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

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Prepared by David Hare FIA

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# Contents

# 1. Introduction

## The Independent Expert

1.1. When a scheme for the transfer of insurance business from one company to another is submitted to the High Court of Justice of England and Wales (the "Court") for approval, it has to be accompanied by a report from an Independent Expert. This is a requirement of Section 109 of Part VII of the Financial Services and Markets Act 2000 ("FSMA") and the report must be made in a form approved by the Prudential Regulation Authority ("PRA") having consulted the Financial Conduct Authority ("FCA"), the UK regulators (together, the "Regulators").

1.2. I have been appointed as the Independent Expert to provide the required report on a proposed scheme for the transfer of the entire long-term insurance business of National Provident Life Limited ("NPLL") to Phoenix Life Assurance Limited ("PLAL"). For this proposed scheme of transfer (the "Scheme"), I have been appointed jointly by NPLL and PLAL (together, the "Companies"). My appointment has been approved by the PRA.

1.3. Both of the Companies are part of the Phoenix Group.

1.4. The Scheme will be submitted to the Court for sanction under Section 111 of Part VII of the FSMA. If approved, it will become operative on 6 April 2015 (the "Transfer Date"), but will take effect, insofar as it creates rights and obligations that exist only between the Companies, on 1 January 2015 (the "Effective Date"), including for accounting and financial reporting purposes. This report (my "Report") and any supplementary report (my "Supplementary Report" and, together with my Report, my "Reports") will be presented to the Court at a hearing (the "Sanction Hearing") and it is likely that the Court will consider the contents of these Reports in deciding whether to sanction the Scheme.

1.5. I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1988, and am a Partner in the Actuarial and Advanced Analytics practice of Deloitte MCS Limited ("Deloitte"). I joined Deloitte as a partner in May 2012, from Standard Life plc, a savings and investment company, where, from January 2007 until December 2011, I was Chief Actuary, UK & Europe and the Actuarial Function Holder ("AFH") for Standard Life plc's four UK-regulated insurance companies. As AFH I advised the Boards of Standard Life Assurance Limited ("SLAL"), Standard Life Investment Funds Limited ("SLIF") and Standard Life Pension Funds Limited ("SLPF") on the transfer (on 31 December 2011) of the entire business of SLIF to SLAL. I have been the Independent Expert for two previous schemes for the transfer of long-term insurance business, including one involving the Companies. I am a member of the Institute and Faculty's Life Board and one of the UK profession's representatives (Membre Suppléant) on the Groupe Consultatif Actuariel Européen. In June 2014 I also became Immediate Past President of the Institute and Faculty of Actuaries, having been President from June 2013 until then.

## Independence

1.6. Neither I nor my immediate family hold any policies, investments, shareholdings or have any other financial interests with either of the Companies.

1.7. Partners and staff of Deloitte have advised, and continue to advise, the Companies on various assignments. However, we have not acted as external auditor or performed any regulatory roles. I have not advised the Companies on any significant project.

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

## Regulatory and Professional Guidance

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

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

## The Scope of my Report

1.11. My terms of reference have been agreed with the Companies and seen by the Regulators and are set out in more detail in Appendix 1.

1.12. This Report considers the consequences of the Scheme for the policyholders of each of the Companies, and sets out my findings. I am not required to, and do not, consider the position of each policyholder, but I have reviewed the consequences for each class of policyholders.

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

1.14. To the best of my knowledge, I have taken account of all material facts in assessing the impact of the Scheme and in preparing this Report. In order to reflect any updated financial information or circumstances nearer to the date of the Sanction Hearing, I expect to provide a Supplementary Report setting out my updated opinions in respect of the Scheme.

1.15. In reporting on the Scheme as the Independent Expert, I recognise that I owe a duty to the Court to assist on matters within my expertise. This duty overrides any obligation to the Companies from whom I have received instructions. I believe that I have complied, and confirm that I will continue to comply, with this duty. I also confirm that I am aware of the duties and requirements regarding experts set out in Part 35 of the Civil Procedure Rules, Practice Direction 35 – Experts and Assessors and the Protocol for the Instruction of Experts to give Evidence in Civil Claims.

1.16. My Report can be read as a stand-alone document, although it draws on the information in the terms of the Scheme, and the reports prepared by the Actuarial Function Holders of the Companies. I have considered each of these in coming to my opinions, but have not relied upon the opinions expressed in those reports.

## Reliances and sources of information

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

1.18. My analysis of the solvency position of the Companies is based on estimates of the pre- and post-Scheme financial position as at 31 October 2014 produced by the Companies and described in Appendix 5. Where possible, the Companies have used processes already in place to report monthly management information or have put other governance in place to ensure the estimates are reasonable. I have not checked these estimates or the processes and have relied on them in carrying out my analysis.

1.19. The Report also comments on a second set of solvency calculations, known as the “Pillar 2” or Individual Capital Adequacy Standard (“ICAS”) calculations. These are not audited, but are submitted to and reviewed by the PRA.

1.20. These calculations are produced using established processes, are checked by the Companies and are used by them in practice as an input to decision making. A material error in these figures would be a significant matter, and so I believe it is reasonable to rely on their accuracy, subject to reasonableness checking as stated above.

1.21. I note that the economic position at the Transfer Date cannot be predicted with certainty. The absolute solvency level will therefore differ from that shown in the Report, but I would not expect the impact of the Scheme to vary significantly from the estimates shown and it is this impact which is my primary consideration (alongside the Companies continuing to satisfy regulatory solvency requirements, as is currently the case). I will continue to keep the position under review in the period leading up to the Sanction Hearing, and will prepare further information in my Supplementary Report.

1.22. Selected financial information, data and written information which I have relied on is listed in Appendix 13.

## Limitations

1.23. This Report has been written in accordance with English law, and has been prepared solely for the use of the Companies and the Court, and solely for the purpose of assisting in determining whether the Scheme should be permitted. Policyholders, reinsurers and any others affected by the Scheme may also place reliance on my Reports, as stated in SUP 18.2.34. It should not be used for any other purpose. The Report may not be relied upon by any other party for any purpose whatsoever. Neither I nor Deloitte, its partners and staff owe or accept any duty to any other party and shall not be liable for any loss, damage or expense (including interest) of whatever nature which is caused by any other party’s reliance on representations in this Report.

