PHOENIX LIFE LIMITED

Proposed Scheme to Transfer Long-Term Insurance Business

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

3 September 2013

1. Introduction

In my report entitled 'Report by the Actuarial Function Holder on the Impact of the Scheme on Policyholders of Phoenix Life Limited dated 29 April 2013 ("my report"), I concluded that no class of policyholder of Phoenix Life Limited ("PLL") will be materially adversely affected by the implementation of the Scheme and, in particular, 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 the policyholders remaining in PLL.

In this supplementary report, I consider whether, taking into account developments since the date of my report and their potential impact on PLL and its policyholders, it remains appropriate to proceed with the Scheme. In considering the position, it is important to distinguish between changes that affect or would affect PLL policyholders in any event, irrespective of the implementation of the Scheme, and changes in the position of policyholders or a particular group of policyholders that arise or might arise as a result of the implementation of the Scheme. It is only the second type of change that is of relevance in deciding whether the conclusions reached in my report remain valid notwithstanding any changed circumstances.

As part of my consideration of the Scheme, I have updated the financial analysis to use financial information as at 30 June 2013 (see section 3 for a full explanation of how this information has been calculated) and then considered whether the impact of the Scheme on the security and benefits of PLL policyholders would be affected in light of that updated information.

My conclusions are given in section 7.

This supplementary report is written for the PLL Board in my capacity as Actuarial Function Holder for PLL, but may, like my report, be made available to the High Court, the Independent Expert, the PRA and the FCA to assist them in making their judgements about the Scheme. It is supplementary to my report and should accordingly be read alongside my report. All definitions and abbreviations used in my report apply also to this supplementary report.

The Financial Reporting Council through the Board for Actuarial Standards has published Technical Actuarial Standards ("TAS") that apply to certain types of actuarial work. This report and the work underlying it is 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. Developments since my report

2.1 Changes to the Scheme

I note that there have been a small number of minor amendments to the Scheme since the date of my report. These include:

- Additional paragraphs to provide for the transfer to Guardian of certain annuities that were issued under the terms of "master" policies issued to group pension scheme trustees. These group scheme policies allow for annuities to be issued when a scheme member reaches retirement. The additional wording provides that only those rights and liabilities under the policies relating to the transferring annuities will transfer to Guardian. All other rights and obligations under the group scheme policies will remain with NPLL, PLL or PLA (as the case may be);

- A minor amendment to the continuity of proceedings provision;
- A minor amendment to the Transfer date provision;
- Confirmation of the filenames for the electronic databases setting out the transferring policies; and
- Confirmation of the value of the initial expense reserve assets to be transferred to Guardian.

The proposed amendments were either always expected to be confirmed following the initial submission of the Scheme or are not substantive and I therefore consider that none of the changes affect any of the analysis or conclusions in my report.

2.2 Developments affecting the financial position of PLL

The following summarises the key events that have affected the financial position of PLL and which were not reflected in my report:

2.2.1 Economic Conditions – The financial analysis in my report was prepared as at 31 December 2012. The following table sets out the movement in some key indicators of economic conditions over the course of 2013.

	31/12/2012	**28/3/2013**	**30/6/2013**
FTSE-100	5898	6412	6215
2013 change		*+9%*	*+5%*
Corporate Bond Spreads (basis points over gilts)			
AAA	0.62%	0.56%	0.57%
AA	1.27%	1.15%	0.97%
A	1.74%	1.64%	1.59%
BBB	3.14%	2.97%	2.84%
Property Index	853	864	880
2013 change		*+1%*	*+3%*
15 year gilt yield	2.55%	2.65%	3.22%

PLL's capital position is affected by the performance of its investments – particularly in corporate bonds, gilts and equities and any hedges it has taken against movements in these. The overall investment performance will have different impacts for Pillar 1 and Pillar 2 – both in terms of size of movement and potentially whether it is favourable or not. For Pillar 1, the increase in gilt yield has had a positive impact on the level of excess capital. The impact of this and the other movements has been reflected in the analysis shown in section 3.

