

PHOENIX LIFE ASSURANCE LIMITED

Proposed Scheme to Transfer Long-Term Insurance Business

**Report by the Actuarial Function Holder on the Impact of the
Scheme on Policyholders of Phoenix Life Assurance Limited**

29 April 2013

1. PURPOSE OF REPORT

The purpose of this report is to describe the impact of a proposed scheme under Part VII of the Financial Services and Markets Act 2000 ("FSMA") on the policyholders of Phoenix Life Assurance Limited ("PLA"). Under this scheme (the "Scheme") certain pension annuity policies of PLA, National Provident Life Limited ("NPLL") and Phoenix Life Limited ("PLL"), which are all members of the Phoenix Group, is to transfer to Guardian Assurance Limited ("Guardian").

This report describes how the Scheme is expected to affect the security of benefits and the reasonable benefit expectations of policyholders of PLA. It also sets out how the Scheme is consistent with the requirements to treat customers fairly.

The report is written for the PLA Board in my capacity as Actuarial Function Holder for PLA. As well as the Board, the report may be used by the independent expert, the High Court, the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA") in forming their own judgements about the Scheme.

The Board for Actuarial Standards has published Technical Actuarial Standards ("TAS") that apply to actuarial work. This report and the work underlying it are intended to be compliant with the Insurance TAS, the Transformations TAS and the following generic TASs: TAS R (Reporting), TAS D (Data) and TAS M (Modelling).

2. SUMMARY

In section 3, I have provided background information on PLA and the Phoenix Group, of which PLA is a member.

I have given a summary of the Scheme in section 4, highlighting its effect on the existing policyholders of PLA. The full provisions of the Scheme are set out in the scheme document.

In sections 5, 6, and 7, I have analysed the impact of the Scheme on the policyholders of PLA.

I conclude in section 8 that the Scheme will have no material adverse impact on the interests of PLA policyholders. In particular, in my opinion, there will be no material reduction in the security and benefit expectations of PLA policyholders.

3. BACKGROUND

3.1. Status

I am a Fellow of the Institute of Actuaries. I was appointed as Actuarial Function Holder of PLA on 1 April 2012.

I am an employee of Pearl Group Management Services Limited ("PGMS"), which is a wholly owned subsidiary of Phoenix Group Holdings, the ultimate parent company of PLA. I am not a policyholder of any of the companies within the Phoenix Group, including PLA, nor am I a policyholder of Guardian. I currently have options on a number of Phoenix Group Holdings shares.

I confirm that I have not considered my personal interest in reaching any of the conclusions detailed in this report.

3.2. History of PLA

PLA traces its history back to 1857 when the Pearl Loan Company was formed and to 1862 when the Pearl Life Assurance and Sick Benefit Society was formed. In 1864 the two companies merged to form The Pearl Life Assurance Loan and Investment Company Limited, which sold industrial branch business until 1875 when it started to accept yearly premiums.

The company operated under variations on the "Pearl" name thereafter, most latterly as Pearl Assurance Limited, until 28 September 2012 when it changed its name to Phoenix Life Assurance Limited.

The company sold industrial and ordinary branch life and pension business and general insurance business. It ceased to sell new industrial branch business in 1997 and other business, except for increments on existing business, at the end of 2002.

In 1990, Australian Mutual Provident Society ("AMP") acquired PLA. In December 2003, PLA, together with other UK companies owned by AMP, were de-merged to become subsidiaries of a new UK company called HHG plc.

In April 2005, Sun Capital Partners and TDR Capital bought PLA and the other insurance companies owned by HHG plc and these companies became subsidiaries of the newly formed Pearl Group Limited.

Under a Part VII scheme, which became effective on 15 February 2010, all NPLL's Self Employed Retirement Plan ("SERP") business was transferred from NPLL to PLA.

In March 2012, PLA's general insurance business was transferred to BA (GI) Limited, another company in the Phoenix Group, under a Part VII scheme.

On 30 September 2012, a further Part VII scheme was implemented (the "PLA Scheme") under which all of London Life Limited's business transferred to PLA.

PLA comprises a shareholders fund (the "Shareholders' Fund") and a long-term insurance fund (the "Long-term Fund"). As a result of the PLA Scheme, the Long-term Fund comprises four sub-funds:

- The Pearl With-Profits Fund – from which at least 90% of the surplus is payable to with-profits policyholders of the fund with the balance being distributable to shareholders;
- The SERP Fund – another with-profits fund; if any surplus arises in this fund, it is payable to the policyholders in the fund;
- The London Life With-Profits Fund (the "LL With-Profits Fund") – all of the surplus of which is payable to the with-profits policyholders in the fund; and
- The Non-Profit Fund (the "NP Fund") – from which all of the surplus is payable to shareholders.

