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Office of the
Policyholder
Advocate

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English Version

Introduction from Clare Spottiswoode, policyholder advocate

This leaflet gives updated information about the Norwich Union plan for the 'reattribution' of what are known as the 'inherited estates' in the with-profits funds in two of its businesses – CGNU Life Assurance Company Limited and Commercial Union Life Assurance Company Limited (CULAC). It begins with a short summary of Norwich Union's proposal.

This leaflet also gives some of the main results from our policyholder consultation, explains more about eligibility, gives answers to our most frequently asked questions and tells you how you can find out more about with-profits life insurance and reattribution. We also set out the latest timetable and how to contact us.

My job is to negotiate with Norwich Union on your behalf to try to achieve the best possible offer of a payment in return for your giving up rights to possible future special bonus distributions from the inherited estates. I hope that a worthwhile offer will emerge.

If we are successful, early next year I will write a report for you explaining Norwich Union's offer and my recommendations. You will have several weeks to think about it before you have to decide what to do. I will also hold a series of events throughout the country to explain the options in person.

I am also very concerned to make sure that I answer as many of your questions as possible. Please look at the section 'Getting in touch with us' to find out how you can help me do just that.

I look forward to writing to you again. In the meantime please do keep sending me your comments and questions and if you have internet access, register for our occasional email updates.

Clare Spottiswoode CBE

This leaflet has the following sections

The one minute briefing

- More money has accumulated in two of Norwich Union's with-profits funds than is needed to meet the liabilities of those funds.

- This money forms what are called the inherited estates. Norwich Union calculates that the total amount in the estates concerned was about £5billion at the end of 2006.

- The money helps support the funds but it can also be used by the company for other purposes. It is important that the inherited estates are managed carefully and wisely in the interests of policyholders.

- There are two ways in which any of this money can be released from being used as it is now. First, under what is called a 'distribution', 90 % of part of the inherited estates would go to policyholders in the form of bonuses and 10% would go to shareholders.

- **But**, second, under a different process called a 'reattribution', Norwich Union is proposing that shareholders buy out the interest that policyholders have in the whole of the inherited estates. This would allow the company more freedom in how it uses the money. (It is possible for there to be both a reattribution and a distribution.)

- Clare Spottiswoode is the independent person (called the policyholder advocate) appointed by the company and approved by the Financial Services Authority to champion the cause of policyholders.

- She and her advisers are discussing with Norwich Union how much money is in the inherited estates, what it will be used for in future and how likely it is that there will be 90 % distributions in future. She is also examining, as is the Independent Expert (see page 12), Norwich Union's detailed plans for the future security of your funds.

- Negotiations have begun about the size of any payment to be offered to policyholders for giving up their interest in the inherited estates.

- If negotiations are successfully completed both Norwich Union and Clare Spottiswoode will write to eligible policyholders explaining the result and they will be offered a payment by Norwich Union.

- Policyholders will be asked to say what they want to do and the High Court will be asked whether it approves the reattribution. If the High Court agrees, policyholders who vote to accept will receive a payment from mid-2008.

Consultation – what you told us

Between 21 November 2006 and 28 February 2007 YouGov, a market research company, ran a survey through our website and call centre to learn about key policyholder concerns. The key points are set out below and a full analysis is available on the website.

- *A total of 6614 people responded to the survey (4606 on line and 2008 by telephone)*

- *61% said they either understood or understood thoroughly the letter and leaflet from the Policyholder Advocate*

- *77% of respondents were very or fairly confident that they had been given sufficient ways to have their say*

- *41% of respondents don't know enough yet to form an opinion about whether the reattribution is a good or bad idea; 35% feel it is a good idea and 8% a bad idea*

- *Those in favour of a cash payment outnumber those in favour of a bonus by two to one*

- *Most policyholders believe that those who have been invested for longer should receive more than others*

- *25% of respondents say they have read the Principles and Practices of Financial Management, but only 16% of those who have read it have done so thoroughly*

- *97% regarded the role of Policyholder Advocate as very important (90%) or important (7%)*

During January and February 2007 the Policyholder Advocate visited Edinburgh, Cardiff, Birmingham, Dublin, Belfast and London to talk to policyholders about the process, answer questions and listen to comments.

At each of the events (apart from Dublin where we were unable to use our electronic voting technology) the audience voted on a series of key questions. The results are set out below and a full analysis is available on the website.

