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Report of the Independent Expert on the Proposed Scheme to Transfer Long-Term Insurance Business from Phoenix Life Limited, Phoenix Life Assurance Limited and National Provident Life Limited to Guardian Assurance Limited

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1. Introduction

The Independent Expert

1.1. When a scheme for the transfer of insurance business from one company to another is submitted to the High Court of Justice of England and Wales (the "Court") for approval, it has to be accompanied by a report from an Independent Expert. This is a requirement of Section 109 of Part VII of the Financial Services and Markets Act 2000 ("FSMA") and the report must be made in a form approved by the appropriate Regulators (as defined in Section 5).

1.2. I have been appointed as the Independent Expert to provide the required report on a proposed scheme for the transfer of designated blocks of long-term insurance immediate annuity business (the "Transferring Policies") from Phoenix Life Limited ("PLL"), Phoenix Life Assurance Limited ("PLA"), and National Provident Life Limited ("NPLL") (the "Phoenix Companies", each a "Phoenix Company") to Guardian Assurance Limited ("GAL"), which have been 100% reinsured to GAL since 1 July 2012. For this proposed scheme of transfer (the "Scheme"), I have been appointed jointly by PLL, PLA, NPLL and GAL ("the Companies") and my appointment has been approved by the Regulators. The costs associated with my work are being split between the Phoenix Companies and GAL.

1.3. The Scheme will be submitted to the Court for sanction under Section 111 of Part VII of the FSMA. If approved, it is expected that the Scheme will become operative and take effect on 30 September 2013 (the "Transfer Date"). This report (my "Report") and any supplementary report (my "Supplementary Report" and, together with my Report, my "Reports") will be presented to the Court who will consider the contents of these Reports in deciding whether to sanction the Scheme.

1.4. I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1988, and am a Partner in the Actuarial and Insurance Solutions practice of Deloitte MCS Limited ("Deloitte"). I am an "approved person" for the purposes of Section 59 of the FSMA. I joined Deloitte as a partner in May 2012, from Standard Life plc, a savings and investment company, where, from January 2007 until December 2011, I was Chief Actuary, UK & Europe and the Actuarial Function Holder ("AFH") for Standard Life plc's four UK-regulated insurance companies. As AFH I advised the Boards of Standard Life Assurance Limited (SLAL), Standard Life Investment Funds Limited (SLIF) and Standard Life Pension Funds Limited (SLPF) on the transfer (on 31 December 2011) of the entire business of SLIF to SLAL. I am a member of the Institute and Faculty's Life Practice Executive Committee and one of the UK profession's representatives (Membre Suppléant) on the Groupe Consultatif Actuariel Européen. I am also President-Elect of the Institute and Faculty of Actuaries and expect to become its President in June 2013.

1.5. I have no financial interest in any policies held with any of the firms involved in this Scheme.

1.6. Deloitte is a large consulting firm and has advised both Guardian and the Phoenix Group on various other assignments.

1.7. I do not believe that any of these previous assignments compromise my independence, create a conflict of interest, or compromise my ability to report on the proposed Scheme. The assignments were disclosed to the Regulator prior to their approval of me as the Independent Expert.

The Scope of my Report

1.8. This Report considers the consequences of the Scheme for the policyholders of PLL, NPLL, PLA and GAL. I am concerned particularly to assess whether any group of policyholders might be materially adversely affected by the Scheme. I comment in Paragraph 4.3 on how I have interpreted materiality.

1.9. To the best of my knowledge, I have taken account of all material facts in assessing the impact of the Scheme and in preparing my Report.

1.10. I am required to comment on the proposed Scheme and my Report is not concerned with possible

alternatives to the Scheme.

1.11. In order to reflect any updated financial information or circumstances nearer to the date of the Final Hearing, I will provide a Supplementary Report to update my opinions in respect of the Scheme.

Regulatory and Professional Guidance

1.12. My Report has been prepared in accordance with guidance contained in Chapter 18 of the Supervision Manual of the Regulator's Handbook of Rules and Guidance ("SUP 18") for scheme reports relating to the transfer of long-term insurance business. See Appendix 2 for details of how these requirements have been met.

1.13. The Financial Reporting Council ("FRC") has issued standards which apply to certain types of actuarial work. I have prepared this Report, which is a component report under the relevant FRC definitions, with the intention that it, and the work underlying it, should meet the requirements of Technical Actuarial Standards TAS D, TAS M, TAS R (which cover, respectively, data, modelling, and reporting actuarial information), Insurance TAS, and Transformations TAS. I believe that it and my work underlying it does so in all material respects. I have applied all of the principles outlined in the Transformations TAS in reaching the opinions stated in this Report.

Terms of Reference

1.14. The terms of reference for my Report have been agreed with the Regulator and the Companies and are set out in full in Appendix 1.

1.15. In reporting on the Scheme as the Independent Expert, I recognise that I owe a duty to the Court to assist on matters within my expertise. This duty overrides any obligation to the Companies from whom I have received instructions. I am aware of the duties and requirements regarding experts set out in Part 35 of the Civil Procedure Rules.

1.16. My Report should be read in conjunction with the terms of the Scheme and with the reports prepared by the AFHs of GAL, PLA, PLL and NPLL and the Appendix in the NPLL AFH report from the With-Profits Actuary of NPLL.

Reliances

1.17. In performing my review and preparing this Report, I have relied on the accuracy and completeness of data and information provided to me, both written and oral, by the Companies. I have reviewed the information for consistency and reasonableness using my knowledge of the UK life assurance industry but have not otherwise verified it.

1.18. I have used the audited financial information as at 31 December 2012 in this Report to consider the size and mix of the business in the Companies. My analysis of the solvency position of the Companies is currently based on estimates of the pre- and post-Scheme financial position as at 31 December 2012 produced by the Companies and described in Appendix 8. Where possible, the pre-Scheme position is based on the audited financial position of the Companies. I have been in regular contact with the Companies and have taken account of significant known or expected changes between 31 December 2012 and 31 March 2013.

1.19. The Report also comments on a second set of solvency calculations that the Regulators require long-term insurance companies to produce. Known as the "Pillar 2" or Individual Capital Adequacy Standard ("ICAS") calculations, these are not audited, but are submitted to the Regulators on request, who also expect to see evidence that the calculations are used in the risk management of the insurer concerned. I have considered the most recent Pillar 2 financial information (including recent estimates of what the GAL post-Scheme Pillar 2 position would be as at December 2012) in forming my conclusions in relation to the Scheme. The information I have used in this regard is listed in Appendix 9.

1.20. I note that the economic position at the Transfer Date cannot be predicted with certainty. The absolute solvency level may therefore differ from that shown in the Report, but I would not expect the impact of the Scheme to vary significantly from the estimates shown and it is this impact which is my primary

consideration (alongside the Companies continuing to satisfy regulatory solvency requirements, as is currently the case). I will continue to keep the position under review in the period leading up to the Final Hearing, and will prepare further information in my Supplementary Report.

1.21. Selected financial information, written information and data upon which I have relied is noted in Appendix 9.

Limitations

1.22. The Reports have been written in accordance with English law, and have been prepared solely for the use of the Companies and the Court, and solely for the purpose of assisting in determining whether the Scheme should be permitted. They should not be used for any other purpose. The Reports may not be relied upon by any other party for any purpose whatsoever. Neither I nor Deloitte, its partners and staff owe or accept any duty to any other party and shall not be liable for any loss, damage or expense (including interest) of whatever nature which is caused by any other party's reliance on representations in the Reports.

1.23. The Reports should be considered in their entirety, as parts taken in isolation may be misleading.

1.24. A copy of my Reports may be provided to the following parties:

- The Regulators, for the purposes of the performance of their statutory obligations under the FSMA.
- Legal advisers of the Companies (including any non-UK legal advisers) in connection with the Scheme provided that the Companies inform them that i) the draft Reports are confidential and may not be disclosed to any other party without my prior written consent or otherwise as permitted by this letter, and ii) neither Deloitte nor I accept any responsibility or liability to them in respect of any use they may make of the Reports.
- Tax advisers of the Companies (internal and external), subject to any external tax advisers signing an agreed release letter.
- Other insurance regulators who have a legitimate interest in the Scheme.
- The Court, to assist in determining whether the Scheme should be permitted.
- Any other person who has or asserts a right to receive a copy of any of the Reports, as relevant under the terms of the FSMA, or any non-EEA resident policyholder who has or asserts a right to receive a copy of such relevant Reports under the terms of local legislation (an "Interested Party" and collectively the "Interested Parties").
- A copy of the Report may be provided to the relevant court and regulator in the Isle of Man as well as relevant legal advisers solely in connection with the purpose of the Report, should this territory not be excluded from the Scheme, only provided that the aforementioned recipients are made aware that: (i) neither Deloitte nor I accept any responsibility or liability to them in any respect including the use of the Reports; (ii) the Reports have been written in accordance with English Law; and (iii) the Reports apply equally to business written by the Companies in the Isle of Man as they do to business written in the UK, and may therefore be used to satisfy the requirement for a report by an independent actuary on the terms of the local scheme in that jurisdiction (to the extent that any such local scheme is required).

1.25. A copy of the Report may be published on the websites of the Companies and any other Phoenix or Guardian Group Company and made available for inspection at the offices of the Companies' solicitors. Otherwise, this Report (or any extract from it) should not be published without the prior written consent of Deloitte. A summary of the Report, approved by me, will be provided by the Companies to the policyholders of the Companies with an interest in the Scheme. No other summary of this Report may be made without the prior written consent of Deloitte.

1.26. This Report has been prepared in accordance with agreed terms of reference and for a specific purpose. No liability will be accepted for the use of this Report for a purpose for which it was not intended or for the

results of any misunderstandings by any user of this Report. No liability will be accepted under the terms of the Contracts (Rights of Third Parties) Act 1999.

2. Summary and Conclusions

Introduction

2.1. I have been appointed as the Independent Expert to provide the required report on a proposed Scheme for the transfer of designated groups of long-term insurance non-profit immediate annuity business from the Phoenix Companies to GAL. For this purpose, I have been appointed jointly by the Companies and my appointment has been approved by the Regulator.

2.2. The Scheme is intended to be presented to the Court for sanction under Section 111 of Part VII of the FSMA. If approved, it is expected that the Transfer Date upon which the Scheme will become operative will be 30 September 2013.

2.3. This section summarises my Report, setting out my main considerations in respect of the different groups of policyholders affected by the Scheme, and my key conclusions.

Purpose of the Scheme

2.4. The purpose of the Scheme is to complete the acquisition by GAL of designated blocks of long-term insurance non-profit immediate annuity business from the Phoenix Companies. This acquisition process was started last year with the reinsurance to GAL of the bulk of the liabilities arising from the policies proposed to transfer under the Scheme, which took effect from 1 July 2012. These reinsurance arrangements do not form part of the Scheme, but set the context for my consideration of it.

2.5. Under the current arrangements, while the majority of the risk exposures of the Transferring Policies arise in GAL, the policyholders concerned continue to hold policies with the relevant Phoenix Company. The Scheme will break this link and result in all of the Transferring Policies becoming policies with GAL and the policyholders concerned relying solely on GAL for their benefit security and the meeting of their benefit expectations rather than the relevant Phoenix Company.

Overview of the Scheme

2.6. The broad effect of the Scheme will be to transfer designated blocks of long-term insurance non-profit immediate annuity business and assets from the Phoenix Companies to GAL. The Scheme will not affect the terms and conditions of the Transferring Policies including the benefits payable under those policies.

2.7. In particular, the Scheme will transfer the following blocks of non-profit immediate annuity business from the Phoenix Companies to the non-profit fund of GAL:

- Approximately 78,000 annuities in payment, which are currently held in the non-profit fund of PLA.
- Approximately 210,000 annuities in payment, which are currently held in the non-profit fund of PLL.
- Approximately 38,000 annuities in payment, which are currently held in the long-term fund of NPLL.

2.8. As mentioned above, the Transferring Policies were reinsured to GAL by the Phoenix Companies under separate reinsurance arrangements (the "Reinsurance Agreements"), which became effective on 1 July 2012. The majority of the assets backing the liabilities under the Transferred Policies were transferred to GAL as part of the premium under these arrangements. Prior to the implementation of the Scheme, these assets are subject to investment restrictions and collateral arrangements as set out in certain additional agreements ("Security Agreements"), put in place in connection with the Reinsurance Agreements.

2.9. The Reinsurance Agreements will terminate at the Transfer Date at which point the security given under the Security Agreements will also be released. Consequently, the investment strategy in respect of the

assets backing the Transferring Policies will, from that point on, be solely at the discretion of GAL and not subject to the constraints set out in the Reinsurance Agreements.

2.10. In the event of the Scheme not being approved within 18 months of the effective date of the Reinsurance Agreements as a result of a "Reinsurer Related Event" (in summary, if responsibility for the fact that the Scheme has not taken effect is attributable to GAL), the Phoenix Companies have the right, but not the obligation, to terminate the Reinsurance Agreements. There is no current reason to expect that the Scheme will not proceed as a consequence of a Reinsurer Related Event. In addition, the Phoenix Companies have provided assurances to the Regulators and me that there is no intention to recapture the reinsurance in this scenario and, consequently, I have written the Report under the assumption that the Reinsurance Agreements remain in place if the Scheme is not approved.

2.11. Under the current arrangements, the administration of all the Transferring Policies remains the responsibility of the relevant Phoenix Company and is carried out (as it was before the implementation of the Reinsurance Agreements) under outsourcing arrangements with Pearl Group Management Services Limited and Pearl Group Services Limited (the "Phoenix Service Companies"). The Phoenix Service Companies in turn outsource the policy administration to three third party service providers (the "Outsource Service Partners").

2.12. At the Transfer Date, the administration of all the Transferring Policies will become the responsibility of GAL. As discussed in 2.86 and what follows below, the precise structure of the arrangements under which the Transferring Policies will be administered following the Transfer Date remains a matter of ongoing negotiation between GAL and the Outsource Service Partners. However, it is anticipated that, with effect from the Transfer Date, GAL will take on a direct relationship with Diligenta and Capita (two of the Outsource Service Partners) in respect of the management of all the Transferring Policies.

2.13. I have based my opinions on the expected form of the arrangements to be put in place directly between GAL, Diligenta and Capita and will review this in my Supplementary Report once the arrangements are finalised.

2.14. The Scheme requires that assets be transferred from the Phoenix Companies to GAL in respect of an expense reserve for future administration costs. Under the agreement put in place at the same time as the Reinsurance Agreements (the "Annuity Business Transfer Agreement"), this amount is subject to a true-up based on any differences between the calculation of this amount and the terms offered by the Outsource Service Partners to provide a service that is materially the same as the service currently provided.

Main Considerations

2.15. I have considered the likely impacts of the Scheme on the security of policyholders' benefits, policyholder benefit expectations and service levels (including administration, service standards and governance arrangements).

2.16. At a high level I have considered the implications of the Scheme for the following groups of policyholders separately, as the analysis differs in each case:

- Policyholders transferring from the Phoenix Companies to GAL ("Transferring Policyholders"). I have considered the impact for the Transferring Policies originating in each of the Phoenix Companies.
- Policyholders that remain in the Phoenix Companies ("Non-Transferring Policyholders"). I have considered the impact for the policies held by the Non-Transferring Policyholders ("Non-Transferring Policies") in each of the Phoenix Companies.
- Existing policyholders of GAL ("Existing GAL Policyholders"). For this purpose, the policies I have considered (the "Existing GAL Policies") include policies held within the subsidiaries of GAL.

2.17. Another scheme is expected to occur concurrently with this Scheme, although neither is contingent on the implementation of the other, which will facilitate an internal restructure within Guardian (the "Guardian Scheme"). I have also been appointed as the Independent Expert for the Guardian Scheme and will assess the impact of the Guardian Scheme on the GAL Existing Policyholders in a separate report.

However, in this Report I consider whether the impact of this Scheme is likely to be materially different if the Guardian Scheme does or does not go ahead and, as set out in Sections 7 and 8, conclude that my analysis of the impact of the Scheme will be materially the same in both circumstances.

Security of Policyholder Benefits

Factors to consider

2.18. A key concern of the regulatory regime in the UK is the security of policyholder benefits. To this end, insurance undertakings are required to hold a minimum amount of capital in addition to the reserves in respect of their liabilities to policyholders. Furthermore, they are required to be able to demonstrate that they have sufficient assets both to meet these capital requirements and pay policyholder claims as they fall due, even under a range of adverse scenarios. In practice, the regulatory capital requirement is specified as the more onerous of two sets of calculations, known as “Pillar 1” and Pillar 2.

2.19. Under Pillar 1, prudent reserves are required to be held in respect of all guaranteed policyholder liabilities, with an additional solvency capital requirement set at a level based on the more onerous of two approaches (or “peaks”). Under Peak 1, the solvency capital requirement is calculated as the sum of specified percentages of certain balance sheet measures (e.g. 4% of certain reserves and 0.3% of any excess of guaranteed benefit over reserves held). Under Peak 2, which only applies to entities that have with-profits funds of a certain size (including all of the Companies), an assessment is made of the realistic (or market) value of the best estimate with-profits liabilities. To this is added an additional capital margin, sufficient to ensure that the realistic liabilities can be covered under a series of adverse scenarios specified in the regulations. Where the amount of free capital under Peak 2 is lower than Peak 1, a With-Profits Insurance Capital Component (“WPICC”) is added to the result of the factor-based calculation described above based on the difference. The total capital requirement under Pillar 1 is termed the Capital Resources Requirement (“CRR”). The underlying prudent reserves and the additional regulatory capital required are published in the regulatory returns on an annual basis.

2.20. Pillar 2 is a more risk-based capital calculation, which aims to determine the amount of capital required such that, at any time over the following 12 months, the insurer is 99.5% sure of being able to meet the present value of policyholder liabilities falling due in the future. This amount is termed the Individual Capital Assessment (“ICA”) and is part of a private submission to the Regulator. If the Regulator deems this amount to be insufficient, it can impose an additional amount of capital that must be held, by providing Individual Capital Guidance (“ICG”).

2.21. While the minimum capital that an insurer is required to hold is defined in terms of the Pillar 1 CRR, in line with GENPRU 2.1.13, I note that under INSPRU 7.1.6, the Regulator will consider the Pillar 2 ICA as part of its assessment of the appropriateness of the minimum CRR of the insurer. Where the “biting” capital requirement is the ICA, as I consider likely for companies with significant annuity liabilities, I consider the Pillar 2 result to represent the minimum level of capital that could realistically be held without some form of regulator intervention.

2.22. In addition to the regulatory capital requirements, insurance companies will often draw up a capital policy that defines a target (or minimum) level of additional capital that will be held. Target capital levels are often expressed as a percentage of the capital requirement under the Pillar 1 or Pillar 2 regulatory capital requirements.

2.23. The Phoenix Companies and GAL all have such capital policies (respectively, the “PLL Capital Policy”, the “PLA Capital Policy”, the “NPLL Capital Policy” and the “GAL Capital Policy”) and a key factor in considering the potential impact of the Scheme on the security of policyholder benefits is the relative strength of these different capital policies.

2.24. In making this comparison, I do not place any weight on any capital held in excess of the relevant capital policy at any particular point in time, since it may be possible to remove such capital from the company concerned by means of a dividend and, as such, it cannot be relied upon for policyholder benefit security on an ongoing basis.

2.25. All the Companies’ capital policies include a test set out as a margin over the Pillar 1 capital requirements and also some requirements in respect of Pillar 2 capital measures. In the GAL Capital Policy, the Pillar 2

requirement is specified as a margin over the ICA result. In both the PLL Capital Policy and the PLA Capital Policy, separate minimum margins are specified in respect of the ICA and any ICG applying. A single Pillar 2 margin is specified in the NPLL Capital Policy which applies to the Pillar 2 capital requirement (including any ICG where applicable).

2.26. The capital policies of PLL and PLA also include a further test, concerning minimum liquidity levels required for the potential support of their respective with-profits funds.

2.27. The PLL and PLA capital policies are set out in Court-approved schemes which also include governance requirements around changes to the capital policies (particularly in the case of the PLA Capital Policy).

2.28. Since NPLL is a wholly owned subsidiary of PLA, PLA holds capital in respect of NPLL in accordance with the PLA Capital Policy. However, additional targets are also set for the amount to be held within NPLL on a stand-alone basis. These amounts are not documented in a Court-approved scheme, although any change to the NPLL Capital Policy before 31 December 2016 that would have the effect of reducing the amount of capital that must be held is subject to approval by the Regulator.

2.29. Paragraph 13 of the Scheme outlines, at a high level, the governance structure that will apply for changes to the GAL Capital Policy.

2.30. Alongside the details of the capital policies themselves, a key factor in considering the potential impact of the Scheme on the security of Non-Transferring Policyholder and Existing GAL Policyholder benefits is whether the Scheme changes the ability of the Companies to meet the requirements of their respective capital policies.

2.31. I note that the level of capital held by a company is not the only consideration for policyholder security. In particular, I consider wider elements than the capital policy in my assessment of benefit security, such as the approach to breaches of the capital policy and, of particular importance, the governance around changes to it.

2.32. I have also considered the potential impact of the Scheme on the risk profile of the business that the policyholders are exposed to.

Transferring Policyholders

2.33. While the existing Reinsurance Agreements reduce the overall risk exposure within the Phoenix Companies, the benefit security of the Transferring Policyholders is still principally dependent on the financial strength of the Phoenix Companies. In the unlikely event of the insolvency of one of the Phoenix Companies, the annuity payments received from GAL under the Reinsurance Agreements could be used to meet the benefit payments of all of the policyholders in the Phoenix Company and not just the benefit payments of the Transferring Policyholders. Consequently, when considering the impact of the Scheme on the benefit security of the Transferring Policyholders, I do not consider the fact that the business is currently reinsured to GAL to be directly relevant to my conclusion (other than to the extent that the Reinsurance Agreements impact the ability of the Phoenix Companies to meet their respective capital policies).

2.34. As outlined above, a key consideration in assessing the impact of the Scheme on the benefit security of the Transferring Policyholders is the relative strength of the capital policies applying to the Phoenix Companies compared with the GAL Capital Policy (as any assets in the Companies in excess of the capital policy targets at the Transfer Date could be transferred out of the relevant company in due course and so cannot be relied upon for policyholder benefit security).

2.35. The GAL Capital Policy is less strong than the capital policies that apply to the Phoenix Companies in terms of the assets in excess of Pillar 1 and Pillar 2 requirements which are targeted. I have considered whether this leads to a materially adverse impact on policyholder benefit security. In particular, I have considered whether the implementation of the Scheme will lead to a material difference in the risk that policyholder benefits might be subject to a reduction (due to the relevant company being unable to cover the present value of its policyholder liabilities) or in the size of the potential benefit reduction in the event of a reduction. I am satisfied that there is no materially adverse impact on policyholder benefit security on account of the Scheme for the reasons outlined below.

2.36. I note that holding a relatively smaller capital buffer over the Pillar 1 or Pillar 2 regulatory capital requirements will, all other things being equal, increase the likelihood that the regulatory capital requirements might not be covered at any point in time. The failure of an insurer to cover its regulatory capital requirements would lead to some form of regulatory intervention and, for example, the company being required to submit a plan detailing how it will restore its capital to a level above the regulatory capital requirements. It would not, however, necessarily mean that policyholder benefit payments were affected.

2.37. I note also that, were the failure to become public, then it would be important that policyholder communication (whether reacting to queries, or some proactive communication campaign) was effective in helping customers understand the situation and allay any unnecessary fears. It would be important to make clear that failure to meet regulatory capital requirements did not necessarily mean that the security of policyholder benefit payments was affected. Thus, for the purpose of this Report, I concentrate on more extreme situations, as set out in the following paragraphs.

2.38. I note that, for policyholder benefits to be affected, the firm would need to be in the significantly worse financial position of:

- having insufficient assets to cover the Pillar 1 policyholder liabilities; and
- being unable to raise the additional capital required to address the situation.

In such cases, policyholder liabilities would have to be reduced (potentially by a simple mechanism such as a fixed proportion reduction) in order to reflect the assets available to cover them.

2.39. My approach to assessing the relative benefit security under the different capital policies has been to quantify the likelihood that GAL (if it holds capital in line with its current capital policy) will, following extreme events combined with it being unable to raise further capital, have insufficient assets available to cover its assessment of the present value of policyholder liabilities (consistent with the Pillar 2 calculation) and consequently be in a situation where it might be required to reduce policyholder benefits as compared with the position if GAL were to hold capital in line with the target ratios in the capital policies of the Phoenix Companies.

2.40. The analysis indicates that the increased probability of such an occurrence when the target ratios of the GAL Capital Policy are followed as opposed to those of the Phoenix Companies' capital policies is extremely low. Consequently, I am satisfied that the differences in the capital policies of GAL and the Phoenix Companies do not lead to a materially increased chance of a reduction in policyholder benefits.

2.41. It should be noted that the above analysis is dependent on the modelling of the movements in the value of assets and liabilities under very extreme events. There is a high degree of uncertainty inherent in any models that consider such extreme events and the analysis referred to above makes a number of assumptions on the behaviour of the assets and liabilities under extreme events, some of which may not necessarily hold in reality. Nevertheless, I consider that the analysis is sufficient for the purpose of providing an indication of the relative levels of policyholder benefit security.

2.42. The analysis also relies on the comparability of the ICA bases for GAL and the Phoenix Companies. I have compared the appropriate components of both bases and am comfortable that there were no material differences that would invalidate the conclusion in 2.39. I will keep this comparison under review and reconfirm the comparability in my Supplementary Report.

2.43. I have also assessed the potential difference in the size of the benefit reduction that would be applied based on the level of assets currently targeted under the different capital policies, in the event that policyholder benefits needed to be reduced.

2.44. The amount of capital to be held on account of the Transferring Polices under the GAL Capital Policy is, as a proportion of reserves at the Transfer Date, approximately 1% lower than under the strongest of the Phoenix Companies' capital policies. Consequently, in the event that a scenario of the severity outlined in 2.38 occurred, the policy benefits that policyholders in GAL would receive would not be materially different to what they would have received had GAL's Capital Policy targeted a percentage level of capital equal to that targeted under the strongest of the Phoenix Companies' capital policies. In line with the definition of materiality set out in Section 4.3 of this Report, I do not consider this to be a materially adverse impact on

policyholder benefit security, as a result of the low probability of the scenario described above occurring and the relatively small impact on the level of benefits in the event that it did.

2.45. It should also be noted that, although the above analysis implicitly assumes that no additional capital is available at the point of having insufficient assets to meet the policyholder liabilities, this may not be the case in practice. This assumption is simply consistent with my approach of placing no reliance on any assets in excess of the relevant capital policy targets that are held in any one of the Companies at any specific time.