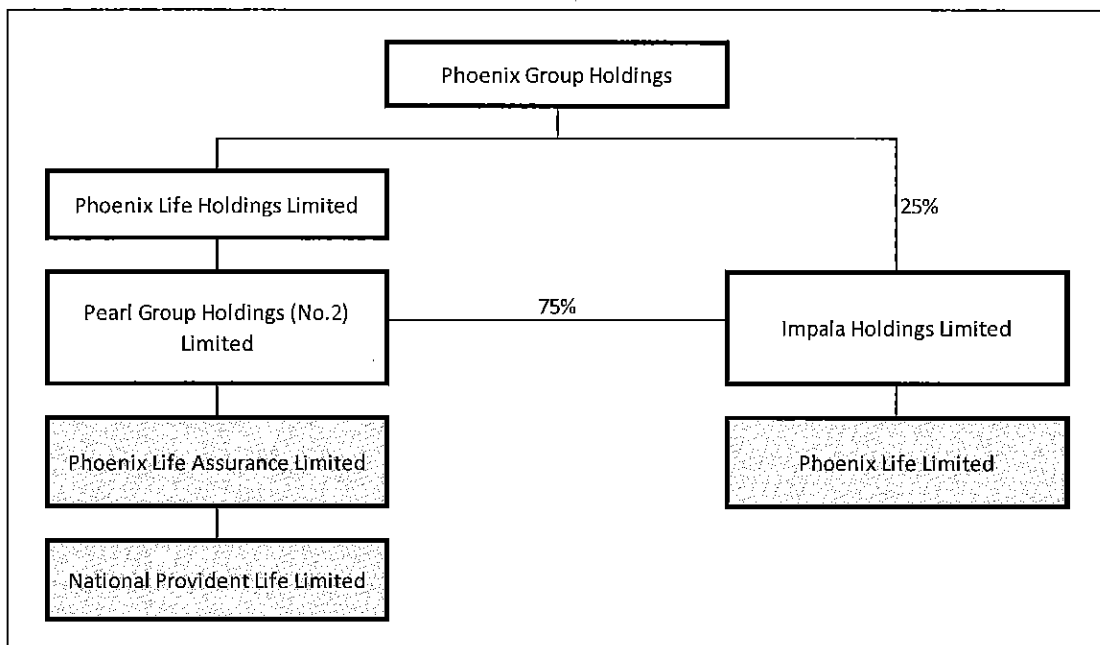
PLA is authorised by the PRA with permission under Part 4A of the Act to effect and carry out contracts of insurance within the United Kingdom falling within classes I, II, III, IV, VI and VII as defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

PLA has a number of subsidiaries, including, since 1999, NP Life Holdings Limited (“NPLH”), which is the holding company of NPLL. NPLH is owned by the Shareholders’ Fund.

3.3. The Phoenix Group

PLA is a member of the Phoenix Group. This was formed in September 2009 when Phoenix Group Holdings, then known as Liberty Acquisitions Holdings (International) Company, acquired Pearl Group Limited. Previously, on 1 May 2008, Pearl Group Limited had acquired Resolution plc.

The Phoenix Group operates in two core segments – life assurance and asset management. The life assurance division comprises three active regulated UK life companies – PLA, PLL and NPLL. The immediate parent company of PLA is Pearl Group Holdings (No.2) Limited. Phoenix Life Holdings Limited (“PLHL”) is the senior UK and EC insurance holding company in the group.



3.4. Guardian

Guardian is part of Guardian Financial Services, the collective trading name for Guardian, Guardian Linked Life Assurance Limited and Guardian Pensions Management Limited.

Guardian is a proprietary life company and was established in 1821. Originally called Guardian Fire & Life, it was renamed as Guardian Assurance in 1902. In 1968 the company merged with Royal Exchange Assurance to form the Guardian Royal Exchange Group and was later acquired by AEGON UK, part of the global AEGON Group. In November 2011 Guardian Financial Services was acquired by Cinven Limited, its current owners.

Guardian closed to new with-profits business in 1998 and it stopped selling new policies altogether in 2001.

At the same time as the Scheme, Guardian intend to transfer the business of Guardian Linked Life Assurance Limited and Guardian Pensions Management Limited to Guardian under a separate Part VII Scheme (the "Guardian Scheme").

More details about Guardian and the Guardian Scheme can be found in the Independent Expert's Report.

3.5. The Business of PLA

3.5.1 The Pearl With-Profits Fund

The Pearl With-Profits Fund contains both ordinary branch ("OB") and industrial branch ("IB") business.

The OB business contains significant volumes of conventional and unitised with-profits life and personal pensions business.

The IB business is divided between whole of life and endowment contracts. Most of the IB business, by mathematical reserves, is with-profits, although a large number of policies with small benefits are non-profit after having been made paid-up.

There were, on 31 December 2012, about 1.53m policies in the Pearl With-Profits Fund, of which approximately 542,000 are paid-up IB policies, which are now non-profit. The statutory net reserves at this date were £5,939m.

3.5.2. The SERP Fund

This fund only includes with-profits SERP policies that were originally issued by NPLL. The SERP policies provide a guaranteed minimum annuity payable at the vesting age specified in the policy contract. NPLL ceased writing new SERP policies with effect from 1 July 1988 and accordingly only increments to existing policies have been written since then. A facility exists to convert the guaranteed annuity and declared bonuses at vesting into cash on guaranteed terms. The cash may be reapplied with PLA or another insurer to purchase a pension at annuity rates prevailing at the time.

There were, on 31 December 2012, about 41,000 policies in this fund with statutory net reserves of £1,378m.

3.5.3 The London Life With-Profits Fund

The LL With-Profits Fund contains the business transferred to PLA from the Pension With-Profits Fund and the Life With-Profits Fund of London Life Limited under the PLA Scheme.