- *the most commonly held products were lump sum investments*

- *mortgage endowments were the second most commonly held products*

- *most attendees do not know a great deal about with profits policies. Only in London (14%) did more than one in ten claim to know ' a great deal'. In all five locations knowing 'a little bit' was the most common response.*

- *generally the most popular reason for having chosen a with-profits policy was 'recommendation'. In Cardiff the main reason was 'low risk/guarantees'.*

- *there was little support for extending eligibility to former policyholders.*

- *there was low support for treating holders of mortgage endowment policies differently to other policyholders. Those voting against were 75% in Birmingham, 66% in London and 59% in Belfast.*

Eligibility

In most cases eligibility is straightforward. There are some circumstances, however, that might disqualify you, such as voluntarily surrendering your policy before the actual date of the reattribution.

As part of the discussions Clare Spottiswoode is having with Norwich Union about the reattribution, she and her advisers have been analysing the possibility that there might be a special bonus distribution from the inherited estates. Norwich Union has made no decisions yet about whether a special distribution will take place but if it did, the eligibility criteria for that special distribution might be different to those for the reattribution. We are discussing with Norwich Union how the eligibility criteria for a special distribution, if it goes ahead, might compare with the eligibility criteria for the reattribution.

Clare Spottiswoode has been keen to answer all the outstanding questions on eligibility and has held discussions with Norwich Union. The results were published recently. The paper was discussed with a number of stakeholders to validate the outcome. The Financial Services Authority was also consulted in view of its responsibilities under the principle of Treating Customers Fairly.

A guide to eligibility has been published on www.policyholderadvocate.org and www.norwichunion.com/fundtransfer. If you do not have access to the internet please call our free phone helpline and a copy will be sent to you.

Frequently asked questions

These questions have been taken from your letters, telephone calls and comments at roadshows. If we have not answered your question here please call us, use the website or write to us.

Some of these questions are not directly related to the reattribution proposal but concern the performance of policies over recent years. This includes questions about Market Value Reductions. We have asked Norwich Union to provide their replies to these issues and these are clearly marked by the Norwich Union logo.

How has all this money built up in the 'inherited estates'? Why hasn't it been paid to policyholders in the past?

Norwich Union tells us that the origin of the estates is difficult to describe in detail, but that the introduction of 'asset share'* calculations in the late 1980s allow it to conclude that current policyholders have not contributed to the estates. Equally, the company has told us that there has not been any shareholder contribution to the estates. Therefore the estates must have emerged as a result of contributions from previous generations of policyholders. The company tells us that it aims to pay out 100% of asset share (the policy's 'fair share') and that the way that calculations are made is set out in its Principles and Practices of Financial Management. They are also reviewed and audited as part of the annual external audit.

If, therefore, 100% of asset shares is being paid out to policyholders on average, then any change to the inherited estates can be explained by other factors, such as investment returns on the inherited estates.

Why hasn't Norwich Union used the estates to make up for mortgage endowment shortfalls? The policyholder advocate should insist that shortfalls are made up from the estates.

We are all aware of the mortgage endowment shortfalls that some policyholders are facing and sympathise. However, there is a Mortgage Endowment Promise from Norwich Union to support some mortgage shortfall cases.

Clare Spottiswoode has to consider the interests of all policyholders whose investments are in these funds. Everyone will have been affected by poor stock market performance and the needs of those saving for pensions, for example, are as relevant as those whose endowment policies are not performing well.

In our roadshows policyholders said that they should be treated equally and that there should not be special deals for different groups.

*see footnote page 10

These funds should be distributed and the split should be 90% for policyholders and 10% for shareholders. The policyholder advocate should accept nothing less.

As mentioned in the section on eligibility above, there have been discussions about the possibility of a special bonus distribution.

If a special bonus distribution is agreed by Norwich Union directors that will certainly be 90/10. That raises the question of how much of the estates should be paid out in that way. Should it be all of the estates or just part of them? That is a question for Norwich Union; Clare's role is to try to achieve a fair deal for policyholders from the reattribution.

Under the reattribution proposal Norwich Union would buy out policyholders' rights to the estates, that is, special bonus distributions. The money in the estates would remain available to support the fund, but it would be 100% shareholder controlled and eventually will be released to them. The estates provide financial backing for some of the services that the with-profits funds provide. The cost of these services will be deducted from the inherited estates as part of the negotiation process.