1.24. This Report should be considered in its entirety, as parts taken in isolation may be misleading. A copy of the final version of my Report may be provided to the following parties:

- the Regulators, for the purposes of the performance of their statutory obligations under FSMA;
- legal advisers of the Companies in connection with the Scheme provided that the Companies

inform them that i) the Report is confidential and may not be disclosed to any other party without my prior written consent or otherwise as permitted by this letter, and ii) neither Deloitte nor I accept any responsibility or liability to them in respect of any use they may make of the Report;

- tax advisers of the Companies (internal and external), subject to the external tax advisers signing an agreed release letter;
- the Court, to assist in determining whether the Scheme should be permitted;
- any other person who has or asserts a right to receive a copy of this Report, provided for under the terms of the FSMA and SUP 18.2, or any Jersey, Guernsey or other non-EEA resident policyholder who has or asserts a right to receive a copy of the Report under the terms of local legislation (an "Interested Party" and collectively the "Interested Parties");
- other insurance regulators who have a legitimate interest in the Scheme and the local schemes in Jersey and Guernsey (the "Overseas Schemes", see paragraphs 3.17 and 3.18 below); and
- the relevant courts in Jersey and Guernsey, solely in connection with the Scheme or the Overseas Schemes.

1.25. The Companies have been advised that, in order to transfer insurance business carried on in, or from within, Jersey and to transfer policies issued to residents of Guernsey, local schemes will also need to be effected in each of those territories, subject to the sanction of the Royal Court of Jersey or the Royal Court of Guernsey (the "Overseas Courts") as appropriate. The terms of the transfers under the local schemes are based on (and are in all material respects the same as) the Scheme, and the local schemes are expected to take effect on the same date as the Scheme. The local schemes are conditional upon the sanction of the Scheme by the Court. In the event that the transfer under a local scheme is delayed, the policies intended to be transferred thereunder (if any) will be fully reinsured pursuant to the Scheme until the relevant local scheme transfer is effected.

1.26. In writing this Report, I have also considered the effect of the Overseas Schemes on policyholders. My Report and conclusions apply equally to business carried on in, or from within, Jersey or comprising policies issued to residents of Guernsey as they do to business comprising policies held by residents in the UK or any other territory, and this Report may therefore be used to satisfy the requirement for a report by an independent actuary on the terms of the local schemes in Jersey and Guernsey. I will, as necessary, provide additional reports or commentary in respect of Jersey and Guernsey to assist the Overseas Courts.

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

1.28. This Report has been prepared in accordance with agreed terms of reference and for a specific purpose. No liability will be accepted for the use of this Report for a purpose for which it was not intended or for the results of any misunderstandings by any user of this Report. No liability will be accepted under the terms of the Contracts (Rights of Third Parties) Act 1999.

## Form of my Report

1.29. Section 2 is a stand-alone summary describing what the Scheme is designed to do, and setting out my conclusions.

1.30. Section 3 describes the various Companies involved in the Scheme, and how they are impacted.

1.31. Section 4 explains the role of the Independent Expert and the approach I have taken in carrying out my analysis and reaching my conclusions.

1.32. Section 5 provides the key information relating to the security of policyholder benefits before and after the Scheme.

1.33. Sections 6 and 7 deal with the policyholders of PLAL and NPLL respectively, and set out my analysis and conclusions on how they are affected by the Scheme in respect of benefit security and benefit expectations. Each section is written so that a policyholder in the relevant Company can understand the significant implications of the Scheme for them by reading it. For those reading the whole Report, there will be some repetition across these Sections.

1.34. Section 8 explains the effect of the Scheme on service standards and investment management services provided to policyholders.

1.35. Section 9 describes the impact of tax matters on the Scheme.

1.36. Section 10 deals with the plans for communicating the Scheme to policyholders, and my opinion on those plans.

1.37. Further background information is given in the appendices, which include my terms of reference and a glossary.

# 2. Summary and Conclusions

## Introduction

2.1. I have been appointed as the Independent Expert to provide the required report on a proposed Scheme for the transfer of long-term insurance business between NPLL and PLAL. I have been appointed jointly by the Companies.

2.2. Both of the Companies are part of the Phoenix Group, and so the Scheme transfers policies between entities of the same group, and does not introduce any significant new risks to the group.

2.3. I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1988, and am a Partner in the Actuarial and Advanced Analytics practice of Deloitte. I have acted as the Independent Expert on previous Part VII schemes that have been approved by the Court. My appointment has been approved by the PRA.

2.4. I am independent of the Companies involved in the Scheme, and neither I nor any partner or member of staff of Deloitte has provided any advice concerning the development of this Scheme.

2.5. I have considered the effect which the proposed Scheme is expected to have on different groups of policyholders in the Companies, and whether the position of any group is, or is likely to be, "materially adversely affected". Paragraph 4.3 explains how I have interpreted this. As part of my analysis of the Scheme, I have considered whether the effects of the Scheme are likely to differ significantly for the different generations of policyholders. I am satisfied that this is not the case for this Scheme and I conclude on the equitability of the Scheme throughout my Report.

2.6. This Report sets out my findings, to assist the Court in deciding whether or not to allow the Scheme to go ahead. The Scheme will be submitted to the Court for approval at a Sanction Hearing which is scheduled for 30 March 2015. If approved, it is expected to become operative on the Transfer Date of 6 April 2015, although it will take effect, insofar as it creates rights and obligations that exist only between the Companies, on the Effective Date of 1 January 2015. I will continue to review the implications of the Scheme for policyholders, and I expect to provide a Supplementary Report for the Court shortly in advance of the Sanction Hearing.

## Purpose of the Scheme

2.7. The purpose of the Scheme is to simplify the structure of the Phoenix Group by reducing the number of active life companies in the group. This will lead to improved liquidity and capital efficiency in PLAL. In addition, the Scheme will simplify the operation of the with-profits fund to which NPLL policyholders are allocated and provide increased consistency of management practices and principles across the group, which should in turn result in efficiencies in governance, financial reporting and management information processes. The transfer will also provide an opportunity to use Phoenix Life as the consistent brand across all Phoenix's UK life companies.