2.46. I am therefore satisfied that, while the GAL Capital Policy is less strong than those currently applying to the Phoenix Companies in terms of assets which are targeted in excess of Pillar 1 and Pillar 2 requirements, this does not lead to a materially adverse impact on the security of policyholder benefits for the Transferring Policies.

2.47. The governance related to changes in the GAL Capital Policy includes the requirement to consult with the Regulator and to take “appropriate actuarial advice”. The GAL Board have confirmed to me that they will explicitly consider the extent to which “appropriate actuarial advice” should include advice from an actuary independent of Guardian in the event that any proposed changes represent a weakening of the GAL Capital Policy relative to the policy in place at the Transfer Date. I consider that this provides an element of protection against changes to the GAL Capital Policy that could have a material adverse impact on policyholder benefit security.

2.48. The Phoenix Companies have agreed, until 31 December 2016, to obtain written consent from the Regulator for any change to the capital policies that would lead to a reduction in the level of capital targeted. In addition, changes to the PLA Capital Policy that would lead to a reduction in the level of capital held require a certificate from an independent actuary stating that they do not believe that the change would lead to a material adverse effect on PLA policyholders. I have considered the differences between these governance requirements and the requirements relating to the GAL Capital Policy and am satisfied that, due to the temporary nature of the Phoenix Companies’ requirement to obtain permission from the Regulator and the confirmation received from the GAL Board, the governance arrangements under the GAL Capital Policy are not materially less strong.

2.49. In contrast to the PAL and PLL Capital Policies, the GAL Capital Policy does not include any explicit requirements around the minimum level of liquid assets that need to be held. I do not consider that this change will have a materially adverse impact on the security of policyholder benefits because the PLA and PLL Capital Policies require sufficient liquid assets to be held to support their respective with-profits funds in the event that they require capital. As this requirement relates to scenarios specific to Phoenix and the liquid assets are not held for the benefit of the Transferring Policyholders, I do not consider that this is relevant when considering benefit security for the Transferring Policyholders. In addition, liquidity risk in GAL is managed in accordance with its Liquidity and Funding Policy, the requirements of which for annuities in payment give me no cause for concern in relation to the Transferring Policies.

2.50. The GAL Capital Policy contains an indication of the expected timeframe under which solvency levels would be returned to the target in the event that they fell beneath the levels specified in the policy. The timeframe under the GAL Capital Policy is longer than the timeframe specified by the Phoenix Companies (which is four months). It is stated in the GAL Capital Policy that the business will be managed in such a way that, in the event that the capital is insufficient to meet the capital policy, it will be returned to the target level within a 12 month timeframe, through what are referred to as “organic actions”. The GAL Board have confirmed to me that, as part of these organic actions, the Board would not approve the payment of a dividend until the levels of capital were restored to the target documented in the GAL Capital Policy. Additionally, they have confirmed that no dividend would be payable at any time that would result in the breaching of any of the requirements of the GAL Capital Policy applying at that time. I do not consider this difference in timeframe to represent a materially adverse impact on the security of policyholder benefits as the GAL Capital Policy still aims for a return to compliance within a reasonably short timeframe and continued non-compliance would be likely to result in regulatory intervention.

2.51. The risk profile of the business within GAL is not identical to the risk profile of the business held in the Phoenix Companies. In particular, the Transferring Policies may be exposed to different risk types and different concentrations of exposure as a result of the Scheme. The Pillar 2 regulatory capital requirement includes a consideration of the actual risks faced by the undertaking and also the relative proportions of each risk (through the allowance made for risk diversification). Consequently, I consider that, provided

the Pillar 2 ICA adequately reflects the risk profile of the GAL business (and I have no particular concerns that lead me to doubt that this will be the case as the calculations are subject to regulatory requirements, signed off by the board and can be reviewed by the Regulators), the change in risk exposure as a result of the Scheme will not have a materially adverse impact on the security of policyholder benefits for the Transferring Policies.

2.52. I note that, should the risk profile of GAL materially change in future as the result of, say, another Part VII transfer or a significant reinsurance transaction, there will be a requirement to consider, in advance of such developments being approved, the impact of such a change on the policyholders held within GAL at that point. Consequently, I only consider the impact of the immediate change in the exposure of the Transferring Policies as result of the Scheme and not potential future changes.

Non-Transferring Policyholders

2.53. There are no changes to the capital policies of any of the Phoenix Companies as a result of the Scheme. Consequently, the key consideration relating to benefit security for these policyholders relates to the impact of the Scheme on the ability of the Phoenix Companies to meet the relevant capital policy.

2.54. As detailed in Section 6, the Scheme is expected to have a small positive impact on the financial strength of the Phoenix Companies on a Pillar 2 basis and a larger positive impact on a Pillar 1 basis, in respect of the transfer of expense and counterparty risks and the termination of the Reinsurance Agreements.

2.55. Thus, I am satisfied that the Scheme will not have an adverse impact on the security of policyholder benefits for the Non-Transferring Policyholders.

Existing GAL Policyholders

2.56. There are no changes to the GAL Capital Policy as a result of the Scheme. As a result, the key consideration relating to benefit security for these policyholders concerns the impact of the Scheme on the ability of GAL to meet its capital policy.

2.57. As detailed in Section 6 of this Report, the Scheme will have little impact on the financial strength of GAL as the major part of the risks associated with the Transferring Policies has already passed to the GAL non-profit fund (“GAL NPF”) through the Reinsurance Agreements put in place in July 2012.

2.58. As discussed in Section 7, of itself, the Scheme will have no material impact on the solvency position, either immediately after the Transfer Date or on the expected position in the future, of the GAL with-profits fund (“GAL WPF”).

2.59. A consequence of the implementation of the Scheme is that GAL will be able to take more risk on the assets backing the annuities than it is permitted to under the Reinsurance Agreements. However, any additional risk that is taken will be reflected in the calculation of the GAL ICA, and hence included in the calculation of the capital required under the GAL Capital Policy. Consequently, the security of Existing GAL Policyholders will depend on the continued management of GAL in line with its capital policy. Thus, I am satisfied that the Scheme will not lead to a materially adverse impact on the security of policyholder benefits for the Existing GAL Policyholders.

Guardian internal Part VII transfer

2.60. Under the Guardian Scheme, the business currently held in the subsidiaries of the GAL NPF, Guardian Pensions Management Limited (“GPM”) and Guardian Linked Life Assurance Limited (“GLLA”) is expected to transfer into the GAL NPF at the same time as this Scheme. The impact of the Guardian Scheme is considered fully in a separate report, but the transfer does not impact materially the levels of capital available nor the aggregate risk exposure within GAL and, consequently, the expected level of security of policyholder benefits for the Transferring Policies.

Solvency II

2.61. The current UK solvency regime will be replaced by a new regime known as "Solvency II". The most recent published implementation date was the 1st January 2014, but this appears certain to be delayed until at least 1st January 2016. Due to this uncertainty, it is unclear how the capital required under Solvency II will compare to that required under the existing regulatory regime.

2.62. If the level of capital required is higher than under the current regulatory regime, this will add to the level of policyholder security, but only if the company concerned can meet the new requirements. The ability of the Companies to meet any higher capital requirement will depend on a number of factors, including how the company is managed over the years leading up to the implementation of Solvency II. I consider that any assessment of the relative abilities of the Companies to meet the capital requirements under Solvency II is highly speculative, due to these areas of uncertainty and the length of time until implementation.

2.63. Thus, in assessing the impact of the Scheme on policyholder benefit security, I consider it is sufficient to concentrate my analysis on the impact under the current regulatory regime.

Policyholder Benefit Expectations

Factors to Consider

2.64. In considering policyholder benefit expectations, I am particularly concerned with situations where the benefit amount payable to policyholders is impacted in some way by the discretionary choices made by management.

2.65. This can happen, for example, for with-profits business, where the insurer will typically have discretion in a number of areas that could influence policyholder payouts (for example, concerning investment strategy, the size of any regular bonuses declared and the application of smoothing of investment returns to policyholder payouts). UK regulations require that the way in which an insurer exercises discretion in its management of its with-profits business be set out by it in a public document, known as the Principles and Practices of Financial Management ("PPFM"). Thus, in considering the potential impact of a scheme on the benefit expectations of with-profits policyholders, the Independent Expert will typically pay particular attention to any situation in which the relevant PPFM document might be changed by the scheme.

2.66. Some aspects of discretion around with-profits business will typically be exercised taking account of the financial strength of the fund concerned. Thus, for with-profits business, there can be a link between with-profits policyholder benefit expectations and financial strength. As a consequence, in considering the potential impact of a scheme on the benefit expectations of with-profits policyholders, the Independent Expert will also typically pay particular attention to any situation in which the scheme changes the financial position of the relevant fund to such an extent that it could influence how management would be expected to exercise the discretion available to them under the associated PPFM.

2.67. Management discretion can also play a part in the benefit expectations for unit-linked business, where the number of units on which a policyholder's payout will be based depends on the level of charges applied (via unit deductions) and the level of at least some of these charges can be varied by the insurer in certain circumstances – for example, it may be that charges for life cover can be varied depending on the insurer's mortality experience.

2.68. For non-unit-linked, non-profit policies there is no management discretion on the level of policyholder benefits at maturity, so the policyholder benefit expectations are defined by the terms and conditions of the policy. There may be a degree of management discretion applicable to the level of benefits payable on early surrender for these policies.

Existing GAL Policyholders

2.69. There are four groups of Existing GAL Policyholders whose benefit expectations need to be considered:

- Long-term insurance policyholders whose policies are in the GAL NPF;

- Long-term insurance policyholders whose policies are in the GAL WPF;
- PHI business in the PHI fund; and
- General insurance policyholders whose policies are in the GAL shareholder fund.

2.70. The Scheme will not alter the terms and conditions of any of these groups of policies.

2.71. Within the GAL NPF, there are unit-linked policies under which GAL management has discretion around the setting of certain charges. The Scheme will not alter the extent of this discretion.

2.72. Within the GAL NPF (despite its name), there are also some with-profits policies. The guarantees on these policies are so far "in the money" that the exercise of management discretion is unlikely to influence policyholder payouts, at least at maturity, as the guarantees are expected to bite with a high degree of certainty. Where elements of management discretion could have an impact on the benefits payable (for example at surrender), the Scheme will not alter the extent of any applicable management discretion or have a direct influence on the management decisions that could be taken.

2.73. The benefits of the remaining business in the GAL NPF, the general insurance business in the GAL shareholder fund and the PHI business in the PHI fund are not dependent on any elements of management discretion at maturity. Where such policies have a surrender value, the Scheme will not alter the extent of any applicable management discretion.

2.74. Within the GAL WPF, there are with-profits policies whose guarantees are not so far in the money, and for which the exercise of management discretion could play a more significant role in determining the size of policyholder payouts. However, as with the GAL NPF with-profits policies, the Scheme will not affect the way in which the GAL WPF policies are managed or the operation of discretion affecting these policies. It also makes no material change to the financial position of the GAL WPF fund at the Transfer Date and is not expected to materially affect the solvency position in the future (as discussed in Section 7).

2.75. Thus, I am satisfied that the Scheme will not have a materially adverse impact on the benefit expectations of the Existing GAL Policyholders.

Transferring Policyholders

2.76. There is no discretion involved in calculating the benefits payable under the Transferring Policies. They are all non-profit annuities in payment. Some of the policies have fixed annuity amounts, but some have pre-agreed benefit escalation features (either fixed increase rates or increases in line with specified indices). The Scheme makes no changes to these arrangements or to any other aspect of the terms and conditions of these policies.

2.77. Thus, I am satisfied that the Scheme will not have any impact on the benefit expectations of the Transferring Policyholders.

Non-Transferring Policyholders

2.78. The Scheme will not alter the terms and conditions of any of the Non-Transferring Policies in the Phoenix Companies.

2.79. The policies transferring from PLA and PLL are coming from non-profit funds and the Scheme will have no material impact on the with-profits funds in those companies. Thus, of itself, the Scheme makes no changes to the operation of any discretion that influences policyholder payouts in these two companies.

2.80. The policies transferring from NPLL are transferring from its only long-term insurance fund, which includes with-profits business. However, the Scheme will not change the way in which NPLL's with-profits business is managed and will have no impact on policy asset shares. Further, the majority of the liabilities under this block of the Transferring Policies have already been reinsured out of the fund through the relevant provisions of the Reinsurance Agreements and so the Scheme will not result in a material change to the financial position of the NPLL long-term insurance fund. Thus, of itself, the Scheme makes no changes to the operation of any discretion that might influence policyholder payouts in NPLL.

2.81. The Scheme removes expense risk from the Phoenix Companies, along with the counterparty risk associated with the Reinsurance Agreements. Consistent with this, the estimated impact of the Scheme, as at 31 December 2012, demonstrates that the Scheme results in a capital benefit to the Phoenix Companies.

2.82. Thus, I am satisfied that the Scheme will not have any material impact on the benefit expectations of the Non-Transferring Policyholders.

Service standards and investment management

2.83. The administration of the Existing GAL Policies is not changing as a result of the Scheme. I am satisfied that there is not likely to be a materially adverse impact on the standards for these policies as a result of the Scheme.

2.84. Outsourcing arrangements are in place covering the service and administration of Non-Transferring Policies. These are not changing as a result of the Scheme and so I am satisfied that there is not likely to be a materially adverse impact on the standards for these policies as a result of the Scheme.

2.85. As non-profit annuities in payment, I view the key consideration for the Transferring Policyholders to be continuity of payments under their policies, which is dependent on the administration arrangements that will operate post Scheme.

2.86. The Annuity Business Transfer Agreement into which the Phoenix Companies and GAL entered at the date of the Reinsurance Agreements envisages that the administration of the Transferring Policies will continue to be carried out by the Outsource Service Partners and overseen, on behalf of GAL, by the Phoenix Service Companies for a period following the Transfer Date (the "Transitional Services Period"). The Annuity Business Transfer Agreement sets out general principles with respect to the contents of a “Transitional Services Agreement” which would cover the precise arrangements for the Transitional Services Period. In summary, it is anticipated that the current administration arrangements (where Phoenix management oversees the Outsource Service Partners) will remain in place until an agreed transfer date up to two years after the receipt of an “Acceptable Offer” from the Outsource Service Partners to continue the outsourcing arrangement under a direct contract with GAL at a service level not materially lower than currently offered.

2.87. I understand that the parties have now agreed that it would be preferable for GAL to have a more direct responsibility for the administration of the Transferring Policies with effect from the Transfer Date, rather than for there to be a Transitional Services Period where the Phoenix Service Companies remain involved. I further understand that GAL intends to put in place direct arrangements with Diligenta and Capita, two of the Outsource Service Partners, that will take effect from the Transfer Date and that these arrangements are currently being negotiated; and that GAL intends that responsibility for administering those Transferring Policies which are currently administered by HCL (the third Outsource Service Partner) will either be migrated to Diligenta or taken over by GAL itself in-house (or, in the event that GAL is not able to do so by the Transfer Date, that GAL will enter into a short-term direct relationship with HCL for the provision of administration services until the migration to a new provider can be completed).

2.88. I have based my conclusion on the current expected form of the arrangements that will be put in place between GAL, Diligenta and Capita. I will review my conclusion in my Supplementary Report when the details are finalised.

2.89. Although it is expected that GAL will use the service providers as set out in paragraph 2.86 above with effect from the Transfer Date, in the event it chose to self-administer the Transferring Policies (including those policies currently administered by HCL), there could be an impact on the Transferring Policies and the Existing GAL Policies. GAL has stated that there is no intention to reduce the service standards for policies as a result of the Scheme and policyholders are protected by GAL's obligation to Treat Customers Fairly.

2.90. Following the Transfer Date there will be a change in governance and GAL will be directly responsible for the governance of administration service arrangements. I have seen evidence that several members of the senior management team at GAL have previous experience governing large outsourcing arrangements and, while they are still in post, I do not view there to be a material risk of a change in

standards as a result of the change in governance. In the event that there is a change in senior management, it will be important that those appointed have similar expertise and experience.

2.91. Thus, I am satisfied that the Scheme will not have a materially adverse impact on the service standards and the effectiveness of how they are overseen.

2.92. With the exception of any impact on benefit security as discussed in relation to the Existing GAL Policyholders in 2.59, the benefits payable on the Transferring Policies have no dependence on the investment management of the assets considered to be backing them. The Scheme does not make any changes to the investment management of the with-profits and unit-linked business in GAL or the Phoenix Companies, where benefits may depend on the performance of underlying investments.

2.93. Thus I am satisfied that the Scheme will not have a materially adverse impact on policyholders as a result of changes in investment management.

Equitability of Scheme

2.94. I have concluded that the Scheme will not have a materially adverse impact on any of policyholders in GAL and the Phoenix Companies. Consequently, I am satisfied that the Scheme is equitable to all classes and generations of policyholders in GAL and the Phoenix Companies.

Conclusions

2.95. With regard to security of benefits, on implementation of the Scheme, all groups of policyholders will benefit from solvency coverage that is targeted to be maintained at a level well in excess of that required by UK regulations. So long as that continues to be targeted, and there are safeguards in place to ensure that it is, I do not consider that the Scheme will materially adversely affect the security of benefits for any group of policyholders.

2.96. I am satisfied that all groups of policyholders in PLL, PLA, NPLL and GAL will experience no material change to their benefit expectations as a result of the Scheme.

2.97. With regard to service standards and investment management, I am satisfied that, of itself, the Scheme will not have a materially adverse impact for policyholders.

2.98. I am satisfied that the Scheme will be equitable to all classes and generations of policyholders in GAL and the Phoenix Companies.

3. Outline of the Scheme

Overview and Purpose of the Scheme

3.1. The purpose of the Scheme is to transfer designated blocks of non-profit immediate annuity long-term insurance business and assets of the Phoenix Companies to GAL, without affecting the contractual policy benefits or substantially changing how the business is managed.

3.2. These designated blocks are already reinsured to GAL by the Phoenix Companies under separate Reinsurance Agreements which became effective on 1 July 2012. This Scheme will effect the transfer of business covered by these agreements to the non-profit fund of GAL and the Reinsurance and associated agreements will be terminated.

3.3. Assets relating to the reserves in respect of these blocks of business have already been transferred to GAL in line with the Reinsurance Agreements. Under the Scheme, the Phoenix Companies' rights and obligations in respect of the Transferring Policies will transfer to GAL, together with certain additional assets. The Security Agreements associated with the Reinsurance Agreements will be terminated with effect from the Transfer Date.

3.4. I include in the remainder of this Section a more detailed outline of the Scheme and its key features, as well as some information on the Reinsurance and associated Agreements.

Background on the companies

3.5. NPLL, PLL and PLA are all wholly-owned indirect subsidiaries of Phoenix Group Holdings, which is the ultimate parent company of the Phoenix Group. Details of the structure and business of the Phoenix Group, PLL, NPLL and PLA can be found in Appendices 4 to 7.

3.6. GAL is a wholly-owned subsidiary of Guardian Financial Services Holdings UK Limited, which is ultimately owned by Cinven. Details of the structure and business of Guardian Financial Services Holdings UK Limited can be found in Appendix 3.

3.7. In advance of the Scheme, a series of agreements relating to the Transferring Policies was put in place with effect from 1 July 2012.

- The Annuity Business Transfer Agreement sets out the parties' agreement to transfer the Transferring Policies from the Phoenix Companies to GAL and various arrangements to be put in place relating to the Scheme, including with respect to the transfer of administration services and associated costs to GAL. Some elements of this apply to the period immediately after the Scheme.

- The Reinsurance Agreements effected the reinsurance of the Transferring Policies to GAL, thereby transferring the bulk of the risk and reward associated with the Transferring Policies with effect from 1 July 2012, and contained provisions relevant to this reinsurance, including investment restrictions relating to the assets backing the reinsured business.

- Security Agreements – GAL also charged the assets backing the reinsured business as security for the performance of its obligations under the Reinsurance Agreements under the terms of the Security Agreements.

3.8. These agreements are discussed in more detail later in this Section.

Summary of the Scheme

Transferring Policies

3.9. The Scheme will transfer the following blocks of business from the Phoenix Companies to the non-profit fund of GAL.

- Block 1: Approximately 78,000 annuities in payment currently held in the non-profit fund of PLA.
- Block 2: Approximately 210,000 annuities in payment currently held in the non-profit fund of PLL.
- Block 3: Approximately 38,000 annuities in payment currently held in the long-term fund of NPLL.

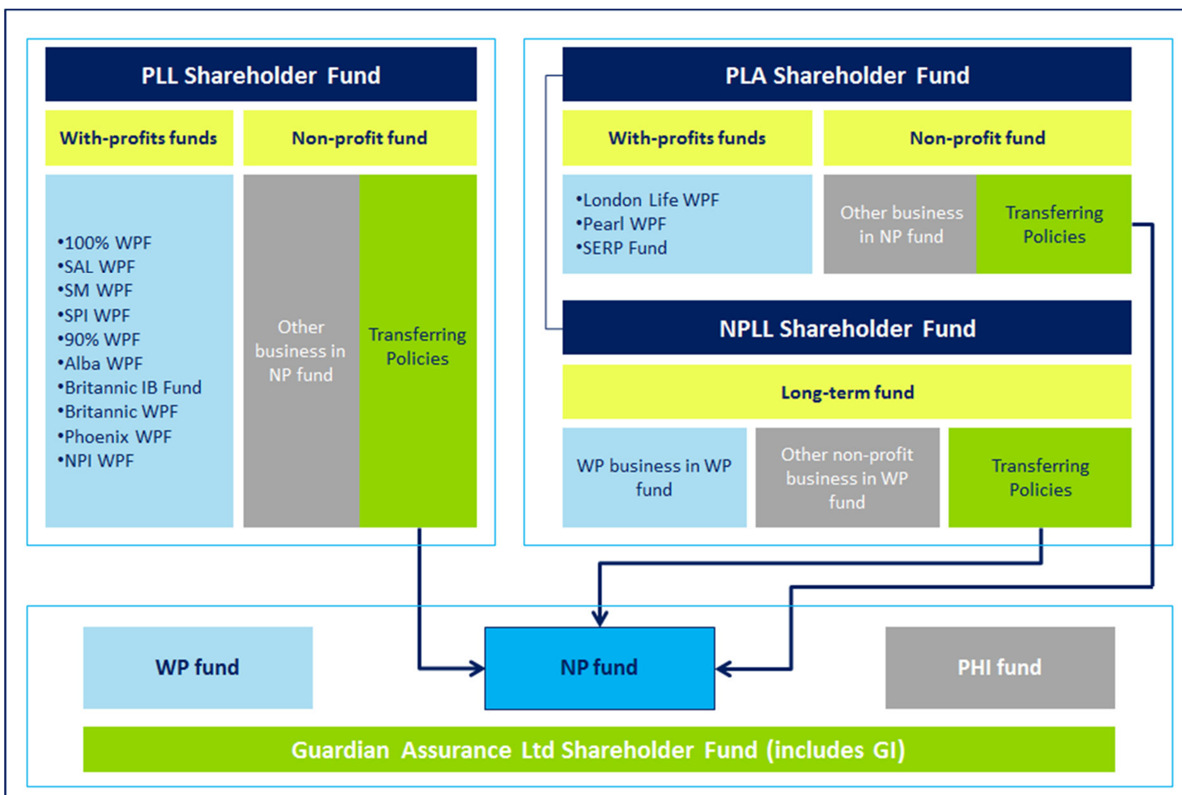
3.10. The Scheme provides for policies which cannot be transferred to GAL on the Transfer Date, or which GAL and the Phoenix Companies agree should not transfer, to remain with Phoenix ("Residual Policies"). These policies may not transfer because, for example, the necessary certificate has not been issued in respect of any Transferring Policy for which the state of commitment is an EEA state other than the UK, or because the relevant policy is not capable of being transferred pursuant to the FSMA at the Transfer Date. However, the Phoenix Companies have informed us that they do not expect there to be any such Residual Policies.

3.11. The Residual Policies will remain with the Phoenix Companies but will be fully reinsured to GAL (under the terms of the Scheme) with effect from the Transfer Date, allowing them to be treated as far as possible in the same way as if they had transferred under the Scheme until the relevant obstacle to their transfer has been removed and they can be transferred to GAL. The reinsurance in respect of these policies will terminate automatically in 6 months from the Transfer Date, at which point assets sufficient to cover the liabilities and capital requirements in respect of these policies will be transferred to the Phoenix Companies. At this point, any remaining Residual Policies will become "Excluded Policies" and will not transfer to GAL.

3.12. The Transferring Policies do not include any policies which constitute Jersey or Guernsey policies and therefore a separate scheme will not be required in respect of these territories.

3.13. A diagram summarising the policies to be transferred under the Scheme is provided below.

3.14. Figure 3.1 – Illustration of Transferring Policies under the Scheme



Assets and Liabilities Transferring

3.15. As a consequence of the reinsurance of the Transferring Policies to GAL, the majority of the assets backing the Transferring Policies have already been transferred to the GAL non-profit fund. These assets are subject to the security arrangements and investment restrictions set out in, respectively, the Security Agreements and Reinsurance Agreements put in place with effect from 1 July 2012.

3.16. GAL will assume responsibility for the management of the policies and full freedom in the investment management of the assets at the Transfer Date.

3.17. On the Transfer Date, liabilities and reserves in respect of administration services will transfer to GAL and a payment (the "Initial Expense Reserve Amount") will be made. The Scheme states that the assets backing this Initial Expense Reserve Amount ("IERA") will be cash and government debt.

Capital Policy of GAL

3.18. The Scheme requires that the GAL Capital Policy may only be amended if the Guardian Board is satisfied that the amendment is appropriate:

- having taken appropriate actuarial advice;
- having consulted with the Regulators; and
- having regard to its obligations to treat policyholders fairly.

Agreements prior to the Scheme

3.19. In advance of the Scheme, as mentioned in 3.7 above, a series of agreements relating to the Transferring Policies was put in place with effect from 1 July 2012.

Annuity Business Transfer Agreement

3.20. The Annuity Business Transfer Agreement sets out the parties' agreement to transfer the Transferring Policies from the Phoenix Companies to GAL in accordance with the Scheme, the Reinsurance Agreements and various other transaction documents. It included various provisions relating to the transfer including:

- Details relating to the provision of administration services during a Transitional Services Period. The two key elements of this are the calculation and payment of amounts of expenses relating to the administration of the Transferring Policies, including true-up payments, and the Transitional Services Agreement ("TSA"). However, as discussed in paragraph 2.87, it is currently expected that there will not be a Transitional Services Period and that, from the Transfer Date, the administration of the Transferring Policies will be covered by direct arrangements between GAL and certain of the Outsource Service Partners.

- Terms relating to the conduct of the Phoenix Companies and GAL prior to the Transfer Date, covering communication, notification and compliance.