The LL With-Profits Fund consists of conventional with-profits pension policies, around half of which have Guaranteed Annuity Options, conventional with-profits endowments and whole of life assurances. There is also a small amount of unitised with-profits life and pensions business.

There were, on 31 December 2012, about 43,000 policies in this fund, with statutory net reserves of £787m.

3.5.4. The Non-Profit Fund

The NP Fund consists of the balance of the policies of PLA.

The main liabilities are pension annuities (92% by mathematical reserves), of which the majority are annuities in payment. The life business primarily consists of regular premium whole of life and endowments policies, term assurance and annuities in payment.

Pension business from the Pearl With-Profits Fund, the SERP Fund and the LL With-Profits Fund currently vests into this fund.

As outlined in section 4.1, the future claims on a specific group of pension annuities in payment are fully reinsured to Guardian. Guardian bears the longevity and investment risk of the business reinsured to it. Some of the remaining pension annuities in payment are reinsured to Opal Reassurance Limited ("Opal") (which is a captive reinsurer within the Phoenix Group); Opal bears the longevity and investment risk of the business reinsured to it. The total liabilities reinsured under the Guardian arrangement at 31 December 2012 were £1,160m and under the Opal arrangement were £1,288m.

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

Following the implementation of the PLA Scheme there were, on 31 December 2012, approximately 341,000 policies in this fund, and statutory net reserves at this date were £1,258m.

3.6. PLA Capital Policy

Under the terms of the PLA Scheme, PLA maintains a particular capital policy (the "PLACP") which is described below.

The objective of the PLACP is to ensure that, based on various tests, the company can continue to meet the PRA's capital requirements, details of which are given in section 5.1, in internally specified stress scenarios. These stress scenarios have regard to the risk appetite that the PLA Board has set and currently are set by reference to a risk appetite of PLA having a 1 in 20 chance over a one year time period of failing to meet the PRA's capital requirements. The results of this scenario testing are the percentages given below. The percentages are regularly reviewed to ensure that the capital policy continues to meet its objective. As a result, the percentages change from time to time without changing the strength of the policy by reference to the scenario testing process.

Adherence to the PLACP results in more capital being available in PLA than is required by the PRA's capital requirements. The PLACP is dynamic, as described above, and moves in line with the amount of business in the company. It also offers protection to policyholders, because it can only be changed in specified circumstances set out in its terms or otherwise with the agreement of the High Court.

The policy involves three main tests and a fourth liquidity test and provides that PLA intends to hold the amount of capital indicated by the most onerous of these tests. At the date of this report, the tests are:

Test 1: (Based on the PRA's Pillar 1 test)

The required capital is the sum of:

- in respect of each with-profits fund, the proportion of the Capital Resources Requirement ("CRR") attributable to that fund, plus an amount equal to the greater of (i) the value of any positive free assets and (ii) 175% of the proportion of the Long-Term Insurance Capital Requirement ("LTICR") attributable to that fund less its With-Profits Insurance Capital Component ("WPICC"), and
- in respect of the NP Fund, 70% of its CRR, less 100% of the sum of any positive free assets for each with-profits fund, to the extent that those free assets represent the value of future transfers to the NP Fund or the Shareholders' Fund, a negative overall result being permitted.

Test 2: (Based on the PRA's Pillar 2 test, excluding any Individual Capital Guidance ("ICG"))

The required capital is the sum of:

- in respect of each with-profits fund, 139% of its Individual Capital Assessment ("ICA"), and
- in respect of the NP Fund, 139% of its ICA.

Test 3: (Based on the PRA's Pillar 2 test including any ICG)

The required capital is the sum of:

- in respect of each with-profits fund, 110% of its ICA plus 110% of any additional capital which the PRA indicates via ICG should be held, and
- in respect of the NP Fund, 110% of ICA plus 110% of ICG.

For Test 1, the presence of excess capital within a with-profits fund will have the effect of reducing the capital required in the NP Fund, as described above. In all other aspects, when calculating whether the total capital available in PLA satisfies each basis, any excess capital in a with-profits fund over the calculated minimum capital for that fund will not be taken into account.

The fourth test is a liquidity test, the objective of which is to ensure that the NP Fund and the Shareholders' Fund together have sufficient admissible assets to meet the Pillar 1 liabilities of the NP Fund and the Shareholders' Fund, together with sufficient liquid assets to meet any immediate demands from the with-profits funds for support in accordance with the PLACP (in other words, actual capital injections to meet either regulatory or realistic liabilities) plus an additional amount to be determined by the PLA Board at least once a year. This additional amount (which is currently £66m) is derived by considering the ability of the NP Fund and the Shareholders' Fund to meet the same test (excluding the additional amount) in the same range of scenarios as is used to derive the parameter percentages for Tests 1, 2 and 3. For this purpose, a liquid asset is any asset which can be transferred to a with-profits fund to support it, and so will not, for example, include the value of future shareholder transfers from with-profits funds. This test means that the NP Fund and the Shareholders' Fund are expected to have sufficient assets of an appropriate quality under the terms of the PLACP to transfer assets to, and to meet the objectives of the PLACP in respect of, the with-profits funds in a range of specified scenarios.