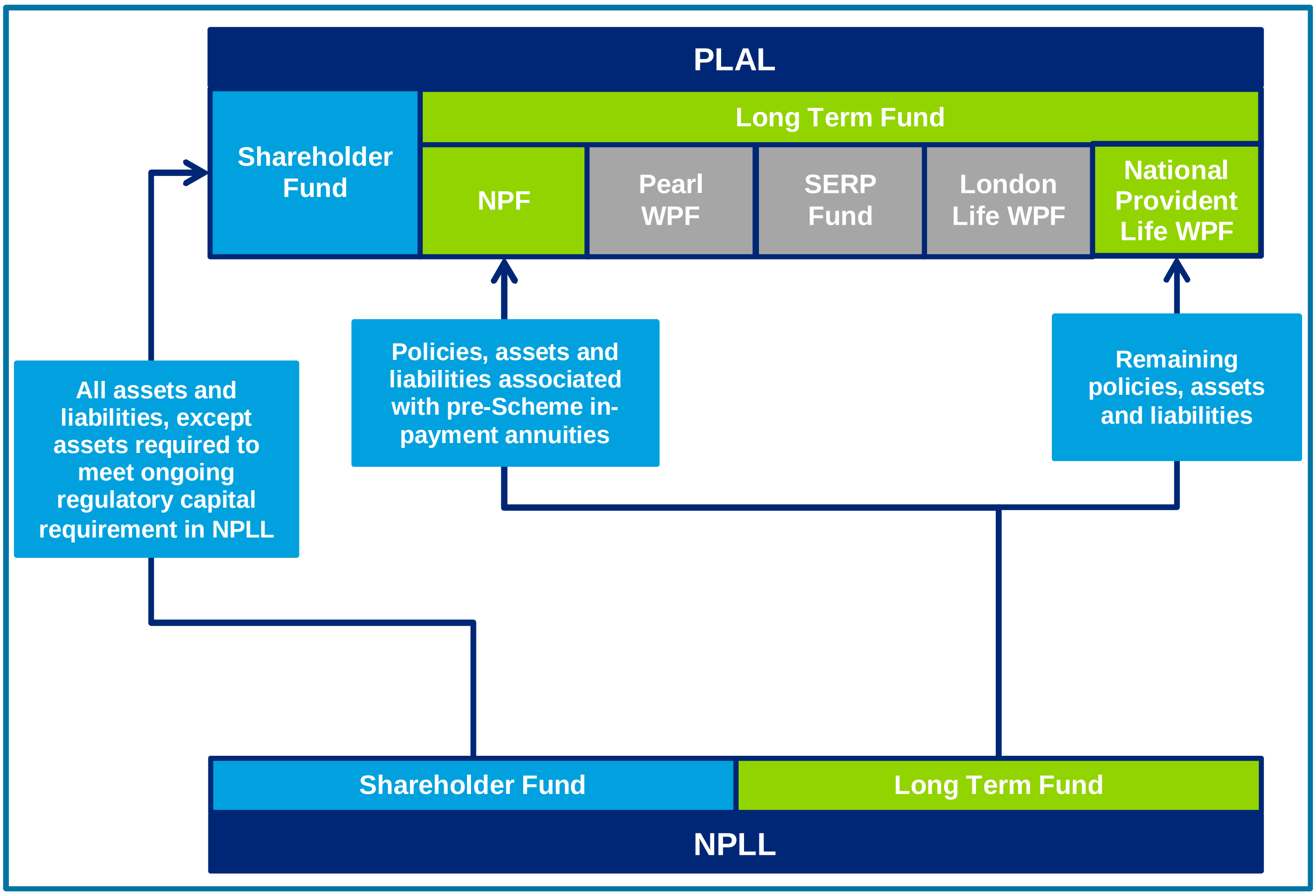
## Scope and Impact of the Scheme

2.8. The Scheme will transfer the entire long-term insurance business of NPLL to PLAL and simplify the capital support arrangements for the business currently held in NPLL. The Scheme will simplify the management of the policies currently held in NPLL, bringing it more closely in line with the management of the policies in PLAL.

2.9. Throughout the Report, the policies transferring from NPLL are referred to as the "Transferring Policies" that are owned by the "Transferring Policyholders". Those policies already in PLAL are known as "Existing PLAL Policies" whose owners are known as "Existing PLAL Policyholders".

2.10. A diagram outlining the transfers under the Scheme is provided in Figure 2.1.

***Figure 2.1: Transfers under the Scheme***




2.11. PLAL and NPLL are both wholly-owned indirect subsidiaries of the Phoenix Group. NPLL is wholly-owned by the shareholder fund of PLAL (the "PLAL SHF") via an intermediate holding company, called NP Life Holdings Limited.

2.12. At the Transfer Date, all assets to be transferred from the shareholder fund of NPLL (the "NPLL SHF") shall be allocated to the PLAL SHF. An amount of capital to cover the remaining regulatory capital requirement (expected to be the Base Capital Resources Requirement ("BCRR") and any associated currency risk) will be held in the NPLL SHF until the de-authorisation of NPLL, at which point the remaining assets and liabilities of NPLL will be transferred to PLAL under the Scheme.

2.13. The assets and liabilities relating to all in-payment annuities in the long-term insurance fund in NPLL (the "NPLL LTF"), including certain annuity business which is currently reassured to the non-profit fund in PLAL (the "PLAL NPF"), will be transferred to the PLAL NPF at the Transfer Date.

2.14. The remaining assets and liabilities of the NPLL LTF will be transferred to a newly created fund in PLAL (the National Provident Life With-Profits Fund ("NPL WPF")) at the Transfer Date.

## Main Considerations

2.15. As the Independent Expert I am required to consider the effect of the Scheme on both the Transferring Policyholders and the Existing PLAL Policyholders. In both cases, in arriving at my opinion I have discussed the Scheme's documentation and intended operation with the management of the Companies as part of my review.

2.16. The Scheme will lead to changes in the management of the business and I have considered whether these changes are likely to lead to a change in the reasonable benefit expectations of policyholders. Additionally, as policies move from one fund to another, other factors can change, such as the level of benefit security. I have considered the likely impacts of the Scheme on the security of policyholder benefits, service standards, investment management, and the governance arrangements in place to ensure policyholder interests are protected in future.

2.17. My consideration of the effect of the Scheme is based on the potential policyholder impact of the Scheme in and of itself, and includes consideration of any protections built into the Scheme. Where I make statements in my Report such as "will continue to", these statements refer to the impact of the Scheme in isolation and do not mean that the current situation could not be changed by the Companies' management at some point in the future as part of the normal management of the business. Such future changes will be subject to the Companies' internal governance framework, including in relation to regulatory obligations regarding Treating Customers Fairly ("TCF").