Costs of the Scheme

3.21. The Annuity Business Transfer Agreement provides that each of the Phoenix Companies and GAL will pay their own costs incurred in connection with the preparation and implementation of the Scheme. This excludes the costs of the Independent Expert and any jointly-appointed counsel for the transfer, court fees, advertisements placed for the transfer and costs incurred in transferring the Residual Policies. For such costs, 50% will be paid by GAL and 50% will be borne by the Phoenix Companies.

Administration services

3.22. The administration of the Transferring Policies is currently carried out for the Phoenix Companies by the Phoenix Service Companies under outsourcing arrangements which also cover the administration of the Non-Transferring Policies. The Transferring Policies are parts of blocks of business which are covered by outsourcing arrangements between the Phoenix Service Companies and three Outsource Service Partners based on four different platforms.

3.23. The Annuity Business Transfer Agreement envisages that the administration of the Transferring Policies will continue to be carried out by the Outsource Service Partners and overseen, on behalf of GAL, by the Phoenix Service Companies for a Transitional Services Period. The Annuity Business Transfer Agreement sets out general principles with respect to the contents of a Transitional Services Agreement which would cover the precise arrangements for a Transitional Services Period. In summary, it is anticipated that the current administration arrangements will remain in place until an agreed transfer date, up to two years after the receipt of an "Acceptable Offer" from the Outsource Service Partners to continue the outsourcing arrangement under a direct contract with GAL, at a service level not materially lower than currently offered.

3.24. I understand that the parties have now agreed that it would be preferable for GAL to have a more direct responsibility for the administration of the Transferring Policies with effect from the Transfer Date, rather than for there to be a Transitional Services Period where the Phoenix Service Companies remain involved. I further understand that GAL intends to put in place direct arrangements with Diligenta and Capita, two of the Outsource Service Partners, that will take effect from the Transfer Date and that these arrangements are currently being negotiated; and that GAL intends that responsibility for administering those Transferring Policies which are currently administered by HCL (the third Outsource Service Partner) will either be migrated to Diligenta or taken over by GAL itself in-house (or, in the event that GAL is not able to do so by the Transfer Date, that GAL will enter into a short-term direct relationship with HCL for the provision of administration services until the migration to a new provider can be completed).

3.25. I will revisit this section in the Supplementary Report, when the administration arrangements to be in place, with effect from the Transfer Date, have been finalised.

Expense reserves and true-ups

3.26. Under the Annuity Business Transfer Agreement, the following reserves, expense payments and true-ups are payable:

- The Initial Expense Reserve Amount is payable from the Phoenix Companies to GAL, being the Phoenix Companies' best estimate of the future outsourcer costs in relation to the Transferring Policies at the Transfer Date.

- GAL is responsible for paying the Phoenix Service Companies the actual outsourcer costs over the Transitional Services Period. However, as noted in paragraph 3.24 above, it is currently anticipated that GAL will enter into direct arrangements for the administration of the Transferring Policies with effect from the Transfer Date.

- True-ups are payable between GAL and the Phoenix Companies in respect of any differences in the actual number of policies and the market conditions at the Transfer Date and the number assumed for the purposes of calculating the Initial Expense Reserve Amount.

Reinsurance Agreements

3.27. There are separate Reinsurance Agreements covering the Transferring Policies of PLA, PLL and NPLL. These have been effective since 1 July 2012.

3.28. The Reinsurance Agreements were entered into in anticipation of the transfer. All of the Transferring Policies are covered by these agreements. Under the Reinsurance Agreements GAL is financially responsible for payment of the annuity claims but the Phoenix Companies continue to bear the administration costs.

3.29. Each of these Reinsurance Agreements will automatically terminate on the Transfer Date, but they will remain in place if the Scheme does not go ahead, other than if the Phoenix Companies exercise their option to terminate as a result of a Reinsurer Related Event (in summary if responsibility for the fact that the Scheme has not taken effect is attributable to GAL).

3.30. In the event that such a situation arises, the Phoenix Companies have the right, but not the obligation, to terminate the Reinsurance Agreements. There is no current reason to expect that the Scheme will not proceed as a consequence of a Reinsurer Related Event. The Phoenix Companies have provided assurances to the Regulators and me that there is no intention to recapture the reinsurance in this

scenario and, consequently, I have written the Report under the assumption that the Reinsurance Agreements remain in place if the Scheme is not approved.

3.31. The Reinsurance Agreements include restrictions relating to the management of the assets backing the liabilities reinsured to GAL from the Phoenix Companies. The key investment restrictions relate to the type of assets which can be held, the credit rating of assets purchased, the maximum exposure to certain asset classes and the level of sensitivity of the value of the assets, relative to the sensitivity of the liabilities, to small changes in interest rates.

Security Agreements

3.32. As part of the reinsurance of the Transferring Policies, GAL was required to open certain accounts with a custodian (Citibank N.A. in the first instance), to which the assets backing the Transferring Policies were transferred by the Phoenix Companies. GAL gave a charge over the assets credited to these accounts in favour of the Phoenix Companies, as security for its performance of its obligations under the Reinsurance Agreements under the terms of the Security Agreements.

Guardian internal scheme

3.33. Under the Guardian Scheme, Guardian is proposing to implement an internal transfer of long-term insurance business from GLLA and GPM (two subsidiaries of GAL) to GAL.

3.34. While the implementation of either scheme is not contingent on the implementation of the other, the Guardian Scheme is expected to be implemented concurrently with the Scheme considered in this Report.

3.35. I will assess the impact of the Guardian Scheme in detail in a separate report. However, in this Report I will consider whether the impact of this Scheme is expected to be materially different depending on whether or not the Guardian Scheme goes ahead.

4. The Role of the Independent Expert

Overview

4.1. The Independent Expert is asked to prepare a scheme report in a form approved by the Regulators and in accordance with the guidance contained in SUP 18. The purpose of this scheme report is to assist the Court in deciding whether to sanction the scheme. This Report is the Independent Expert scheme report for the Scheme described in 1.2 and 1.3.

4.2. As Independent Expert, I need to consider the effect that the Scheme may have on the various classes of policyholders in the Companies which are affected by the Scheme. In doing so, I consider separately:

- Transferring Policyholders, which in the case of the Scheme are the holders of designated policies in PLA, PLL and NPLL;
- Non-Transferring Policyholders of PLA, PLL and NPLL whose contracts will not be transferring under the Scheme; and
- Existing GAL Policyholders, that I take to include not just those Policyholders of the transferee company, GAL, but also those of its direct subsidiaries (GLLA and GPM).

4.3. For any group of policyholders affected by a scheme of transfer, there may be some changes for the better and some for the worse. If there are some changes for the worse, this does not necessarily mean that the Scheme is unfair or unreasonable, as they might be outweighed by other benefits, or they might be extremely small. The test I have applied in considering this Scheme is whether the position of any group is, in the round, “materially adversely affected” – this phrase is used in the context of considering policyholder security in SUP 18.2 of the Regulator’s Handbook. The word “material” is not defined, so where there are adverse changes I have attempted to give some context as to their size or likelihood of occurring. If a potential effect is very unlikely to happen and does not have a large impact, or if it is likely to happen but has a very small impact, I do not consider it material.

4.4. In considering the effect of the Scheme on any group of policyholders and as required by SUP 18, I have reviewed in particular the likely impact on:

- the security of policyholders’ benefits;
- policyholders’ benefit expectations, particularly for policies where benefits are significantly dependent on the exercise of discretion; and
- service levels.

4.5. The effect of the Scheme on policyholders will depend on the type of policy held. The Transferring Policies are all non-profit policies which provide guaranteed benefits in return for the fixed premiums which have already been paid. For these the security of future benefits is of paramount importance and is the focus of my consideration. Where the Scheme could impact policies which include discretionary benefits, such as with-profits policies, I need to consider the implications of the Scheme for how this discretion might be exercised as well as for the security of benefits.

4.6. Some policies have other discretionary elements, such as the level of charges on unit-linked policies or policies with reviewable premiums. None of the Transferring Policies have these features and, for Non-Transferring Policies, the Scheme has no direct impact on management discretion and therefore there is no need for me to consider the future exercise of discretion for charges and premium reviews.

4.7. In my role as the Independent Expert I am not required to consider the possible effects on new policyholders entering into contracts after the Transfer Date, and I do not do so in this Report.

4.8. Except where I have commented on the forthcoming Solvency II regime, all of my considerations are made in the context of the current UK regulatory regime for life insurance companies.

4.9. I have considered the Scheme only in the form in which it is to be presented to the Court. I am not required to, and do not, consider any possible alternative schemes or arrangements.

5. Capital Requirements and Capital Policies

Introduction

5.1. In this Section I explain the capital requirements that the Companies must satisfy under UK regulations and the internal capital policies they have put in place.

5.2. The capital policies influence the ability of the Companies to meet the regulatory requirements and are key to my analysis of the effect of the Scheme on the security of benefits of the Transferring Policyholders, the Non-Transferring Policyholders and the Existing GAL Policyholders, the conclusions on which are set out in Sections 7 to 9.

5.3. Changes are expected to the regulatory regime in the form of Solvency II and, in what follows, I comment on the extent to which I have taken account of any potential implications of these changes in my consideration of the Scheme.

Current Supervisory Regime

5.4. The Regulators are responsible, amongst other things, for the supervision of UK authorised insurance companies. One of the aims of the Regulators' supervisory regime is to ensure that, as far as possible, insurance companies remain solvent and will be able to meet policy claims when they fall due and fulfil the benefit expectations of their policyholders.

5.5. In April 2013, the Financial Services Authority ("FSA") was replaced by the Financial Conduct Authority ("FCA") and the Prudential Regulation Authority ("PRA"). The FCA is responsible for, amongst other things, consumer protection including matters relating to the fair treatment of policyholders. The PRA's role is defined in terms of two statutory objectives to promote the safety and soundness of the firms (including insurers) that it regulates and, specifically for insurers, to contribute to the securing of an appropriate degree of protection for policyholders. Throughout this Report, references to the Regulator(s) should be read as meaning:

- the FSA, for references related to the period before April 2013; and
- the PRA, the FCA or both (as the context requires), for references related to the period from April 2013 onwards.

5.6. Since life insurance business can be very long-term, with some contracts lasting for 30 years or more, it is necessary to set solvency standards and monitor insurance companies against those standards. No supervisory regime can ensure that every company will remain solvent in all possible circumstances, but a good one will ensure that the chance of an insurance company becoming insolvent is remote. Furthermore, a good regime acts as an early warning system, permitting remedial action to be taken if a company starts getting into financial difficulty.

5.7. The current regulatory capital requirements for a UK life insurer are based on satisfying at all times two minimum standards, referred to as Pillar 1 and Pillar 2. Companies are required to ensure that they have adequate capital to meet these requirements at all times during the year, and failure to do so could lead to the regulator imposing restrictions on how the business is run.

5.8. The Pillar 1 calculations are split into two parts, known as "peaks". Under Peak 1 of Pillar 1, admissible assets are taken at market value and reserves are set up to cover a fund's liabilities. These liabilities exclude non-guaranteed discretionary payments and are valued using assumptions that include prudent margins. Additional solvency capital, expressed as a percentage of reserves and of sums at risk (excess of guaranteed benefit over reserves held), is required in addition to the base reserves. The additional solvency capital is known as the Long-Term Insurance Capital Requirement ("LTICR"). This calculation is commonly referred to as the "regulatory peak".

5.9. Insurance companies such as GAL, PLA, PLL and NPLL, which have a with-profits fund in excess of £500m, are also required by UK regulations to report under Pillar 1 on a realistic, "market consistent", basis. In this second calculation, assets are again taken at market value, while liabilities include allowance for any non-guaranteed benefits that are expected to be paid. The liabilities are valued using best estimate assumptions including a

"market consistent" value of guarantees. A Risk Capital Margin ("RCM") is held in addition to the realistic liabilities, reflecting the additional capital that would be needed in moderately adverse scenarios specified in the Regulator's rules. These calculations are referred to as the "realistic peak", or Peak 2 of Pillar 1. If the excess assets after the RCM are less than the excess assets under the regulatory peak, then an addition, called the WPICC, is made to the regulatory peak capital requirements based on the difference less an allowance to reflect any liability to pay shareholder transfers. This ensures that the more onerous requirement of the two peaks is met under Pillar 1.

5.10. For companies subject to the realistic peak requirements, the CRR is set equal to the sum of the LTICR and any WPICC. For those companies subject only to the regulatory peak requirements, the CRR is the sum of the LTICR and a Resilience Capital Requirement ("RCR"), calculated based on specified market risk stresses.

5.11. The main Pillar 1 focus of my analysis will be the regulatory peak as (with the exception of NPLL) the Transferring Policies are moving from a non-profit fund within the Phoenix Group to a non-profit fund within GAL and Peak 2 relates to with-profits funds. The Transferring Policies from NPLL are currently written in a with-profits fund and for that business I will consider the biting peak.

5.12. Pillar 2 requires that each UK insurance company undertakes its own ICA. The ICA is based on an analysis of the various risks affecting the company (including market, credit, insurance, operational and liquidity risk), the results of various stress and scenario tests, and an overall assessment of the amount and type of capital required to meet those risks. Companies can set their own risk tolerance which must be based on a confidence level at least as high as the Regulator's minimum standard of a 99.5% solvency confidence level over one year. The Regulator may issue ICG requiring the insurance company to hold additional capital if the Regulator feels that the ICA is insufficient to meet the minimum 99.5% confidence level. This may occur, for example, if the Regulator is not satisfied with the severity of the stress scenarios used by the company, or if it is not satisfied that the company has fully taken into account all of its risks. This effectively means that a company with sufficient capital to meet the higher of its ICA and ICG should (at least) be able to withstand an event or combination of events of a severity expected to occur on average only once every two hundred years and still be able to meet its best estimate liabilities.

5.13. Insurance companies are required to publish their Pillar 1 calculations each year and these are externally audited. Pillar 2 figures are not published or audited and are commercially sensitive. However, the Companies have made their Pillar 2 figures available to me in my role as Independent Expert for the Scheme. I have reviewed the Companies' estimated Pillar 1 and Pillar 2 figures pre and post-Scheme to assess the impact on the security of policyholders' benefits. Although the Pillar 2 calculations are not shown in my Report, I have included a qualitative summary of the relevant findings emerging from my analysis.

5.14. As explained in Paragraph 1.18, the Pillar 1 and Pillar 2 calculations shown or referred to in this report are company estimates as at 31 December 2012 and, where possible, have been based on audited results. I have used this information in my assessment of whether the Companies are expected to meet their various regulatory solvency requirements at the time of the Scheme. I will continue to monitor the financial impact of the Scheme with any updated analysis provided by the Companies as the Transfer Date approaches, and will comment on any developments in my Supplementary Report as necessary.

5.15. My main concern is to consider the impact of the Scheme on the solvency position. Mis-estimates of the base position, as long as they are not too large, do not necessarily affect my consideration to a material extent. I would, however, be concerned if any mis-estimate led to doubt about whether the minimum solvency requirements were being met.

5.16. Companies will usually choose to hold a level of capital in excess of the capital requirements determined under the above Pillar 1 and Pillar 2 assessments, if only because they will want to ensure that they can continue to meet their solvency requirements in adverse conditions, or in order to satisfy rating agency requirements or their own internal capital standards. The level of capital that a company wishes to hold is often set out in an internal capital policy. In such situations, any capital which a company happens to be holding in excess of its capital policy requirements cannot be relied upon for benefit security as it may be distributed out of the company via dividends. The internal capital policies of GAL and the Phoenix Companies are explained later in this Section.

Solvency II

5.17. The regulatory capital regime for insurers is due to be superseded by a new European Directive, referred to as Solvency II. The Solvency II regime is designed to enhance policyholder benefit security by better reflecting the risk profile of the insurance undertaking. The latest timetable approved by the European Parliament has an implementation date of 1 January 2014. However, a delay is expected as some areas of the rules are still to be agreed and it is likely that implementation will now be on 1 January 2016 at the earliest. The Framework Directive for Solvency II was issued by the European Parliament and Council of the European Union in 2009 but

changes to this Directive are expected under what is known as Omnibus II. Omnibus II will amend some aspects of the Directive including governance changes and will move elements from the current implementing measures (known as Level 2) into the Directive itself. Some draft implementing measures and guidance are available, but these cannot be finalised until Omnibus II has been agreed.

5.18. One of the outcomes of Omnibus II is expected to result in changes to the discounting of contracts with long-term guarantees and has been the subject of heated debate. Consequently, it was decided that an assessment of the impact of a package of measures in a variety of economic conditions, aimed to inform the requirements that will ultimately be set (the Long-Term Guarantees Assessment "LTGA"), should be carried out across Europe. The field work by the insurance companies selected to take part, was due to be completed by the end of March 2013, before being passed to the appropriate regulators for review. It is planned that the results of the assessment will be published by the end of June 2013.

5.19. There are still significant areas of uncertainty under Solvency II and it is not certain that the new rules will lead to an increase in the level of capital that is required to be held in respect of any of the groups of policies considered in this Report. Solvency II does not, of itself, change the liabilities or the risks related to the policies. Consequently, if the new rules do lead to an increase in the capital required by the Companies, this will, all else being equal, provide additional benefit security to policyholders. The ability of the Companies to meet any increased capital requirement will depend on how the Companies are run over the coming years before implementation and the finalised form of the Solvency II rules, including the existence of any transitional measures. Given the high degree of uncertainty relating to both of these areas, I consider that any assessment of the relative ability of the Companies to meet their solvency capital requirements under Solvency II would be highly speculative.

5.20. Notwithstanding this, I consider it important that my review of the impact of the Scheme, on Transferring Policyholders in particular, includes consideration at a high level of the Companies' preparations for compliance with the Solvency II regulations. Although there is continued uncertainty around the implementation date for Solvency II and the detail of the proposed new regime, both the Phoenix Companies and Guardian have programmes in place to work towards compliance at the implementation date (whenever it is). While I have not reviewed the detail of either programme, as I do not believe that level of analysis to be necessary for my consideration of the Scheme, from what I have reviewed and the discussions that I have had with management, the breadth of activity within these programmes appears commensurate with the chosen approach to Solvency II compliance and, for both programmes, there is evidence of board engagement in the process. I do not believe that the implementation of the Scheme will have any material adverse impact on the ability of the Companies to comply with the requirements of Solvency II at the implementation date. In fact, the Scheme is likely to have a positive impact under Solvency II for the Phoenix Companies as a result of the removal of the counterparty risk associated with the Reinsurance Agreements.

5.21. Once Solvency II has been introduced, it will be important for all of the Companies to review their respective capital policies to ensure that they target a level of assets that provides a level of policyholder benefit security that is not materially less strong than the level under the current policies.

5.22. I will revisit this in my Supplementary Report, if further information becomes available in advance of the Transfer Date.

GAL Capital Policy

5.23. GAL is required to manage its business in line with its capital policy which it set in 2012 and was approved by its Board in June 2012.

5.24. The target under the GAL Capital Policy is to hold at least as much as the more onerous of two tests based on a) a margin over the Pillar 1 capital requirements and b) a margin over the Pillar 2 ICA capital requirements. It is stated in the GAL Capital Policy that the business will be managed in such a way that, in the event that the capital is insufficient to meet the capital policy, it will be returned to the target level within a 12 month timeframe, through what are referred to as "organic actions". While the GAL Capital Policy does not explicitly state what these actions might be, I have been shown a GAL board paper that sets out a range of possible actions that the GAL board considered, when agreeing to approve the GAL Capital Policy, and that were suggested could be used in order to restore the required capital buffers within the target timeframe. I have written to the GAL Board asking for confirmation that these organic actions include the retention, to the extent necessary, of the expected surplus emerging and the suspension of dividends until such time that the level of capital available is at least as great as that required by the GAL Capital Policy. The GAL Board have confirmed that this is the case.

5.25. As well as the specific targets for margins over Pillar 1 and Pillar 2 capital requirements, the GAL Capital Policy also states the risk appetite of the firm for the risk that it might fail to meet its regulatory capital requirements. The margins over the regulatory requirements set out in the GAL Capital Policy have been calculated as an

approximation of the amount required to comply with a stated risk appetite and the current margin targets are thought to be higher than the minimum level that would be required to comply with the stated risk appetite. GAL has stated an intention to review the margins periodically to ensure that the targets represent the stated risk appetite. Additionally, regardless of whether the Scheme is implemented, I expect that the GAL Capital Policy will be re-defined, with new margins set out, when Solvency II is introduced.

5.26. The GAL Capital Policy does not change as a result of the Scheme. The Scheme includes requirements relating to the governance of any future changes to the GAL Capital Policy as described in Section 3.

Phoenix Companies capital policies

5.27. The PLL Capital Policy and the PLA Capital Policy were set out in separate schemes approved by the Court in 2009 and 2012 respectively. Adherence to these policies results in PLL and PLA holding more capital than the regulatory minimum amounts required by the Regulator under Pillar 1 and Pillar 2. The objective of these policies is to ensure that, based on various tests, the companies can continue to meet the Regulator's capital requirements in internally specified stress scenarios.

5.28. NPLL is a wholly owned subsidiary of PLA and, accordingly, PLA makes an allowance for NPLL in determining its own capital requirements. In addition, NPLL has a capital policy of its own which provides for a buffer to absorb losses without the need for regular cash transfers between PLA and NPLL. The NPLL Capital Policy is not set out in a Court-approved Scheme. However, any changes proposed to the NPLL Capital Policy that would reduce the amount of capital required would need to be approved by the Regulator as set out in 5.33 below.

5.29. The PLA Capital Policy and the PLL Capital Policy refer to the most onerous of three main tests based on: a) a margin over Pillar 1 capital requirements; b) a margin over the Pillar 2 ICA requirements; and c) a margin over any Pillar 2 ICG requirements.

5.30. The NPLL Capital Policy refers to the most onerous of three tests based on: a) an absolute margin over Pillar 1 capital requirements; b) an absolute margin over the Pillar 2 ICA requirements; and c) a percentage margin over any Pillar 2 ICG requirements.

5.31. Additionally, the capital policies of PLL and PLA consider a further test relating to a requirement to hold a certain level of liquid capital in order that, for each company, there would be sufficient assets in the relevant non-profit fund and/or shareholder fund to be able to cover the non-profit fund's regulatory liabilities and to make any loans into the company's with-profits funds that would become necessary in the extreme events considered under the policy.

5.32. The parameters in the Phoenix Companies' capital policies are regularly reviewed to ensure that they continue to satisfy their underlying objective of being able to meet regulatory capital requirements in specified stress scenarios.

5.33. The Phoenix Group has agreed with the Regulator that, until 31 December 2016, the Phoenix Companies will obtain the Regulator's prior written approval to any change to the parameters (excluding the liquidity test) that would reduce the amount of capital required to be held within the relevant company.

5.34. The terms of the Court-approved PLL Capital Policy and PLA Capital Policy also include specific provisions dealing with their future amendment. The PLL Capital Policy provides that any aspect of the policy may be amended to reflect changes to the Regulator's rules providing that the amended tests continue to be such as to ensure that PLL can met its Pillar 1 and Pillar 2 capital requirements in internally specified stress scenarios. The PLA Capital Policy, on the other hand, includes provisions enabling the PLA Board to change the stress scenarios used to determine the parameters in the PLA Capital Policy from time to time in order to reflect a change to the risk appetite which the Board has set providing that, to the extent that such a change would have the effect of reducing the amount of capital required to be held by PLA, PLA must obtain a certificate from an independent actuary to the effect that, in his or her opinion, the proposed change to the stress scenarios is unlikely to have a material adverse effect on the interests of PLA policyholders.

5.35. In addition, the PLA Capital Policy provides that, prior to the implementation of Solvency II, PLA will design replacements for the tests set out in the PLA Capital Policy that are appropriate in the context of the regulatory changes brought about by Solvency II, so as to ensure that PLA can meet its new Pillar 1 capital requirements in internally specified stress scenarios which the Board considers appropriate (taking account of PLA's risk appetite and the requirement to treat policyholders fairly). These replacement tests will come into effect when Solvency II is implemented, provided that the Regulator has been notified of the proposed replacements and has not objected.

5.36. The Phoenix Group has also agreed with the Regulator, unless otherwise agreed by the Regulator, to maintain a specified additional amount of liquid assets within the group to support PLL, its subsidiaries and Phoenix Group Management Services Limited ("PGMS"), although that capital is not specifically earmarked for PLL.

5.37. Similarly, PLA and Phoenix Life Holdings Limited ("PLHL") have undertaken to the Court that additional capital is held available by PLHL and PLA to support PLA and its subsidiary NPLL in addition to the capital held under the terms of the PLA Capital Policy. The amount of additional capital may also be changed on the implementation of Solvency II or at any time after 31 December 2016, but only if such change is agreed by an independent actuary and the Regulator.

5.38. No account or reliance is placed on this potential additional capital in setting the parameters of the capital policies of any of the Phoenix Companies, or when assessing whether the relevant capital policy is satisfied.

Protection in the event of insolvency

5.39. In my consideration of policyholder benefit security I also consider what might happen in the event of insolvency. This is impacted by both the guarantee provided by the current Financial Services Compensation Scheme and the existence of the Insurers (Winding Up) Rules 2001.

5.40. In the event of insolvency of an insurance company the Financial Services Compensation Scheme covers 90% of insurance claims on long-term life insurance policies for UK insurance policies held by individuals. It also covers some policies written elsewhere in the EU. The Scheme does not impact the existence of this cover for the Transferring Policies and also for the Existing GAL Policies and the Non-Transferring Policies.

5.41. In a winding up scenario the claim in respect of each type of business would be set out in line with the Insurers (Winding Up) Rules 2001. These rules set out the policy value definitions to be used for different types of business and these are summarised below:

- For non-linked policies (including with-profits policies) the value of the policy is the sum of the present value of guarantees including accrued bonus; the present value of any bonus expectations; and the present value of any options, less the present value of future premiums. For closed with-profits funds, such as those of both GAL and the Phoenix Companies, it is possible that the bonus expectations would include any likely distributions of estate (the excess assets within a with-profits fund above the realistic liabilities of that fund).

- For linked policies the value of the policy is the sum of the unit value and any non-linked liabilities (for example, reserves in respect of expenses or additional risk cover that applies to the policy), less the present value of expected future unit fund deductions.

5.42. In the unlikely event of the insolvency of GAL before the Transfer Date, the Phoenix Companies will be entitled to enforce the security granted to them by GAL under the Security Agreements. These assets, secured in favour of the Phoenix Companies under the Security Agreements, would not be available to meet the policyholder liabilities (guaranteed or otherwise) of the remaining Existing GAL Policyholders. If there is a shortfall in the level of the assets recovered by the Phoenix Companies under the Security Agreements, any claim of the Phoenix Companies would be assessed in line with the Insurers (Winding Up) Rules 2001 and it is unclear whether it would rank below any distribution of the estate to with-profits policyholders (since it is possible that, in the context of a closed fund, their bonus expectations would be considered to extend to likely distributions of estate).