These complicated issues are being thought through by the Policyholder Advocate and her team.

Will the reattribution affect my future bonuses if it goes ahead?

The reattribution process is about changing the way that some of the resources to support the Norwich Union life business are arranged. The process itself is separate from the way the funds are managed to earn income. The income depends on the skill of the Norwich Union asset managers and the market conditions at the time. Other factors that affect the returns are the mix of assets and the level of risk associated with the fund. Fund security and considerations about how it will operate after a reattribution will be commented on by the Independent Expert, Nick Dumbreck. (See the section 'Where can I find out more?' for details of an interview with Nick Dumbreck.)

How secure will the fund be after a reattribution?

The security of the fund is a key matter for Norwich Union, the Financial Services Authority, the policyholder advocate and the Independent Expert. If an agreement is reached and the High Court is asked to approve a reattribution, the judge will need to be satisfied about future security.

How much is any payment likely to be, when will it be paid and how will it be paid?

At this stage we cannot say how much might be offered because the negotiations are still under way. It is hoped to make payments from mid-2008, so long as the High Court agrees to the proposal. If a special distribution is made that would be paid as a bonus to policies that are in force. For the reattribution, in the vast majority of cases, it is expected that payment would be made by cheque.

Will it be taxable?

Discussions continue about the tax treatment of a payment resulting from the reattribution. Taxation is a complicated issue and it may be necessary for policyholders to consult with an independent adviser as each individual's tax circumstances are likely to be different. A bonus added to a policy under a distribution is not taxable when it is added to the policy but will be subject to tax, as normal, when the benefits are paid.

How will Clare report to us?

We are planning a range of communications to give policyholders the choice about how much detail they want. We are considering the following approach:

- *A letter and short explanatory leaflet (about 10-12 pages) sent to all policyholders*
- *An executive summary of Clare's full report available on request*
- *Clare's full report (expected to be about 300 pages) available on request*
- *All working papers and appendices available on request (CD-Rom)*
- *All documents to appear on the website www.policyholderadvocate.org*

Clare will also make visits to parts of the country with large numbers of policyholders, give media interviews and seek other ways to communicate with policyholders.

Why has Norwich Union applied Market Value Reductions (MVRs) to my policy when they have all this money?

NORWICH UNION *says:*

There are currently no MVRs in force on Norwich Union with-profits policies.

When MVRs are applied it is to ensure that policyholders receive only their fair share of the With-Profits Fund, without putting other policyholders who remain invested in the fund at a disadvantage.

To show how this works, assume three policyholders each invest £10,000 to give a fund of £30,000. If the stock market then drops by 10% the fund would only be worth £27,000. If one investor decided to withdraw his money, without any MVR, he would receive £10,000, leaving only £17,000 for the remaining two investors. This would not be fair to the remaining investors.

If all of this money is available why hasn't smoothing improved my annual returns?

NORWICH UNION *says:*

Investment returns are passed to customers through bonuses. In good years, some of these returns are held back to help pay bonuses in poorer years. This helps make bonuses paid year to year more stable than actual investment returns. This is known as smoothing.

The principles behind Norwich Union's smoothing are:

- *we aim to return to policyholders on average their fair share of the fund (the 'asset share'*)*
- *year to year we aim to ensure that total payouts to policyholders on equivalent policies do not change by more than 15%*

We aim on average to return at maturity 100% of the asset share over the long term. In any one year payouts can, in general, range between 80% and 140% of the asset share as a result of smoothing.

The value of each policyholder's policy can only be fully assessed once a payout is made (i.e. on maturity, surrender or death). It is at this point that any difference between the payout and the asset share can be identified. Any such difference (whether it is positive or negative) will be passed to a smoothing "pot" which will be carried forward to apply to future payouts. Smoothing profits and losses do not pass into the estates. When guaranteed benefits exceed asset shares the cost of meeting the guarantee is met by the inherited estate. Thus current policyholders cannot contribute to the estate but they can benefit from it through the provision of guarantees.

** Asset share (the 'fair share') indicates the value of a policy at a point in time. There are two parts to it. It is the sum of premiums paid, together with the proportion of the policy's share of the investment return of the with-profits fund. From this are taken expenses, the cost of guarantees, tax and other charges. An insurance company will usually aim to pay out on maturity policy claims at or around 100 % of asset share.*

Aviva / Norwich Union has made big profits in recent years, so why has my policy performed so badly?