2.18. The NPLL Demutualisation Scheme (the "NPLL Scheme", as discussed further in paragraph 3.10) includes a provision covering the situation that is now the subject of the Scheme. As can be seen from the wording in 6.34 below, the provision sets out a requirement for the National Provident Life Fund Supervisory Board (the "Supervisory Board") to co-operate with such an application if certain conditions are met. In addition to my consideration of the impact of the Scheme I have provided my opinion as an actuary in relation to these conditions - an opinion on policyholder effects, which I do not intend to be stronger or weaker than the alternative phraseology used elsewhere in my Report. However, my opinion in this respect is not intended to absolve the Supervisory Board of their responsibility to consider the compliance of the Scheme with the conditions in the NPLL Scheme and I do not accept any liability in the event that such a reliance is made. In particular, I note that my opinion does not constitute a legal opinion on how the provision should be interpreted. I note that, on 3 November 2014, the Supervisory Board approved the proposal for the Companies to make an application for approval of the Scheme.

## Policyholder Benefit Expectations

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

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

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

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

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

2.24. I have also considered whether the benefit expectations of any group of policyholders are changed as a result of the Scheme changing the scope of application of previously agreed Court schemes or introducing new powers for the Companies.

2.25. In my consideration of the impact of the Scheme, I discuss separately the impact of the Scheme on the benefit expectations of:

- the Transferring Policyholders, currently held in the NPLL LTF; and
- the Existing PLAL Policyholders.

Where relevant, I have considered the holders of different types of policies separately (for example, unit-linked, with-profits and non-profit non-linked policies), reflecting the different extent to which the actions of management can impact the level of policyholder benefits paid.

## Transferring Policyholders

2.26. The following key considerations apply to with-profits Transferring Policies. Taking account of these, I am satisfied that the Scheme will not materially adversely impact the benefit expectations of the holders of these policies.

- There will be no change to the asset share, bonus rates and surrender value calculations, which will continue to use the current methodology. The current process for allocating investment returns to asset shares will continue to apply.

- Although the Supervisory Board will not have direct responsibility for the overall management of the NPL WPF following the Scheme (as is currently the case for the NPLL LTF), the power to manage investment and bonus policy for the NPL WPF will be held by the PLAL With-Profits Committee ("WPC"), which will be required to have regard solely to the interests and reasonable expectations of NPL WPF policyholders when carrying out its duties in respect of that fund. The wider management of the NPL WPF by the PLAL Board will also be subject to oversight by the PLAL WPC. This brings the management of the NPL WPF into line with the management of the other with-profits funds within PLAL ("PLAL WPFs"). I consider this further in Section 8.

- The Scheme will result in all of the annuities in payment and assets corresponding to the realistic reserve for this business being transferred to the PLAL NPF. Consequently, any profits arising on this business that would previously have arisen in the NPLL LTF will accrue to the PLAL NPF as a result of the Scheme. However, the majority of this business is already largely reinsured to the PLAL NPF (either fully reinsured, on original terms, for annuities written since 31 March 2012, or reinsured other than in relation to the administration expenses for certain pension annuities written before 1 January 2000), and so any profits on this reinsured business would already be expected to arise largely in the PLAL NPF. The remaining business had a realistic reserve of approximately £13.6m at 31 December 2013, and so I am satisfied that any future profits on this business would not materially affect the benefit expectations of the holders of with-profits Transferring Policies. This view is consistent with the opinion expressed by the NPLL With-Profits Actuary ("WPA") in his report on the Scheme.

- The Scheme will allow, but not require, the reallocation of non-profit policies within the NPL WPF to the PLAL NPF. The Scheme requires the PLAL Board to seek appropriate actuarial advice and to ensure that the terms of such a reallocation are fair and equitable. I also note that any such proposal would be subject to TCF and other regulatory requirements.

- Consistent with the terms which apply to the management of PLAL's existing with-profits funds, the Scheme will provide that PLAL must convert the with-profits policies in the NPL WPF into non-profit policies when the statutory with-profits liabilities (before reinsurance) of the NPL WPF fall below £50m, and close the fund. Although there is currently no equivalent clause applicable to the Transferring Policyholders, any such wind-up and conversion of benefits would require prior written approval from the Regulators, would be on a basis based on appropriate actuarial advice and would include the full distribution of any surplus in the fund, to help protect the interests of the affected policyholders.

- While the term "appropriate actuarial advice" is not specifically defined, I have discussed this with the Companies and they have confirmed my expectation that "appropriate" is likely to include seeking an independent, external actuarial review (similar to that provided by the Independent Expert in relation to the Scheme) where a particular issue is material or considered likely to be contentious.

- The Scheme allows for the future merger of the NPL WPF with another with-profits fund in PLAL when the with-profits liabilities of the NPL WPF fall below £750m, subject to future increases related to inflation. In this occurrence the Scheme also provides protection for existing policyholders by ensuring that there is a review from an independent actuary to ensure that the merger would not adversely affect their expectations. The terms of any merger would also be subject to the prior approval of the Regulators. This replaces a similar clause in the NPLL Scheme (as defined in section 3.10), whereby the fund could cease to be maintained as a separate fund once with-profits assets of the fund fall below £500m, adjusted for inflation since 31 December 1999 – equivalent to £750m as at 31 December 2013.

- A new chapter will be added to the PLAL PPFM reflecting the new NPL WPF. This will replicate the key aspects of the NPLL PPFM. Further details are provided in Appendices 7 and 12. I will review any proposed changes to the NPL WPF PPFM in the period leading up to the Sanction Hearing and will comment in my Supplementary Report on any changes that I consider could have a material effect on the interests of policyholders.

2.27. On the basis of the analysis below, I am satisfied that the Scheme will not have a material impact on the benefit expectations of the unit-linked Transferring Policyholders.

- The Scheme will allow PLAL to:
    - merge, divide or modify the investment objectives of any unit-linked funds, subject to this not being precluded by policy terms and conditions and having considered the interests of affected policyholders; and
    - wind-up very small unit-linked funds, which are administratively infeasible to maintain.

  These powers are subject to conditions relating to maintaining the interests of the affected policyholders and the, more general, requirement of PLAL to comply with the applicable regulations (including the TCF obligation). In either event, policyholders would be entitled to a free switch.