5.43. After the Transfer Date, the liabilities associated with the Transferring Policies will rank *pari passu* with the other policyholder liabilities. Any shortfall in the assets assumed to be backing these liabilities would, therefore, reduce the level of assets to meet other policyholder liabilities, potentially including any distributable share of the estate.

5.44. I consider whether this change has a materially adverse impact on policyholder benefit security for the existing GAL Policies in Section 7 of this Report.

6. Financial Impact of the Scheme

Introduction

6.1. In this Section, I consider the analysis provided to me by the Companies that I have used in my assessment of the financial impact of the Scheme.

6.2. My assessment considers whether the Companies currently hold capital in excess of the level of capital targeted under their respective capital policies. I also consider whether the Scheme has a material impact on the level of capital available in the Companies and their ability to meet the capital targets under their respective capital policies.

6.3. This information is important to my analysis of the effect of the Scheme on the security of benefits of Existing GAL Policyholders, Transferring Policyholders and Non-Transferring Policyholders, the conclusions on which are set out in Sections 7 to 9.

Estimated Impact of the Scheme on Solvency

6.4. The estimated impact of the Scheme on the Pillar 1 and Pillar 2 solvency positions of the Companies has been calculated with reference to market conditions at 31 December 2012. The analysis provided to me by the Companies includes analysis based on the audited Pillar 1 position reported in the annual regulatory returns.

6.5. I have relied upon the accuracy and appropriateness of the impacts provided by the Companies and, while I have performed a high level review of their reasonableness, I have not performed a detailed review of the figures.

6.6. I recognise that the economic position at the time of the Scheme cannot be predicted with certainty, so the absolute solvency level and impact at the Transfer Date is likely to differ from that shown in the Report. Nevertheless, I consider that the calculated impact at 31 December 2012 provides a reasonable indication of the expected impact of the Scheme at the Transfer Date. As noted in paragraph 1.18, I have been in regular contact with the Companies and have been provided with information relating to significant known or expected changes between 31 December 2012 and 31 March 2013. Nothing in that information has caused me to alter my overall conclusions about the expected impact of the Scheme. I will continue to monitor the expected impact of the Scheme in the period leading up to the Final Hearing, and will comment on this in my Supplementary Report.

6.7. In assessing the impact of the Scheme on the solvency of the companies, I have considered the ratio of available capital to the capital requirement before and after the Scheme. Generally, the higher the ratio of available capital to the capital requirement is, the greater the level of security of policyholders. Used with care, and alongside other indicators, such a ratio is a helpful guide to the inherent strength of an insurer and its long-term fund(s), particularly when one can observe the change in the ratio, calculated using consistent methods and assumptions. I have not placed any reliance on assets held above the level targeted in the relevant capital policies, as such assets could be transferred out of the company and, consequently, do not provide any benefit security on an ongoing basis.

Estimated Effect on the Pillar 1 Solvency Position

6.8. The following tables show the estimated Pillar 1 solvency position at 31 December 2012 pre and post-Scheme, with a more detailed breakdown by fund in Appendix 8.

6.9. The figures in Table 6.1 are based on the total position of the company including the assets in the with-profits funds. Some of these with-profits funds had free assets at 31 December 2012, which would only be available to support the capital requirements of the Transferring Policies in the extreme event of insolvency (and even then, there is uncertainty, as detailed in Section 5, around whether these assets would be available). Consequently, I have also considered the figures in Table 6.2, which exclude the capital resources and capital requirements for with-profits funds with surplus assets.

6.10. The financial analysis from 31 December 2012 demonstrates that the GAL WPF is in a strong surplus position and, consequently, I consider it reasonable to consider the financial figures excluding the WPF (Table 6.2). For Phoenix, however, there is already shareholder support in place for some of the with-profits funds, so I consider it appropriate to consider the figures in Table 6.1.

Existing Policyholders of GAL

Table 6.1 Impact of the Scheme on Pillar 1 solvency as at 31 December 2012

		PLL	PLA	NPLL	GAL
Pre-Scheme	Capital Requirement (including WPICC)	£3,693m	£1,446m	£132m	£1,417m
	Surplus	£780m	£606m	£232m	£561m
	Solvency Ratio	121%	142%	276%	140%
Post-Scheme	Capital Requirement (including WPICC)	£3,586m	£1,397m	£126m	£1,417m
	Surplus	£954m	£718m	£249m	£561m
	Solvency Ratio	127%	151%	298%	140%

Source: financial analysis provided by Phoenix and Guardian

Notes:

(1) PLA figures include capital requirements from NPLL which is a subsidiary

(2) GAL figures include capital requirements from GLLA and GPM

(3) Surplus figures are calculated as available capital less the CRR (including any WPICC) and the solvency ratio is calculated as the ratio of the available capital to the CRR (including any WPICC)

Table 6.2 – Impact of the Scheme on Pillar 1 solvency position, excluding with-profits funds in surplus, as at 31 December 2012

		PLL	PLA	NPLL	GAL
Pre-Scheme	Capital Requirement	£454m	£316m	£132m	£315m
	Surplus	£432m	£450m	£232m	£561m
	Solvency Ratio	195%	244%	276%	278%
Post-Scheme	Capital Requirement	£349m	£267m	£126m	£315m
	Surplus	£604m	£562m	£249m	£561m
	Solvency Ratio	274%	310%	298%	278%

Source: financial analysis provided by Phoenix and Guardian

Notes:

(1) PLA figures include capital requirements from NPLL which is a subsidiary

(2) GAL figures include capital requirements from GLLA and GPM

(3) Surplus figures are calculated as available capital less the CRR and the solvency ratio is calculated as the ratio of the available capital to the CRR

6.11. The analysis of the impact of the Scheme on GAL shows no change to the solvency position as a result of the Scheme. Consequently, I do not expect the Scheme to have a material impact on GAL's Pillar 1 Solvency position. This is as a result of the fact that the Transferring Business is currently reinsured to GAL and so is already included as a reinsurance liability in the pre-Scheme position.

6.12. It is estimated that the Pillar 1 solvency position of the Phoenix Companies would have improved by £286m had the Scheme been implemented as at 31 December 2012. There are two key reasons for the change - a change in the expense reserve and a change in the Pillar 1 capital requirements. The IERA which is to be transferred to GAL is based on the cost of the payments to the Outsource Service Partners in respect of policy administration. Additional expenses are also incurred currently, by both the Phoenix Companies and Guardian, in respect of governance and financial management. The Phoenix Companies will not incur these costs after the Transfer Date and therefore are able to release the associated expense reserves. The Pillar 1 capital calculations restrict the extent to which the benefits of reinsurance and the full impact of the pre-Scheme transfer of risk can be recognised. This will be recognised in full at the Transfer Date and so the capital requirements of the Phoenix Companies will reduce.

6.13. In March 2013, the boards of the Phoenix Companies approved dividends for PLL, PLA and NPLL. Had this occurred at 31 December 2012, the removal of these surplus assets would have resulted in a reduction in the solvency ratios to 114% for PLL (120% post-Scheme), 127% for PLA (136% post-Scheme) and 211% for NPLL (230% post-Scheme).

Estimated Effect on the Pillar 2 Solvency Position

6.14. For GAL, the Pillar 2 capital requirements are more onerous than the Pillar 1 requirements at 31 December 2012.

6.15. The Scheme makes relatively small changes to the risk profile of GAL as the Reinsurance Agreements have already transferred the main risks associated with the Transferring Policies to GAL. Thus, the Scheme will not have a material impact on GAL's Pillar 2 capital requirements and hence will not affect which basis is more onerous immediately after the Transfer Date.

6.16. However, with the termination of the Reinsurance Agreements as a consequence of the Scheme, GAL will not be subject to the current investment restrictions that apply as a result of those Reinsurance Agreements to the assets held in respect of the Transferring Policies.

6.17. Thus, of itself, the Scheme will not affect which of Pillar 1 and Pillar 2 is more onerous for GAL immediately after the Transfer Date. However, following the implementation of the Scheme, GAL is able to take more investment risk than is the case under the Reinsurance Agreements. Any such decisions are subject to GAL's governance processes and need to take account of GAL's financial strength and how the change impacts on the ability to meet the targets under the GAL Capital Policy.

6.18. Based on the 31 December 2012 financial position, GAL will continue to be able to meet its Pillar 2 capital requirements immediately after the implementation of the Scheme.

6.19. For the Phoenix Companies, prior to the Scheme, the Pillar 2 regulatory capital requirements at 31 December 2012 are more onerous than the Pillar 1 requirements for PLA and NPLL, but Pillar 1 is more onerous for PLL.

6.20. Based on the 31 December 2012 financial position, the Scheme will have a positive impact on the Pillar 2 solvency position of the Phoenix Companies. This is because the current realistic reserve for expenses is higher than the IERA as a result of not having to allow for future governance and financial management costs (as discussed in the context of the Pillar 1 requirements). However, the impact on the ICA is not as large as the impact on the LTICR Pillar 1 capital requirement. This has the impact of changing which solvency test is more onerous at the Transfer Date for PLL from a Pillar 1 to a Pillar 2 basis.

6.21. Based on the 31 December 2012 financial position, the Phoenix Companies will continue to be able to meet their Pillar 2 capital requirements immediately after the implementation of the Scheme.

6.22. I will consider any updated impact assessments that the Companies provide to me in my Supplementary Report.

Estimated Effect on the Solvency Position under Solvency II

6.23. Similar to the Pillar 2 capital requirements, the Solvency II capital requirements are intended to be sensitive to the risks to which the Companies are exposed. Consequently, I expect the impact of the Scheme under Solvency II to be broadly in line with the impact of the Scheme on the current Pillar 2 positions of the Companies, even if the precise balance sheet numbers will be different once the detailed requirements for the former have been agreed.

Estimated Effect on the Solvency targeted by the capital policies

6.24. On the basis of the information provided to me, each of the Companies will continue to satisfy the requirements of its capital policy immediately following the implementation of the Scheme. I will continue to review the situation and confirm the position in my Supplementary Report in due course.

Reviewing benefit security for policyholders

6.25. In later Sections I refer to the above analysis in considering the effect of the Scheme on benefit security for different groups of policyholders.

6.26. In assessing the impact of the Scheme on the security of benefits of each group of policyholders I have considered the following factors:

- the underpinning level of capital protection afforded to each group of policyholders by the GAL Capital Policy and the Phoenix Companies' capital policies;
- the changes in the capital available to support each group of policyholders as a consequence of the Scheme, by reference to the various measures of capital required. In particular, I have considered the ratio of available capital to required capital before and after implementation of the Scheme. Generally, as noted earlier, the higher this ratio is, the greater the level of security for policyholders at a particular point in time, although this can be obscured where there are implicit areas of prudence in assumptions. However, considered alongside a capital management strategy or capital policy, such ratios are a helpful guide to the inherent strength of a fund, particularly where one can observe the change in the ratio, calculated using consistent methods and assumptions, as is the case here; and
- substantive changes in the nature or size of the risks to which each group of policyholders is exposed.

7. Existing Policyholders of GAL

Introduction

7.1. As described in Section 3, the broad effect of the Scheme is to transfer designated blocks of annuities in payment from the Phoenix Companies to the GAL NPF. These blocks of annuities are currently reinsured from the Phoenix Companies to the GAL NPF.

7.2. In this Section I consider the likely impact of the Scheme on the security of benefits and benefit expectations for the Existing GAL Policyholders.

7.3. In analysing the likely impact of the Scheme on Existing GAL Policyholders, I consider the likely impact of the Scheme on the following different groups of policies:

- The business held within the GAL NPF.
- The general insurance business held within the GAL shareholder fund. There is a relatively small amount of this business in the GAL shareholder fund, primarily asbestos claims in run-off.
- The PHI business in the PHI fund. This is a small, shareholder-owned fund, which is closed to new business.
- The business held within the GAL WPF. This business includes both non-profit and with-profits business and some with-profits deferred annuities which are reinsured to the non-profit fund.
- The business held within GLLA and GPM which are owned by GAL.

7.4. The Guardian Scheme is expected to occur at the same time as the Scheme and is assessed in a separate report. In my assessment below I consider whether the Scheme might be expected to have a materially different impact if the Guardian Scheme did or did not proceed.

Benefit Security

General Considerations

7.5. One of the key considerations applicable to the security of benefits for Existing GAL Policyholders is the level of surplus assets available to meet the capital requirements of the business. The GAL Capital Policy described in Section 5 sets out a target level of capital in excess of regulatory capital requirements. I view the GAL Capital Policy and the impact of the Scheme on the ability of GAL to meet its capital policy to be critical in the assessment of impact on benefit security for GAL policyholders.

7.6. The Scheme does not directly change the GAL Capital Policy, so the benefit security of Existing GAL Policyholders is only impacted by any changes to the ability to meet the capital policy on an ongoing basis.

7.7. Section 13 of the Scheme contains details of the governance required to change the GAL Capital Policy. This states that the capital policy can only be changed by the GAL board if they are able to satisfy themselves that the change is appropriate,

- having taken account of appropriate actuarial advice;
- having consulted with the Regulators; and
- having regard to the board's obligations to treat policyholders fairly.

7.8. I consider that the governance requirements in this section of the Scheme provide additional protection against any future weakening of the capital policy and represent a strengthening of policyholder benefit security for the Existing GAL Policyholders.

7.9. In particular, I note that there is a requirement to take account of "appropriate actuarial advice". I have written to the GAL Board asking them to confirm that they will explicitly consider the extent to which "appropriate actuarial advice" should include advice from an actuary independent of Guardian in the event that any proposed changes

represent a weakening of the GAL Capital Policy relative to the policy in place at the Transfer Date. The GAL Board have confirmed that this is the case.

7.10. As described in Section 6 of this Report, the estimated impacts demonstrate that the Scheme will not have a material impact on the regulatory capital requirements of GAL. This is because the majority of the material risks associated with the Transferring Policies have already transferred through the Reinsurance Agreements and this is reflected within the regulatory capital requirements. In particular, the analysis demonstrates that GAL will have sufficient capital to satisfy its regulatory capital requirements and the additional capital buffer required by the GAL Capital Policy after the implementation of the Scheme, assuming it is doing so immediately before the Transfer Date.

7.11. At present, there is a significant estate in the GAL WPF. In the event of insolvency, the ring-fencing of the GAL WPF would break down and the surplus assets in this fund could potentially be made available to support the policies in the other funds of GAL. Consequently, these surplus assets could be viewed as providing an element of benefit security for policyholders outside the GAL WPF. I note, however, that under the Insurers (Winding Up) Rules 2001 (as described in Section 5), the value of with-profits policies could include a share of the estate, which would mean that any surplus assets in the GAL WPF would not be available to support other parts of GAL. This legislation has not been tested and, due to this uncertainty and the separate management of the GAL WPF, I view it to be appropriate to assess benefit security of the Existing GAL Policyholders on the basis that any surplus assets in the GAL WPF are not available to enhance benefit security for policyholders in the other funds.

Non-profit, shareholder and PHI funds

7.12. The benefit security for the existing business in the GAL NPF, the business in the PHI fund and the general insurance business held within the GAL shareholder fund will be impacted primarily by the level of surplus within the non-profit and shareholder funds, as any surplus within the with-profits fund is ring-fenced for the benefit of policies within that fund. I have confirmed that GAL calculates capital requirements at this ring-fenced fund level and that a clarification of the GAL Capital Policy wording was ratified by the GAL Board in March 2013.

7.13. As noted already in this report, because the Reinsurance Arrangements have already been put in place, no material change to the available capital or risks for this business will take place as a result of the Scheme. I note that the Reinsurance Arrangements have resulted in a very large concentration of longevity and credit risk exposure, and my opinion on the impact of the Scheme does not consider the impact of the Reinsurance Arrangements which have been put in place.

7.14. On the Transfer Date, GAL assumes overarching responsibility for the expense risks, including administration services, and consequently accepts additional expense and operational risk. The estimated impact provided by GAL indicates that these additional risks will not materially reduce the excess capital resources on a Pillar 1 basis and will not lead to a material change in GAL’s Pillar 2 position. Thus, GAL’s ability to meet its capital policy immediately after the implementation of the Scheme is not affected materially by the Scheme.

7.15. Implementation of the Scheme does allow GAL to take additional risk on the assets backing the annuities than is permissible under the terms of the Reinsurance Agreements. In particular, the current restrictions limit the level of exposure to certain credit-risky assets, assets denominated in overseas currencies, individual counterparties and the risk of changes in the underlying level of interest rates. Any changes to the risk profile of GAL will be reflected in the ICA Pillar 2 capital requirement and, as a result, in the capital held to meet the GAL Capital Policy (I consider this assumption to be reasonable, as the calculations are subject to regulatory requirements, signed off by the board and can be reviewed by the Regulators). I have reviewed the proposed revised investment restrictions and do not believe that they include any conditions that would cause such a material change to the risk profile of GAL that additional safeguards would be required in the interests of policyholder benefit security in addition to what is already in place (in, for example, the GAL Capital Policy and the governance arrangements in GAL). I am satisfied that, provided GAL continues to meet the requirements of its capital policy, the removal of the restrictions contained in the Reinsurance Agreements will not result in a materially adverse impact on the security of benefits for this business.

7.16. For these reasons, I am satisfied that the Scheme will not result in a materially adverse impact on the security of policyholder benefits for this business.

GAL WPF

7.17. The assets of the GAL WPF are ring-fenced for the benefit of the policyholders of the GAL WPF, which has a strong surplus position. This fund is operated and capitalised on the basis that it should be able to meet its own required capital and additional capital under the GAL Capital Policy. Consequently, these assets are the main driver of the benefit security for the business. The Scheme will not have a material impact on the assets or liabilities in this fund on the Transfer Date.

7.18. In extreme scenarios the GAL WPF could require (or provide) support from (or to) the other funds of GAL. As discussed above, the Scheme will not have a material impact on the assets available in these other funds and the ability to meet the capital policy on an ongoing basis. Consequently, I do not consider the likelihood of the ring-fencing breaking down to be materially altered by the Scheme.

7.19. As discussed in Section 5.42, the Scheme could, depending on the interpretation of the Insurers (Winding Up) Rules 2001, have an impact on policies in the GAL WPF in the event of any future insolvency of GAL. This is because the Scheme will alter the relative ranking of policyholder benefits that would apply in such an event and this could mean that any surplus assets, in excess of what is required to cover the policy liabilities at that time, would be shared between all GAL policies rather than potentially just spread over the Existing GAL Policies. Given the low probability of GAL's insolvency at this time and the fact that the Scheme does not materially change the likelihood of such an insolvency event occurring in the future, I do not believe that this potential consequence of the Scheme represents a material impact on the benefit security or expectations of the Existing GAL Policyholders in the WPF.

7.20. For these reasons, I do not view there to be a material impact of the Scheme on this business.

Non-profit fund subsidiaries

7.21. The benefit security for the business held within GLLA and GPM is primarily related to the level of capital resources within these companies and their ability to meet their capital policy. The level of capital resources within GLLA and GPM is not impacted by the Scheme.

7.22. Additionally, as subsidiaries of GLA, there is an expectation that, in the event of one of these companies failing to meet its regulatory solvency capital requirement, GLA would provide additional capital. As discussed above, I do not consider that the Scheme has a material impact on the ability of the funds within GAL to meet their capital policy targets on an ongoing basis and, consequently, I do not believe that the Scheme will have a material impact on the likelihood of GAL being unable to provide additional capital if required by one of the subsidiaries.

7.23. For these reasons, I do not view there to be a materially adverse impact of the Scheme on benefit security for this business.

Impact of Guardian Scheme

7.24. Under the Guardian Scheme, it is intended that the business in GLLA and GPM will transfer into the GAL NPF at the same time as this Scheme is implemented. I consider the impact of the Guardian Scheme in a separate report. However, for the purposes of this Report, I note that, if the Guardian Scheme were deemed to occur immediately before the Scheme, my analysis for these policyholders would be similar to that for the business held in the GAL NPF currently and so I am satisfied that that the Scheme will not result in a materially adverse impact on the security of benefits for this business. Furthermore, due to the immaterial impact of the Guardian Scheme, I am satisfied that the assessment of the impact of the Scheme in Section 6 would not be materially different if the Guardian Scheme was implemented at the same time.

Impact of Solvency II

7.25. As discussed in Section 6, the Scheme, of itself, will not materially change the risk profile of GAL. As a consequence, the Scheme will not materially change the ability of GAL to meet what will be its Solvency II capital requirements, relative to its ability to meet those requirements immediately before the Transfer Date.

Conclusion

7.26. I am satisfied that the Scheme will not have a materially adverse effect on the benefit security of the Existing Policyholders of GAL for the reasons stated above.

Benefit expectations

Business in non-profit, shareholder and PHI funds

7.27. There is a small amount of General Insurance business held within the GAL shareholder fund and some PHI business held within the PHI fund. This business has no discretionary features and the terms of this business are not impacted by the Scheme. Therefore, I am satisfied that there is no materially adverse impact on benefit expectations for these contracts as a result of the Scheme.

7.28. The GAL NPF holds unit-linked business, for which there is management discretion relating to the level of charges taken. The Scheme will not impact the terms and conditions of these policies and, as a result, I am satisfied that there is no materially adverse impact on the policyholder benefit expectations of these policyholders as a result of the Scheme.

7.29. The remaining non-profit business within the non-profit fund does not have any discretionary features and the terms of this business will not be impacted by the Scheme. I am satisfied that there is no materially adverse impact on policyholder benefit expectations for these contracts as a result of the Scheme.

7.30. The GAL NPF holds with-profits contracts with discretionary features, which were transferred into the GAL NPF from the GAL WPF as part of a with-profits fund restructure in 2012. The guarantees on this business are heavily in the money and, as a result, the exercise of management discretion is unlikely to influence policyholder payouts, at least at maturity, as the guarantees are expected to bite with a high degree of certainty. As a result, the products behave more like non-profit contracts than with-profits contracts. The Scheme will not change the terms and conditions of these policies or change the PPFM relevant for this business. As a result, I am satisfied that there is not likely to be a material change in the exercise of any remaining discretion with relation to these contracts (such as in the calculation of surrender values or other alterations) on account of the Scheme. As a result of these reasons, I am satisfied that there will be no materially adverse impact on policyholder benefit expectations for these contracts as a result of the Scheme.

Business in the GAL WPF

7.31. The business held within the GAL WPF does include business where the benefits have discretionary elements. However, these discretionary elements are set with reference to the assets within the ring-fenced fund and not the overall position of GAL. The Scheme will not change the PPFM for this business, nor does it impact directly the way in which this business is expected to be managed. As a result, in itself, the Scheme will not lead to any changes in the calculation of discretionary benefits, including surrender values.

7.32. For some with-profits funds there could be an impact through a changing share of overhead expenses. However, consistent with the GAL PPFM, the expenses charged to the GAL WPF are based on a fixed per-policy expense agreement with Guardian Companies Services Limited and, as a result of the fact that the Scheme will not change the number of policies in the fund, no change is expected to the expenses charged.

7.33. Similarly there could be an impact as a result of any changes to the level of tax charged to the GAL WPF. The GAL WPF is taxed as if it was a stand-alone company and, as a result, the Scheme will not have a material tax impact on the fund. This is discussed further in Section 11.

7.34. Therefore, subject to my conclusions on policyholder benefit security above, I am satisfied that the Scheme will not have a material impact on benefit expectations for the business within the with-profits fund.

Business in subsidiaries

7.35. The business held within GPLL and GPM is expected to be transferred into the GAL NPF at the same time as the Scheme. This business is primarily unit-linked business for which there is discretion through the setting of charges. The business is currently managed together with the business of GAL and no changes to the use of discretion are required as a result of the Scheme. Therefore, I am satisfied that there will be no materially adverse impact on benefit expectations for these contracts as a result of the Scheme.

Guardian Scheme

7.36. Under the Guardian Scheme, the business in GPM and GLLA is expected to transfer into the GAL NPF at the same time as this Scheme. I consider the impact of the Guardian Scheme in a separate report. However, for the purposes of this Report, I note that, if the Guardian Scheme were deemed to occur immediately before the Scheme, my analysis for these policyholders would be similar to that for the business held in the GAL NPF currently and so I am satisfied that the Scheme will not result in a materially adverse impact on the benefit expectations for this business. Furthermore, I am satisfied that the assessment of the impact of the Scheme set out above does not depend on whether or not the Guardian Scheme is implemented at the same time.

Conclusion

7.37. For the reasons stated above, I am satisfied that the Scheme will not give rise to a materially adverse effect on the benefit expectations of the Existing GAL Policyholders.

Equitability of the Scheme

7.38. As I have concluded that the Scheme will not have a materially adverse impact on any of the Existing GAL Policyholders, I am satisfied that the Scheme is equitable to all classes and generations of Existing GAL Policyholders.

8. Transferring Policyholders

Introduction

8.1. As described in Section 3, the Scheme will transfer certain blocks of immediate annuities in payment from the Phoenix Companies to the GAL NPF. These blocks of annuities are currently reinsured from the Phoenix Companies to the GAL NPF.

8.2. In this Section I consider the likely impact of the Scheme on the benefit expectations and the benefit security for the Transferring Policyholders.

8.3. In analysing the likely impact of the Scheme on the Transferring Policyholders I consider the likely impact on different groups of policies. All the Transferring Policies are of the same type, annuities in payment, so the groups of policyholders I consider are based on the fund they are currently written into. I consider the following different groups of policies:

- Policies transferring from PLL. This business is transferring from the non-profit fund of PLL which contains a mix of non-profit business. More detail on the mix of business is shown in Appendix 5.

- Policies transferring from PLA. This business is transferring from the non-profit fund of PLA which contains a mix of non-profit business. More detail on the mix of business is shown in Appendix 6.

- Policies transferring from NPLL. This business is transferring from the long-term fund of NPLL, which is a with-profits fund which contains both with-profits and non-profit business. More detail on the mix of business is shown in Appendix 7.

8.4. The Guardian Scheme is expected to occur at the same time as the Scheme and is assessed in a separate report. In my assessment below I consider whether the Scheme might be expected to have a materially different impact if the Guardian Scheme did or did not proceed.

Benefit Security

General considerations

8.5. As discussed in the context of Existing GAL Policyholders, the level of surplus assets available to meet the capital requirements of the business is very important to policyholder security. Both GAL and the Phoenix Companies have capital policies which lay down the minimum level of surplus capital to be targeted. (As noted earlier in my assessment of policyholder security, I have placed no reliance on any surplus assets above these targets that may be present on the Transfer Date continuing to be available for additional policyholder security in the future.)

