Important changes – simplifying our structure
Technical detail

This leaflet gives you more technical detail about the changes we are planning to make to Zurich Assurance Ltd (ZAL). These changes have recently been communicated to all our policyholders and trustees in our letter 'Simplifying the Structure of Zurich Assurance Ltd' and the accompanying 'Questions and answers'. You should read this leaflet with the 'Questions and answers' document as it gives you supplementary information. Please note that throughout this document, wherever we refer to policyholders, this includes anyone who is a trustee.

The information below is reasonably technical in nature. We've tried to write this leaflet in plain language, but some technical terms are unavoidable. We've put these terms in bold print and given an explanation in the '**Technical terms**' section at the end. If, having read it, you have further questions or need further explanation, please call us on the number in our letter.

Key elements of our proposals

The company in which you are a policyholder, Zurich Assurance Ltd is a member of the worldwide Zurich Financial Services Group. The structure of ZAL is complex, both in terms of the companies it owns and the assets held.

We want to simplify ZAL by transferring some companies to other parts of the Zurich Financial Services Group. These proposals, together with other actions undertaken during the year, reduce the financial risks in ZAL. Therefore we will be able to increase ZAL's financial efficiency by taking some money out of the company while still ensuring that your interests remain adequately protected.

How we'll achieve our proposals

We are working in close consultation with our UK industry regulator, the Financial Services Authority (FSA), throughout the process. To ensure all parties are treated fairly, where companies are to be transferred, we have appointed experts independent of the Zurich Financial Services Group to assess the market value.

The release of money from ZAL would normally be done by payment of a dividend. A company needs to have **distributable reserves** to pay a dividend. ZAL does not have sufficient **distributable reserves** to pay the dividend required, although it has more than sufficient money. Because of this, ZAL is going through a court process, known as a **capital reduction** to reduce its **share capital**. The court process will conclude with a High Court hearing known as a petition hearing, in London. This will enable the money to be released.

In order to proceed with the court process we had to gain consent from the Board of Directors of ZAL and its shareholders. The High Court will decide whether we can undertake the **capital reduction**. It will assess whether the financial protection that ZAL has put in place is adequate to protect both creditors and policyholders after the **capital reduction**. This financial protection includes an agreement that the Zurich Financial Services Group will put money back into ZAL, should it be deemed necessary, up to the value of that removed through the **capital reduction**. This financial protection will be in place for 20 years.

As a policyholder of ZAL, you are entitled to attend the petition hearing and, if you feel it necessary, you may object to the **capital reduction**. So that we can be clear on attendee numbers, if you intend to object, please let us know by calling the number on the letter in your pack or writing to us no less than fourteen days before the hearing.

What does this mean to Zurich Assurance Ltd policyholders?

The main impact on policyholders is explained in the 'Question and answers' document enclosed with your letter. More financial and technical information is given below.

Based on the risk profile of ZAL, the Board of Directors has decided to target a greater than 99.5% certainty that ZAL will be able to meet its liabilities in the next year. The Board of Directors also intends to hold excess assets at least 25% greater than the required minimum (the **Capital resources requirement – CRR**). This may be reviewed and changed if considered prudent in the light of changes in the risks facing ZAL.

The reduced financial risks in ZAL, due to these proposals, and other actions undertaken during the year means that some money can be taken out of ZAL while still comfortably meeting the target of the Board of Directors. The proposals will reduce the coverage of **Capital Resources Requirement** but, for the time being, the Board of Directors will target a minimum cover of 1.25 times.

Confidence is further increased through the Zurich Financial Services Group's commitment to support ZAL. For a period of 20 years, Zurich Financial Services Group has agreed that before ZAL reached a position where it was unable to pay its policyholders, Zurich Financial Services Group would have put back all the money taken out of ZAL through the **capital reduction** process.

Comparison with what we told policyholders last year

When we wrote to our policyholders during 2004, we gave details of what ZAL's **statutory solvency** position would be, using 31 December 2003 data, assuming that the action to bring the UK life companies together at 1 January 2005 had already taken place. In summary, the position we presented was:

	£m
Excess of available assets over liabilities	1,200
Required minimum solvency margin (RMM)	620
Excess assets	580
Cover for **RMM**	1.9 times

The FSA has brought in new rules on how to measure and report the **statutory solvency** position of insurance companies. Based on these new rules, the equivalent presentation of the above is:

	£m
Excess of available assets over liabilities	1,440
Capital resources requirement (CRR)	970
Excess assets	470
Cover for **CRR**	1.48 times

This fall in cover is not an indication of reduced strength, but simply a consequence of the new FSA calculation basis.

The table below shows how the figures have changed since we last wrote to our customers about our **statutory solvency.**

	(1) 2004 communication (new rules) based on 31/12/2003 figures **£m**	(2) actual position at 31/12/2004 **£m**	(3) New Target Minimum position following the proposals * **£m**
Excess of available assets over liabilities	1440	1871	939
Capital resources requirement (CRR)	970	911	751
Excess assets	470	959	188
Cover for **CRR**	1.48 times	2.05 times	1.25 times
Zurich Financial Services Commitment	N/A	N/A	200
Cover for **CRR** (including commitment)	1.48 times	2.05 times	1.51 times

*Based on 31/12/2004 figures, adjusted for the proposals.

You can see that the cover for **CRR** had risen to 2.05 times at the end of 2004. If we apply the proposed changes to the 31/12/2004 figures, the minimum cover for **CRR** changes to 1.25 times, in line with the capital management principles of the Board of Directors as outlined above. However, the Board of Directors wants customers to feel reassured that adequate financial strength will be maintained. Because of this, we have arranged that £200m of the Zurich Financial Services Group commitment will be available to ZAL if the cover for **CRR** falls significantly below 1.25 times. As you can see, taking this £200m into account, the minimum cover for **CRR** is 1.51 times, slightly higher than the position communicated in 2004.

Technical terms

'Capital reduction'
Reducing **share capital** in a company by buying back shares, or converting the **share capital** into **distributable reserves**.

‘Capital resources requirement – CRR’
Level of capital required to be held - as determined by the FSA’s rules.

'Distributable reserves'
Profits from past years that have yet to be distributed to shareholders, or reserves produced by the conversion of **share capital**.

‘RMM – Required Minimum Margin’
This is the minimum amount of assets in excess of liabilities that the FSA required companies to hold at the time of the last communication.

'Share capital’
When shareholders provide money to the company other than by a loan, the company recognises the investment by issuing share capital. If the company makes profits in future, these can be passed on to shareholders by paying dividends. However, returning the original investment, represented by the issued share capital, to shareholders is not straightforward. Carrying out a capital reduction is one way of returning this original investment.

'Statutory solvency'
A company’s ability to meet its financial obligations as determined by the FSA’s rules.