The percentages of LTICR, ICA and the with-profits funds' free assets set out above will be subject to regular review by the PLA Board to ensure that the PLACP continues to meet its underlying objective, namely that the funds can meet Pillar 1 and Pillar 2 capital requirements in the internally specified stress scenarios. The PLA Board may change the stress scenarios used to determine the percentages from time to time. To the extent that any such change would have the effect of reducing the amount of capital required to be held by PLA, PLA is required to obtain a certificate from an independent actuary to the effect that in his opinion the change will not have a material adverse effect on the interests of PLA policyholders overall.

The PLA Board may amend the PLACP if the PRA's rules governing the calculation of the Pillar 1 or Pillar 2 capital requirements, the LTICR, the WPICC or the ICA or any other component in the calculation of the PLACP change materially, subject to the amended policy continuing to be such as to ensure that PLA can meet its Pillar 1 and Pillar 2 capital requirements in the specified stress scenarios referred to above.

When Solvency II is introduced (see section 5.1.3), changes will be required to the PLACP as terms such as LTICR, CRR and ICA will no longer exist. The PLA Scheme outlines that PLA will set new tests before Solvency II is implemented with the objective that PLA can meet its Pillar 1 and Pillar 2 capital requirements under Solvency II in internally stressed scenarios. The adoption of the new tests and their parameters will be subject to the PRA's non-objection. It is anticipated that the parameters of the revised test will continue to be subject to regular review on the same basis as the current test.

In addition, PLA and PLHL have undertaken to the Court that additional capital is held available by PLHL and PLA to support PLA in addition to the capital held under the terms of the PLACP. This additional capital totalled £75m as at 31 December 2012 and will reduce in line with the run-off of PLA's liabilities to policyholders thereafter. Currently it comprises £50m held by PLHL until 31 December 2016 to support PLA and its subsidiary NPLL, with the balance held by PLA directly within the PLA Shareholders' Fund. The amount of this additional capital may 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 PRA.

Notwithstanding the above, no allowance for this additional capital is taken when considering any review of the capital policy. In addition, no benefit is taken for the additional capital held by PLHL in the financial analysis shown in section 5.

4. THE PROPOSED SCHEME

4.1. Background to the Scheme

On 26 June 2012, PLA, PLL and NPLL entered into a transaction with Guardian. As part of this, reinsurance agreements were put in place with Guardian under which, with effect from 1 July 2012, the future claims on a specific group of pension annuities held in PLA, PLL, and NPLL were fully reinsured to Guardian. At the same time, PLA, PLL and NPLL entered into a separate agreement with Guardian (the "Annuity Business Transfer Agreement") in which each party agreed it would use its reasonable endeavours to effect the transfer of those pension annuities to Guardian pursuant to a Scheme under Part VII of FSMA.

The main objective of the transaction from the perspective of PLA, PLL and NPLL was to release a portion of the regulatory capital held to back the annuity business,

which in turn assisted in improving the position under the PRA's group tests. In addition the transaction allowed the Phoenix Group to manage its risk profile better, primarily by enabling it to reduce its exposure to longevity risk.

Annuities included in the reinsurance agreement with Guardian are pension annuities in payment and consist of:

- PLL Block – certain PLL annuities transferred to PLL from Century Life plc, Britannic Assurance plc, NPI Limited, Scottish Mutual Assurance Limited and Scottish Provident Limited.
- PLA Block – certain PLA annuities, where the first life assured was born after 1 January 1943.
- NPLL Block – certain NPLL annuities.

The following annuities have been specifically excluded: impaired life annuities, with-profits annuities, annuities certain and those where the annuitant is believed to have died before 1 July 2012 (i.e. suspended policies and suspected deaths).

As well as satisfying PLA's responsibilities under the agreement with Guardian, the Scheme will remove all risks in association with the business being transferred, except a small temporary residual expense risk which continues until the true-up process (see section 4.3) is complete. In addition, the Scheme will remove the need to account for the reinsurance, reducing the administration costs of PLA, and it will reduce the CRR.

If the transfer does not take place, it is PLA's current intention that the reinsurance arrangement will remain in place and hence the policies will remain reinsured to Guardian.

4.2. Summary of the Scheme

4.2.1 The Transfer

The Scheme is expected to transfer certain immediate annuities of PLA, PLL and NPLL to Guardian on 30 September 2013 (the "Transfer Date"). The annuities that will transfer are those annuities reassured to Guardian under the reinsurance arrangement described in 4.1, which are in-force as at the Transfer Date. The policy numbers of the affected annuities will be listed in the schedules provided by PLA, PLL and NPLL to Guardian on or before the Transfer Date.

The assets and liabilities in respect of transferring policies will transfer from the NP Fund of PLA, the non-profit fund of PLL and the long-term insurance fund of NPLL to the non-profit fund of Guardian.

Following implementation of the Scheme, Guardian will assume responsibility for administering the policies. The Scheme provides for the transferring assets from each transferor to include an estimated amount in relation to the future costs of this in respect of their respective annuities. The amount of this (the "initial expense reserve amount") will be determined between the Directions and Final Hearings.

