

**Report from the Board of
Aviva Life & Pensions Ireland (ALPI)
Designated Activity Company (DAC)
to its With-Profits Policyholders in the
Participating and Closed Funds for 2020**

Contents

1	Introduction	3
2	Summary	3
3	Governance Arrangements – Making sure we comply with the With-Profits Operating Principles	4
4	Compliance with the With-Profits Operating Principles during 2020	5
5	Potential Conflicts of Interest Between Policyholders and Shareholders	8
6	Changes to the WPOP in 2020	9



1. Introduction

Rules for the management of the with-profits funds of Aviva Life & Pensions Ireland DAC are set out in our published With-Profits Operating Principles (“WPOP”). The WPOP for each fund is available from www.aviva.ie/friendsfirst/with-profit/.

This Report from the Board sets out how we managed the Participating and Closed Funds in 2020. This Report does not cover the Irish With-Profits Fund, which will be covered by a separate report to the policyholders in this fund.

A printed copy of this report can be obtained by sending a written request to:

Aviva Life & Pensions Ireland DAC, One Park Place, Hatch Street, Dublin 2.

If you have any questions about your policy, please call us on the number shown on your annual statement.

2. Summary

In the opinion of the Board of Aviva Life & Pensions Ireland DAC, throughout 2020 the Participating and Closed Funds have been managed in accordance with the WPOP.

The Board is also of the view that the decisions made in managing the Participating and Closed Funds were both appropriate and treated with-profits policyholders fairly.

3. Governance Arrangements – Making sure we comply with the With-Profits Operating Principles

The Board of Aviva Life & Pensions Ireland DAC has overall responsibility for the management of the Participating and Closed Funds and takes all the key decisions that affect the funds.

Before making these decisions, the Board must seek and consider the advice of the Head of Actuarial Function. The Head of Actuarial Function provides advice to the Board on how discretion in the management of the Participating and Closed Funds should be applied. The Head of Actuarial Function looks to balance the interests of Aviva's policyholders and shareholders and to ensure that it's with-profits policyholders are treated fairly.

The activity of the Board

During 2020, the Board considered a wide range of topics. These included:

- The investment strategy of the fund (see section 4.2 below).
- Proposals for bonuses to be added to policies (see section 4.3 and 4.4 below).
- The review of certain policyholder communications.

The Board, in reviewing management recommendations and actions, endeavours to ensure that all policyholders are treated fairly and that an appropriate balance is struck between the interests of different groups of policyholders and between policyholders and shareholders.

These governance arrangements, with their combination of Board level decision making and advice from the Head of Actuarial Function, help ensure that Aviva manages the Participating and Closed Funds in accordance with the WPOPs and treats its with-profits policyholders fairly.

The Board has received a report from the Head of Actuarial Function (HoAF) on the ongoing compliance of the Participating and Closed Funds with the Principles contained in the WPOPs.

The HoAF has confirmed that, in his opinion, discretion in relation to the Participating and Closed Funds has been exercised fairly and in accordance with the WPOPs. In the HoAF's opinion the Company has complied with the WPOPs in all material respects but notes the error mentioned below. The HoAF confirms that, in his opinion, the discretion exercised by the Board during 2020 may be regarded as taking, or having taken, the interests of the with-profits policyholders of ALPI into account in a reasonable and proportionate manner with appropriate management of any conflicts.

The HoAF identified an issue in relation to the payouts for a small number of policies in the Closed Fund. This error is currently being investigated with remediation planned.

4. Compliance with the With-Profits Operating Principles during 2020

4.1 Introduction

With-Profits Terminology

In broad terms, the assets of the Participating and Closed Funds are used to back the:

- Asset Shares (see below)
- Cost of Meeting Guarantees
- Assets backing Non-Profit Business (see below).

How the assets of the with-profits fund are used



Note: This diagram is for illustrative purposes only and is not to scale.

An explanation of these terms will help you understand how the with-profits fund is managed.

The **Asset Shares** represent the amounts paid in by policyholders whose policies are still in the fund, less deductions for expenses, claims, charges and tax, plus investment earnings on those amounts. This is the value of the policyholders' net contributions to the fund and is the main driver for determining the amounts paid to policyholders.

In some cases, the guarantee that applies to a policy can mean that the amount paid to a policyholder exceeds the policy's **Asset Shares**. Where this is expected to happen in the future, assets are put aside to cover the additional **Cost of Meeting Guarantees** (over and above **Asset Shares**).

The assets of the fund in excess of the **Asset Shares** and the Cost of Meeting Guarantees are the **Assets Backing Non-Profit Business**. The Assets Backing Non-Profit Business are used to pay the benefits for Non-Profit Business.

Further information on the **Asset Shares** are provided in the WPOP.