8.6. While the relative strength of these capital policies is a key factor in the consideration of the impact of the Scheme on the Transferring Policies, I have also considered other qualitative elements of the capital policies and any impact of the Scheme on the ability of the fund to meet its capital requirements on an ongoing basis.

8.7. The capital policies are discussed in Section 5.

8.8. The GAL Capital Policy was introduced in 2012 and the requirements it sets out were taken into account by the Regulator when it was granting its “non-objection” to both the Reinsurance Agreements and the recent change of control of GPM and GLLA. It is currently not covered by a Court-approved scheme but the Scheme sets out requirements relating to the governance involved in making a change to the capital policy. I have considered the protection that these requirements provide against the possibility that future changes to the GAL Capital Policy lead to a material reduction in policyholder benefit security.

8.9. The capital policies of the Phoenix Companies and GAL operate in a similar manner, with a series of tests setting out a target margin of surplus assets in excess of minimum regulatory capital requirements. Such capital policies are valuable and, through triggering management actions when the target margins are not met, act as an early warning system for remedial action before a company fails to satisfy its regulatory capital requirements.

8.10. Generally, as the margin required above minimum regulatory capital requirements increases, so does the security provided by the capital policy. However, this is not the only relevant factor. A good capital policy will have due regard to the main risks of a company and seek to ensure that sufficient capital is available to support

these. All the capital policies described above have the ability to adapt to and accommodate new or developing risks as circumstances change in two ways - through the most onerous test generally being the margin above ICA, which should reflect changing risks, and through the level of the margin in the Capital Policies being calibrated using internally specified stress scenarios which are designed to reflect the key risks of the business.

Size of capital margin

8.11. The margin of capital held in addition to the level required by the regulations is a key consideration in my assessment of the relative strength of the different capital policies. If the margin specified is too low, there is a significant risk of the company not being able to meet its regulatory capital requirements in extreme scenarios. Failure to do so could lead to intervention by the Regulators, including restrictions on the way in which the company is managed. I note, however, that failing to meet the regulatory capital requirements will not necessarily result in any impact on the benefits payable to policyholders. In particular, the Pillar 2 measure, the ICA, is set at a level such that, at any time over the following 12 months, the insurer is 99.5% sure of being able to cover its best estimate of the present value of its policyholder liabilities. Holding less capital than required by the ICA would lead to a reduction in the probability that the company will be able to meet its policyholders' liabilities as they fall due over the future, but would not, in itself, necessarily result in the company actually being unable to meet its policyholder liabilities.

8.12. Holding a margin over the regulatory capital requirements has the effect of increasing the probability that the company will be able to meet its policyholder liabilities as they fall due over the future. I note, however, that the marginal benefit to policyholder benefit security decreases as the amount of capital held in addition to the regulatory capital requirements increases. For example, holding 105% as opposed to 100% of regulatory capital requirements will increase the probability of being able to pay all policyholder benefits as they fall due by more than the impact of holding 120% as opposed to 115% of regulatory capital requirements. These numbers are provided for illustration and are not intended to be representative of any of the capital policies considered.

8.13. The percentage margin required to be held over the Pillar 1 and Pillar 2 regulatory capital requirements is lower in the GAL Capital Policy than under the capital policies of PLA and PLL. Under the NPLL Capital Policy, the levels of capital targeted in excess of the regulatory capital required for two of the tests are expressed as absolute amounts. Based on the financial position at 31 December 2012, these absolute amounts represented a higher percentage margin over the Pillar 1 CRR and the Pillar 2 ICA than targeted under the GAL Capital Policy. I have considered the relative impact on the benefit security of the Transferring Policyholders by considering the relative impact on the likelihood of being able to meet the present value of policyholder liabilities under the respective capital policies.

8.14. I have considered analysis provided by GAL (using the framework of the Guardian ICA model), which demonstrates that, under the GAL Capital Policy, the one year probability of GAL failing to meet the present value of its policyholder liabilities falling due in the future is approximately 0.05% higher than the corresponding probability if it was to target the same percentage levels of solvency cover as in the strongest capital policy of the Phoenix Companies. This is broadly equivalent to saying that, were GAL to adopt the maximum percentage targets in the capital policies of the Phoenix Companies, this would provide additional protection to GAL policyholder benefit security under a scenario that would be expected to occur once in every 2000 years.

8.15. I note that this analysis is based on a number of assumptions, including assumptions regarding the distribution of very extreme losses and about the behaviour of the balance sheet under extreme loss events, not all of which will hold in reality and that the modelling of extreme events is inherently uncertain. However, despite the uncertainty relating to any assessment of the level of security under a given capital policy, I consider that this analysis still provides an indication of the relative levels of benefit security under the different capital policies and am satisfied that the difference in the level of security is not highly sensitive to the choice of the distribution of very extreme events.

8.16. This analysis is based on the assumption that the Pillar 2 capital requirement is the more onerous of the capital requirements. I note that, by definition, if the Pillar 1 capital requirement is more onerous, then the regulatory capital requirement will provide benefit security at a level at least as strong as the one year 99.5% probability considered under Pillar 2.

8.17. In addition, I have considered the absolute difference in the capital amounts that would be held under the GAL Capital Policy and the most onerous of the Phoenix Companies' capital policies and compared this amount to the total best estimate liabilities of the Transferring Policies. The amount of capital to be held on account of the Transferring Polices under the GAL Capital Policy is, as a proportion of reserves at the Transfer Date, approximately 1% lower than under the strongest of the Phoenix Companies' capital policies. Consequently, in the (extreme) event of the wind-up of the company, the policy benefits that policyholders in GAL would receive would not be materially different to what they would have received had GAL's Capital Policy targeted a percentage level of capital equal to that targeted under the strongest of the Phoenix Companies' Capital Policies. I do not consider this to represent a material impact on policyholder benefit security.

8.18. The analysis above assumes that the bases used for the calculation of the best estimate liabilities and ICA are comparable between the Companies. I believe that this is a reasonable assumption, as the calculations are subject to regulatory requirements, signed off by the board and can be reviewed by the Regulators.

8.19. For these reasons, I am satisfied that the Scheme does not have a materially adverse impact on benefit security for the Transferring Policyholders, as a result of the different capital targets in the GAL and Phoenix Companies' capital policies.

Other elements of the capital policies

8.20. As noted in 5.31, the PLL Capital Policy and the PLA Capital Policy include a liquidity test relating to a requirement to hold a certain level of liquid capital in order that, for each company, there would be sufficient assets in the relevant non-profit fund and/or shareholder fund to be able to cover the non-profit fund's regulatory liabilities and to make any loans into the company's with-profits funds that would become necessary in the extreme events considered under the policy. Thus, the liquidity requirements are not in place to support annuity payments under the Transferring Policies but, rather, to facilitate certain potential inter-fund support arrangements internal to the relevant Phoenix Company.

8.21. There is no such explicit requirement in the GAL Capital Policy, but I do not consider this a material issue for the Transferring Policies, given the purpose of the liquidity buffer in PLL and PLA described above.

8.22. There are also differences in the principles set out for responding to scenarios where the business is not meeting its target margin. The GAL Capital Policy states that the business will be managed in such a way as to return to a level of capital that meets the target margin using what are referred to as "organic actions" within 12 months. The Phoenix Companies' Capital Policies only rely on such actions (including the suspension of dividends) if a return to target can be achieved within four months. As noted in Section 5 of this Report, while the GAL Capital Policy does not explicitly state what these actions might be, I have been shown a GAL board paper that sets out a range of possible actions that the GAL board considered, when agreeing to approve the GAL Capital Policy, and that were suggested could be used in order to restore the required capital buffers within the target timeframe. The GAL Board have confirmed to me that, as part of these organic actions, the Board would not approve the payment of a dividend until the levels of capital were restored to the target documented in the GAL Capital Policy. Additionally, they have confirmed that no dividend would be payable at any time that would result in the breaching of any of the requirements of the GAL Capital Policy applying at that time.

8.23. Within the Phoenix Group, there is a requirement for £100m of liquid assets to be available in the group until December 2016 to support PLL, its subsidiaries and Phoenix Group Management Services, although this amount is not specifically earmarked for PLL. Similarly, PLA has undertaken to the Court that £75m (reducing in line with the run-off of the business), is available within the group to support PLA in addition to the capital required by the capital policy. I have not made any allowance for these amounts in my analysis of the Scheme because of the temporary nature of the former requirement and relatively low significance of the latter as a proportion of the total liabilities.

8.24. As noted in Section 5 of this Report, Phoenix has agreed with the Regulator that, until 2016, any changes to the capital policies of PLL, PLA and NPLL that lead to a reduction in the amount of capital held will require prior written approval from the Regulator. In addition, changes to the PLA Capital Policy that would reduce the level of capital held require an assessment from an independent actuary, to ensure that the change does not have a material adverse impact on policyholder interests. Section 13 of the Scheme sets out high level governance requirements relating to changes to the GAL Capital Policy. In particular, this requires Guardian to consult with the Regulators and take appropriate actuarial advice. I note that these requirements are less strong than the requirement to get consent from the Regulator and that "appropriate actuarial advice" need not be sought from an actuary who is independent of the company. However, I consider that there is only a very low likelihood of GAL weakening the capital policy in the event that the Regulator provided feedback that such a change would materially adversely impact policyholders. I also note that, after 2016, the requirement for Phoenix to get written approval from the Regulator for amendments to the PLL and NPLL capital policies may cease, but there is no time limit on the governance proposed by the Scheme. The GAL Board have confirmed to me that they will explicitly consider the extent to which "appropriate actuarial advice" should include advice from an actuary independent of Guardian in the event that any proposed changes represent a weakening of the GAL Capital Policy relative to the policy in place at the Transfer Date. Overall, I am satisfied that the different governance arrangements do not lead to a materially adverse impact on policyholder benefit security.

8.25. The capital policies of the Phoenix Companies include an explicit test in relation to the situation when the Regulator has issued an ICG that leads to an increase in the Pillar 2 regulatory capital requirement. The GAL Capital Policy does not explicitly detail how the capital policy would apply in the circumstances when an ICG has been imposed. GAL has stated that, in the event that the Regulator imposes an ICG, they will work with the Regulator to ensure that the ICA addresses the concerns raised, removing the need for an ICG. This is not as strong as the equivalent position for the Phoenix Companies, where 110% of any ICG would currently become

the target (if this were higher than the results of the other tests). However, I do not consider that this difference in approach to a potential future situation is sufficient to represent a materially adverse impact on Transferring Policyholders at the Transfer Date. Additionally, I note that, in the event that GAL was holding insufficient capital to allow it to cover an ICG, some sort of regulatory intervention would be expected.

8.26. I note that the GAL Capital Policy was reviewed by the Regulator in 2012 as part of their consideration of the Annuity Business Transfer Agreement and the change of control of the GLLA and GPM subsidiaries and that no objection was raised at that stage. While I have not relied on this "no objection" in my consideration of the GAL Capital Policy, I consider that it provides evidence that the risk appetite and minimum capital buffers set out in the policy are not viewed as inadequate by the Regulator for the purposes of the security of policyholder benefits.

8.27. For these reasons, I am satisfied that the Scheme will not have a materially adverse impact on benefit security for the Transferring Policyholders, as a result of the differences in the GAL and Phoenix Companies' capital policies.

Other considerations

8.28. The biting constraint for each of the capital policies is the margin above the ICA requirements. The ICA and the margin above it should adapt to and accommodate new or developing risks as circumstances change and this flexibility is important in ensuring that policyholders are adequately protected. For example, at the Transfer Date, GAL will accept full responsibility for expense risks and this should be reflected in the ICA. Similarly, if GAL chose to implement a more risky investment strategy for the assets backing the Transferring Policies once the Reinsurance Agreements are terminated, the increase in risk should be reflected in additional capital requirements.

8.29. The Scheme will result in the Transferring Policyholders being exposed to the risk profile of a different company, including any concentrations of risk exposure that it might have. The ICA calculation takes account of the risk profile of the company and, particularly, the relative concentration of risk, through the allowance for risk diversification, with companies that are heavily exposed to a small number of risks (rather than a large number of risks) holding a relatively higher level of capital as a result. I am satisfied that the requirement to consider the Pillar 2 position within the GAL Capital Policy means that any differences between the risk profile of the other policies in GAL and the Non-Transferring Policies in the Phoenix Companies will not, of themselves, result in the Scheme having a materially adverse impact on the benefit security of Transferring Policyholders.

8.30. I note that, if Solvency II increases the amount of capital that is required to be held in respect of the Transferring Policies, this will, in itself, increase policyholder benefit security, relative to that under the current solvency regime. Once Solvency II is implemented, the impact of the Scheme on policyholder benefit security for the Transferring Policyholders will relate to the relative ability of the Companies to meet the regulatory capital requirements. As discussed in Section 5, the impact of Solvency II is still subject to material uncertainties and the relative ability of the Companies to meet any increased capital requirement is based on a number of factors, including the management of the Companies in the years leading up to the implementation of Solvency II. Given these material uncertainties, I consider any comparison to be highly speculative. Thus, in assessing the impact of the Scheme on policyholder benefit security, I consider it is sufficient to concentrate my analysis on the impact under the current regulatory regime.

Guardian Scheme

8.31. Under the Guardian Scheme, it is intended that the business in GPM and GLLA will transfer into the GAL NPF at the same time as this Scheme. I consider the impact of the Guardian Scheme in a separate report. However, for the purposes of this Report, I note that the analysis provided to me of the estimated impact of the Guardian Scheme demonstrates that the Guardian Scheme does not have a material impact on the solvency position of the GAL NPF. Thus, I am satisfied that the assessment of the impact of the Scheme in Section 6 and the conclusions stated above would not be materially different if the Guardian Scheme was implemented at the same time or not.

Conclusion

8.32. I am satisfied that the benefit security of the Transferring Policyholders will not be materially adversely impacted by the Scheme.

Benefit expectations

8.33. The benefits for the Transferring Policies have no discretionary elements and the terms of these contracts are not impacted by the Scheme. While the benefits under some of the Transferring Policies escalate, the escalation is specified either by reference to an index or at a fixed rate per annum and these arrangements are not

impacted by the Scheme. Therefore, I am satisfied that the Scheme will not have a materially adverse impact on the benefit expectations of the Transferring Policies.

Equitability of the Scheme

8.34. As I have concluded that the Scheme will have no materially adverse impact on any of the Transferring Policyholders, I am satisfied that the Scheme is equitable to all classes and generations of Transferring Policyholders.

9. Non-Transferring Policyholders

Introduction

9.1. As described in Section 3, the Scheme will transfer certain blocks of immediate annuities in payment from the Phoenix Companies to the GAL NPF. These blocks of annuities are currently reinsured from the Phoenix Companies to the GAL NPF.

9.2. In this Section I consider the likely impact of the Scheme on the benefit expectations and the security of benefits for the policyholders remaining in the Phoenix Companies.

9.3. In analysing the likely impact of the Scheme on the business remaining in the Phoenix Companies I consider the likely impact on different groups of policies. I consider the following different groups of policies:

- Policies in the non-profit fund of PLL. This fund contains a range of non-profit policies, including unit-linked business, annuities and protection business.

- Policies in the other with-profits funds of PLL. PLL has ten with-profits funds. More detail on these is given in Appendix 5.

- Policies in the non-profit fund of PLA. The main business in this fund comprises protection and annuity contracts (including some annuity contracts which are not Transferring Policies). Pension contracts from each of the PLA with-profits funds currently vest into this fund. More detail on these is given in Appendix 6.

- Policies in the other with-profits funds of PLA. PLA has three with-profits funds. More detail on these is given in Appendix 6.

- Policies in NPLL. More detail on the mix of business is shown in Appendix 7.

Benefit Security

General Considerations

9.4. As discussed in Sections 7 and 8, I consider the relevant capital policies to be very important in the assessment of the impact of the Scheme on policyholder benefit security. No change is caused to the capital policies that apply to the Non-Transferring Policies as a result of the Scheme.

9.5. There is little change to the risks the Phoenix Companies are exposed to as a result of the Scheme, as the majority of the risks (particularly the longevity and credit risks) associated with these contracts are already reinsured to GAL under the Reinsurance Agreements effected in 2012. A small expense risk associated with the Transferring Policies remains under the Annuity Business Transfer Agreement and this will cease at the Transfer Date. The Scheme will remove the counterparty default risk from the Phoenix Companies in respect of the Reinsurance Agreements.

9.6. As discussed in Section 6, the Scheme is expected to have a slightly beneficial impact on the solvency position of the Phoenix Companies and so, immediately after the Transfer Date, all three companies are expected to show slightly higher coverage of the relevant capital policy capital requirements than immediately before. As noted earlier, any capital above the minimum levels in these capital policies may be transferred out and therefore cannot be relied upon to improve policyholder benefit security. Consequently, I do not view the immediate impact of the Scheme to have a material impact on policyholder benefit security.

9.7. There are no changes to the capital policies as a result of the Scheme.

PLL and PLA non-profit funds

9.8. The risk profile of the PLL and PLA non-profit funds is expected to be materially unchanged by the Scheme. The changes caused by the Scheme primarily relate to the transfer of expense risk and the removal of the counterparty default risk associated with the existing Reinsurance Agreements.

9.9. Given the limited nature of these changes, I am satisfied that, of itself, the Scheme will not give rise to an adverse impact on the benefit security of the Non-Transferring Policies in these funds.

PLL and PLA with-profits funds

9.10. For the with-profits funds of PLL and PLA the impact is slightly different, as they are ring-fenced (in all but the most extreme events) and any capital released in the course of business is retained in the fund until it is distributed, as applicable, to policyholders and the shareholder. These with-profits funds are not exposed to the change in counterparty default risk mentioned above and, as discussed below, analysis provided by the Phoenix Companies demonstrates that any change in respect of the expenses allocated to the fund is likely to be immaterial. Consequently, the Scheme will not cause a material release of capital in the fund. In addition, there will be no changes to the way the funds are managed as a result of the Scheme.

9.11. The main areas where the Scheme could impact the capital positions of these funds, albeit in a small way, are the share of expenses and tax costs allocated to the funds and/or the policies within them. While policy-related expenses are currently charged to the with-profits funds on a per policy basis in line with fixed expense agreements, overhead expenses are currently spread across the funds.

9.12. In PLL, the direct expenses are allocated to each fund by reference to assets under management, and these will not change materially as a result of the Scheme as the bulk of the assets backing the Transferring Policies have already been transferred as part of the Reinsurance Agreements. Consequently, the allocation of direct expenses to the PLL with-profits funds will not be materially affected by the Scheme.

9.13. In PLA, some direct expenses are allocated to with-profits funds by reference to number of policies. However, based on analysis provided by Phoenix, I am satisfied that this will not cause the Scheme to have a material impact on the expenses charged to these with-profits funds.

9.14. My analysis of the potential impact relating to any changes to the level of tax charged to the with-profits funds is discussed in Section 11. This confirms that the Scheme will not lead to a material change to the level of tax charged to the with-profits funds.

9.15. Thus, I am satisfied that the Scheme will not result in a material change to the capital position of the with-profits funds in PLL and PLA. Consequently, I am satisfied that, of itself, the Scheme will not have an adverse impact on the benefit security of the Non-Transferring Policies in these funds.

NPLL policyholders

9.16. There could theoretically be a more direct impact on Non-Transferring Policyholders in NPLL as some of the Transferring Policies are written into this long-term fund.

9.17. The Scheme will not result in any changes to the way in which the with-profits business in this fund is managed. It does not change any of the benefits of the non-profit policies in the fund, nor does it change the capital policy requirements that apply in NPLL.

9.18. Any reduction in expense risk capital requirements as a result of the Scheme will increase the surplus assets of the fund. However, capital has been loaned to this fund and therefore any capital released could be used to reduce these loans and not to provide additional benefit security.

9.19. Thus, of itself, the Scheme will not have a material impact on the ability of NPLL to meet the capital targets in its capital policy and I am satisfied that, of itself, the Scheme will not have an adverse impact on the benefit security of the Non-Transferring Policies in this fund.

Residual Policies

9.20. As noted in Section 3, the Scheme allows for the situation where it is not possible to transfer all the intended policies. Subject to the number of Residual Policies not being material in the context of the number of Transferring Policies, I am satisfied that the analysis above will apply equally to the Residual Policies and so there will be no materially adverse impact on the benefit security of Residual Policies as a result of the Scheme.

Conclusion

9.21. For the reasons stated above, I am satisfied that there will be no adverse impact on the benefit security for any group of Non-Transferring Policies as a result of the implementation of the Scheme. While the Scheme would have improved the solvency position of the Phoenix Companies on both a Pillar 1 and Pillar 2 basis, had it occurred at 31 December 2012, I place no reliance when assessing the security of policyholder benefits on capital held above the level targeted under the applicable capital policy.

Benefit Expectations

9.22. Nothing in the way that any of the Non-Transferring Policies are managed is required to change as a result of the Scheme. There are no changes to the terms and conditions of any policies or the various with-profits funds' PPFMs as a result of the Scheme. This impacts my consideration of the benefit expectations for policies for which the benefits are subject to a degree of management discretion, specifically unit-linked and with-profits policies.

PLL and PLA non-profit funds

9.23. The majority of the benefits for the business in the non-profit funds of PLL and PLA have no discretionary elements, with the exception of any discretion relating to the calculation of surrender values. The terms of the contracts are not impacted by the Scheme, so I am satisfied that the Scheme will not have a materially adverse impact on the benefit expectations for the Non-Transferring Policies in these funds.

9.24. The unit-linked business in these funds may have some elements of discretion relating to the level of charges for expenses and any death benefits. Neither the policy terms and conditions or the way the business is managed are required to change as a result of the Scheme. Thus, there is no reason why the Scheme should have a material impact on the level of any discretionary charges that apply on the unit-linked business. Therefore, I am satisfied that, of itself, the Scheme will not give rise to an impact on the benefit expectations for the Non-Transferring Policies in the non-profit funds of PLA and PLL.

PLL and PLA with-profits funds

9.25. The business in the with-profits funds of PLL and PLA does include business where the benefits have discretionary elements. However, the business is not transferring from these funds and, similarly to the points noted in the context of the GAL with-profits funds (in Section 7), the ring-fencing of these funds limits the extent to which the benefit expectations of the relevant policyholders are impacted by changes to the other funds within the companies. As with GAL, there will be no change to the way the with-profits business in these funds is managed as a result of the Scheme.

9.26. Certain discretionary management decisions, primarily relating to the levels of bonuses, are based on the financial strength of the fund rather than the financial strength of the company. As discussed above, the Scheme does not have a material impact on the assets and liabilities of the fund, nor will it have a material impact on either the expenses or the tax allowances charged to the with-profits funds.

9.27. I am satisfied that, of itself, the Scheme will not give rise to a material impact on the benefit expectations for the Non-Transferring Policies in these funds.

NPLL long-term fund

9.28. The business in the long-term fund of NPLL is, at least in theory, impacted more directly as some of the Transferring Policies are written in that long-term fund.

9.29. This fund is closed to new business.

9.30. There is a significant level of shareholder support in place for this fund and so any estate generated by profits on the non-profit business is expected to be used to pay guarantees or repay the shareholder support. This is reflected in the NPLL PPFM which states that there is no distribution of the estate at present nor is there likely to be for the foreseeable future.

9.31. The Scheme will have no impact on the asset shares of the policies, as overhead expenses are charged to the estate, in line with the PPFM for the fund, and there is not expected to be any tax impact from the Scheme.

9.32. For policies where the guarantees are not heavily in the money or for non-guaranteed benefits (such as on surrender), the benefits payable are dependent on the asset shares. The Scheme will have no impact on the asset shares or change the terms and conditions applicable to these policies.

9.33. For policies where the value of the guaranteed benefits heavily exceeds the asset share (as I understand is the case for the majority of policies in this fund), the policies behave more like non-profit policies with little scope for discretion. As there will be no changes to the terms and conditions applicable to these policies as a result of the Scheme, there will be no change on account of the Scheme to the (guaranteed) benefit that is paid out.

9.34. The unit-linked business in this fund may have some elements of discretion relating to the level of charges for expenses and any death benefits. Neither the policy terms and conditions or the way the business is managed are required to change as a result of the Scheme. Thus, there is no reason why the Scheme should have a material impact on the level of any discretionary charges that apply on the unit-linked business in this fund.

9.35. The other non-profit business in the fund has no discretionary elements and the Scheme will not change the terms and conditions of this business.

9.36. Thus, I am satisfied that, of itself, the Scheme will not give rise to a material impact on the benefit expectations for the Non-Transferring Policies in this fund.

Conclusion

9.37. For the reasons stated above, I am satisfied that, of itself, the Scheme will not have a material impact on the benefit expectations for any group of Non-Transferring Policies.

Equitability of the Scheme

9.38. As I have concluded that the Scheme will not have a materially adverse impact on any of the Non-Transferring Policyholders, I am satisfied that the Scheme is equitable to all classes and generations of Non-Transferring Policyholders in PLL, PLA and NPLL.

10. Service Standards and Investment Management

Introduction

10.1 In this Section, I consider the effect of the Scheme on the service standards and investment management of the Transferring Policies, the Existing GAL Policies and the Non-Transferring Policies.

Service Standards

Transferring Policies

10.2 I view the key consideration for the Transferring Policyholders in terms of service standards to be continuity of payments under their policies, which is dependent on the administration arrangements put in place.

10.3 As described in Section 3, it is anticipated that GAL will enter into direct arrangements with certain of the Outsource Service Partners in respect of the administration of the Transferring Policies with effect from the Transfer Date. Although the terms of these new arrangements remain to be finalised, in the case of the majority of the Transferring Policies this will mean that the Outsource Service Partner will remain the same following the Transfer Date, and GAL has also confirmed that their expectation is that there will be no degradation of service standards for any of the Transferring Policyholders. In particular, the intention is that the same teams at Diligenta and Capita will continue to service the policies and that the contractual obligations of Diligenta and Capita relating to the servicing of the policyholders will remain the same. In addition, as regards those Transferring Policyholders who are currently administered by HCL, the intention is that the contractual obligations under the new arrangement to be put in place in respect of those policies between GAL and Diligenta, will ensure that the relevant Transferring Policyholders will continue to benefit from the same levels of service as are currently provided by HCL.

10.4 In general, whatever the precise form of the administration agreements which may be put in place between GAL and the Outsource Service Partners, the key consideration is the reliance on GAL to provide the governance and oversight for these outsourcing relationships. Although GAL has not previously managed outsourcing arrangements of this scale, I have seen evidence that several members of the senior management team at GAL have previous experience governing large outsourcing arrangements and, while they are still in post, I do not view there to be a material risk of a change in standards as a result of the change in governance. In the event that there is a change in senior management, it will be important that those appointed have similar expertise and experience. Consequently, I do not view there to be a material risk of a change in standards as a result of the change in governance, in the event that Guardian enters into outsourcing agreements with the existing outsourcers from the Transfer Date.

