2010 and applying Aviva's assumption of 5 per cent annual growth thereafter.

3. As has been stated, forecasts of new business affect directly the value of benefits foregone by eligible policyholders. No one can forecast what these levels might be given, for example, the withdrawal of its Inflation Protected Guarantee bond, if sales of the remaining products were to be at the levels for the second half of 2009 as they were for the first half, aggregate new business sales for the year would be 80% of Aviva's assumption for the reattribution. Aviva say that they will try and find another product to replace the withdrawn product. However, there is no evidence to indicate that the actual numbers for 2009 will be any higher then this 80%.

4. Whatever my personal view of likely sales, neither I nor anyone else can actually predict what these numbers will be. To cater for these uncertainties we provided a series of sensitivities on alternative levels of new business. Following the removal of the IPG bond, even if Aviva were to meet its projected sales of remaining products for the rest of 2009, increase those sales by 30% in 2010 and achieve 5% annual sales growth thereafter, eligible policyholders' projected special distributions would be similar to my -5% decline sensitivity, substantially larger than under Aviva's assumed new business levels. If this sensitivity, which I believe to be more realistic, were to be the outcome, then non-electors could expect significantly higher special distributions. Experience since writing our June 2009 report shows how fast projections can change, and with them expected special future distributions from the estate for current policyholders. The latter is an unfortunate consequence of intergenerational transfer. Of course after a reattribution these special distributions will not accrue to electors, but instead to shareholders and non-electors.

The value of the inherited estates

5. The Supplementary Report stated (summary, chapter 1, paragraphs 5-7) that the PA had been informed by the FSA that, in arriving at the value of the inherited estate for the purpose of calculating the PIP, the FSA had agreed with KPMG that, in the absence of convincing arguments to the contrary, Aviva should make the £20 million addition with respect to the new business subsidy associated with sales of new with-profits business during 2008 and 2009. The PA also said that she considered that in addition to the £20 million adjustment Aviva should also take some account of the balance of £54 million adjustments which the PA took into account in assessing Aviva's PIP offer but which Aviva did not allow for when formulating its offer.

6. In a letter dated 4 September letter to the PA, Aviva said it had agreed to add £20 million to the 31 May 2009 inherited estate value for the purpose of the PIP calculation. As to the PA's request for an additional adjustment, Aviva argued that the PA's assessment of Aviva's reattribution offer, based on the end 2008 inherited estate value, took account of KPMG's higher adjustment and KPMG's recent assessment had added no additional prudence between end 2008 and 31 May 2009. On this basis, Aviva concluded that no further adjustments are necessary for the purpose of the PIP calculation.

7. It is true that the PA's assessment of future special distributions did take into account the KPMG adjustment. This helped us to check the extent to which the benefits. which would have gone to future policyholders. were indeed shared as the FSA directed, and informed our guidance to eligible policyholders as to whether the firm's offer was in their interests. It could not be used, as explained above, to obtain a better deal for policyholders - only the FSA can achieve that. Without FSA intervention, which we requested, Aviva had no reason to agree to make any adjustments to the PIP, and they did not do so.

Investment in strategic assets

8. As referred to in my original report, one of the permitted uses of the inherited estate is to invest in so-called strategic assets. These are assets which are not

conventional portfolio investments but are instead assets which (while expected to make an acceptable investment return) are primarily motivated by the group's strategic objectives (e.g. investments in business joint ventures, office property, loans to brokers etc). I had hoped that Aviva would agree (notwithstanding that this is permitted under COBS) not to allocate any strategic assets to the Old WPSF, but they have refused to do so. I do not agree that any of assets of the Old WPSF estate should be invested in any form of strategic asset. Contrary to what Aviva is saying, there is no relevant matching of assets and liabilities since these are primarily held for shareholder purposes, and their 0:100 per cent fund is the New WPSF. There is no asset / liability rationale for placing them in a 90:10 fund.]