Areas of Discretion

The principal areas of the management of the fund where the Board has some flexibility or can exercise its discretion are:

- The funds' investment policy, and in particular the investment policy for the **Asset Shares**.
- Setting bonus rates.
- Setting surrender value terms.
- Charging costs and expenses to the funds (including any charges applied to contribute to the **Cost of Meeting Guarantees**).

Whilst the Board can make choices or exercise its discretion in these areas, it must do so in accordance with the rules set out in the WPOP.

4.2 Investment Policy for Asset Shares

Setting Investment Strategy – How it Works

The investment strategy for the Asset Shares is set by the Board and must observe the procedures and limits set out in the WPOP. The investment strategy reflects the fund's capacity to take risk, which in turn is dictated by the value of its assets and the level of guarantees provided to its policyholders.

Should the fund have the capacity to take risk then part of the Asset Shares can be invested in assets such as company shares and commercial property, in the expectation that these assets will, in the longer term, provide superior returns. When setting investment strategy, the Board also takes into account current and expected future investment conditions, as well as the advice of our investment managers.

Investment Strategy in 2020

Following the financial crisis in 2008, the investment strategy for both funds has been quite conservative, mainly investing in government and corporate bonds. The improved investment performance in recent years has seen the fund take moderate steps back into equity and property markets since 2016. In 2020 as a result of the COVID-19 crisis, the equity content of both the Participating and Closed funds were sold to de-risk both funds and protect against further equity losses.

The gross of tax returns achieved on the Asset Shares of the fund in 2019 and 2020 are shown in the table below.

	2020	2019
Participating Fund for guaranteed business	4.5%	6.7%
Participating Fund for non-guaranteed business*	-8.8%	11.8%
Closed Fund	0.1%	7.3%

* By non-guaranteed business, we mean Unitised With-Profits where there is no guarantee greater than 0%

The mix of assets backing the Asset Shares and the investment strategy is monitored closely throughout the year. The mix of the assets in the Participating Fund and the Closed Fund are shown in the table below.

With-Profits Asset Splits as at 31/12/2020		
	Participating Fund	Closed Fund
Equities	0.1%	0.0%
Property	5.2%	6.2%
Govt Bonds	46.7%	93.0%
Corp Bonds	46.1%	0.0%
Cash	2.0%	0.8%
Total	100.0%	100.0%

Conclusion

During 2020, the assets backing Asset Shares were managed in accordance with the requirements of the WPOP and the Board is satisfied that the investment strategy followed is appropriate for the with-profits policyholders.

The mix of assets backing the Asset Shares and the investment strategy is monitored closely throughout the year.

4.3 Bonus rates

Setting Bonus Rates – How it Works

What are bonuses?

- We add your share of the returns which the with-profits fund earns to your investment, through a system of bonuses.
- Bonuses cannot be negative, but they can be zero, and this provides policyholders with some protection from losses made by the with-profits funds.
- There are two main types of bonus:
 - Regular Bonus
 - Terminal Bonus

What's the difference between Regular and terminal bonuses?

- Regular Bonuses are designed to provide steady growth in the value of your guaranteed benefits over the lifetime of your policy. They are not intended to fully reflect the performance of the fund.
- Terminal Bonuses aim to pay any balance between the Regular Bonuses which we have already added to your policy and the performance of the fund over the whole period of your investment.

- Asset Shares are used as a guide to set Terminal Bonuses and this means that the Terminal Bonuses reflect the performance of the fund. Terminal Bonuses are payable when you cash in or switch your investment out of the With-Profits fund, but they are not guaranteed.
- Our aim is to use Regular and Terminal Bonuses together to provide a balance between the guaranteed and non-guaranteed policy benefits. The guarantees provided protect your benefits from adverse conditions such as investment market falls or poor investment returns.

Where guaranteed benefits exceed Asset Share, it is likely that the Terminal Bonus will be zero. Whilst the Terminal Bonus is zero, policyholders will have benefitted from the guarantee provided to them.

Bonus rates are set for groups of policyholders as opposed to individual policyholders. In this way, policyholders share in the performance of the fund and benefit from the pooling of risk with other policyholders. Changes in bonus rates are smoothed over time with the aim of smoothing out some of the ups and downs that result from the volatility of the funds' asset values.

Smoothing does not, however, protect policyholders from prolonged falls in investment returns which, other than where guarantees apply, will be shared with policyholders.

Bonus rates are set by the Board, having taken the advice of the Head of Actuarial Function.

Bonus Rates in 2020

At the end of 2020, Regular Bonus rates did not change and remained at 0% unless a higher guarantee was attached to the policy.

Terminal bonus rates were reviewed at the end of 2020 for the Participating Fund. Reflecting movements in the investment returns over time, for conventional products: terminal bonus rates did not change for endowments and increased slightly for pension products with a longer term and decreased slightly for pension products with a shorter term, for unit linked products: overall terminal bonus rates decreased slightly for non-guaranteed benefit business.

