PHOENIX LIFE 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 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 Limited ("PLL"). Under this scheme (the "Scheme") certain pension annuity policies of PLL, National Provident Life Limited ("NPLL") and Phoenix Life Assurance Limited ("PLA"), 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 PLL. It also sets out how the Scheme is consistent with the requirements to treat customers fairly.

The report is written for the PLL Board in my capacity as Actuarial Function Holder for PLL. 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 PLL and the Phoenix Group, of which PLL is a member.

I have given a summary of the Scheme in section 4, highlighting its effect on the existing policyholders of PLL. 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 PLL.

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

3. BACKGROUND

3.1. Status

I am a Fellow of the Institute of Actuaries. I was appointed as Actuarial Function Holder of PLL on 30 July 2010.

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 PLL. I am not a policyholder of any of the companies within the Phoenix Group, including PLL, 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 PLL

PLL traces its history back to 1971, when it was incorporated as Lloyds Life Assurance Limited. It was subsequently renamed Royal Heritage Life Assurance Limited ("RHL"), after its acquisition by the Royal Insurance Group in 1985.

Following the merger of the Royal Insurance Group with the Sun Alliance and London Insurance Group, the businesses of Royal Life (Unit Linked Assurances) Limited, Royal Life (Unit Linked Pension Funds) Limited, Sun Alliance Linked Insurance Limited, Sun Alliance Pensions Limited and Property Growth Assurance Company Limited were transferred into RHL in 1998. RHL was renamed Royal & Sun Alliance Linked Insurances Limited ("RSALI") at the same time.

On 30 September 2004, the company was acquired by Resolution Life Group. Under a Part VII scheme which became effective on 31 December 2005 (the "PLL 2005 Scheme"), the long-term insurance businesses of Bradford Insurance Company Limited ("Bradford"), Phoenix Assurance Limited ("PAL") and Swiss Life (UK) plc ("Swiss Life") were transferred into RSALI. RSALI was renamed Phoenix Life Limited at the same time.

Under a Part VII scheme which became effective on 31 December 2006 (the "PLL 2006 Scheme"), the long-term insurance businesses of Alba Life Limited, Britannic Assurance plc, Britannic Retirement Solutions Limited, Britannic Unit Linked Assurance Limited ("BULA"), Century Life plc ("Century") and Phoenix Life & Pensions Limited were transferred into PLL.

Under a Part VII scheme which became effective on 1 January 2009 (the "PLL 2009 Scheme"), the long-term insurance businesses of Scottish Mutual Assurance Limited ("SMA") and Scottish Provident Limited ("SPL") were transferred into PLL. This transfer excluded certain protection policies of SMA and SPL which were transferred to The Royal London Mutual Insurance Society Limited in December 2008.

Under a Part VII scheme which became effective on 1 January 2011 (the "PLL 2011 Scheme"), the long-term insurance business of Phoenix & London Assurance Limited ("PALAL") was transferred into PLL.

Under a Part VII scheme which became effective on 1 January 2012 (the "PLL 2012 Scheme") the long-term insurance business of NPI Limited was transferred into PLL.

The PLL 2009 Scheme, the PLL 2011 Scheme and the PLL 2012 Scheme are in full operation, and will continue to be so irrespective of whether the Scheme goes ahead.

The long-term insurance fund of PLL (the "Long-term Fund") now comprises eleven sub-funds:

- The 100% With-Profits Fund (the "100% WPF") – which is a with-profits fund from which all surplus is payable to policyholders;
- The 90% With-Profits Fund (the "90% WPF");
- The Alba With-Profits Fund (the "Alba WPF");
- The Britannic Industrial Branch Fund (the "BIB Fund");
- The Britannic With-Profits Fund (the "Britannic WPF");
- The Phoenix With-Profits Fund (the "Phoenix WPF");

- The SAL With-Profits Fund (the "SAL WPF");
- The Scottish Mutual With-Profits Fund (the "SM WPF");
- The SPI With-Profits Fund (the "SPI WPF");
- The NPI With-Profits Fund (the "NPI WPF"); and
- The Non-Profit Fund (the "NPF") – from which all of the surplus is payable to shareholders.

There is also a shareholders' fund in PLL (the "Shareholders' Fund").