10.5 In addition, in the event that GAL chooses to establish new outsourcing arrangements with alternative providers or to self-administer any of the Transferring Policies, GAL would, in either case, be required to satisfy its regulatory requirement to Treat Customers Fairly. In particular, Outcome 5 of the Treating Customers Fairly ("TCF") regulations, requires that companies ensure that policyholder "service is of an acceptable standard and as [policyholders] have been led to expect"[1]. I note that any company could make the decision to change outsource provider or self-administer and that, subject to meeting the TCF Outcome described above, this should not lead to a materially adverse impact on policyholder service standards. In particular, the Phoenix Companies could choose to change outsource provider or self-administer in the absence of the Scheme. As a result, I am satisfied that service standards for the Transferring Policyholders will not be materially adversely impacted by the Scheme.

Existing GAL Policies

10.6 No direct change is required relating to the administration of the Existing GAL Policies as a result of the Scheme. There could be an indirect impact through management attention being diverted to the administration of the Transferring Policies. However, I note that GAL has an ongoing obligation to satisfy TCF Outcome 5 and to provide service standards for these policies in line with policyholder expectations. Consequently, I am satisfied that there will not be a negative impact on the standards for these policies as a result of the Scheme.

[1] Extract from TCF Outcome 5, available at **http://www.fsa.gov.uk/doing/regulated/tcf**

Non-Transferring Policies

10.7 Outsourcing arrangements are in place covering the servicing and administration of Non-Transferring Policies. The Scheme does not impact these agreements and, as a result, I am satisfied that there will not be a materially adverse impact on policyholder service standards as a direct result of the Scheme.

Investment Management

10.8 The Phoenix Companies have informed me that there will be no changes after implementation of the Scheme to the investment management or mandate for the assets backing the Non-Transferring Policies and, therefore, I am satisfied that there will be no impact on the management of the assets backing these policies as a result of the Scheme.

10.9 GAL has informed me that there will be no changes, as a result of the Scheme, to the investment management or mandate for the assets backing the Existing GAL Policies and, therefore, I am satisfied that there will be no impact on the management of the assets backing these policies as a result of the Scheme.

10.10 As discussed in Section 3, the investment restrictions that are currently in place for the assets backing the Transferring Policies will no longer apply after the Transfer Date. Instead, following the Transfer Date, the investment mandate and decisions will be determined by GAL, which might involve investment in amounts or types of assets which are different from that provided for by the investment restrictions in the Reinsurance Agreements.

10.11 To the extent that a different investment mandate is used, there could be an impact on the risk profile of the company and therefore the security of benefits for Transferring Policies and Existing GAL Policies. My analysis of policyholder benefit security in respect of these policies is set out in Sections 7 and 8 of this Report. I do not consider that service standards for the Transferring Policyholders are directly impacted by the investment management decisions. In particular, unlike unit-linked business for example, there is no investment choice for the policyholders and the Transferring Policyholders do not directly bear any of the risk associated with the investment expenses. Consequently, I am satisfied that any change in the investment mandate as a consequence of the Scheme, provided any such change is consistent with the requirements of the GAL Capital Policy, will not have a materially adverse impact on policyholders.

11. Tax Considerations

Introduction

11.1. I have received information from the Companies, setting out the expected tax implications of the Scheme, both for the Companies and for policyholders. In particular, I have seen copies of the external professional advice obtained by the Companies. I have considered whether there are any tax considerations that could have a material adverse impact on policyholder benefit expectations or security.

11.2. Although my review has not identified any material adverse tax impacts for Transferring or Non-Transferring Policyholders, there will always be some risk of an adverse tax effect due to changes to tax legislation between now and the Transfer Date, or in relation to execution (for example, the obtaining of tax clearances or confirmations and notification requirements). I am not aware of any proposed legislative changes that would have an adverse effect at the present time.

11.3. As the Transferring Policies are already reinsured to GAL, I have compared the tax position of both Transferring and Non-Transferring Policyholders before the Scheme effective date (i.e. including the effect of the reinsurance), and after the Scheme effective date (i.e. once the business has been transferred and the reinsurance collapsed).

11.4. The corporation tax position of the Companies should be largely unaffected by the Scheme, as the business is already reflected in GAL due to the reinsurance arrangements in place. There should not, therefore, be any impact on the Transferring Policyholders in this respect.

Transferring Policyholders

11.5. The tax position of the Transferring Policyholders should not change as a result of the Scheme.

11.6. The Scheme transfers non-profit pension annuity policies to GAL. I note that, whilst not strictly necessary, it would be prudent for the Companies to write to the Pension Scheme Office to confirm a number of points; in particular to confirm that the tax status of the Transferring Policies as pension business is unaffected, and that no unauthorised payments arise. The Companies have confirmed that they intend to seek such confirmations. I do not expect there to be any change to the tax status of the Transferring Policies, or for any unauthorised payments to arise; and on that basis there should be no impact on the Transferring Policyholders.

11.7. As set out above, the corporation tax position of the Companies should be largely unaffected by the Scheme as the Transferring Policies are already reinsured to GAL. There should not, therefore, be any impact on Transferring Policyholders in this respect.

Existing GAL Policyholders

11.8. The corporation tax position of GAL should be largely unaffected by the Scheme as the Transferring Policies are already reinsured to GAL. There should not, therefore, be any impact on Existing GAL Policyholders in this respect.

11.9. I have not considered how tax is currently charged to the GAL WPF and the GAL NPF. However, on the basis that all business is transferred to the GAL NPF, I would not expect there to be any change to the charging mechanism and therefore there should be no impact on Existing GAL Policyholders.

11.10. I further understand that the investment return from the assets backing the Transferring Policies is separately identifiable (and will remain so post transfer), so there should be no impact on the allocation (for tax purposes) of investment return attributable to the Existing GAL Policies.

Non-Transferring Policyholders of PLL

11.11. The corporation tax position of PLL should be largely unaffected by the Scheme as the Transferring Policies are already reinsured to GAL. There should not, therefore, be any impact on the Non-Transferring Policyholders of PLL in this respect.

11.12. In particular, I note that tax is charged to PLL's ten with-profits funds as if they were standalone mutual or proprietary entities (as required by the relevant Part VII scheme). Any differences between the total annual tax liabilities of PLL, and the sum of the individually calculated tax liabilities of its with-profits funds, are borne by the PLL non-profit fund. I understand that this will not change following the Scheme.

11.13. The tax charged to with-profits funds is borne by policyholders, and the tax charged to non-profit funds is borne by shareholders. Thus the shareholders of PLL will continue to benefit from any such negative difference (synergy) as a result of the Scheme, and conversely to bear the cost of any positive difference. Given the existing reinsurance, the Scheme should have no significant impact on those differences and thus there should be no impact on the Non-Transferring Policyholders of PLL in this regard.

Non-Transferring Policyholders of PLA

11.14. The corporation tax position of PLA should be largely unaffected by the Scheme as the Transferring Policies are already reinsured to GAL. There should not, therefore, be any impact on the Non-Transferring Policyholders of PLA in this respect.

11.15. In particular, I note that tax is charged to PLA's three with-profits funds as if they were standalone mutual or proprietary entities (as required by the relevant Part VII Scheme). Any differences between the total annual tax liabilities of PLA, and the sum of the individually calculated tax liabilities of its with-profits funds, are borne by the PLA non-profit fund. I understand that this will not change as a result of the Scheme.

11.16. The tax charged to with-profits funds is borne by policyholders, and the tax charged to non-profit funds is borne by shareholders. Thus the shareholders of PLA stand to benefit from any such negative difference (synergy) as a result of the Scheme, and conversely would bear the cost of any positive difference. Given the existing reinsurance, the Scheme should have no significant impact on those differences and thus there should be no impact on the Non-Transferring Policyholders of PLA in this regard.

Non-Transferring Policyholders of NPLL

11.17. The corporation tax position of NPLL should be largely unaffected by the Scheme as the Transferring Policies are already reinsured to GAL. There should not, therefore, be any impact on the Non-Transferring Policyholders of NPLL in this respect.

11.18. In particular, I note that NPLL has a single with-profits fund which bears the cost of the annual tax liabilities of the entity. Thus, the with-profits policyholders of NPLL are exposed to any tax cost arising in NPLL as a result of the Scheme, and conversely would stand to benefit from any tax synergy.

11.19. Given the business being transferred from NPLL was wholly reinsured to PLA prior to it being reinsured to GAL, it is unlikely that the Scheme will have any impact on the tax position of NPLL, and I am therefore comfortable that this does not expose the Non-Transferring Policyholders of NPLL to risk of material adverse tax effects.

Tax Clearances and Confirmations Conclusion

11.20. I note that it would be prudent to seek a number of tax clearances or confirmations. The Companies have confirmed that these tax clearances and confirmations are being sought. In the event that the Companies do not secure these clearances and confirmations, I will discuss any policyholder impact in my Supplementary Report.

Conclusion

11.21. On the basis of the information referred to in 11.1 above, I conclude that there should be no materially adverse tax effects on Transferring Policyholders, Non-Transferring Policyholders or Existing GAL Policyholders on account of the implementation of the Scheme.

12. Policyholder Communications

Introduction

12.1. Parties to a Scheme made pursuant to Part VII of FSMA must comply with the notice requirements set out in the relevant regulations ("Transfer Regulations"). Sections 18.2.42 – 18.2.50 of the Regulator's Supervision Manual set out the requirements and guidance that will need to be satisfied by the Phoenix Companies and GAL in communicating the Scheme to policyholders.

12.2. The Transfer Regulations require a notice to be sent to all policyholders of the parties involved and to be published in two national newspapers. The form of the notices must be pre-approved by the Regulator. Where required, the Companies will also provide notice to any reinsurers of the Phoenix Companies or to anyone else who has notified the Phoenix Companies of their interest in these Transferring Policies. The Phoenix Companies' communication strategy states that they are also planning to write to counterparties to contracts identified as key to the Transferring Policies to give them notice of the Scheme.

12.3. I summarise below the notifications that the Companies will send out to policyholders and my view on whether these communications are appropriate for the purpose. The analysis has due regard for any practicalities and costs for the Companies and benefits to policyholders related to the communications.

Transferring Policyholders

12.4. Transferring Policyholders whose mailing details are available on the Phoenix Companies' computerised records will be sent copies of a covering letter, a scheme guide explaining the Scheme and its implications and containing a copy of the legal notice, and a question and answer booklet. All policyholders will also be able to access the full scheme document, my Reports and reports from the Actuarial Function Holders of the Phoenix Companies (including the appendix from the NPLL With-Profits Actuary) on each company's website, as well as the scheme guide and question and answer booklet.

12.5. Policyholders will also be able to call a helpline with any enquiries about the Scheme.

12.6. The Transfer Regulations require policyholders, which includes anyone with an indirect or beneficial interest in a policy, to be notified unless a dispensation is granted by the Court. The Phoenix Companies intend to seek a dispensation from the Court not to send the mailing packs to policyholders who are "uncontactable". I understand from the Phoenix Companies that the proportion of policyholders who are not contactable is currently around 1% of the total number of policyholders and, based on their experience with bulk mailings, the Phoenix Companies expect to be unable to contact a small proportion of policyholders. The Phoenix Companies have regular procedures in place to try to contact policyholders when the address provided is no longer valid, but no additional actions are being taken to contact them for the purpose of the Scheme. I am satisfied that, given the small volumes of these policyholders and the procedures already in place to contact them along with advertising that might bring the Scheme to their attention, this is an appropriate approach.

12.7. The Phoenix witness statement for the Scheme includes a request for dispensation to not contact some groups of policyholders directly. This includes group pension scheme members who are to be notified through the scheme trustees and policies subject to power of attorney where the third party with power of attorney will be sent the communication. The Phoenix Companies do not have records for all cases where rights to receive payments have passed to a trustee in bankruptcy and, consequently, the Phoenix Companies will be unable to send the communication packs to some of these trustees. However, if the Phoenix Companies have the contact details of the annuitant, they will mail the annuitant. I believe that the proposed approach is reasonable.

12.8. Among the Transferring Policyholders, 4,320 have their address outside the UK and the Phoenix Companies will ask the Regulator to notify EEA regulators about the Scheme. The Phoenix Companies are advertising in two national newspapers in each of five EEA states where more than 150 Transferring Policyholders are resident, which collectively account for a total of 3,812 Transferring Policyholders. Correspondingly, Phoenix is seeking dispensation not to advertise in the remaining 22 EEA states (in which a total of 508 policyholders are resident). The Phoenix Companies have informed me that the cost of advertising in each EEA state is estimated to be a minimum of £6,000 for each state. Given the disproportionate cost of advertising and the proposal to send a mailing pack directly to each policyholder where the address is held, I am satisfied that this is a reasonable approach.

12.9. The mailing pack also makes reference to the Guardian Scheme, informing the Transferring Policyholders about Guardian's intention to transfer policies to GAL from its subsidiaries. The proposed Phoenix communication

packs do not mention the Guardian Scheme in the covering letter but there is a section in the Scheme guide which provides details about this other Scheme. I am satisfied that this is a reasonable approach, given the immaterial impact of the Guardian Scheme.

12.10. I am satisfied that the proposed approach to communicating with Transferring Policyholders is reasonable. I have also reviewed the proposed communication pack and am satisfied that these documents should help Transferring Policyholders to understand the material effects of the Scheme with respect to their policies.

Non-Transferring Policyholders

12.11. The Phoenix Companies do not plan to send similar information on the Scheme to Non-Transferring Policyholders, but information will be available to these policyholders on the websites of the Phoenix Companies and notices will be published in the London, Edinburgh and Belfast Gazettes and six national newspapers.

12.12. A tailored Non-Transferring Policyholder Guide will also be made available on the websites of the Phoenix Companies. This guide will also be sent to the Non-Transferring Policyholders on request to the Phoenix Companies.

12.13. I am satisfied that this is an appropriate and proportionate approach for the following reasons:

- There are no changes to the terms and conditions of any Non-Transferring Policies, nor will any governance arrangements change for these policies;
- The Scheme does not result in any changes to the current operation or financial management of the long-term insurance funds of the Phoenix Companies;
- Costs associated with the Scheme will be met from the PLA and PLL shareholders' funds and accordingly will not be met by the long-term funds of the Phoenix Companies, so the Non-Transferring Policyholders have no cost implications as a result of the Scheme;
- The security of the Non-Transferring Policyholders is supported by the capital policies in the Phoenix Companies which will continue to remain in force after the Scheme is implemented;
- As described in Section 9 of this report, the Scheme does not cause a materially adverse impact on the benefit expectations or security of Non-Transferring Policyholders.
- The total number of Transferring Policies is a small proportion of the total number of Non-Transferring Policies (around 5%); and
- The relevant information is being made publicly available on the website and through advertising in the media.

Existing GAL Policyholders

12.14. All Existing GAL Policyholders, including all with-profits policyholders, whose mailing details are available will be sent copies of a covering letter, scheme guide and question and answer booklet explaining the Scheme and its implications. All policyholders will also be able to access the full scheme document, my Reports and the report by the Actuarial Function Holder of GAL on the company's website, as well as the scheme guide and question and answer booklet. GAL estimates that 9% of the policyholders in GAL are "uncontactable". GAL has a business-as-usual system in place to trace such policyholders, which will continue, and is putting adverts in a number of newspapers in an attempt to contact these policyholders.

12.15. This mailing pack will also include details on the Guardian Scheme and how it affects policyholders. I will consider the communication in the mailing pack that is specific to the Guardian Scheme in a separate report.

12.16. In addition, policyholders will be able to call a helpline with any enquiries about the Scheme.

12.17. The terms of the Transfer Regulations require the beneficiaries of policies to be notified. The Guardian witness statement for the Scheme includes a request for dispensation to not contact some groups of policyholders directly. I believe that the proposed approach is reasonable.

12.18. I am satisfied that the proposed approach to communicating with Existing GAL Policyholders outlined above is reasonable. I have also reviewed the proposed communication packs and am satisfied that these should help policyholders to understand the material effects of the Scheme with respect to their policies.

Objections

12.19. Transferring Policyholders, Non-Transferring Policyholders or Existing GAL Policyholders who feel they will be adversely affected by the Scheme may put their objections to the Court either in writing, by attending the hearing or by asking a representative to raise their objection. In deciding whether to sanction the Scheme, the Court will consider any objections. I will also consider objections that have been made in writing sufficiently in advance of the Court date, in coming to my view on the appropriateness of the Scheme and will report as appropriate in my Supplementary Report.

Appendix 1: Independent Expert Terms of Reference

Scope of the work of the Independent Expert in relation to the proposed scheme (the "Scheme")

The Reports are to consider the terms of the Scheme generally and the effect which the Scheme will have on the holders of long-term policies of the Companies.

In preparing the Reports, the Independent Expert must have regard to the duty that he owes to assist the High Court on those matters within his expertise. This duty overrides any obligations to the Companies. The Reports apply equally to business written by the Companies in Jersey, Guernsey and the Isle of Man as they do to business written in the UK, and may therefore be used to satisfy the requirement for a report by an independent actuary on the terms of the local schemes in those jurisdictions (to the extent that any such local schemes are required).

In particular the Reports should consider the following specific matters:

- The matters listed in SUP 18.2.33G, 18.2.36G and 18.2.39G.
- The impact of the Scheme on the security of the different groups of policyholders involved in the Scheme.
- The impact of the Scheme on the benefit expectations of the different groups of policyholders involved in the Scheme.
- Consideration of any change in tax that may be charged to policies or policyholder funds, or other loss of favourable tax status.
- Consideration of the effect of the GAL Scheme proceeding or not.
- A review of, and opinion on the adequacy of, the communications made to policyholders concerning the Scheme.
- An assessment of the Scheme on the level of service (including administration and investment management services) provided to the different groups of policyholders involved in the Scheme.
- The adequacy of any safeguards in the Scheme to protect the ongoing interests of different groups of policyholders.
- Any other matters drawn to the attention of the Independent Expert by the Financial Services Authority or required by the Financial Services Authority to be addressed within the Reports.

The review and Reports will address generally the way in which the Companies have conducted their long-term business but taking into account the particular circumstances of the class of business to be transferred. It will consider inter alia the following aspects of each Company:

- The Memorandum and the Articles of Association, at least insofar as these affect the rights, expectations and interests of policyholders.
- To the extent potential concerns arise, consideration of the terms of policies issued by each Company or otherwise held by policyholders of each Company.

- The existing and proposed internal working arrangements relating to the financial management of the long-term business funds of each Company, including the operational and administrative arrangements which will apply to the policies to be transferred under the terms of the Scheme.
- The terms and conditions expected to be imposed by the Scheme to be presented to the Court and the terms and conditions of any other schemes or arrangements in overseas jurisdictions which may be required to transfer certain of the policies, including the views expressed by the governing body or management of each Company.
- The terms of any previous schemes of transfer that created particular rights or protections for a class of policyholders within one or more of the Companies.

The above list is not intended to be exclusive of any other aspects which may be identified during the completion of the project and which are considered to be relevant.

The Independent Expert shall not be directly involved in the formulation of the proposed transfer although he will be expected to give guidance during the evolution of the detailed proposals on those issues which are of concern to him, or which he considers unsatisfactory.

Appendix 2: Regulatory requirements for Independent Expert Report

Chapter 18 of the Supervision Manual of the Regulator's Handbook of Rules and Guidance ("SUP 18") sets out the Regulator's requirements relating to the transfer of long-term insurance business. In particular, SUP 18.2 sets out the requirements of a scheme report in relation to the transfer of insurance business within the UK. The following table sets out details of this guidance and where appropriate I have included references to the sections in the main body of the Report which cover the scope required by these regulations.

Table A2.1 – SUP 18 cross reference

SUP 18.2 item number and details	Section and paragraph reference in this Report	Executive summary
SUP 18.2.33G		
(1) who appointed the independent expert and who is bearing the costs of that appointment;	1.2	N/A
(2) confirmation that the independent expert has been approved or nominated by the appropriate regulator;	1.2	N/A
(3) a statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role;	1.4	N/A
(4) whether the independent expert has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest;	1.5 – 1.7	N/A
(5) the scope of the report;	1.8 – 1.11	N/A
(6) the purpose of the scheme;	3.1 – 3.4	2.4, 2.5
(7) a summary of the terms of the scheme in so far as they are relevant to the report;	3.9 – 3.18	2.6 – 2.14
(8) what documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided;	Appendices 8 and 9	N/A
(9) the extent to which the independent expert has relied on:		
(a) information provided by others; and	Appendix 9 & Sections 7 - 9	N/A
(b) the judgment of others;	Appendix 9	N/A
(10) the people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable;	Appendix 9	N/A
(11) his opinion on the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between:		
(a) transferring policyholders;	Section 8	2.33 – 2.52; 2.76 – 2.77
(b) policyholders of the transferor whose contracts will not be transferred; and	Section 9	2.53 – 2.55; 2.78 – 2.82

Appendix 2

SUP 18.2 item number and details	Section and paragraph reference in this Report	Executive summary
(c) policyholders of the transferee;	Section 7	2.56 – 2.59; 2.69 – 2.75
(11A) his opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme;	N/A	N/A
(12) what matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the scheme; and	1.9	N/A
(13) for each opinion that the independent expert expresses in the Report, an outline of his reasons.	Sections 7-9	2.33 – 2.59; 2.69 – 2.82
SUP 18.2.35G		
(1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme; and	N/A	N/A
(2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred.	N/A	N/A
SUP 18.2.36G		
The independent expert's opinion of the likely effects of the scheme on policyholders should:		
(1) include a comparison of the likely effects if it is or is not implemented;	Sections 7-9	2.33 – 2.59; 2.69 – 2.82
(2) state whether he considered alternative arrangements and, if so, what;	1.10	N/A
(3) where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders; and	Sections 7-9	2.33 – 2.59; 2.69 – 2.82
(4) include his views on:		
(a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;	7.5 – 7.26; 8.5 – 8.32; 9.4 – 9.21	2.33 – 2.59
(b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:	Section 10	2.83 – 2.93
(i) the security of policyholders' contractual rights;		
(ii) levels of service provided to policyholders; or		
(iii) for long-term insurance business, the reasonable expectations of policyholders; and		
(c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations.	Section 11 (tax)	N/A
SUP 18.2.39G		
For a scheme involving long-term insurance business, the report should:		

Appendix 2

SUP 18.2 item number and details	Section and paragraph reference in this Report	Executive summary
(1) describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits;	7.31; 9.25, 9.28 – 9.36	2.72, 2.74, 2.79, 2.80
(2) if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;	N/A	N/A
(3) describe the likely effect of the scheme on the approach used to determine: (a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and (b) the levels of any discretionary charges;	7.30, 7.31; 9.23, 9.25 – 9.36 7.28, 7.35; 9.24	2.72, 2.74, 2.78 – 2.82 2.71, 2.78 – 2.82
(4) describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm;	3.18	N/A
(5) include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders;	7.37; 8.33; 9.37	2.96
(6) state whether the independent expert is satisfied that for each firm the scheme is equitable to all classes and generations of its policyholders; and	7.38, 8.34, 9.38	2.94
(7) state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented.	3.18	N/A

Appendix 3: Background to Guardian Assurance Limited

Introduction

Guardian Fire & Life was established in 1821 and was renamed as Guardian Assurance in 1902.

In 1968 the company merged with Royal Exchange Assurance and became Guardian Royal Exchange Group (GRE). In 1970, five life funds (Guardian, Royal Exchange, Atlas, Caledonian and Licences & General) were merged to form the With-Profits Fund of GAL.

Subsequently, in 1999, the life and pensions businesses of GRE along with the Guardian name were acquired by Aegon UK.

In November 2011 they were then acquired by Cinven, a private equity firm. The Cinven Group comprises private equity businesses in a number of jurisdictions, which are engaged in the provision of investment management and advisory services either directly or indirectly to various investment funds.

At this time GLLA, GPM and GAL were all subsidiaries of Guardian Financial Services Holdings UK Limited. All three firms trade under the name Guardian Financial Services.

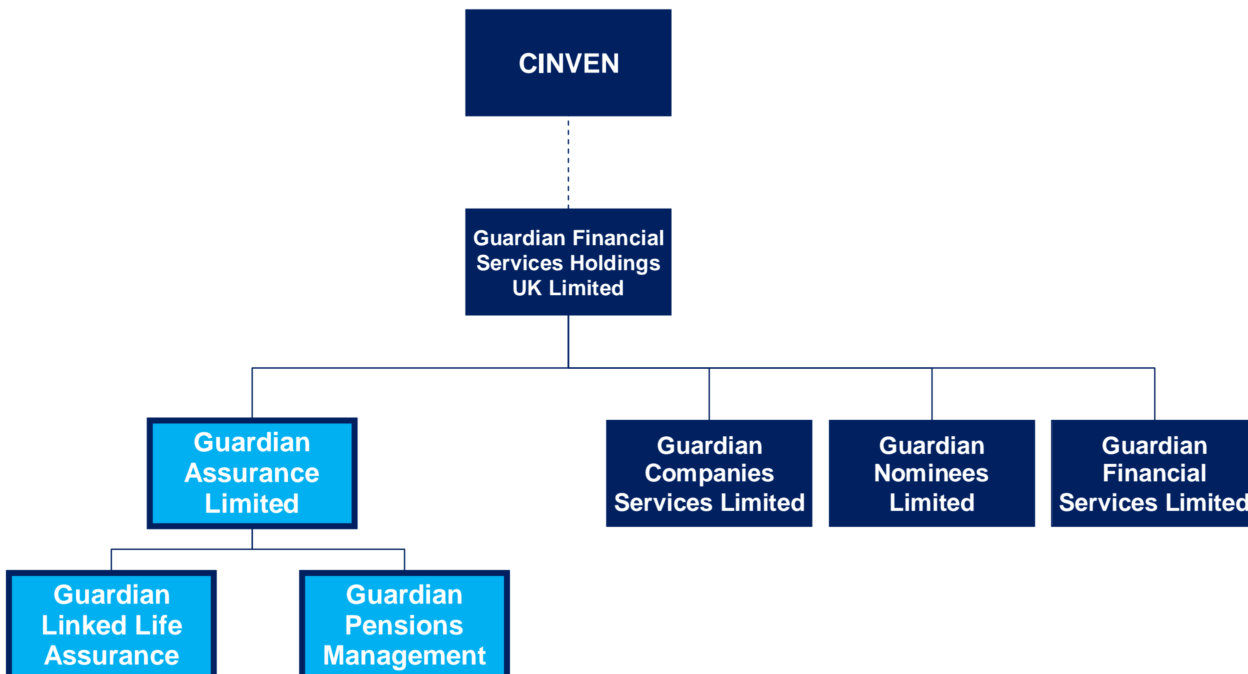
In June 2012, a change of control was approved by the Regulator under which GLLA and GPM became subsidiaries of GAL. The change of control is discussed in more detail below.