- The unit-linked policies in the NPL WPF will remain invested in the same unit-linked funds as previously in NPLL, with the same number and value of units, and with the same range of fund choice available to them.

- The value of each policy's unit holdings will be unchanged, and the pricing principles used for each unit-linked and unitised with-profits fund will be unchanged by the Scheme. The level of fund charges will also be unchanged.

- There will be no change to the unit pricing principles, investment mandates, charges or taxation of any unit-linked fund.

2.28. On the basis of the analysis below, I am satisfied that the Scheme will not have a material impact on the benefit expectations of the other non-profit Transferring Policyholders.

- All NPLL annuities in payment will transfer to the PLAL NPF under the Scheme. The Scheme does not change the benefits payable under these policies or their terms and conditions.

- There will be no change to the benefits, terms and conditions of any other non-profit Transferring Policies.

## Existing PLAL with-profits policies

2.29. The following key considerations apply to Existing PLAL Policyholders with with-profits policies in the PLAL WPFs. Taking account of these, I am satisfied that the Scheme will not have a materially adverse impact on the benefit expectations of those policies.

- There will be no change to the basis on which asset shares are determined, the current level of asset shares and guaranteed benefits, the expected level of emerging profits or how they are shared, expected bonus rates and payout levels, or the smoothing of payouts.
- The PLAL WPFs contains non-profit business, and profits or losses from that business remain in the relevant fund for the potential benefit of the with-profits policyholders. All of the non-profit business will remain within the respective funds, and there will be no change to the basis on which profits are shared.
- With-profits policyholders have a contingent interest in any surplus assets in their particular fund, and, while they remain in the fund, will receive a share of any such assets that are distributed in the future. The level of surplus assets in each existing PLAL WPF is unchanged, and so the value of this contingent interest is unaffected in each case.
- There will be no changes to the investment policy or asset mix of any fund as a result of the Scheme.
- The Scheme will not change the PPFM for this business, nor does it impact directly the way in which this business is expected to be managed.
- The governance arrangements and the existing policyholder protections will be maintained.
- The Scheme will not change the powers and areas of management discretion (and any associated policyholder protections) that have resulted from previous Court schemes.

2.30. On the basis of the analysis below, I am satisfied that the Scheme will not have a material impact on the benefit expectations under existing unit-linked policies in PLAL.

- Immediately after the implementation of the Scheme, the unit-linked policies in PLAL will remain invested in the same unit-linked funds as previously, with the same number and value of units, and with the same range of fund choice available to them.
- The value of each policy's unit holdings will be unchanged by the Scheme, as will the pricing principles used for each unit-linked and unitised with-profits fund will be unchanged by the Scheme. The level of fund charges will also be unchanged.
- There will be no change to the unit pricing principles, investment mandates, charges or taxation of any unit-linked fund.

2.31. I am satisfied that the Scheme will have no impact on existing non-profit policyholders in PLAL based on the following analysis:

- The benefits payable under existing non-profit policies in PLAL are fixed, or escalate with respect to inflation or at a fixed rate. The Scheme will have no impact on the benefits or premiums payable under any non-profit policy. The terms and conditions of the existing non-profit policies in PLAL will not be changed by the Scheme.

- The Scheme will not affect the current premium levels or charges of any non-profit policies with reviewable premiums or charges. Future reviews will continue in accordance with existing practice and having regard to TCF.

## Conclusion

2.32. I am satisfied that the Scheme will not materially adversely impact the benefit expectations of any group of policyholders.

## Benefit Security

2.33. A central part of my considerations is the security of benefits. I would be concerned if the Scheme meant that some policies move from a financially strong company to a weak one which has a significant chance of not honouring its obligations to policyholders.

2.34. The Regulators are responsible, amongst other things, for the supervision of UK authorised insurance companies. Each company is managed to at least meet minimum capital requirements set out in regulations. There are two main requirements, known as "Pillar 1" and "Pillar 2". These set a strong standard – for example, the Pillar 2 requirement is that a company must have enough capital to continue to meet the best estimate of policyholder liabilities following an event or combination of events of a severity expected to occur only once in every 200 years. Based on my review, I confirm that the requirements under both Pillars are expected to be met for every group of policyholders immediately following the Scheme.

2.35. Companies will usually choose to hold a level of capital in excess of these minimum requirements, so that they can continue to meet these solvency requirements in adverse conditions. The level of additional capital that a company wishes to maintain is often set out in an internal capital policy.

2.36. I consider the use of solvency ratios, such as the ratio of capital resources to capital requirements under Pillar 1 and Pillar 2, to be a useful indicator of the immediate impact of the Scheme on the level of benefit security provided to policyholders, especially where the "before" and "after" ratios are calculated using consistent methods and assumptions, as is the case in this Report. While this is helpful, I would be concerned if subsequent actions meant that a fund could be weakened in future, for example through the payment of dividends to shareholders. For many firms, including PLAL and NPLL, the constraint on such action is their capital policy, which I consider in more detail below. In considering the level of benefit security afforded to policyholders, I have placed heavy emphasis on this.

2.37. The Companies determine the amount of capital to be held under their respective capital policies by reference to the same series of tests, with the most onerous test determining the level of capital held. These tests are described in detail in Section 5. An important consequence of this current practice is that both Companies are targeting the same risk appetite when reviewing the targets set out in the respective capital policy.

2.38. Where the Companies hold capital in excess of the level targeted under their respective capital policies, I place limited reliance on this capital in my consideration of policyholder benefit security. This is because such capital can be removed from the Companies (potentially in the form of dividends) and, as such, may not be available to provide benefit security on an ongoing basis. Indeed, I note that the NPLL Board has resolved to pay any excess over its capital policy requirements to PLAL and that, in practice, NPLL normally considers any payment of excess twice a year and seeks to maintain a small working buffer over its capital policy requirements.

## Contagion risk

2.39. When several funds exist in the same company, capital resources may flow from one to another in the event that one of the funds has insufficient assets to meet its liabilities. I refer to the risk of a fund having to provide capital in this way as "contagion risk". This could impact adversely on the security of policies in the fund from which the capital resources have moved (and, for with-profits policies, their benefit expectations, if some of the surplus in the funds is lost).