NORWICH UNION *says:*

It is not appropriate to link bonus performance to Aviva's profit performance as they are completely separate issues. With-profits bonus performance is closely linked to the investment performance of the funds alone. Aviva's worldwide profits are based on a wide range of factors including operating profits generated across a range of different businesses throughout the world. Aviva's profits do not contribute to the investment performance of the funds.

What happens next?

1. Negotiations continue over the next few months

2. If the negotiations are successful Clare Spottiswoode will write a report with her recommendations

3. A preliminary court hearing will take place in Spring 2008

4. Policyholders will be sent letters from Clare Spottiswoode and Norwich Union setting out details

5. A series of roadshows will take place in the Spring so that policyholders can ask questions about any agreement

6. Policyholders will have several weeks to consider the outcome before they have to decide what to do

7. If enough policyholders accept an offer a High Court hearing will take place in the middle of next year

8. If the High Court approves the plan, payments can begin to be made from mid – 2008 onwards.

Dates are indicative

Where can I find out more?

Some policyholders have asked us where they can learn more about the with-profits life insurance industry and reattribution.

This note gives *some* references and sources of information; it is not a comprehensive list. Please note that this office cannot provide the material to policyholders. If policyholders do not have access to the internet they may wish to use the facilities at public libraries.

1. Our website contains a downloadable interview with Nick Dumbreck explaining the work of the Independent Expert. If you do not have internet access and want to read the interview, call our helpline and we will send you a copy.

2. The FSA website gives full details of the with-profits review. This comprehensive review took place after the AXA reattribution in 2000. The full reference is given below. The Conduct of Business rules may be found through the second reference.

http://www.fsa.gov.uk/Pages/Library/Other_publications/Profits/index.shtml
http://fsahandbook.info/FSA/html/handbook/COB/6/12

3. The judgement in the AXA case can be found under the links section of our website.

4. '**A Practitioner's Guide to FSA Regulation of Insurance'**, City and Financial Publishing, second edition 2004, ISBN 1 898830 86 X.

5. **'Ownership of the Inherited estate'**, British Actuarial Journal 2, 1273-1298. Smaller, S.L., Drury, P., George, C.M., O'Shea, J.W., Paul, D.R.L., Pountney, C.V., Rathbone, J.C.A., Simmons, P.R. & Webb, J.H. (1996). This considers alternative views on ownership of the inherited estate.

6.**'Life office bonuses; the road to 90-10'**, The Actuary, January /February, 28-29 Sibbett, T. (1996). This sets out how shareholders' and policyholders' participation rights were different in the 19th century.

7. '**Medium and Long-Term Saving: A Review'**, HM Treasury chs 6, 10, Sandler, R. (2002).

http://www.hm-treasury.gov.uk/Documents/Financial_Services/Savings/fin_sav_sand.cfm

This was a Treasury-commissioned review. Chapter 6 deals with with-profits business; chapter 10 gives the (overall) conclusions.

8. **'A review of policyholders' reasonable expectations'**, British Actuarial Journal, 8 (4) 705-755. Shelley, M., Arnold, M. and Needleman, P.D. (2002). This paper examines several issues on what with-profits policyholders may reasonably expect from their policies, including reference to the inherited estate.

9. **'Constraints on discretion: distributing surplus in with-profits life insurance, Journal of Financial Regulation and Compliance'**, 12, 118-127 O'Brien, C. (2004). This paper summarises court cases where with-profits policyholders have complained that the allocation of surplus was unfair (but does not refer to the inherited estate specifically).

Note:

The Actuary is published by the Staple Inn Actuarial Society, www.sias.org.uk

The British Actuarial Journal is published by the Actuarial Profession, www.actuaries.org.uk

Journal of Financial Regulation and Compliance is now published by Emerald, www.emeraldinsight.com

Getting in touch with us

We want to make sure that we continue to hear your views and answer your questions.

You can send us your views through the website www.policyholderadvocate.org. Please note that we cannot, however, enter into email correspondence with you.

You can telephone our help lines on 08000 566 399 (for the Republic of Ireland call 1800 635 059, international callers should use +44 (0)208 945 0998) and ask questions or dictate your views for the Policyholder Advocate to read.

You can also write to us at:

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