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Your with-profits annuity - planned reduction to income payments

Dear Mr Sample

I am very sorry to let you know that we will need to make changes to your with-profits annuity, which will significantly reduce your income payments. This letter gives you some warning, before your next review date.

We have done our best to protect you, as far as possible, from the major setbacks we have recently experienced. However, unfortunately, to be fair to all our other policyholders, we must now begin to make these changes.

Reductions which have taken place so far on with-profits policies

Since 20 July 2000, our decisions on bonuses have been particularly affected by:

- the falling value of investments in stocks and shares;
- the cost of guaranteed annuity rates (GARs); and
- increases in the money we set aside for potential claims for compensation.

Following the House of Lords' decision in July 2000, we had to reduce the value of with-profits policies. We did this, other than for with-profits annuities, by reducing the policy value by 5% at that time. We made significant further reductions in July 2001, April 2002 and July 2002. This means, allowing for bonuses, our other with-profits policyholders have suffered an overall reduction of about 20%.

So far we have largely protected you from these falls. In fact, you and other with-profits annuitants have generally received a positive investment return of about 14% over the same period.

As we have said, most other with-profits policyholders have suffered significant reductions in the value of their policies, whereas those who have with-profits annuities have not. We were able to do this because if you have a with-profits annuity, you cannot withdraw your funds. It was possible for us to phase the cuts to with-profits annuities in the hope of improved financial conditions. Unfortunately, because conditions have not improved we can no longer keep doing this.

This basically means that with-profits annuities, like yours, are now out of line by about 30%.



Action we need to take now

We now need to bring with-profits annuities back into line with other policyholders and we plan to do this over two years. We will be putting in place the following changes.

- On your policy anniversary after 1 February 2003, we will reduce the value of your total annuity, which we would otherwise pay, by up to 20%. This action replaces the current approach of reducing the overall rate of return over the term of the policy. We will then reduce your income payment again in 2004 to regain any overpayment which may still apply.
- The interim rate of return for 2002 for all with-profits policyholders, except those with annuities, is zero. From 1 December 2002 we will bring the interim rate of return for you into line, and this will also be zero.
- So far, we have only taken from with-profits annuity policies in force on 20 July 2000 (the date of the House of Lords' decision) part of the 5% reduction. We have previously announced that we will recover this cost at the rate of 1% each year for five years. This adjustment applied in 2000 and 2001 and we will now recover the rest at a rate of 1.5% in 2002 and 2003, or as soon as bonus rates allow.

We also review the amount of your income payments each year at the anniversary of the date your with-profits annuity policy started. That review reflects the gap between the expected bonus rate you chose and the bonus rate which applies. This then sets the level of income payments you will receive for the following year. The reductions quoted above will apply to the amount of annuity after this review.

We would like to emphasise that you will not receive less than the guaranteed payments under the annuity (known as the 'basic annuity' and 'declared bonus annuity') and this may reduce the effect of these reductions.

We have enclosed:

- a leaflet that includes details of how your with-profits annuity policy works;
- some examples of the effect of these changes; and
- other questions and answers you may find useful.

Why do we need to change now?


We originally decided to spread the reductions over the term of with-profits annuity policies because we hoped that poor investment conditions would recover reasonably quickly. However, we are now in one of the longest periods of poor stock-market performance for many years. And, like most other companies, we have suffered heavy investment losses. We have reduced our investments in stocks and shares to very low levels in order to secure and stabilise the with-profits fund. Unfortunately, because of our circumstances now - highlighted in the Interim Report that you should have received - we can no longer afford to phase these reductions in.

Summary

I am very sorry that we have had to take this decision. We carried out a great deal of work to look for alternatives that would avoid reducing incomes in this way. We had hoped to continue to reduce your income in a phased way over the term of your annuity. However, our changing circumstances and the growing gap between with-profits annuities and other policies meant that it would have been very unfair to other policyholders to continue to act in this way. We must balance the interests of all continuing policyholders and it is no longer fair to delay the reduction in values that our other policyholders have recently suffered.

Because we cannot set final bonuses in advance, it is not possible to provide individual calculations before the anniversary date. However, I hope that the details set out above, together with the enclosures with this letter, will give you a reasonably clear idea of how much the reduction in your income next year will be. You will, of course, receive a statement at your anniversary date in the usual way.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Charles Thomson', written in a cursive style.

Charles Thomson
Chief Executive