2.40. The Pillar 2 regulatory requirements require each Company to be able to withstand an event or combination of events of a severity expected to occur only once in every 200 years, and PLAL's capital policy (the "PLAL Capital Policy") requires a higher standard of coverage. The chance of contagion risk emerging is therefore remote. As NPLL is an indirect subsidiary of PLAL, the Existing PLAL Policyholders are already indirectly exposed to the risks within NPLL. Although currently NPLL could theoretically be allowed to fail to meet its liabilities, even if PLAL had available capital, I consider that such an outcome to be extremely unlikely given the potential reputational damage this could cause the Phoenix Group. I also note that the PLAL Board has given an undertaking to provide further capital to the NPLL SHF if this is required to enable NPLL to meet its capital policy, provided that in so doing PLAL remains able to meet its own capital policy.

## Existing PLAL Policyholders

2.41. Having regard to the summary below, the Scheme will not have a material adverse impact on the benefit security of the Existing PLAL Policyholders.

- These policies do not move, and will continue to have recourse to surplus in their relevant fund and the PLAL SHF.

- They will continue to benefit from the protection provided by the PLAL Capital Policy which targets a level of capital well in excess of regulatory requirements on an ongoing basis. The level of protection that it targets for the policies will not change as a result of the Scheme, nor will the governance processes in place to protect against future changes to it that could be detrimental to the Existing PLAL Policyholders.

- The amount held by PLAL under its capital policy already takes into account the capital requirements of NPLL as a subsidiary of the PLAL SHF. However, due to the workings of the PLAL Capital Policy, unless the parameters used to calculate the Pillar 1 margin targeted are reviewed post-Scheme, the transfer of the NPLL business into PLAL will result in an increase in the overall amount of capital targeted under that test. As a consequence of this, as set out in paragraph 5.34, the PLAL Board intend to change the parameters used to calculate the Pillar 1 margin in order to avoid any change in the amount targeted as a result of the Scheme, where there is not a change in the underlying regulatory capital requirement. This change does not represent a change in the overall level of protection targeted by the PLAL Capital Policy.

- The Scheme, in and of itself, leads to little change in the risks to which the Existing PLAL Policyholders are exposed. Such risks are mitigated through the capital that is held against them and the strength of the PLAL Capital Policy. Had the Scheme taken effect on 31 October

2014, PLAL would have been able to meet the level of capital targeted by its capital policy immediately after the Scheme, and I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015). The Scheme is not expected to materially change the solvency coverage ratios on either a Pillar 1 or Pillar 2 basis.

- The Scheme does not materially change the level of contagion risk that the Existing PLAL Policyholders are exposed to. As NPLL is an indirect subsidiary of PLAL and the PLAL Capital Policy already takes NPLL into account, the Existing PLAL Policyholders are already exposed directly and indirectly to the risks within NPLL. (As outlined above, there is an existing undertaking from the PLAL Board to provide additional capital to NPLL, provided that in doing so PLAL remains able to meet its own capital policy, and I consider it highly unlikely that, while PLAL remained solvent, it would allow NPLL to become insolvent due to the detrimental impact this would have for the reputation of the Phoenix Group.)

## Transferring Policyholders

2.42. Having regard to the summary below, the Scheme will not have a material adverse impact on the benefit security of the Transferring Policyholders.

- Following the Transfer, these policies will continue to be protected by a capital policy, which targets a level of capital well in excess of regulatory requirements on an ongoing basis. As at 31 October 2014 this level of capital held under the PLAL Capital Policy represented a higher percentage margin over regulatory capital requirements than that held under NPLL's capital policy (the "NPLL Capital Policy"). The PLAL Capital Policy is subject to the governance processes in place to protect against future changes to it that could be detrimental to the benefit security of the policyholders within PLAL (including, after the implementation of the Scheme, the Transferring Policyholders). In addition, as it was contained in a Court-sanctioned scheme, the PLAL Capital Policy represents a stronger shareholder commitment than the NPLL Capital Policy.

- The Scheme, of itself, leads to little change in the risks to which the Transferring Policyholders are exposed. Such risks are mitigated through the capital that is held against them and the strength of the PLAL Capital Policy. PLAL is expected to be able to meet the level of capital targeted by its capital policy immediately after the Scheme. Had the Scheme taken effect on 31 October 2014, the solvency coverage ratio on a Pillar 1 basis would have been lower in PLAL than in NPLL, and I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015). However, as noted above, I place limited weight on assets held in excess of the level targeted under the capital policy of a company.

- The Scheme simplifies the capital support arrangements in place to protect the Transferring Policyholders (as set out below). These changes do not reduce the level of capital support available to support policyholder benefit security for the Transferring Policies.

- The Scheme results in the Transferring Policyholders being exposed to the risks within PLAL. Such risks would only impact the Transferring Policyholders in the event that one of the other funds within PLAL was insolvent and any surplus assets available from within the NPL WPF were transferred to the fund. At the same time, the Scheme provides that such support could only be provided in a situation where there are no available assets in the PLAL SHF or PLAL NPF – a scenario which I consider to be of very low likelihood – and on terms which are no less favourable than arm's length commercial terms and will not detrimentally affect the reasonable expectations of the policyholders in the NPL WPF. The Scheme also removes the risk, however remote, that PLAL chooses to allow NPLL to become insolvent and does not provide support in excess of the level already provided.

## Capital Support

2.43. The Scheme simplifies the capital support mechanisms available to support the NPL WPF in meeting its guaranteed benefit payouts, where these payouts exceed the available policy asset share and any estate. A number of these mechanisms (which I describe in detail in Section 5) have been provided by the NPLL SHF and, as such, would need to be repaid in the event that a surplus over the amount required to meet guaranteed payouts arises in the fund.

2.44. As a result of the Scheme, there is no change to the total level of capital support available. However, two of the mechanisms (including one provided by the NPLL SHF) will be combined with the estate, removing the requirement to repay these in the event of a surplus arising over the amount required to meet guaranteed payouts arises in the fund. This would allow more of any surplus arising to be distributed to with-profits policyholders in the NPL WPF.

2.45. I am satisfied that these changes do not lead to a materially adverse impact on the benefit security of the Transferring Policyholders. I am also satisfied that these changes do not lead to an adverse impact on the benefit expectations of any of the Transferring Policyholders and will lead to a slight positive impact on the benefit expectations of with-profits Transferring Policies under scenarios where a surplus arises in the NPL WPF.

## Solvency II

2.46. The current regulatory solvency regime is expected to be replaced, on 1 January 2016, by a new regime known as “Solvency II”. Many of the principles of how this will operate are known, but not all the details, and there are some substantive issues that are yet to be formally approved.