Any policies which are not capable of being transferred to Guardian on the Transfer Date – referred to as Residual Policies in the Scheme – will be the subject of a Residual Policies Reinsurance Arrangement set out in the terms of the Scheme. This will provide for any Residual Policies to be fully reinsured to Guardian, until such time as those policies can be transferred. This Residual Policies Reinsurance Arrangement will terminate not later than six months after the Transfer Date, at which

point Guardian will transfer back to PLA, PLL or NPLL (as the case may be) cash equal to the present value of the liabilities attributable to any remaining Residual Policies, such value to be agreed between PLA, PLL or NPLL (as the case may be) and Guardian. The administration of any relevant PLA policies within the Residual Policies will continue to be handled by the same outsourcer with the result that the practical consequences of this reinsurance arrangement for policyholders should be limited.

4.2.2 Impact on PLA Policies

The policies in PLA which are not transferring to Guardian under the Scheme, namely policies within the with-profits funds and the remaining policies in the NP Fund (including any annuities that are not reassured to Guardian) will remain in the same funds as now and no changes are being proposed to their terms and conditions under the Scheme. Further, there will be no change to the operation of the with-profits funds nor the NP Fund and these will continue to operate as discrete funds.

The transferring PLA policies will become policies of Guardian and PLA will have no further liability for them. The terms and conditions of the transferring policies will not change. Guardian has its own capital policy and the Scheme includes controls on how that can be changed in the future.

Those costs associated with the Scheme that are attributable to the Phoenix Group will be met by the Shareholders' Fund and the shareholders' fund of PLL. Therefore no costs will be met by any part of the Long-term Fund.

4.3. Other consequences of the Scheme

On the Transfer Date, the reinsurance agreement with Guardian described in section 4.1 will terminate as will the associated security arrangement.

Under the terms of the Annuity Business Transfer Agreement, the initial expense reserve amount will be subject to a true-up process to be completed after the Transfer Date.

5. FINANCIAL POSITION BEFORE AND AFTER THE TRANSFER

5.1. Introduction

5.1.1. Current Regulatory Solvency Requirements

All insurance companies are required by the PRA to maintain a minimum level of capital calculated on two different bases.

First, companies are required to maintain capital in excess of basic policy liabilities. The amount of capital required (the CRR) to meet this test (known as Pillar 1) is calculated using a basis specified in the PRA Handbook.

Secondly, companies are required to carry out and submit to the PRA their own assessment of how much capital they need to hold. This assessment is known as the ICA and is submitted to the PRA privately. The calculation requires a company to assess the major risks it is running and the capital it requires to ensure that it remains able to meet its liabilities to policyholders in all but the most extreme circumstances. The PRA reviews the ICA and may give guidance on the company's own assessment

of its capital requirement using ICG. The PRA may indicate through the ICG that the company should hold additional capital over and above its ICA. This test is known as Pillar 2.

A company's failure to hold sufficient capital to cover the capital requirements under either Pillar 1 or Pillar 2 would be likely to lead to regulatory intervention by the PRA. On the other hand, the ability to demonstrate that a company has capital at least equal to the greater of Pillar 1 and Pillar 2 gives a strong indication that a company has sufficient capital to provide appropriate security for policyholder benefits.

Subject to the usual legal restrictions on the making of distributions and the repayment of capital and also the PRA's capital requirements, shareholders are able to withdraw profits from a life company (comprising profits held in the company's shareholders' fund plus any surplus available to be transferred from the long-term insurance fund to the shareholders' fund). Surplus available to be transferred to the shareholders' fund can include all surplus arising in non-profit funds and any surplus arising in with-profits funds which is attributable to the shareholders' fund (for example, because the with-profits fund is 90:10). Consequently, any assets available to be transferred to the shareholders' fund and in the shareholders' fund of a company in excess of the amount of assets required to satisfy the PRA's capital requirements are of little significance when assessing security for policyholders, unless the company has a policy of holding excess assets above these levels and it is considered that such policy is of sufficient standing that it can be relied upon.

In addition to the above, insurance groups are required to maintain overall group capital sufficient to meet the PRA's group requirements. These requirements reflect the expectation that insurers should be part of financially stable corporate groups. It also prevents the double use of capital within the group. The PRA can intervene if this requirement is not being met, even if the individual companies' requirements are being met. There are two tests for this as well corresponding to the Pillar 1 and Pillar 2 tests referred to above. The test based on Pillar 1 is known as the "Group Capital Adequacy Test" and the test based on Pillar 2 as the "Group ICA Test". These tests apply to the senior holding company within the group that is registered in the European Community.

5.1.2. What this means for PLA

PLA's capital policy (see section 3.6) requires PLA to retain capital in excess of the amounts required to satisfy the greater of the Pillar 1 and Pillar 2 tests. This means that policyholders are and will continue to be afforded greater security than required under the PRA's rules. However, it also means that little reliance can be placed on any assets in the Shareholders' Fund or the NP Fund in excess of the amount of assets required to satisfy the PLACP when assessing the security for policyholders.

Within the Phoenix Group, the group tests are applied to PLHL.