In June 2012, internal restructuring moved business out of the Guardian with-profits fund into a non-profit fund. This is described in more detail below.

Corporate Structure

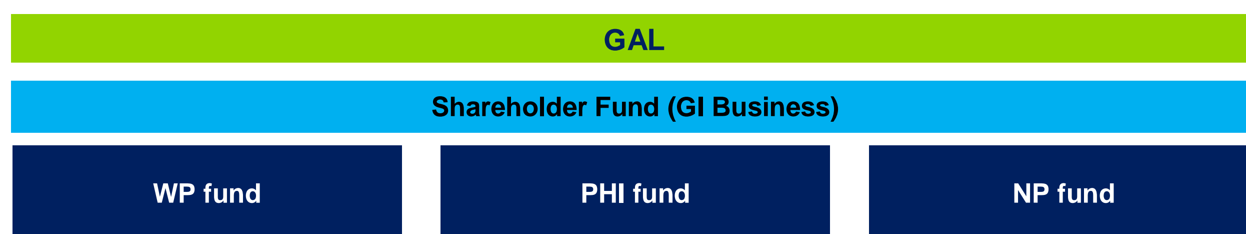
The following diagram shows ownership of the Guardian companies. This diagram does not show all the entities owned by Cinven.

Figure A3.1 – Structure of the Guardian companies



GAL has one long-term insurance fund, which has three sub-funds. GAL closed to new business in 1998. The non-profit fund was created as part of the with-profits restructuring described below. In addition to the business in the long-term insurance fund, GAL has a small amount of general insurance business in its shareholder fund.

Figure A3.2 – GAL fund structure



Capital policy

The capital policy is described in detail in Section 5.

Nature of Business of GAL

The following table shows the split of business in the GAL NPF as at 31 December 2012.

Table A3.1 – Business in GAL NPF, values at 31 December 2012

Product Type	Number of policies	Gross Mathematical Reserves (£m)	Reinsured Mathematical reserves (£m)	Net Mathematical reserves (£m)
Non-profit deferred annuities and annuities in payment	55,690	1,729	0	1,729
Non-profit annuities in payment reinsured to Scottish Equitable	39,586	1,032	1,028	4
With-profits deferred annuities reinsurance accepted	13,029	975	0	975
Unit Linked reinsurance accepted		1	0	1
Reinsurance accepted	318,082	5,053	82	4,971
Other	0	43	0	43
Total	**426,387**	**8,833**	**1,110**	**7,723**

The following table shows the split of business in the GAL WPF as at 31 December 2012.

Table A3.2 – Business in GAL WPF, values at 31 December 2012

Product Type	Number of policies	Gross Mathematical Reserves (£m)	Reinsured Mathematical reserves (£m)	Net Mathematical reserves (£m)
Unitised with-profits business	18,738	1,076	0	1,076
Traditional with-profits endowments	24,558	465	0	465
With Profit deferred annuities and residual annuities in payment	12,656	1,341	975	366
Unit Linked	104,656	1,480	1,110	370
Other non-profit	18,433	73	0	73
Other	5,460	95	0	95
Total	**184,501**	**4,530**	**2,085**	**2,445**

GAL also contains a small PHI fund (£9m of reserves at 31 December 2012) and a small amount of General Insurance business in its shareholder fund (£4m of reserves at 31 December 2012).

Outsourcing Arrangements

Investment management agreements exist between GAL and investment manager Kames Capital and BlackRock which are paid an annual management charge in return for managing the existing investments of the insurer (with the exception of those managed by Ignis relating to the Reinsurance Agreements). An expense management agreement also exists between GAL and Guardian Companies Services Limited, which provides all other administrative services to GAL in return for an agreed level of expense fees. These arrangements do not cover the business reinsured from the Phoenix Companies under the Reinsurance Agreements.

GLLA, GPM - Change of control

The non-objection to the transfer of ownership of GLLA and GPM to GAL was received on 21 June 2012. The transfer was effected on a “nil consideration” basis (with a nominal price of £1 per company) as it was an internal transfer. Prior to the change in control, GLLA and GPM were direct wholly-owned subsidiaries of Guardian Financial Services Holdings UK Limited. The current structure is shown in Figure A3.1.

The change of control was part of a project of intra-group restructuring, intended to simplify the Guardian group of companies and improve capital efficiency. This plan to simplify the group had been set out in the previous change of control which related to the transfer of the Guardian Companies from Aegon to Cinven.

The change of control documentation relating to the transfer of GLLA and GPM set out plans to subsequently transfer all of the insurance business in GLLA and GPM to the GAL NPF under a Part VII scheme of transfer (the Guardian Scheme). This is intended to improve the capital efficiency and simplify the governance arrangements in GAL.

With-profits fund restructuring

As part of the same project of internal restructuring as the change of control of GLLA and GPM, business was moved from the with-profits fund of GAL to the non-profit fund of GAL. The impact of this restructuring was effective retrospectively from 1 January 2012. The terms of the restructure were reviewed by the Regulator and the With-Profits Committee of GAL. The Regulator confirmed that they had no objection to the restructure.

This restructuring was implemented to accelerate estate distribution in the fund for with-profits policyholders. It is intended that this will result in higher bonus pay-outs for with-profits policyholders in the future compared to the bonuses that would have been paid out without the restructure.

Appendix 3

The main components of the restructure are set out below:

1) The non-profit fund of GAL was created as a 0:100 fund.
2) The non-profit guaranteed annuity policies (both annuities in payment and non-profit deferred annuities) were transferred into the non-profit fund of GAL.
3) The risks associated with some with-profits deferred annuity policies were transferred into the non-profit fund of GAL by means of an inter-fund reinsurance agreement. The guarantees on these policies are heavily in the money and so the policies behave more like non-profit contracts than with-profits contracts. In addition to the guaranteed liabilities, the GAL NPF will pay out a 0.5% bonus every year in respect of these policies.

The following changes were also effected as part of the with-profits restructuring:

1) A 19% holding in Empire Life, an unlisted Canadian Life company, was transferred from the GAL WPF to its NPF.
2) Reassurance treaties relating to certain unit-linked business written in the GAL WPF were changed so that 100% of this business is reinsured into the GAL NPF. Previously 70% was reinsured to GLLA and GPM, which are now subsidiaries of GAL.
3) Some of the annuities in payment in the fund were reinsured out to Scottish Equitable and, following the transfer of these policies to the GAL NPF, the reinsurance arrangement is now between Scottish Equitable and the GAL NPF.

Appendix 4: Background to the Phoenix Group

Introduction

Phoenix Group Holdings ("PGH") is the ultimate parent company of several authorised life assurance companies collectively known as the Phoenix Group. The Phoenix Group is the largest UK consolidator of closed life assurance funds. It has approximately 6 million policies in force and around £68.6 billion worth of assets as at 31 December 2012. PGH is listed on the London Stock Exchange.

History

Phoenix can trace its history back to 1782 and has a long and complex history, more details of which can be found on the Phoenix website.

Some of the more recent history of Phoenix is outlined below.

In 2005, Pearl Group Limited ("PGL") was set up to acquire and manage closed life insurance funds. In that year, it acquired the life business of HHG plc ("HHG"), comprising Phoenix Life Assurance Limited ("PLA"), National Provident Life Limited ("NPLL"), London Life Limited ("LL"), National Provident Institution Limited ("NPIL") and HHG Services Limited (which provided administration services to all four life companies).

On 1 May 2008, PGL acquired Resolution plc ("Resolution"). Resolution had been formed in September 2005 from the merger of Resolution Life Group Limited and Britannic Group plc. Resolution Life Group Limited had previously acquired the United Kingdom life insurance business of the Royal and Sun Alliance Group and Swiss Life (UK) plc. The Britannic Group acquired the life insurance operations of Allianz Cornhill in December 2004 and the Century Group in April 2005.

In September 2006, Resolution acquired the life insurance companies of Abbey National plc, including Scottish Mutual Assurance Limited ("Scottish Mutual") and Scottish Provident Limited.

In 2008, following the acquisition of Resolution, PGL sold the protection and healthcare business of Scottish Mutual and Scottish Provident Limited to Royal London Group.

In 2009, Liberty Acquisition Holdings (International) Company ("Liberty") acquired PGL and became the ultimate holding company. Liberty was incorporated in 2008 as a non-operating Special Purpose Acquisition Company. Following the acquisition of PGL, Liberty changed its legal name to Pearl Group and moved its principal place of business to Jersey.

On 15 March 2010, Pearl Group changed its name to Phoenix Group Holdings, and subsequently moved its primary listing to the London Stock Exchange.

The Phoenix Group in recent years has carried out various schemes enabling it to simplify its group structure. This work has included reducing the number of regulated life insurance entities, brands and funds as well as reducing the amount of intra-group reinsurance. Some of the recent schemes are outlined below.

Current structure

The Phoenix Group has two core areas of business: life assurance companies mostly owned by Phoenix Life Holdings Limited and asset management companies owned by Ignis Asset Management.

The Phoenix Group life assurance business includes four regulated life companies, PLA, NPLL, PLL and Scottish Mutual International Limited. None of these companies writes new business other than as a result of increments or options on existing policies.

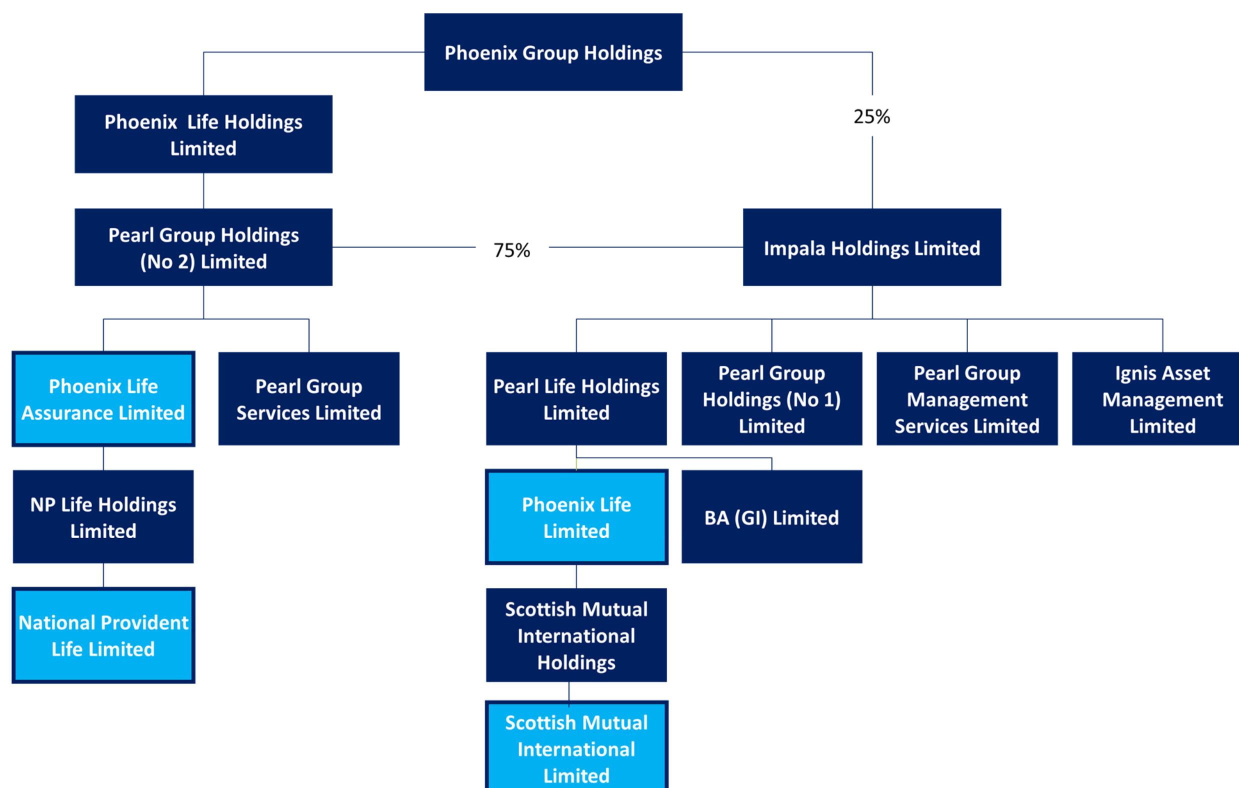
The companies within the Phoenix Group have operated under various names and, until September 2012, PLA operated under the name "Pearl".

Appendix 4

Ignis Asset Management Limited is the Phoenix Group's asset management business, providing services to the Phoenix Group's life companies as well as to third-party clients, including retail and institutional investors. Ignis currently provides asset management services to GAL in respect of the assets backing the Transferring Policies which were transferred to GAL when the business was reinsured to GAL on 1 July 2012

The following diagram illustrates the structure of the Phoenix Group. This diagram is simplified and does not show the full company structure. The entities shown in light blue are regulated insurance entities.

Figure A4.1 – Simplified Phoenix Life Holdings Limited Group company structure



Previous Schemes

The Phoenix Group has implemented several schemes in recent years to transfer business between its entities. The Court-approved schemes detailed below involve one or more of the Phoenix Companies.

The following schemes resulted in the transfer of business into PLL:

- In 2006 the life businesses of Alba Life Limited, Britannic Assurance plc, Britannic Retirement Solutions Limited, Britannic Unit-Linked Assurance Limited, Century Life plc and Phoenix Life & Pensions Limited were transferred into PLL (the "2006 Scheme").
- In 2009 the life businesses of Scottish Mutual Assurance Limited (excluding the Self Assurance protection portfolio and Pegasus business) and Scottish Provident Limited (excluding the Self Assurance protection portfolio) were transferred to PLL on 6 February 2009, but with effect from 31 December 2008 (the "2009 Scheme").
- In 2011 all the Phoenix & London Assurance Limited policies were transferred to PLL (the "2011 Scheme"). The policies were transferred on 21 February 2011, but with effect from 1 January 2011.
- In 2012 all of the business from NPIL and certain policies from NPLL transferred to PLL (the "March 2012 Scheme"). This transfer took place on 31 March 2012 but with an effective date for accounting purposes of 1 January 2012.

The following schemes resulted in the transfer of business into PLA:

- In 2010 Self Employed Retirement Plan ("SERP") business was transferred from NPLL to PLL (the "Pearl SERP Scheme").

- In 2012 all of London Life Limited's business transferred to PLA (the "September 2012 Scheme").

PLA owns NPLL which is subject to the terms of a scheme from 2000 (the "NPLL Scheme"). This scheme governed the demutualisation of National Provident Institute ("NPI") and transferred all of NPI's long-term insurance business into NPLL. The terms are such that the NPLL long-term insurance fund continues to operate as if it were a mutual company and eligible policyholders are entitled to 100% of the profits and losses on long-term insurance business written prior to demutualisation.

Appendix 5: Business in PLL

Introduction

The history of PLL is discussed in Appendix 4. This appendix provides more detail of the structure within the company and the business it contains.

The Corporate Structure

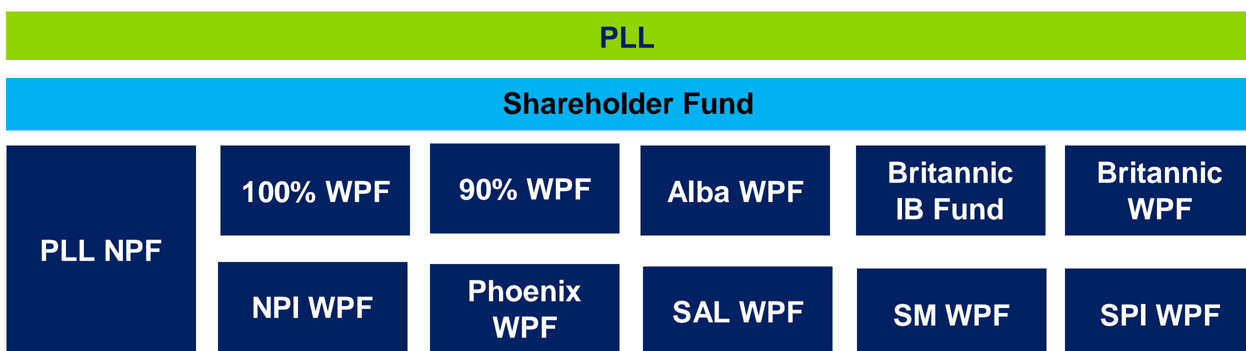
PLL has a shareholders fund (the "PLL Shareholders' Fund") and a long-term insurance fund (the "PLL Long-term Fund"). The long-term insurance fund has 11 sub-funds:

- The Non-Profit Fund (the "PLL NPF") is a 0:100 fund.
- The 100% With-Profits Fund (the "100% WPF") is a 100:0 fund.
- The 90% With-Profits Fund (the "90% WPF").
- The Alba With-Profits Fund (the "Alba WPF") is a mixed 100:0/90:10(1)fund.
- The Britannic Industrial Branch Fund (the "Britannic IB Fund") is a 90:10 fund.
- The Britannic With-Profits Fund (the "Britannic WPF") is a 90:10 fund.
- The NPI With-Profits Fund (the "NPI WPF") is a 100:0 fund.
- The Phoenix With-Profits Fund (the "Phoenix WPF") is a 90:10(2)fund.
- The SAL With-Profits Fund (the "SAL WPF") is a 90:10(2) fund.
- The Scottish Mutual With-Profits Fund (the "SM WPF") is a 90:10 fund.
- The SPI With-Profits Fund (the "SPI WPF") is a 90:10 fund.

(1) In the Alba WPF, policies are divided into various classes. For certain classes, no transfer to shareholders is made and for the remaining, a 90:10 sharing is applied.

(2) The maximum permissible transfer to shareholders in these funds is 1/9th of the value of bonuses. However, this is currently only applied to some classes of policies in the fund. For certain classes of unitised business, the sharing is currently 95:5.

Figure A5.1 – Fund structure of PLL



Nature of Business of PLL

The Transferring Policies are held within the PLL NP Fund and the following table shows the value of business in this fund at 31 December 2012.

Appendix 5

Table A5.1 – Business in PLL non-profit fund, values at 31 December 2012

Product Type	Number of policies	Gross Mathematical Reserves (£m)	Reinsured Mathematical reserves (£m)	Net Mathematical reserves (£m)
Term assurance	134,319	114	38	76
Annuities in payment	341,594	7,896	4,556	3,340
Deferred annuities	27,025	546	0	546
Other	1,215,224	11,397	307	11,091
Total	**1,718,163**	**19,954**	**4,901**	**15,053**

As discussed in Section 3, Transferring Policies from PLL were reinsured to GAL on 1 July 2012.

The with-profits sub-funds include a range of business, both with-profits and non-profit. None of the Transferring Policies are held within these funds. The with-profits funds are ring-fenced and therefore would only be impacted by the Transferring Policies in extreme scenarios.

The table below shows the size of the business in these funds.

Table A5.2 – Business in PLL with-profits funds, values at 31 December 2012

Fund	Number of policies	Gross Mathematical Reserves (£m)	Reinsured Mathematical reserves (£m)	Net Mathematical reserves (£m)
100% WPF	1,073	27	0	27
90%WPF	396,132	86	0	86
Alba WPF	127,059	3,098	1,529	1,569
Britannic IB Fund	474,287	225	0	225
Britannic WPF	307,206	3,133	1	3132
Phoenix WPF	225,347	4,006	140	3866
SAL WPF	359,687	4,812	16	4796
SM WPF	40,619	2,318	1	2317
SPI WPF	126,661	1,952	3	1949
NPI WPF	9490	152	152	0
Total	2,067,561	19,807	1,842	17,965

Appendix 6: Business in PLA

Introduction

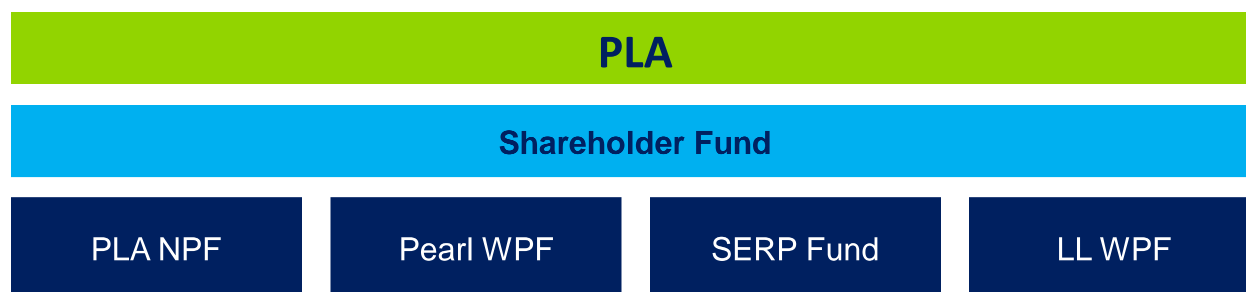
The history of PLA is discussed in Appendix 4. This appendix provides more detail of the structure within the company and the business it contains.

Current Structure

PLA has a shareholders fund (the “PLA Shareholders’ Fund”) and a long-term insurance fund (the “PLA Long-term Fund”). The long-term insurance fund has four sub-funds:

- The Non-Profit Fund (the “PLA NPF”) is a 0:100 fund.
- The Pearl With-Profits Fund (the “Pearl WPF”) is a 90:10 with-profits fund.
- The SERP Fund is a 100:0 with-profits fund.
- The London Life With-Profits Fund (the “LL WPF”) is a 100:0 with-profits fund.

Figure A6.1 – Fund structure of PLA



Nature of Business of PLA

The Transferring Policies are held within the PLA NPF and the following table shows the value of business in this fund at 31 December 2012.

Table A6.1 – Business in PLA Non-Profit Fund, values at 31 December 2012

Product Type	Number of policies	Gross Mathematical Reserves (£m)	Reinsured Mathematical reserves (£m)	Net Mathematical reserves (£m)
Term assurance	51,849	-32	-5	-27
Annuities in payment	228,706	3,828	2,984	845
Deferred annuities	2,376	40	0	40
Other	58,867	413	13	400
Total	**341,798**	**4,249**	**2,992**	**1,258**

Pension business from the three with-profits funds currently vests into this fund.

As discussed in Section 3, Transferring Policies from PLA were reinsured to GAL on 1 July 2012.

Some of the remaining pension annuities in payment are reinsured to Opal Reassurance Limited ("Opal") (which is a captive reassurer within the Phoenix Group). Opal bears the longevity and investment risk of the business reinsured to it. The total liabilities reinsured under the Opal arrangement at 31 December 2012 were £1,288m.

PLA currently retains the expense risk for the business reinsured to Opal and Guardian. Increments and new business are not accepted under either treaty, and so are retained by PLA.

The with-profits sub-funds include a range of business, both with-profits and non-profit business. None of the Transferring Policies are held within these funds. The with-profits funds are ring-fenced and therefore would only be impacted by the Transferring Policies in extreme scenarios.

The table below shows the size of the business in these funds

Table A6.2 – Business in PLA with-profits funds, values at 31 December 2012

Fund	Number of policies	Gross Mathematical Reserves (£m)	Reinsured Mathematical reserves (£m)	Net Mathematical reserves (£m)
Pearl WP	1,528,679	5,945	7	5,938
SERP	41,104	1,378	0	1,378
LL WP	43,329	796	9	787
Total	**1,613,112**	**8,119**	**15**	**8,103**

Appendix 7: Business in NPLL

Introduction

The history of NPLL is discussed in Appendix 4. This appendix provides more detail of the structure within the company and the business it contains.

Corporate Structure

NPLL has a shareholder fund and one long-term insurance fund which is known as the National Provident Life Fund (the "NPLF"). It contains both with-profits and non-profit business.

There are a number of capital support arrangements in place for NPLL:

- In 1998, £260m of capital was secured on the embedded value of most of the unitised with-profits and unit-linked business.
- A sum of £800m was paid into the shareholders fund of NPLL to provide capital support for the company, in order to meet guarantee costs where they cannot be met by surplus. Repayments can only be made to the extent that a deficit will not be created in the NPLF and the repayment will not have an adverse effect on the reasonable expectations of NPLL policyholders.
- The shareholder has subsequently provided further capital support to the NPLF, which is available to meet guarantee costs if required but does not otherwise form part of policyholders' reasonable expectations.

In addition, PLA has agreed to provide an indemnity to NPLL for any losses that might occur in the event that GAL defaults on the Reinsurance Agreements.

Figure A7.1 – Fund structure of NPLL

Nature of Business of NPLL

NPLL has a range of non-profit and with-profits business, as summarised in the table below (as at 31 December 2012):

Table A7.1 – Business in NPLL, values at 31 December 2012

Product Type	Number of policies	Gross Mathematical Reserves (£m)	Reinsured Mathematical reserves (£m)	Net Mathematical reserves (£m)
Annuity NP	45,240	698	659	38
Life Conventional WP	1,883	23	0	23
Pens Conventional WP	7,389	424	0	424
Miscellaneous	9,104	107	17	90
Life UWP	10,150	196	13	183
Pens UWP	112,199	2,266	-1	2,267

Deposit Admin	1,056	28	0	28
UL Life	5,440	74	71	3
UL Pens	127,123	1,629	1,576	53
Total	**319,584**	**5,445**	**2,336**	**3,109**

As discussed in Section 3, Transferring Policies from NPLL were reinsured to GAL on 1 July 2012.

Appendix 8: Financial information

Introduction

This appendix provides a fund level breakdown of the financial impact of the Scheme, as summarised in Section 6 of this Report.

Summary Pillar 1 Financial Information

Pre-scheme Pillar 1 solvency position

Notes:

(1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to the Regulator's rules on capital tiers.
(2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component plus CRR of regulated subsidiary.
(3) Capital Resources less Capital Required (where the latter is that part of the entity-level requirements that arises in respect of the relevant fund).
(4) Capital Resources divided by Capital Resources Requirement.