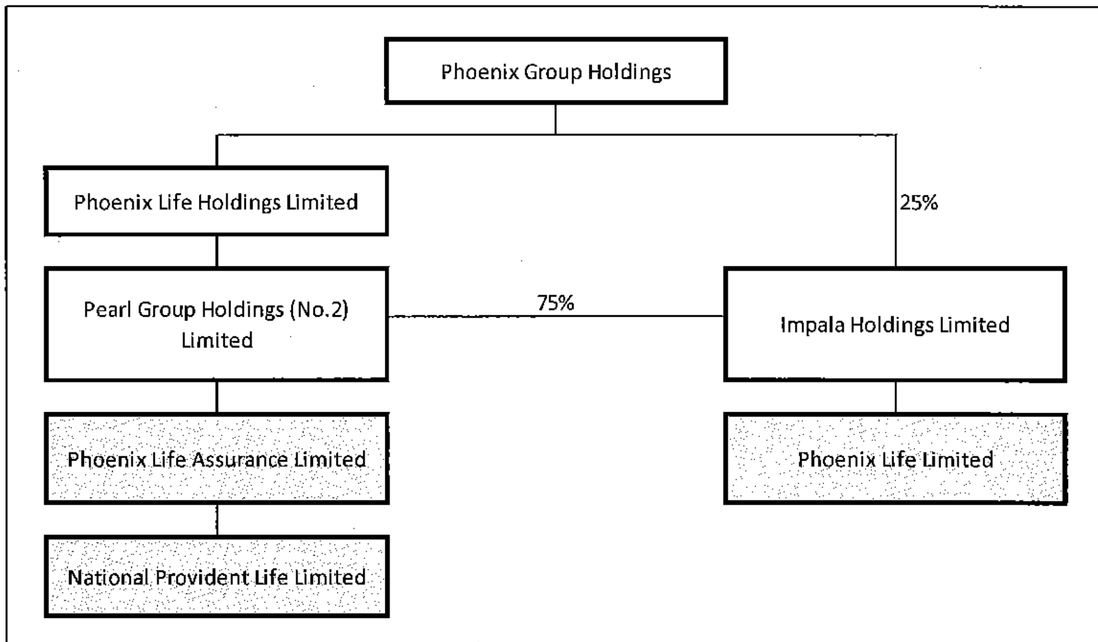
PLL has one subsidiary which is a life insurance company, Scottish Mutual International Limited ("SMI"), which is incorporated in Ireland and is owned by the Shareholders' Fund. SMI became a subsidiary of PLL in 2008.

PLL closed to new business in 2002, although it has continued to issue policies under options on existing policies, including the acceptance of new members to existing pension arrangements and the issue of immediate annuities in respect of vesting pension policies.

3.3. The Phoenix Group

PLL 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 – PLL, PLA and NPLL. 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 PLL

3.5.1. The 100% With-Profits Fund

The 100% WPF consists of the with-profits policies transferred to PLL from the PAL participation fund, the Swiss Life With-Profits Fund and the Bradford long-term business fund. The with-profits policies are mainly traditional endowments and whole life policies.

3.5.2. The 90% With-Profits Fund

The 90% WPF consists of the conventional with-profits policies transferred to PLL from the Swiss Life Ordinary Branch Fund (including former with-profits policies which became non-profit policies on becoming paid-up) and BULA (being policies originally issued by Allianz Cornhill), together with the with-profits policies of the Swiss Life Industrial Branch Fund. The with-profits policies are mainly traditional endowments and whole life policies. In addition, the investment element of certain unitised with-profits policies are reassured into the fund from the NPF in respect of former Swiss Life business.

In addition, there are a substantial number of Swiss Life Industrial Branch policies which are now non-profit (having been made paid-up). The sum assured of these is very small in comparison to that for the with-profits policies.

3.5.3. The Alba With-Profits Fund

The Alba WPF mainly consists of traditional with-profits life and corporate pension business. There is also some unitised with-profits business as well as non-profit deferred and immediate annuities.

The fund mainly consists of United Kingdom business but there is also some overseas business, mainly former branch business of the Life Association of Scotland written in the Republic of Ireland.