2.47. It is important to realise that Solvency II does not change any of the assets, liabilities or risks in the Companies. These are the main determinants of benefit security. The new regime is intended to improve oversight of such risks, and to ensure strong minimum standards for the capital that must be held against each risk. It will also involve operational changes – for example, reporting and governance changes.

2.48. I note that Solvency II will impact the Companies irrespective of the Scheme – if it has an adverse (or positive) effect on a particular company, the effect will apply whether or not the Scheme occurs. Nevertheless, I would be concerned if a proposed Scheme meant that a group of policyholders moves into a company that will be badly affected by Solvency II to the extent that the benefit security of its policyholders was materially worse. For example, this might happen if a particular fund contained product types which incur heavier capital requirements under the new rules, meaning that its reported solvency position falls.

2.49. I have reviewed an estimate of the financial position of the Companies calculated under their current understanding of the likely Solvency II rules and estimates of the expected impact of the Scheme on this position. This analysis shows that while both Companies are expected to be able to meet their Solvency II capital requirements, in percentage terms, the ratio of capital resources to the capital requirements is expected to be lower on a Solvency II basis than on a Pillar II basis. This partly reflects the requirement to hold a prudent “risk margin” under Solvency II.

2.50. The Solvency II estimates showed PLAL to have a lower solvency ratio (taken as a ratio of the available capital resources to the Solvency Capital Requirement) than NPLL as at the date used. When taken as a ratio of the available capital resources to the Minimum Capital Requirement under Solvency II, the solvency ratio of PLAL was shown to be higher than that of NPLL. Given the uncertainty around these estimates, I place limited reliance on these comparisons and will revisit the estimated relative positions of the Companies under Solvency II in my Supplementary Report.

2.51. I note that the Solvency II regulations include "transitional" measures which could be used by the Companies (subject to approval from the PRA) to stagger the move from the current approach to the Solvency II approach for key elements of the solvency calculation. In addition, PLAL is investigating different actions that management could take to improve the solvency position on a Solvency II basis. PLAL has provided me with estimates of the impact of both the transitional measures (under a range of potential interpretations) and possible management actions and both are expected to improve the solvency position.

2.52. The impact of the Scheme is expected to be largely neutral on the solvency position of PLAL under Solvency II, reflecting the fact that the NPLL figures would be reflected in the PLAL Solvency II position on a look-through basis. There could be a risk to policyholders if they were moving from a company that was well-prepared for the move to Solvency II, and understood the implications for its solvency, to one that was poorly prepared. That is not the case under this Scheme. The Companies are all part of the same group and are part of the same implementation programme, and so no group of policyholders should be disadvantaged on this account.

2.53. Under the terms of a previous Court scheme, PLAL will set new tests before Solvency II is implemented with the objective that PLAL can meet its Solvency II Pillar 1 capital requirements in internally stressed scenarios. The adoption of the new tests and their parameters will be subject to the Regulators' non-objection. As a result, the PLAL Capital Policy will provide ongoing protection to all policyholders affected by the Scheme after Solvency II is implemented.

2.54. I will continue to monitor the impact of the Scheme in relation to Solvency II and will comment further in my Supplementary Report. In particular, I will comment on any developments concerning the PLAL Capital Policy and how it may be updated in light of Solvency II.

## Conclusion

2.55. I am satisfied that the Scheme will not materially adversely impact the benefit security of any group of policyholders.

## Governance

2.56. I am satisfied that under the terms of the Scheme there will be no materially adverse effect on the governance of the Transferring Policies because:

- As a result of the Scheme, the PLAL WPC receives some of the powers that the Supervisory Board previously held, as described in Section 3. These include the power to set bonus and investment policy for the NPL WPF, as well as a requirement for the PLAL Board to obtain the PLAL WPC's prior consent in relation to certain reserved matters, including the acquisition or disposal of any assets or business of or by the NPL WPF otherwise than for investment purposes. However, as a result of the Scheme, the management of the NPL WPF is generally the responsibility of the PLAL Board, subject to oversight by the PLAL WPC. This brings the management of the NPL WPF into line with the management of the other PLAL WPFs and with the current legal and regulatory framework (under which responsibility for the management of a regulated business is allocated to the board of directors).

- Various provisions from the NPLL Scheme governing the rights and obligations of the Supervisory Board are also replicated in the Scheme, such as the obligation for the PLAL WPC to have regard solely to the interests and reasonable expectations of policyholders in the NPL WPF when carrying out its duties in respect of the NPL WPF.

- Some provisions that currently exist under the NPLL Scheme are not being replicated and I provide an overview of these in Appendix 11. I am satisfied that these do not have a material bearing on the effectiveness of the fund governance (for example, because they were historical provisions, which are no longer relevant).

2.57. The governance arrangements relating to the Existing PLAL Policyholders will not change as a result of the Scheme other than as regards certain additional requirements set out in the Scheme which will apply to the composition and procedure of the PLAL WPC. In practice, the membership of the Supervisory Board and the PLAL WPC is currently the same and there will therefore not be any immediate changes to the membership of the PLAL WPC. However, including these provisions in the Scheme will ensure that the same requirements continue to apply to the composition of the PLAL WPC in future and therefore strengthen the governance protections for Existing PLAL Policyholders with with-profits policies.

## Service standards and investment management

2.58. The Scheme will not change the administration arrangements for any of the groups of policyholders. They will continue to be serviced by the same teams, using the same systems.

2.59. There will be no change to the method for allocating expenses to the assets shares of the Existing PLAL Policyholders with with-profits policies.

2.60. Expenses will be allocated to the NPL WPF in line with the current level of expenses and escalating in a similar manner to the approach currently used in the NPLL LTF.

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

## Tax considerations

2.62. I have reviewed information provided to me by the Companies and, on the basis of this information, I am satisfied that there should be no adverse tax effects on Transferring Policyholders or Existing PLAL Policyholders on account of the implementation of the Scheme. This is subject to the clearances referred to in Section 9 being received and other confirmatory matters being satisfactorily concluded.

## Policyholder Communications

2.63. I have reviewed the proposed approach to communicating the Scheme and its potential impact to the affected policyholders. While the Companies will be writing directly to the Transferring

Policyholders, they have applied for a waiver from writing to the Existing PLAL Policyholders. Given the other activity through which the Companies will advertise the Scheme (including advertising in a range of national newspapers) and the fact that I have concluded that I am satisfied that the Scheme will not have a materially adverse effect on the Existing PLAL Policyholders, I am satisfied that the proposed approach is reasonable.