2.2.2 Half Year Valuation – The Board have approved changes to the assumptions used in the June 2013 valuation. The most material changes were a release of part of the Peak 1 credit risk provision and the harmonisation of the valuation interest rate setting methodology. The impact of this has been offset by the correction of some data errors identified since the valuation as at 31 December 2012.

2.2.3 Individual Capital Assessment – In August 2013, the PLL Board approved a revised ICA, which was based on a review of assumptions and methodology and on data as at 31 December 2012. These changes decreased the amount of ICA for PLL.

3. Review of Financial Analysis

I have reviewed the contents of section 5 of my report and an update is given below.

3.1 Pillar 1 position of PLL before and after transfer

My report showed the projected Pillar 1 position of PLL before and after the Scheme based on the position as at 31 December 2012. The following tables and the comments in this section 3 update this analysis as at 30 June 2013, taking into account the dividend paid in March 2013, which was referred to in section 5.2 of my report, the events referred to in section 2.2 of this supplementary report and financial conditions as at 30 June 2013.

Table 1 below shows the estimated financial position of PLL as at 30 June 2013, as adjusted for the above factors. The estimated position as at 31 December 2012 in my report is shown in brackets.

Table 1	**PLL as at 30 June 2013 before the effect of the Scheme**		
	Available Capital	**LTICR**	**WPICC**
	£m	£m	£m
Alba WP Fund	9 (5)	73 (86)	- (-)
Britannic IB Fund	132 (135)	8 (9)	110 (113)
Britannic WP Fund	1,306 (1,203)	124 (129)	1,015 (933)
Phoenix WP Fund	697 (705)	157 (169)	459 (437)
90% WP Fund	49 (48)	3 (4)	42 (42)
100% WP Fund	67 (67)	1 (1)	66 (66)
SM WP Fund	210 (241)	89 (93)	114 (139)
SPI WP Fund	699 (700)	75 (80)	584 (571)
SAL WP Fund	530 (487)	180 (196)	303 (255)
NPI WP Fund	- (-)	2 (2)	-
NP Fund	143 (50)	337 (354)	-
Shareholders' Fund	548 (831)	8 (12)	-
Total	**4,390 (4,473)**	**1,057 (1,136)**	**2,693 (2,557)**
Total Free Assets (Available Capital less LTICR less WPICC)			**£640m (£780m)**
Overall Cover for CRR (= LTICR + WPICC)			**117% (121%)**
Overall Cover for LTICR			**415% (394%)**

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

Table 1 shows that since my report there has been a decrease in the amount of Free Assets. This is mainly due to the dividend payment in March 2013.

Table 2 below shows the estimated financial position of PLL as at 30 June 2013, adjusted for the above factors, and as if the Scheme had been implemented on that date. The estimated position as at 31 December 2012 given in my report is shown in brackets.

Table 2	PLL as at 30 June 2013 after the implementation of the Scheme		
	Available Capital	**LTICR**	**WPICC**
	£m	£m	£m
Alba WP Fund	9 (5)	60 (66)	- (-)
Britannic IB Fund	132 (135)	8 (9)	110 (113)
Britannic WP Fund	1,306 (1,203)	124 (129)	1,015 (933)
Phoenix WP Fund	697 (705)	155 (169)	459 (437)
90% WP Fund	49 (48)	3 (4)	42 (42)
100% WP Fund	67 (67)	1 (1)	66 (66)
SM WP Fund	210 (241)	89 (93)	114 (139)
SPI WP Fund	699 (700)	75 (80)	584 (571)
SAL WP Fund	530 (487)	180 (196)	303 (255)
NPI WP Fund	- (-)	- (-)	-
NP Fund	234 (121)	263 (269)	-
Shareholders' Fund	546 (826)	8 (12)	-
Total	**4,478 (4,540)**	**966 (1,029)**	**2,693 (2,557)**
Total Free Assets (Available Capital less LTICR less WPICC)			**£819m (£954m)**
Overall Cover for CRR (= LTICR + WPICC)			**122% (127%)**
Overall Cover for LTICR			**464% (441%)**

Again, and for the reasons stated above, this shows that the Free Assets of PLL after the Scheme has been implemented have decreased compared to the position at 31 December 2012. The presentation continues to show that implementation of the Scheme will increase the amount by which PLL will be able to meet its Pillar 1 capital requirements, that this will be met by a significant margin and that the overall cover for the CRR will be greater than the corresponding cover now.]