3.5.4. The Britannic Industrial Branch Fund

The BIB Fund contains the former Industrial Branch business of Britannic Assurance, which comprises:

- Industrial assurance business – the distinguishing feature of which is that home service agents have traditionally collected premiums in cash. This business would have been sold under the Industrial Assurances Act 1923 before 1 December 2001.
- Home service business – business sold since 1 December 2001 where premiums were initially received in cash by collectors more frequently than once every two months. This business would have previously been sold under the Industrial Assurances Act 1923.

Policies may be with-profits or non-profit. The main types of business are endowment assurances and whole of life assurances.

3.5.5. The Britannic With-Profits Fund

The Britannic WPF comprises mainly:

- traditional with-profits endowment assurances;
- unitised with-profits business;
- traditional with-profits business that formed part of the With-Profits Fund of Century prior to the PLL 2006 Scheme; and
- unit-linked business, the unit liability of which is wholly reassured to the NPF.

3.5.6. The Phoenix With-Profits Fund

The Phoenix WPF comprises the with-profits contracts originally written by Phoenix Life & Pensions Ltd. These mainly fall into the following categories:

- traditional endowments and whole life policies;
- traditional pension policies, most of which have guaranteed annuity options;
- single premium unitised with-profits whole life bonds; and
- unitised with-profits pension policies, some of which are reassured to the fund by the SAL WPF.

There is also a range of non-profit contracts in the Phoenix WPF, the majority of which fall into the following categories:

- endowment or whole life policies;
- term assurance policies on a guaranteed premium basis;
- critical illness policies on a guaranteed premium basis;
- immediate and deferred annuities; and
- unit-linked regular and single premium pension policies, the liability for which (apart from any unitised with-profits element) is reassured to the NPF.

3.5.7. The SAL With-Profits Fund

The SAL WPF consists of conventional with-profits policies, unitised with-profits policies, non-profit policies, unit-linked policies and some immediate and deferred non-profit annuities.

3.5.8. The Scottish Mutual With-Profits Fund

The SM WPF consists of business originally sold by SMA. It comprises conventional with-profits and unitised with-profits policies and unitised with-profits benefits under policies which are written in the NPF and reassured to the SM WPF. It also contains with-profits liabilities reassured to it by SMI.

3.5.9. The SPI With-Profits Fund

The SPI WPF consists of conventional with-profits policies, unitised with-profits policies, deposit administration business and with-profits benefits under policies written in the NPF.

3.5.10. The NPI With-Profits Fund

The NPI WPF contains the with-profits investment element of the unitised with-profits policies which transferred to PLL from NPI Limited, and it wholly reassures this to the Pearl With-Profits Fund in PLA.

3.5.11. The Non-Profit Fund

The NPF consists of the balance of the policies of PLL.

The range of non-profit policies in the fund mainly falls into the following categories:

- unit-linked regular and single premium life and pension policies;
- immediate and deferred annuities; and
- term assurance, critical illness and income protection policies written on both guaranteed and reviewable premium bases.

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. The total liabilities reinsured under the Guardian arrangement as at 31 December 2012 were £3,341m.

3.5.12. PLL Long-term Fund

The approximate number of policies and statutory net reserves in each sub-fund of the PLL Long-term fund as at 31 December 2012 are shown in the table below.

Fund	100% WPF	90% WPF	Alba WPF	BIB Fund	Britannic WPF	Phoenix WPF	SAL WPF	SM WPF	SPI WPF	NPI WPF	NPF
Policies (000)	1	396	127	474	307	225	360	41	127	9	1,719
Reserves (£m)	27	86	1,569	225	3,132	3,866	4,796	2,317	1,949	0	15,053

In total, PLL at 31 December 2012 had approximately 3.8 million policies in force with total reserves in excess of £33 billion.

3.6. PLL Capital Policy

Under the terms of the PLL 2009 Scheme, PLL maintains a particular capital policy (the "Phoenix Capital Policy "or "PCP") which is described below.

The objective of the PCP 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. The strength of the PCP is a function of these scenarios. 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 PCP results in in more capital being available in PLL than is required by the PRA's capital requirements. The PCP 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.

If at any point there is a deficit relative to the PCP, but that deficit is small relative to the capital policy, then no action is taken other than that no capital can be released (for example through the payment of dividends). However, larger deficits would require consideration of corrective action which may involve the drawing down of the additional £100m held within the group to support PLL, its subsidiaries and PGMS (see final paragraph of this section).