5.1.3. Solvency II

Solvency II represents a new framework for EU insurers that will replace all existing prudential regulation including Pillar 1 and Pillar 2. Implementation of Solvency II has been delayed – it was expected to come into force on 1 January 2014, but it now appears likely that this will be delayed until at least 1 January 2015. The delay has been caused by the fact that it has not been possible to reach agreement on some aspects concerning the calculation of liabilities for long-term insurance business. As

a result, it is still not certain what the impact of the new requirements will be on individual insurance companies.

5.2. Basis of calculation of the solvency position of PLA before and after the Scheme

As part of the considerations as to whether the benefit security of policyholders remaining in PLA will be affected by the Scheme, it is helpful to compare the solvency position of PLA before and after the Scheme. A similar comparison of the solvency position of PLA before the Scheme and Guardian after the Scheme is required in respect of the transferring policyholders. This section describes the approach that I have taken in respect of the calculations for PLA.

In order to make this assessment using up to date information, I have considered the expected impact of the Scheme on PLA as if the Scheme had been implemented on 31 December 2012. The Board approved a dividend payment in March 2013 and since this will be paid before the Scheme is implemented, the effect of this on the expected impact of the Scheme has also been shown.

In the tables in sections 5.3.1 and 5.4.1:

- The LTICR represents the capital required by the PRA to be held in respect of an insurer's liabilities over and above the assets held to back those liabilities, with both assets and liabilities being valued on the basis set out in PRA rules referred to as the "regulatory" basis. This basis generally does not reflect discretionary benefits which might be awarded to with-profits policies.
- The WPICC represents the capital required by the PRA over and above the LTICR, determined using an alternative valuation basis which reflects a "realistic" valuation of the assets and liabilities. This basis takes into account future discretionary benefits that might be awarded to with-profits policies.
- Available Capital is the excess of assets over liabilities with both assets and liabilities being valued on the basis set out in PRA rules referred to as the "regulatory" basis.
- Free Assets are the total Available Capital less the total LTICR and WPICC.
- Cover for CRR is the Available Capital divided by the CRR.
- Cover for LTICR is the Available Capital divided by the LTICR.

5.3. PLA before the transfer

5.3.1. Pillar 1 position

Table 1 below shows the financial position of PLA and its CRR basis as at 31 December 2012 calculated in accordance with section 5.2.

Table 1	PLA as at 31 December 2012 before the effect of the Scheme		
	Available Capital	LTICR	WPICC
	£m	£m	£m
Pearl WP Fund	1,287	239	891
LL WP Fund	5	32	-
SERP Fund	5	55	-
NP Fund	22	96	-
Shareholders' Fund	734	132	-
Total	2,053	555	891
Total Free Assets (Available Capital less LTICR less WPICC)			£606m
Overall Cover for CRR (= LTICR + WPICC)			142%
Overall Cover for LTICR			370%

Note – The numbers in the tables in this section may not add up due to rounding.

Taking into account the dividend payment in March 2013, the Overall Cover for CRR would be 132% and the Overall Cover for LTICR 343%.

5.3.2. Pillar 2 position

As at 31 December 2012, PLA met its Pillar 2 capital requirements.

5.3.3. PLACP tests

As stated in section 3.6, the level of capital implied by the PLACP is higher than that required by the PRA's requirements outlined above. As at 31 December 2012, PLA met the higher levels implied by the PLACP, at which time Test 1 of the PLACP was the most onerous.

5.4. PLA after the transfer

5.4.1. Pillar 1 position

Table 2 shows pro-forma figures for PLA as if the Scheme had been implemented, again as at 31 December 2012 for ease of comparison.

Table 2	PLA as at 31 December 2012 following the implementation of the Scheme		
	Available Capital	LTICR	WPICC
	£m	£m	£m
Pearl WP Fund	1,287	239	891
LL WP Fund	5	32	-
SERP Fund	5	55	-
NP Fund	77	53	-
Shareholders' Fund	742	126	-
Total	2,115	506	891
Total Free Assets (Available Capital less LTICR less WPICC)			£718m
Overall Cover for CRR (= LTICR + WPICC)			151%
Overall Cover for LTICR			418%

Taking into account the dividend payment in March 2013, the Overall Cover for CRR would be 141% and the Overall Cover for LTICR 388%.

The implementation of the Scheme will lead to an increase in available capital as the reserves released in respect of future expenses will be greater than the initial expense reserve amount paid to Guardian under the Scheme. In addition, the LTICR will be lower reflecting the lower reserves. Both these factors mean that the ratios quoted increase.

5.4.2. Pillar 2 position

The Pillar 2 solvency position has been estimated as at 31 December 2012 for PLA on a pro-forma basis (adjusted for material transactions on the same basis as the Pillar 1 analysis) and on this basis after implementation of the Scheme, PLA would meet its Pillar 2 capital requirements by an increased amount.

5.4.3. PLACP tests

Based on analysis of the position of PLA after implementation of the Scheme, Test 2 is expected to become the most onerous test under the PLACP and PLA is expected to continue to be able to meet the higher levels implied by the PLACP.

5.4.4. Group Capital Adequacy Test and Group ICA

Implementation of the Scheme is expected to lead to an increase in the surplus under the PRA's Group Capital Adequacy Test.

5.4.5. Solvency II

As noted in section 5.1.3, there is still no certainty about the capital requirements under Solvency II and therefore the capital requirements of PLA under Solvency II before and after the Scheme cannot be established with any degree of reliability at this time. However, it is envisaged that the free capital for PLA under Solvency II will be higher if the Scheme takes place than if it does not.