The 30 June 2013 position in the above tables and referred to in the rest of section 3 are based on the results of the valuation undertaken as at that date and additional figures calculated as at the same date. These figures are produced in the following way:

- The most recent audited balance sheet figures were completed as at 31 December 2012. These were then included in the 2012 annual return to the FSA.
- Balance sheet figures, determined using the same underlying methodologies and process, were completed as at 30 June 2013. This involved the same internal controls and review processes (including review by the Actuarial Function Holder and Board and an analysis of the change from the 31 December 2012 position). The results have been reviewed by the auditors, although they have not conducted a full audit, and will be included in PLL's private half-year reporting to the PRA.
- The figures as at 30 June 2013 accordingly take into account directly the emerging experience including economic conditions and the other items described in section 2.

3.2 Pillar 2 position of PLL before and after transfer

The Pillar 2 solvency position has been calculated as at 30 June 2013 for PLL before and after the Scheme in a similar manner to the Pillar 1 analysis above. As at 30 June 2013, PLL met its Pillar 2 (ICA and ICG) capital requirements comfortably.

The Pillar 2 position of PLL as at 30 June 2013, as if the Scheme had been implemented at that date, shows that PLL will continue to be able to meet its Pillar 2 capital requirements with a significant margin and by an increased margin compared to the situation before the Scheme is implemented. This is in line with the analysis performed for my report.

3.3 Capital Policy Tests

The capital policy is described in detail in section 4.3 of my report. Based on further analysis, which is not shown here, PLL on a pro-forma basis is expected to be able to meet the additional capital requirements imposed by its capital policy. This is in line with the analysis performed for my report.

In line with its normal practice, the Board of PLL on 3 September 2013 will consider the review of the percentage parameters used in the capital policy tests. If any changes are approved, they will not be implemented until they are approved by the PRA. Any changes will not affect the conclusions in this supplementary report.

3.4 Group Capital Adequacy Test and Group ICA

An updated analysis shows that the implementation of the Scheme is expected to lead to an increase in the surplus under the PRA's Group Capital Adequacy Test and Group ICA Test. This is in line with the analysis performed for my report.

3.5 Economic conditions and market events since 30 June 2013

Given the timing of the final hearing of the Scheme, it will not be feasible to update the financial analysis of the impact of the Scheme beyond 30 June 2013. However, I am not aware of any subsequent events or facts, nor has anything been drawn to my attention by PLL or its board, which would materially change the above analysis.

3.6 Solvency II

The Solvency II rules still remain to be finalised, and hence, it remains the case that the Solvency II capital requirements of PLL before and after implementation of the Scheme cannot be established with any degree of reliability at this time. However, it remains likely that implementation of the Scheme will increase the free capital of PLL under Solvency II.

3.7 Guardian

The figures and statements in section 3.7 have been prepared and supplied by the Actuarial Function Holder of Guardian. I have not reviewed or checked these statements or the calculations.

Table 3 below shows the estimated financial position of Guardian and its CRR on a pro-forma basis as at 30 June 2013 with values as at 31 December 2012 shown in brackets.

Table 3	Guardian as at 30 June 2013 before the implementation of the Scheme		
	Available Capital	**LTICR**	**WPICC**
	£m	£m	£m
With Profits	1,124 (1,102)	58 (62)	1,066 (1,040)
Non Profit	808 (876)	292 (315)	-
Total	**1,932 (1,978)**	**350 (377)**	**1,066 (1,040)**
Total Free Assets (Available Capital less LTICR less WPICC)			**£516m (£561m)**
Overall Cover for CRR (= LTICR + WPICC)			**136% (140%)**
Overall Cover for LTICR			**552% (525%)**

The main change since the year end relates to the payment of a dividend of £88m.

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.

The Actuarial Function Holder of Guardian has stated that as at 30 June 2013, 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.