The policy involves three main tests and a fourth liquidity test and provides that PLL 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 NPF, 85% of its CRR plus 85% of the CRR of SMI, less 100% of the sum of any positive free assets for each with-profits 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, 138% of its Individual Capital Assessment ("ICA"), subject to a minimum of the ICA plus 1% of the With-Profits Benefit Reserve ("WPBR"), and
- in respect of the NPF, 138% 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 NPF, 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 NPF, as described above. In all other aspects, when calculating whether the total capital available in PLL 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 NPF and the Shareholders' Fund together have sufficient admissible assets to meet the Pillar 1 liabilities of the NPF 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 PCP (in other words, actual capital injections to meet either regulatory or realistic liabilities) plus an additional amount to be determined by the PLL Board at least once a year. This additional amount (which is currently £238m) is derived by considering the ability of the NPF 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 NPF and the Shareholders' Fund are expected to have sufficient assets of an appropriate quality under the terms of the PCP to transfer assets to, and to meet the objectives of the PCP 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 PLL Board to ensure that the PCP 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 PLL Board may amend the PCP 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 PCP change materially, subject to the amended policy continuing to be such as to ensure that PLL can meet its Pillar 1 and Pillar 2 capital requirements in the specified stress scenarios referred to above.

The policy and its predecessor, which was very similar, have operated successfully since 1 January 2007, enabling prudent releases of capital and on occasions requiring corrective action to be taken to bring the level of capital in PLL back up to the level indicated by the PCP.

In addition, members of the Phoenix Group and PLL have agreed with the PRA that until 31 December 2016 and unless otherwise agreed by the PRA:

- PLL will use its best endeavours to ensure that it maintains capital margins equivalent to the first three tests shown above; and
- PLL will obtain the PRA's prior written approval to any change to the first three tests above that would reduce the amount of capital required to be held by PLL.

Members of the Phoenix Group have also agreed with the PRA for the same period and unless otherwise agreed by the PRA to maintain an additional amount of £100m liquid assets within the group to support PLL and PGMS, although this capital is not specifically earmarked for PLL.

4. THE PROPOSED SCHEME

4.1. Background to the Scheme

On 26 June 2012, PLL, PLA 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 PLL, PLA, 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 PLL, PLA 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, Britannic Assurance plc, NPI Limited, SMA and SPL.
- 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 PLL'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 referred to in section 4.3 is complete. In addition, the Scheme will remove the need to account for the reinsurance, reducing the administration costs of PLL and it will reduce the CRR.

If the transfer does not take place, it is PLL'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 PLL, PLA 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 schedules provided by PLL, PLA and NPLL to Guardian on or before the Transfer Date.

The assets and liabilities in respect of transferring policies will transfer from the NPF of PLL, the non-profit fund of PLA 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 PLL 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 PLL Policies

The policies in PLL which are not transferring to Guardian under the Scheme, namely policies within the with-profits funds, and the remaining policies in the NPF (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 NPF and these will continue to operate as discrete funds.

The transferring PLL policies will become policies of Guardian and PLL 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 PLA. 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 PLL

PLL's capital policy (see section 3.6) requires PLL 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 NPF in excess of the amount of assets required to satisfy the PCP 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 PLL before and after the Scheme

As part of the considerations as to whether the benefit security of policyholders remaining in PLL will be affected by the Scheme, it is helpful to compare the solvency position of PLL before and after the Scheme. A similar comparison of the solvency position of PLL 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 PLL.

In order to make this assessment using up to date information, I have considered the expected impact of the Scheme on PLL 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. PLL before the transfer

5.3.1. Pillar 1 position

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

Table 1	PLL as at 31 December 2012 before the effect of the Scheme		
	Available Capital	LTICR	WPICC
	£m	£m	£m
Alba WP Fund	5	86	-
Britannic IB Fund	135	9	113
Britannic WP Fund	1,203	129	933
Phoenix WP Fund	705	169	437
90% WP Fund	48	4	42
100% WP Fund	67	1	66
SM WP Fund	241	93	139
SPI WP Fund	700	80	571
SAL WP Fund	487	196	255
NPI WP Fund	-	2	-
NP Fund	50	354	-
Shareholders' Fund	831	12	-
Total	**4,473**	**1,136**	**2,557**
Total Free Assets (Available Capital less LTICR less WPICC)			**£780m**
Overall Cover for CRR (= LTICR + WPICC)			**121%**
Overall Cover for LTICR			**394%**

Note – The numbers in the table above and elsewhere 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 114% and the Overall Cover for LTICR 372%.