5.5. Guardian

The figures and statements in this section 5.5 have been prepared and supplied by the Actuarial Function Holder of Guardian. I have not reviewed or checked these statements or the calculations.

5.5.1. Pillar 1 position before the transfer

Table 3 below shows the estimated financial position of Guardian and its CRR on a pro-forma basis as at 31 December 2012.

Table 3	Guardian as at 31 December 2012 before the implementation of the Scheme		
	Available Capital	LTICR	WPICC
	£m	£m	£m
With Profits	1,102	62	1,040
Non Profit	876	315	-
Total	1,978	377	1,040
Total Free Assets (Available Capital less LTICR less WPICC)			£561m
Overall Cover for CRR (= LTICR + WPICC)			140%
Overall Cover for LTICR			525%

5.5.2. Pillar 1 position after the transfer

The Actuarial Function Holder of Guardian has indicated that he expects that the assets being transferred to Guardian on implementation of the Scheme to be sufficient to cover the additional expense and operational risk and as a result there will no impact on the total free assets.

5.5.3. Pillar 2 position

The Actuarial Function Holder of Guardian has stated that as at 31 December 2012, an estimate of the Pillar 2 solvency position of Guardian on a pro-forma basis has shown that it is expected to meet its Pillar 2 requirements immediately after implementation of the Scheme.

5.5.4. Position under Guardian's Capital Policy

Guardian maintains a capital policy under which it holds capital in excess of that required by regulation. The Actuarial Function Holder of Guardian has stated that following implementation of the Scheme, it is expected that Guardian will continue to meet the higher levels required by that.

5.5.5. Impact of the Guardian Scheme

The Actuarial Function Holder of Guardian has stated that the Pillar 1 position of Guardian is unaffected by whether the Guardian Scheme is implemented or not. He has also indicated that the statements made in sections 5.5.3 and 5.5.4 are unaffected by whether the Guardian Scheme is implemented or not.

6. EFFECT OF THE SCHEME ON TRANSFERRING PLA POLICIES

6.1. Security of Benefits

Following the implementation of the Scheme, security for the benefits of transferring policyholders will be provided by Guardian.

I have reviewed the report prepared by the Actuarial Function Holder of Guardian for the board of Guardian. As noted above, I have not gone through the calculations and I have relied on the statements made in the report. In particular, I have not reviewed the Pillar 2 calculations nor seen the Pillar 2 results and would not expect to do so as they are confidential. However, the Pillar 2 results are subject to PRA review and I take some comfort from that.

The report shows that Guardian will meet the PRA requirements after the Scheme has been implemented on both Pillar 1 and Pillar 2, and it will meet the requirements of its own capital policy.

The security of benefits for transferring policyholders is provided by:

- the PRA's regulatory requirements, which include a buffer over the policy liabilities and which are intended to ensure that the company can remain solvent even after a 1 in 200 year event; and
- Guardian's own capital policy, which provides an additional buffer over the PRA's requirements.

These protections will be supported by:

- Guardian taking actions if their capital policy is breached;
- the PRA taking actions if its minimum requirements are breached; and
- the controls on how the Guardian capital policy can be changed.

In the unlikely event that intervention by the PRA is ineffective, the company may become insolvent. However, in this situation, policyholders would receive substantial protection through the Financial Services Compensation Scheme.

In determining whether the Scheme will materially affect the security of benefits for transferring policyholders, I have considered:

- the strength of and controls on changing Guardian's capital policy relative to the PLACP; and
- the change to the risk of insolvency facing policyholders particularly as a result of the different capital policies, and the implications for policyholder benefits in the unlikely event of insolvency.

The Guardian capital policy is not as strong as the PLACP. The Scheme includes controls on the way in which Guardian's capital policy can be changed. These differ from the controls in place for the PLACP as a result of the PLA Scheme, which were outlined in section 3.6. The PLACP requires PRA consent to changes and an independent actuary's certificate to be obtained if the policy is being weakened. The Scheme requires the Guardian Board to consult with the PRA and take account of appropriate actuarial advice. I am satisfied that in practice Guardian are unlikely to make a change without the non-objection of the PRA and hence the difference between PRA consent and consultation is minimal. I note with regard to the second point that Guardian have confirmed that independent actuarial advice will be sought if a material reduction in the policy is planned.

It is only in extremely unlikely circumstances that the capital required by the PRA together with the additional capital held under the Guardian capital policy would be insufficient to cover the present value of future policyholder liabilities for transferring policyholders as compared to the situation were they to remain in PLA. In such a situation the Independent Expert has estimated that the policies transferring to Guardian might receive a benefit reduction of approximately 1% relative to the amount that would have been received had the policies been retained in PLA. I do not consider this to be a materially adverse impact on policyholder benefit security because of the extremely low probability of this scenario occurring and the relatively small impact on the level of benefits in the event that it were to.

In conclusion, Guardian will hold capital in excess of the PRA's minimum requirements. I believe that the resulting level of security in Guardian should be satisfactory based on the information in the report by the Guardian Actuarial Function Holder and nothing I have seen leads me to conclude that the level of security for transferring policyholders will be materially weaker after the Scheme is implemented.