Table A8.1 – GAL pre-scheme solvency position (including GAL WPF), values at 31 December 2012

£m	WPF	NPF	SHF	PHI	Total
Capital Resources (1)	**1,103**	**529**	**344**	**3**	**1,978**
LTICR	62	297	-	3	362
RCR	-	-	-	-	0
CRR Regulated Subsidiary	-	15	-	-	15
WPICC	1,041	-	-	-	1,041
Capital Requirement (2)	**1,103**	**312**	**0**	**3**	**1,417**
Surplus assets in excess of Capital Requirement (3)	**0**	**217**	**344**	**0**	561
Cover for Capital Requirement (4)					***140%***

Table A8.2 – GAL pre-scheme solvency position (excluding GAL WPF), values at 31 December 2012

£m	NPF	SHF	PHI	Total
Capital Resources [1]	**529**	**344**	**3**	***876***
LTICR	297	-	3	300
RCR	-	-	-	0
CRR Regulated Subsidiary	15	-	-	15
WPICC	-	-	-	0
Capital Requirement [2]	**312**	**0**	**3**	**315**
Surplus assets in excess of Capital Requirement [3]	**217**	**344**	**0**	**561**
Cover for Capital Requirement [4]				***278%***

Table A8.3 – PLL pre-Scheme solvency position, values at 31 December 2012

£m	ALBA	BIB	BWP	PWP	90%	100%	SMA	SPI	SAL	NPI	Non Annuity	Annuity	NPIL Annuity	SHF	Total
Capital Resources [1]	**5**	**135**	**1,203**	**705**	**48**	**67**	**241**	**700**	**487**	**0**	**20**	**20**	**10**	**831**	**4,473**
LTICR	86	9	129	169	4	1	93	80	196	2	147	182	25	-	**1,124**
CRR Regulated Subsidiary	-	-	-	-	-	-	-	-	-	-	-	-	-	12	**12**
WPICC	-	113	933	437	42	66	139	571	255	-	-	-	-	-	**2,557**
Capital Requirement [2]	**86**	**122**	**1,062**	**606**	**46**	**67**	**232**	**651**	**451**	**2**	**147**	**182**	**25**	**12**	**3,693**
Surplus assets in excess of Capital Requirement [3]	**-81**	**13**	**140**	**99**	**3**	**0**	**9**	**49**	**36**	**-2**	**-127**	**-162**	**-15**	**819**	**780**
Cover for Capital Requirement [4]															***121%***

Table A8.4 – PLA pre-Scheme solvency position, values at 31 December 2012

£m	PWP	SERP	LL WP	NPF	Opal	SHF	Total
Capital Resources [1]	**1287**	**5**	**5**	**27**	**-5**	**734**	**2053**
LTICR	239	55	32	96	-	-	423
CRR Regulated Subsidiary	-	-	-	-	-	132	132
WPICC	891	-	-	-	-	-	891
Capital Requirement [2]	**1130**	**55**	**32**	**96**	**0**	**132**	**1446**
Surplus assets in excess of Capital Requirement [3]	**156**	**-50**	**-27**	**-69**	**-5**	**601**	**606**
Cover for Capital Requirement [4]							***142%***

Table A8.5 – NPLL pre-Scheme solvency position, values at 31 December 2012

£m	LTF	SHF	Total
Capital Resources [1]	**0**	**364**	**364**
LTICR	132	-	132
CRR Regulated Subsidiary	-	-	0
WPICC	-	-	0
Capital Requirement [2]	**132**	**0**	**132**
Surplus assets in excess of Capital Requirement [3]	**-132**	**364**	**232**
Cover for Capital Requirement [4]			***276%***

Post-scheme Pillar 1 solvency position

Notes:

(1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to the Regulator's rules on capital tiers.
(2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component plus CRR of regulated subsidiary.
(3) Capital Resources less Capital Required (where the latter is that part of the entity-level requirements that arises in respect of the relevant fund).
(4) Capital Resources divided by Capital Resources Requirement.

Table A8.6 – GAL post-Scheme solvency position (including GAL WPF), values at 31 December 2012

£m	WPF	NPF	SHF	PHI	Total
Capital Resources (1)	**1,103**	**529**	**344**	**3**	**1,978**
LTICR	62	297	-	3	362
RCR	-	-	-	-	0
CRR Regulated Subsidiary	-	15	-	-	15
WPICC	1,041	-	-	-	1,041
Capital Requirement (2)	**1,103**	**312**	**0**	**3**	**1,417**
Surplus assets in excess of Capital Requirement (3)	**0**	**217**	**344**	**0**	561
Cover for Capital Requirement (4)					***140%***

Table A8.7 – GAL post-Scheme solvency position (excluding GAL WPF), values at 31 December 2012

£m	NPF	SHF	PHI	Total
Capital Resources (1)	**529**	**344**	**3**	***876***
LTICR	297	-	3	300
RCR	-	-	-	0
CRR Regulated Subsidiary	15	-	-	15
WPICC	-	-	-	0
Capital Requirement (2)	**312**	**0**	**3**	**315**
Surplus assets in excess of Capital Requirement (3)	**217**	**344**	**0**	**561**
Cover for Capital Requirement (4)				***278%***

Table A8.8 – PLL post-Scheme solvency position, values at 31 December 2012

£m	ALBA	BIB	BWP	PWP	90%	100%	SMA	SPI	SAL	NPI	Non Annuity	Annuity	NPIL Annuity	SHF	Total
Capital Resources (1)	**5**	**135**	**1203**	**705**	**48**	**67**	**241**	**700**	**487**	**0**	**20**	**57**	**44**	**826**	**4540**
LTICR	66	9	129	167	4	1	93	80	196	-	121	144	4	-	1017
CRR Regulated Subsidiary	-	-	-	-	-	-	-	-	-	-	-	-	-	12	12
WPICC	-	113	933	437	42	66	139	571	255	-	-	-	-	-	2557
Capital Requirement (2)	**66**	**122**	**1062**	**604**	**46**	**67**	**232**	**651**	**451**	**0**	**121**	**144**	**4**	**12**	**3586**
Surplus assets in excess of Capital Requirement (3)	**-61**	**13**	**140**	**101**	**3**	**0**	**9**	**49**	**36**	**0**	**-101**	**-87**	**40**	**814**	**954**
Cover for Capital Requirement (4)															***127%***

Table A8.9 – PLA post-Scheme solvency position, values at 31 December 2012

£m	PWP	SERP	LL WP	NPF	Opal	SHF	Total
Capital Resources (1)	**1287**	**5**	**5**	**82**	**-5**	**742**	**2115**
LTICR	239	55	32	53	-	-	380
CRR Regulated Subsidiary	-	-	-	-	-	126	126
WPICC	891	-	-	-	-	-	891
Capital Requirement (2)	**1130**	**55**	**32**	**53**	**0**	**126**	**1397**
Surplus assets in excess of Capital Requirement (3)	**156**	**-50**	**-27**	**29**	**-5**	**615**	**718**
Cover for Capital Requirement (4)							***151%***

Table A8.10 – NPLL post-Scheme solvency position, values at 31 December 2012

	LTF	SHF	Total
Capital Resources (1)	**11**	**364**	**375**
LTICR	126	0	126
CRR Regulated Subsidiary	-	-	0
WPICC	-	-	0
Capital Requirement (2)	**126**	**0**	**126**
Surplus assets in excess of Capital Requirement (3)	**-115**	**364**	**249**
Cover for Capital Requirement (4)			***298%***

Appendix 9: Data and Reliances

In addition to the reliances set out in Section 1, I have relied upon information provided by the Companies. This includes various emails and documents received from management of the Companies and publically available on the internet. The documents are listed below.

Scheme documents	Date of document	Received from
Annuity business transfer agreement	15/10/2012	Phoenix
Minutes (signed) for the GAL board meeting 2012 06 18	18/06/2012	Guardian
Draft Scheme Witness Statement for Guardian	14/01/2013	Guardian
Draft Scheme Witness Statement for Phoenix	28/03/2013	Phoenix
Draft Scheme document	28/03/2013	Phoenix
Company background		
Company Structure	30/09/2012	Phoenix
Fund Structure	30/09/2012	Phoenix
Guardian Organisation Chart	22/08/2011	Guardian
GAL Articles of Association	22/06/2012	Guardian
NPLL Memorandum and Articles of Association	01/10/1999	Phoenix
PLA Memorandum and Articles of Association	28/09/2012	Phoenix
PLL Memorandum and Articles of Association	06/06/2012	Phoenix
NPLL Abstract of valuation report	31/12/2012	Phoenix
PLA Abstract of valuation report	31/12/2012	Phoenix
PLL Abstract of valuation report	31/12/2012	Phoenix
PPFM		
Principles and Practices of Financial Management (PPFM) - Guardian	Jul-12	Public
Principles and Practices of Financial Management (PPFM) - NPLL	Jan-12	Public
Principles and Practices of Financial Management (PPFM) - PLA	Sep-12	Public
Principles and Practices of Financial Management (PPFM) - PLL	Jul-12	Public
FSA returns		
GAL FSA returns for year ending 2011	2011	Public

NPLL FSA returns for year ending 2011 and 2012	2011/2012	Public
PLL FSA returns for year ending 2011 and 2012	2011/2012	Public
PLA FSA returns for year ending 2012	2012	Public
Pearl Assurance Limited FSA returns for year ending 2011	2011	Public
Actuarial Function Holder reports on the Scheme		
Report by the Guardian AFH on the impact of the proposed transfer on its policyholders	25/03/2013	Guardian
Report by the NPLL AFH on the impact of the proposed transfer on its policyholders	Apr-13	Phoenix
Report by the PLA AFH on the impact of the proposed transfer on its policyholders	Apr-13	Phoenix
Report by the PLL AFH on the impact of the proposed transfer on its policyholders	Apr-13	Phoenix
Reinsurance agreements		
Block 1 Annuity Business Reinsurance Agreement	26/06/2012	Phoenix
Block 2 (Pearl) Annuity Business Reinsurance Agreement	26/06/2012	Phoenix
Block 2 (Phoenix) Annuity Business Reinsurance Agreement	26/06/2012	Phoenix
Block 3 (NPLL) Annuity Business Reinsurance Agreement	26/06/2012	Phoenix
Block 3 (Phoenix) Annuity Business Reinsurance Agreement	26/06/2012	Phoenix
Alpha Security Agreement	2012	Phoenix
PLL - Security Agreement	2012	Phoenix
PAL Security Agreement	2012	Phoenix
NPLL Security Agreement	2012	Phoenix
Capital policies		
Guardian Capital policy	01/06/2012	Guardian
Capital Policy Review	24/10/2012	Phoenix
GAL Capital and resilience	12/06/2012	Guardian
Confirmation of how GAL Capital Policy applies to the GAL WPF	18/03/2013	Guardian
ICA reports		
Pillar 2 Dec 2011 - GAL Results	02/12/2011	Guardian
ICA Results board paper	02/10/2012	Phoenix
GAL Pillar 2- ICA Methodology	31/05/2012	Guardian

MGC Risk capital stresses	12/06/2012	Phoenix
Risk Capital Stresses memorandum for the board	26/06/2012	Phoenix
ICA Coverage Note	11/01/2013	Guardian
Tax		
Guardian draft tax implications for the Part VII Transfers	30/11/2012	Guardian
Tax summary report for Phoenix Companies	27/02/2013	Phoenix
Scheme related financials		
GAL Financial Strength	31/05/2012	Guardian
Phoenix Part VII Financials at 31 Dec 2012	31/12/2012	Phoenix
Year end policy counts and reserves Phoenix business	31/12/2012	Phoenix
Year end policy counts and reserves Guardian business	31/12/2012	Guardian
Guardian Part VII Financials at 31 Dec 2012	31/12/2012	Guardian
Regulatory correspondence		
FSA Guardian Assurance No Objection Letter	21/06/2012	Guardian
FSA letter regarding restructuring of Guardian's WPF	22/06/2012	Guardian
Minutes for the Part VII FSA meeting	01/11/2012	Guardian
Phoenix FSA ICA Letter	29/10/2012	Phoenix
Phoenix letter to the FSA letter regarding publicity and notification	28/03/2013	Phoenix
With profits restructuring		
Guardian Restructure Analysis	30/05/2012	Guardian
Guardian Restructuring Memorandum	08/11/2012	Guardian
Hogan Lovells Memorandum on With Profits Fund Restructuring	01/06/2012	Guardian
Guardian (WP) Board meeting minutes	27/06/2012	Guardian
Guardian Financial Services WP restructure notice	Jun-12	Public
Correspondence		
Correspondence relating to capital policies	Nov-12 - Feb-13	Guardian
Comments from Phoenix and Guardian regarding reviews of draft scheme document	Nov-12 - Mar-13	Phoenix
Correspondence regarding expenses, taxation and Solvency II	Nov-12 - Feb-13	Guardian
Response to information request	14/01/2013	Guardian

Other		
Part VII IE - suggested Investment Guidelines	14/01/2013	Guardian
Reply to IE Information request - direct costs	01/03/2013	Phoenix
Liquidity and Funding Policy	Sep-12	Guardian
High level Solvency II programme documentation	Mar-12 – Apr-13	Guardian
Customer information		
Letter to GAL policyholders about the Scheme and the Guardian Scheme	14/01/2013	Guardian
Letter to GLLA Policyholders about the Scheme and the Guardian Scheme	14/01/2013	Guardian
Letter to GPM Policyholder about the Scheme and the Guardian Scheme	14/01/2013	Guardian
QA for Guardian policyholders regarding the Scheme and the Guardian Scheme	29/04/2013	Guardian
Combined draft Scheme Guide for GAL Policyholders (covering both the Scheme and the Guardian Scheme)	29/04/2013	Guardian
Guardian customer contact strategy	24/04/2013	Guardian
Proposed communication strategy for Phoenix	28/03/2013	Phoenix
Draft Guardian Scheme Q&A	29/04/2013	Guardian
Draft Guardian Scheme GAL Letter	14/01/2013	Guardian
Draft letter to Phoenix policyholders about the Scheme	28/03/2013	Phoenix
Draft of Scheme QA to Phoenix policyholders	28/03/2013	Phoenix
Draft Scheme guide to Phoenix policyholders	28/03/2013	Phoenix
Draft Scheme guide to non-transferring Phoenix policyholders	28/03/2013	Phoenix

Appendix 10: Glossary

Acceptable Offer is an offer made by a Phoenix Service Partner who remains engaged in administering the Transferring Policies on terms that would ensure a level of service provided to GAL in respect of the Transferring Policies that is not materially lower than that which has been provided in respect of the Transferring Policies over the previous 12 months in all material respects.

Actuarial Function Holder (AFH) is the actuary responsible for performing the actuarial function of a long-term insurer, which includes advising the directors of the insurer on the risks the firm runs, the capital required to support those risks and the monitoring required as well as the valuation of its long-term liabilities.

Administration Agreement Entry (AAE) Date is the date at which Guardian confirms it has entered into a new agreement with the Outsource Service Partners.

Administration Services means customer administration and service support.

Administration Transfer Date (ATD) means the point at which the obligations of the Phoenix Service Companies in respect of the administration arrangements cease.

Annuity Business Transfer Agreement is an agreement which sets out various arrangements put in place relating to the Scheme, including with respect to the transfer of administration services and associated costs to GAL.

Approved person is a person in relation to whom the Regulator has given its approval under section 59 of FSMA (Approval for particular arrangements) for the performance of a controlled function.

Asset shares are assessments of the fair value of a policy's share of the gains and losses of the fund in which they are written.

Base Capital Resources Requirement (BCRR) is the minimum level of capital resources that an insurer must hold under GENPRU 2.1.30R.

Capital Resources is the excess of Pillar 1 admissible assets over Pillar 1 regulatory liabilities under the regulatory capital framework specified in the Regulator's Handbook.

Capital Resources Requirement (CRR) is a component of the regulatory capital framework specified in the Regulator's Handbook, specifically in relation to the Pillar 1 capital measure for life insurance companies. Companies must maintain Capital Resources in excess of the CRR.

Companies means PLL, PLA, NPLL and GAL.

Court is the High Court of Justice in England and Wales.

Deloitte is Deloitte MCS Limited, a subsidiary of Deloitte LLP. Registered office: Hill House, 1 Little New Street, London EC4A 3TR, United Kingdom. Registered in England and Wales No 3311052.

Directions Hearing is the initial hearing at the Court relating to the consideration of the Scheme.

European Economic Area (EEA) comprises the European Union and Iceland, Lichtenstein and Norway.

Excluded Policies are Residual Policies which have not transferred within six months of the Transfer Date.

Existing GAL Policies are the policies in the GAL long-term insurance fund prior to the Transfer Date.

Existing GAL Policyholders are the holders of the Existing GAL Policies.

Final Hearing is the final High Court hearing, at which the Scheme is either approved or rejected.

FCA is the Financial Conduct Authority which is one of the new regulatory bodies which replaced the FSA in April 2013 and deal with matters pertaining to the fair treatment of policyholders.

FRC is the Financial Reporting Council that sets the framework of codes and standards for the accounting, auditing, actuarial and investor communities and oversees the conduct of the professionals involved.

FSA is the Financial Services Authority, which is the independent, non-governmental body that had responsibility for the regulation of the UK insurance industry before April 2013.

Regulator's Handbook of rules and guidance is issued by the Regulator from time to time made pursuant to the FSMA together with the rules and regulations implemented pursuant thereto.

FSMA is the Financial Services and Markets Act 2000.

GAL means Guardian Assurance Limited, a company incorporated in England and Wales with registered number 38921.

GAL NPF means the non-profit fund of Guardian Assurance Limited.

GAL WPF means the with-profits fund of Guardian Assurance Limited.

GI means General Insurance.

GLLA means Guardian Linked Life Assurance Limited, a company incorporated in England and Wales with registered number 1397655.

GPM means Guardian Pensions Management Limited, a company incorporated in England and Wales with registered number 985480.

GRB is gross roll up business.

Guardian Scheme is an internal scheme which will result in the transfer of all business from GLLA and GPM to GAL.

HMRC is HM Revenue and Customs, the government department responsible for collecting and administering taxes.

Ignis is Ignis Investment Management, the existing Investment Manager for the Phoenix Companies.

Independent Expert refers to Dr David Hare of Deloitte MCS Limited whose appointment, which has been approved by the Regulator, involves producing a scheme report under the requirements of the FSMA, reflecting the guidance provided by SUP 18.2 of the Regulator's Handbook.

Individual Capital Assessment (ICA) is a component of the regulatory capital framework specified in the Regulator's Handbook, specifically in relation to the Pillar 2 capital measure for companies.

Individual Capital Assessment Standards (ICAS) is the total of the ICA and any required ICG.

Individual Capital Guidance (ICG) is any capital which the Regulator deem appropriate for a company to hold and may include an addition to its ICA.

Initial Expense Reserve Amount (IERA) is the initial reserve transferred from Phoenix to GAL in respect of the expected administration expenses of the Transferring Policyholders.

Interested party any person who has or asserts a right to receive a copy of any of the Reports, as relevant under the terms of the FSMA, or any non-EEA resident policyholder who has or asserts a right to receive a copy of such relevant Reports under the terms of local legislation.

LL WPF means the London Life With-Profits Fund, a sub-fund of PLA.

Long-Term Guarantees Assessment (LTGA) is an assessment of the impact of a package of measures in a variety of economic conditions, aimed to inform the final Solvency II regulations.

Long-Term Insurance Capital Requirement (LTICR) is a component of the regulatory capital framework specified in the Regulator's Handbook, specifically in relation to the Pillar 1 capital measure for life insurance companies.

Matching adjustment is the adjustment made to the risk free rate in the draft Solvency II regulations relating to the additional yield expected to be earned for taking illiquidity risk in the assets backing certain types of long-term business (including annuities).

Non-Profit Policy is a policy (including any unit-linked policy unless stated otherwise) which is not entitled to share in the profits of the company in which it is located, including term assurance, annuity and income protection policies where specified benefits are payable on death or incapacity.

Non-Transferring Policies are collectively those policies from PLL, PLA and NPLL which are not transferring to GAL.

Non-Transferring Policyholders are the holders of Non-Transferring Policies.

Non-Transferring NPLL Policy is a policy in the long-term insurance fund of NPLL which is not intended to transfer to GAL under the Scheme.

NPI means National Provident Institution.

NPLL means National Provident Life Limited, a company incorporated in England and Wales with registered number 3641947.

NPLL Capital Policy is the capital policy, including details of the margins targeted over the Pillar 1 and Pillar 2 regulatory capital requirements, used in NPLL.

Opal Reassurance Limited (Opal) is a captive reassurer within the Phoenix Group.

Outsource Service Partners means the outsource service partners of the Phoenix Companies which are Capita, Diligenta and HCL who provide administrative services.

Peak 1 means the Regulatory Peak.

Peak 2 means the Realistic Peak.

Pearl SERP Scheme means the scheme approved by the order of the Court dated 9 February 2010 providing for the transfer to Pearl of part of the long-term insurance business of NPLL.

Pearl WPF means the Pearl With-Profits Fund, a sub fund of PLA.

PGH is Phoenix Group Holdings.

PGMS is Phoenix Group Management Services.

PGS is Pearl Group Services Limited.

PHLH is Phoenix Life Holdings Limited.

Phoenix Companies means PLL, PLA and NPLL.

Phoenix Service Companies means Pearl Group Management Services Limited and Pearl Group Services Limited.

Pillar 1 is one of the bases of the regulatory capital framework specified by the Regulator's Handbook, required to be calculated by UK insurance companies in order to report their solvency positions to the Regulator's and for public disclosure in the Regulatory Returns.

Pillar 2 is one of the bases of the regulatory capital framework specified by the Regulator's Handbook, required to be calculated by UK insurance companies in order to privately report their solvency positions to the Regulator.

PLA means Phoenix Life Assurance Limited, a company incorporated in England and Wales with registered number 1419.

PLA Capital Policy is the capital policy, including details of the margins targeted over the Pillar 1 and Pillar 2 regulatory capital requirements, used in PLA.

PLA NPF means the non-profit fund of Phoenix Life Assurance Limited.

PLA Shareholders' Fund means the shareholder fund within Phoenix Life Assurance Limited.

PLL means Phoenix Life Limited, a company incorporated in England and Wales with registered number 1016269.

PLL Capital Policy is the capital policy, including details of the margins targeted over the Pillar 1 and Pillar 2 regulatory capital requirements, used in PLL.

PLL NPF is the non-profit sub-fund of the long-term insurance fund of Phoenix Life Limited.

PRA is the Prudential Regulation Authority which is one of the new regulatory bodies which replaced the FSA in April 2013. The PRA will be responsible for matters relating to the solvency of companies.

Principles and Practices of Financial Management (PPFM) is a document describing how a with-profits fund is managed. Each UK with-profits fund is required to make its PPFM publically available.

Realistic Peak is a calculation performed on a realistic basis where assets are taken at market values while liabilities include allowance for any non-guaranteed benefits expected to be paid. The liabilities are valued using best estimate assumptions including a market consistent value of guarantees.

Regulator(s) means, the applicable regulator(s) of the UK insurance industry. Prior to April 2013, this refers to the FSA and from April 2013 this refers to, as the context requires, the PRA, the FCA or both.

Regulatory Peak is a calculation performed as a regulatory requirement under the Pillar 1 basis for all life insurance companies, where asset values are based on market value, liabilities are valued with prudential margins and solvency capital, expressed as a percentage of liabilities and a rate per mille of sums at risk, is required in addition to the liabilities.

Reinsurance Agreements are the existing agreements under which the Transferring Policies are reinsured to GAL.

Reinsurer Related Event are the circumstances, detailed in the Reinsurance Agreements, under which the Phoenix Companies gain the right to terminate the Reinsurance Agreements if the Scheme is not approved.

Remaining Service Provider Offer Date (RSPO) is two years from the date at which Phoenix has obtained an Acceptable Offer.

Report is this Report, as required under the terms of FSMA, Chapter 8 (109).

Reserves are determined by performing a calculation, in respect of a policy or group of policies, of the present value of future benefits and expenses less premiums or charges, using specified assumptions for future experience.

Residual Policies are those policies which are included in the Reinsurance Agreements at the Transfer Date but which do not transfer to GAL on the Transfer Date.

Resilience Capital Requirement (RCR) is a component of the regulatory capital framework specified in the Regulator's Handbook, specifically in relation to the Pillar 1 basis for life insurance companies that are not required to report under the realistic peak.

Risk Capital Margin (RCM) is the amount of Capital Resources that the company must hold under the Realistic Peak calculation within the Pillar 1 assessment.

Scheme is the proposed transfer of long-term insurance business from PLL, PLA and NPLL to GAL under Part VII of the FSMA.

Security Agreements are the agreements under which GAL charges the assets backing the Transferring Policies to the Phoenix Companies.

Signing Date is the date at which the Annuity Business Transfer Agreement was signed.

Solvency II is the new solvency regime for all EU insurers and reinsurers, currently due to come into effect on 1 January 2015, or some later date.

SUP 18 refers to Chapter 18 of the Supervision Manual of the Regulator's Handbook of Rules and Guidance. It sets out the Regulator's requirements relating to the transfer of long-term insurance business.

Supplementary Report is a report produced in advance of the Final Hearing, to consider the impact on the Independent Expert's conclusions of events that have happened subsequent to the release of the initial Report.

Transfer Date is 30 September 2013 or any later date that is agreed, being the date on which the Scheme is to be treated as having taken effect between PLL, PLA , NPLL and GAL (including for accounting purposes).

Transfer Regulations means the Financial Services and Markets Act 2000 Control of Business Transfers Requirements on Applicants Regulations 2001.

Transferring Policies are all Transferring PLL, PLA and NPLL Policies.

Transferring Policyholders are the holders of Transferring Policies.

Transitional Services Agreement (TSA) is an agreement covering the administration of Transferring Policies.

Transitional Services Period is the period during which the Phoenix Services Companies will continue to carry out customer administration and service support as set out in the Annuity Business Transfer Agreement.

Treating Customers Fairly (TCF) is the framework under which the Regulator will assess whether financial services firms treat their retail customers fairly.

Unitised With-Profits Policy is any policy under which the value of the benefits is or may be measured in whole or in part by reference to the number and price of with-profits units (a notional unit whose value varies by reference to bonuses declared by the company) allocated to that policy.

With-Profits Actuary is the actuary responsible for advising the directors of a company on discretionary aspects of with-profits business.

With-Profits Benefit Reserve (WPBR) forms part of the Realistic Peak calculation and generally represents the sum of the asset shares of the with-profits business.

With-Profits Fund is a fund where holders of with-profits policies have a right to share in the profits of the company or part thereof.

With-Profits Insurance Capital Component (WPICC) is an addition made to the Pillar 1 Regulatory Peak capital requirements to account for the difference if excess assets after the RCM on the realistic peak are less than those under the regulatory peak.

With-Profits Policy is a policy which is entitled to share in some of the profits of the company or part thereof.

2009 Scheme means the scheme approved by order of the Court dated 30 January 2009, providing for the transfer to PLL of certain of the long-term insurance businesses of Scottish Mutual Assurance Limited and Scottish Provident Limited and providing for the management of the PLL long-term insurance fund.

2011 Scheme means the scheme approved by order of the Court dated 11 February 2011, providing for the transfer to PLL of the long-term insurance business of Phoenix & London Assurance Limited.

100:0 Fund is a with-profits fund from which all surplus is payable to policyholders.

90:10 Fund is a with-profits fund from which 90% of the surplus is payable to policyholders.

0:100 Fund is a fund from which all surplus is payable to shareholders.

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