5.3.2. Pillar 2 position

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

5.3.3. PCP tests

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

5.4. PLL after the transfer

5.4.1. Pillar 1 position

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

Table 2	PLL as at 31 December 2012 following the implementation of the Scheme		
	Available Capital	LTICR	WPICC
	£m	£m	£m
Alba WP Fund	5	66	-
Britannic IB Fund	135	9	113
Britannic WP Fund	1,203	129	933
Phoenix WP Fund	705	167	437
90% WP Fund	48	4	42
100% WP Fund	67	1	66
SM WP Fund	241	93	139
SPI WP Fund	700	80	571
SAL WP Fund	487	196	255
NPI WP Fund	-	-	-
NP Fund	121	269	-
Shareholders' Fund	826	12	-
Total	**4,540**	**1,029**	**2,557**
Total Free Assets (Available Capital less LTICR less WPICC)			**£954m**
Overall Cover for CRR (= LTICR + WPICC)			**127%**
Overall Cover for LTICR			**441%**

Taking into account the dividend payment in March 2013, the Overall Cover for CRR would be 120% and the Overall Cover for LTICR 417%.

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 will increase.

5.4.2. Pillar 2 position

The Pillar 2 solvency position has been estimated as at 31 December 2012 for PLL 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, PLL would meet its Pillar 2 capital requirements by an increased amount.

5.4.3. PCP tests

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

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 and Group ICA 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 PLL 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 PLL under Solvency II will be higher if the Scheme takes place than if it does not.

5.5. Guardian

The figures and statements in 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 PLL 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 PCP; 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 PCP. The Scheme includes controls on the way in which Guardian's capital policy can be changed. These differ from the controls in place for PLL as a result of the agreement with the PRA (which expires in December 2016) and the PCP. The agreement with the PRA requires PRA consent to any changes if the amounts required under the PCP are being reduced. 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 also note 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 with the position were they to remain in PLL. 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 PLL. 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 two of the outsource providers, who currently provide these services to PLL, which will be similar to the arrangements in place now. This will cover the majority of the policies being transferred from PLL. The administration of the remaining policies is likely to be moved to one of above outsource providers or undertaken directly by Guardian. There is no reason to expect the quality of administration for any transferring policyholder 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 of the transferring policyholders of PLL. 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 PLL policyholders transferring to Guardian.

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

7.1. Security of Benefits

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

- PLL meeting its PRA capital requirements;
- PLHL meeting the minimum group capital requirements;
- PLL meeting the additional capital requirements required by the PCP;
- the strength of, and protections built into, the PCP, including the internally specified stress scenarios that are tested and the process by which these scenarios can be changed; and
- the additional £100m in capital held within the group to support PLL, its subsidiaries and PGMS.

Overall, the risks within the NPF will reduce following implementation of the Scheme. As was shown in section 5.3 to 5.6, this means that the financial position of PLL and of PLHL will be improved following implementation of the Scheme. In PLL 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 PLL 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 NPF. 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 NPF.

The With-Profits Actuaries of PLL have confirmed that they agree with my opinion with regard to with-profits policies.

7.4. Quality of Administration

The terms upon which services are currently provided by PGMS and Pearl Group Services Limited to PLL will continue to apply in respect of the business remaining in PLL 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 of the policyholders remaining in PLL. 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 PLL or the PCP 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 PLL is small (approximately 5%) relative to the existing size of PLL 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 PLL policyholders.

7.7. Conclusions on non-transferring policyholders

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

8. CONCLUSION

In my opinion as Actuarial Function Holder, taking into account the advice and opinions set out above, no class of PLL 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 PLL. For both groups of policyholders, I also believe that the Scheme is consistent with PLL's obligation to treat customers fairly.

A D Rendell
Fellow of the Institute of Actuaries
29 April 2013