However, the Board should also consider the conclusion reached by the Independent Expert on this matter as he has had access to more detailed and confidential information than I have.

My conclusion is the same whether or not the Guardian Scheme is implemented at the same time. This is because the transferors under that scheme are already consolidated into Guardian's numbers and so the Guardian Scheme does not change materially the financial position of Guardian or the conclusions based on it.

6.2. Policyholder Benefit Expectations

The benefits of the transferring policies are set out in the policy terms and conditions. No changes are being proposed under the Scheme to the policy terms and conditions of the transferring policies.

6.3. Quality of Administration

With effect from the implementation date, Guardian will become responsible for the provision of services to policyholders. I understand that Guardian are to put in place services arrangements between themselves and the outsource provider, who currently provides these services to PLA, which will be similar to the arrangements in place now. Therefore, there is no reason to expect the quality of administration to deteriorate as a consequence of the Scheme.

6.4. New Business

I understand that Guardian writes limited amounts of new business, almost exclusively in respect of existing group pension schemes or under options attaching to existing policies. I also understand that the new business to be written by Guardian after the implementation of the Scheme will be written on terms that Guardian expects to be profitable and within such volumes that any additional risk to Guardian will be covered by available capital and so such that Guardian continues to satisfy the requirements of its capital policy.

6.5. Treating Customers Fairly

I believe that implementation of the Scheme, taking into account the contents of the Scheme, is consistent with the requirements to treat customers fairly with respect to the transferring policyholders of PLA. This is because, in my opinion, after the Transfer Date the level of security for benefits for the policies that are transferring to Guardian will not be materially adversely affected and because there will be no changes to policyholder benefits as a consequence of the Scheme.

6.6. Conclusion on transferring policies

For the reasons set out above, I consider that the Scheme will not materially adversely change the position of PLA policyholders transferring to Guardian.

7. EFFECT OF THE SCHEME ON NON-TRANSFERRING PLA POLICIES

7.1. Security of Benefits

Currently the security of benefits for all policies in PLA is provided by:

- PLA meeting its PRA capital requirements;
- PLHL meeting the minimum group capital requirements;
- PLA meeting the additional capital requirements required by the PLACP;
- The strength of, and protections built into, the PLACP, including the internally specified stress scenarios that are tested and the process by which these scenarios can be changed; and
- The additional £75m in capital held by PLA and PLHL under the terms of the Court undertaking.

Overall, the risks within the NP Fund will reduce following implementation of the Scheme. As was shown in section 5.3 and 5.4, this means that the financial position of PLA and of PLHL will be improved following implementation of the Scheme. In PLA this will increase the surplus in excess of the capital policy and so, for the reasons given in section 5.1.2, little reliance or benefit can be placed on this in terms of improving the security of policyholders.

I therefore consider that the level of capital support that will be available to provide security for benefits in PLA after implementation of the Scheme should at worst be the same as the level of capital support available to provide security for benefits currently.

7.2. Benefit Expectations of Policies

No changes are being proposed under the Scheme to the terms and conditions of any policies.

7.3. Policies in the with-profits funds

The conclusions from the last two sections apply equally to policies in the with-profits funds as they do to policies in the NP Fund. The Scheme has little or no bearing on the security or benefit expectations of holders of policies in the with-profits funds as the transferring policies are all coming from the NP Fund.

The With-Profits Actuary of PLA has confirmed that he agrees with my opinion with regard to with-profits policies.

7.4. Quality of Administration

The terms upon which services are currently provided by PGS to PLA will continue to apply in respect of the business remaining in PLA following the Scheme, so there is no reason to expect the quality of administration to deteriorate as a consequence of the Scheme.

7.5. Treating Customers Fairly

I believe that the contents of the Scheme are consistent with the requirements to treat customers fairly with respect to the policyholders remaining in PLA. This is because the capital support that will be available to provide security for benefits of non-transferring policies should be at least as much as the level of capital support currently available to provide security for benefits and because there will be no changes to policyholder benefits as a consequence of the Scheme.

7.6. Notification to Policyholders

Policyholders who are not transferring are not materially affected by the Scheme as has been demonstrated above. There will be no changes to the terms and conditions of policies, the operation of PLA or the PLACP as a result of the Scheme. There will be no new policies allocated to the Long-term Fund.

The number of policies being transferred out of PLA is small (approximately 4%) relative to the existing size of PLA and the major risks associated with the transferring business have already been reassured.

Therefore, I am happy that no notifications in respect of the Scheme need be sent to non-transferring PLA policyholders.

7.7. Conclusions on non-transferring policyholders

For the reasons set out above, I consider that the Scheme will not materially adversely change the position of policyholders remaining in PLA.

8. CONCLUSION

In my opinion as Actuarial Function Holder, taking into account the advice and opinions set out above, no class of PLA policyholder will be materially adversely affected by the implementation of the Scheme. In particular, I believe that the Scheme should have no material adverse impact on the security of transferring policyholders and should not have any adverse impact on the security of benefits of the policyholders remaining in PLA. For both groups of policyholders, I also believe that the Scheme is consistent with PLA's obligation to treat customers fairly.



P. K. Mayes
Fellow of the Institute of Actuaries
29 April 2013