Terminal bonus rates were reviewed at the end of 2020 for the Closed Fund. Reflecting movements in the investment returns over time, for conventional products: terminal bonus rates decreased slightly for both endowments and pension products.

As explained in its WPOP, the Participating fund aims for target maturity pay-outs of 95% of asset share for the Flexible Savings product and 100% for other products. The Closed fund aims for target maturity pay-outs of 100% of asset share. These ranges are expressed as percentages of Asset Share, uplifted where appropriate to distribute the Estate, and are set out in the respective WPOP. Where payouts fall outside the target payout range, the fund may be paying out more, or less, than it can afford, to the detriment, or to the advantage, of the remaining policyholders.

Conclusion

The decisions made by the Board were consistent with the WPOP and with the advice of the Head of Actuarial Function.

4.4 Surrender Values and Market Value Adjustments

Policyholders may choose to cash-in or surrender their policies early or to transfer benefits under their pensions policies to another provider.

The approach for determining surrender values is set out in the WPOP, and surrender values are set with the aim of paying out Asset Shares. Surrender value rates are closely monitored throughout the year and amended if necessary to continue targeting Asset Share.

For unitised policies (other than where guarantees apply on early surrender), if the policy benefits exceed the Asset Share, Aviva may apply a Market Value Adjustment (MVA) on the early surrender of the policy so that surrender values properly reflect the performance of the fund and the value of the underlying assets. This ensures that surrendering policyholders do not benefit from guarantees that are given up on early surrender. If they did, this could be unfair for the remaining policyholders. MVAs were applied during 2020.

4.5 Charges and Expenses

Charges and Expenses – How it Works

Charges for the Participating fund are calculated as a fair share of the expenses to the company. Charges for the Closed fund are calculated as a fair share of the expenses to the company subject to a cap. The HoAF checks the charges for both Funds to ensure they are correct each year.

Charges to cover expenses incurred in running the with-profits business are deducted from policyholder benefits.

Administration services are provided by ALPI and investment management services by a fund manager or managers.

Expenses take into account the administration and investment management services for the with-profits business.

Charges and Expenses in 2020

Tax was allocated to the funds based on an apportionment of the total tax costs of the company, which was considered fair and reasonable and in line with the requirements of the WPOP.

4.6 New With-Profits Business

The Participating and Closed Funds are closed to new business other than a very limited amount of new business for options on and increments to existing policies, and a limited number of new members to existing group pension schemes.

5. Potential Conflicts of Interest Between Policyholders and Shareholders

Given the level of discretion that can be applied by the Board in managing the fund, there is a potential for conflicts between the interests of policyholders and shareholders to arise. Such potential conflicts include:

- Selecting a less risky investment strategy that reduces risk for shareholders but that might also reduce investment returns for policyholders.
- Choosing to allocate increased expenses and tax costs to with-profits policyholders.
- Encouraging policy exits or failing to point out the value of guarantees given up on exit, where it might be to the policyholder's benefit to retain the policy.
- Choosing to declare lower bonuses so that the cost of meeting guarantees is reduced.

Similarly, there is a potential for conflicts between the interests of different groups of policyholders. Such potential conflicts include:

- Following a riskier investment strategy that might be to the benefit of policyholders who intend to retain their policies for a long period but possibly to the detriment of policyholders expecting to exit the fund in the shorter term.
- Policyholders with policies that have high guarantees might be more relaxed about taking risks than policyholders that have policies with low guarantees.
- Smoothing changes in bonus rates over time may benefit one group of policyholders over another.
- Similarly, the sharing of risks within policy groups may benefit some policyholders to the detriment of others.

Given these potential conflicts, it is vital that:

- There are clear rules and guidelines for the management of the fund.
- Strong safeguards are in place to protect the interests of policyholders.

Rules for managing the with-profits funds are set out in the WPOP for each fund, which is published. The rules in the WPOP for each fund address many of the potential conflicts of interest.

Compliance with these rules is monitored and the outcome of this monitoring is considered by the Board. Any breaches are corrected so as to ensure that no policyholders suffer any material detriment.

Discretion in relation to the management of the with-profits funds is exercised by the Board, whose members include individuals who are independent of the Company, and its executive management. Advice on the exercise of discretion is provided by the Head of Actuarial Function, whose appointment must be approved by the Regulator and who must comply with regulatory requirements that are designed to ensure that policyholders are treated fairly.

The Board is of the view that the rules and safeguards set out in the WPOP and the Scheme for each fund, coupled with the protection provided by the input of the Head of Actuarial Function are sufficient to avoid conflicts or ensure that they are dealt with fairly.

6. Changes to the WPOP in 2020

The WPOP was introduced on 1st January 2020. No further changes have been made to the WPOP since it was introduced.