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.

4. Effect of the Scheme on transferring PLL policyholders

4.1 Policyholder Security

The key points in my report with regard to the effect of the Scheme on the security of transferring PLL policyholders were:

- Guardian has its own capital policy, which requires it to hold amounts in excess of the PRA's minimum capital requirements.
- Whilst Guardian's capital policy is not as strong as PLL's, it is only in extremely unlikely events 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 as compared with the position were they to remain in PLL.
- Given the above and the controls on changing the Guardian capital policy, I stated that nothing I had seen led me to conclude that the level of security for transferring policyholders will be materially weaker after the Scheme is implemented.

From the analysis shown in section 3 of this supplementary report I note that:

- PLL currently meets its Pillar 1 and Pillar 2 capital requirements.
- After the Scheme is implemented, based on the information in the supplementary report by the Guardian Actuarial Function Holder, Guardian on a pro-forma basis will be able to meet its Pillar 1 and Pillar 2 capital requirements and the higher requirements of its capital policy.

Therefore, my opinion remains unchanged that the level of security in Guardian should be satisfactory based on the information in the supplementary report by the Guardian Actuarial Function Holder and nothing I have seen leads me to conclude that the level of security for transferring PLL policyholders will be materially weaker after the Scheme is implemented.

4.2 Policyholder Benefits

In my report, I noted that the Scheme would have no impact on the benefits of transferring PLL policyholders. None of the developments since my report have affected the conclusions drawn by me in my report and, therefore, my opinion remains that the benefits of the transferring PLL policies will not be affected by the implementation of the Scheme.

5. Effect of the Scheme on non-transferring PLL policyholders

5.1 Policyholder Security

The key points in my report with regard to the effect of the Scheme on the security of non-transferring PLL policyholders were:

- PLL currently meets its PRA capital requirements and the additional capital requirements under its capital policy.
- The financial position of PLL and PLHL will be improved following implementation of the Scheme.
- This will increase the surplus in PLL in excess of its capital policy, albeit that little reliance or benefit can be placed on this in terms of improving the security of policyholders.
- I considered the level of capital support that will be available to provide security of benefits for non-transferring PLL policyholders to be at worst the same as that available currently.

From the analysis shown in section 3 of this supplementary report I note that:

- PLL currently meets its Pillar 1 and Pillar 2 capital requirements.
- After the Scheme is implemented, PLL on a pro-forma basis will be able to meet its Pillar 1 and Pillar 2 capital requirements and the higher requirements of its capital policy.

Therefore, my opinion remains unchanged that the level of capital support that will be available to provide security for benefits for PLL's non-transferring policyholders after the Scheme is implemented should at worst be the same as the level of capital support currently available.

5.2 Policyholder Benefits

In my report, I noted that the Scheme would have no impact on the benefits of non-transferring PLL policyholders. None of the developments since my report have affected the conclusions drawn by me in my report and, therefore, my opinion remains that the benefits of the non-transferring PLL policyholders will not be affected by the implementation of the Scheme.

6. Other Matters

6.1 Policyholder Communications

I have reviewed the Scheme guides prepared for transferring and non-transferring PLL policyholders and the related materials sent to transferring policyholders and made available on the website. I am satisfied that the information regarding the proposals as contained therein adequately bring the proposals to the attention of policyholders and that it is not necessary to bring the observations made in this supplementary report to the attention of policyholders.

I have reviewed the objections received from PLL policyholders in response to the publicity for the Scheme together with PLL's responses to those objections. I have not seen anything in those objections that affects the conclusions in my report and this supplementary report.

7. Conclusion

My view is that the changes in the economic conditions and the other matters mentioned in this supplementary report have not affected the conclusions that I reached in my report. Therefore my opinion remains that no class of PLL policyholder will be materially adversely affected by the implementation of the Scheme and, in particular, that the Scheme will not have any material adverse impact on the security of benefits of transferring policyholders and should not have any adverse impact on the security of benefits of non-transferring policyholders. For both groups, I believe that the Scheme is consistent with PLL's obligation to treat its customers fairly.

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Actuarial Function Holder
3 September 2013