2.64. Any policyholder or other person who feels they would be adversely affected by the Scheme may put their objections to the Company and/or the Court. I will consider these in coming to my view on the appropriateness of the Scheme, and will report as appropriate on the issues that are raised in my Supplementary Report.

## Excluded Policies

2.65. It is intended that all of NPLL's policies will be transferred under the Scheme. However, if it is not possible to transfer particular policies at the time the Scheme is implemented due to a legal or regulatory impediment, any such policies ("Excluded Policies") will be treated for all practical purposes in the same way as if they had transferred to PLAL until such policies are, in each case, separately novated or otherwise transferred to PLAL. As a result, I am satisfied that my conclusions in respect of the Transferring Policies apply equally to any Excluded Policies. Subject to the PRA providing certain certificates regarding the transfer and the parallel Overseas Schemes being sanctioned by the Overseas Courts, I am also not aware of any reason why there would be any Excluded Policies. I will review this position in my Supplementary Report and comment further in the event that it appears likely that there will be any material number of Excluded Policies.

## Costs of the Scheme

2.66. All costs and expenses incurred in preparing and implementing the Scheme will be borne by the PLAL SHF. None of the costs will be borne by Transferring Policyholders or Existing PLAL Policyholders, or be charged to those policies in future.

## NPLL Scheme – Paragraph 34 Requirements

2.67. As noted above, paragraph 34 of the NPLL Scheme outlines certain conditions regarding an application for the transfer of the business in NPLL to PLAL (then Pearl Assurance plc), such as that which would be effected by the Scheme, and the co-operation of the Supervisory Board. These conditions require that the transfer is such that:

> *"the interests and reasonable expectations of the holders of Policies allocated to the National Provident Life Fund and Excluded Policies would not be adversely affected by any such transfer and the protections afforded to holders of such Policies, whether pursuant to [the NPLL Scheme] or otherwise, would not, in aggregate, be reduced by such transfer."*

2.68. On the basis of the analysis, rationale and conclusions set out in the earlier paragraphs of this section, it is my opinion that the interests and reasonable expectations of the Transferring Policyholders will not be adversely affected by the Scheme and that the protections afforded to the Transferring Policyholders, whether pursuant to the NPLL Scheme or otherwise, will not, in aggregate, be reduced by the Scheme.

## Securitised Loan

2.69. As discussed in paragraph 3.47, NPLL is party to a securitised loan agreement (the "Securitised Loan Agreement"). The terms of the Securitised Loan Agreement restrict NPLL from transferring either its obligations under the Securitised Loan Agreement or the policies comprised within the Securitised Portfolio (as defined in section 3.47) unless it satisfies certain conditions or obtains certain consents. One exception to this restriction is where the policies comprised within the Securitised Portfolio transfer as part of a "Permitted Transfer", which includes a transfer under which all or substantially all of NPLL's business will be transferred to a single legal entity (which assumes all of NPLL's obligations under the Securitised Loan Agreement) and in respect of which two conditions are satisfied. These conditions are (i) the provision of a legal opinion to the trustee of the bonds (the "Bond Trustee") issued by the lender under the Securitised Loan Agreement (the "Issuer"), confirming that the transferee's assumption of NPLL's obligations under the Securitised Loan Agreement will be legal, valid, binding and enforceable, and (ii) confirmation from the rating agents that the transfer will not result in a downwards revision of the credit rating of the bonds or the bonds being placed on credit watch.

2.70. Under the terms of the Scheme, the Securitised Loan will be transferred to the new NPL WPF and continue to operate as now. The Scheme also includes certain additional protections which are designed to ensure that there are no adverse consequences for the bondholders or NPLL's counterparties under the Securitised Loan Agreement as a result of the Scheme. I also note that the Companies have entered discussions with the Bond Trustee regarding the proposed Scheme and have confirmed to me that they will seek to ensure that all formalities necessary for the transfer to constitute a "Permitted Transfer" will be satisfied prior to the Sanctions Hearing of the Scheme. In addition, with the aim of providing further comfort to the Bond Trustee, the Scheme includes a provision that provides that it will not become operative if to do so would constitute a breach of the terms of the Securitised Loan Agreement. Furthermore, the Companies have stated that they will not proceed with the Scheme if it is not confirmed to be a “Permitted Transfer”.

2.71. While I am not aware of any reason why the Scheme should not meet the criteria of a Permitted Transfer, I note that this is a legal question and I do not provide an opinion on it within my Report. The focus of this Report is on the potential effect of the decision to approve the Scheme on policyholders. As a result, my analysis is based on the policyholder position should the Scheme be approved in its proposed form – specifically including the transfer of the Securitised Loan. My analysis includes a comparison against the pre-Scheme position, which I believe to be materially consistent with the likely position should the Scheme not be approved for any reason (with the exception of any costs incurred by the Companies, which I would not expect to be material in the context of the overall financial position of the Companies and will be borne by the PLAL SHF).

## Conclusions

2.72. For the reasons set out above, I am satisfied that the Scheme will not materially adversely impact any group of policyholders.

2.73. I will keep these matters under review until the date of the Sanction Hearing and will draw any significant developments or changes that may affect policyholders to the attention of the Court in my Supplementary Report.

# 3. Outline of the Scheme

## Background and Purpose of the Scheme

3.1. The broad effect of the Scheme will be to transfer the entire long-term insurance business of NPLL to PLAL, bringing the management of the Transferring Policies in line with the management of the Existing PLAL Policies without adversely affecting the policy benefits.

3.2. If the Scheme is approved then, subject to the points noted in paragraph 3.63 below, it will become operative on the Transfer Date (expected to be the 6 April 2015) but will take effect, insofar as it creates rights and obligations that exist only between the Companies, on the Effective Date (1 January 2015), including for accounting purposes. As the Scheme transfers all policies in force at the Transfer Date (it does not, for example, exclude any new business written between the Effective Date and the Transfer Date) and the transfer actually occurs on the Transfer Date, I consider that date to be most pertinent for my analysis of the policyholder impact of the Scheme. I am satisfied that policyholders will not be adversely affected as a result of the Effective Date preceding the Transfer Date by the proposed period of time.

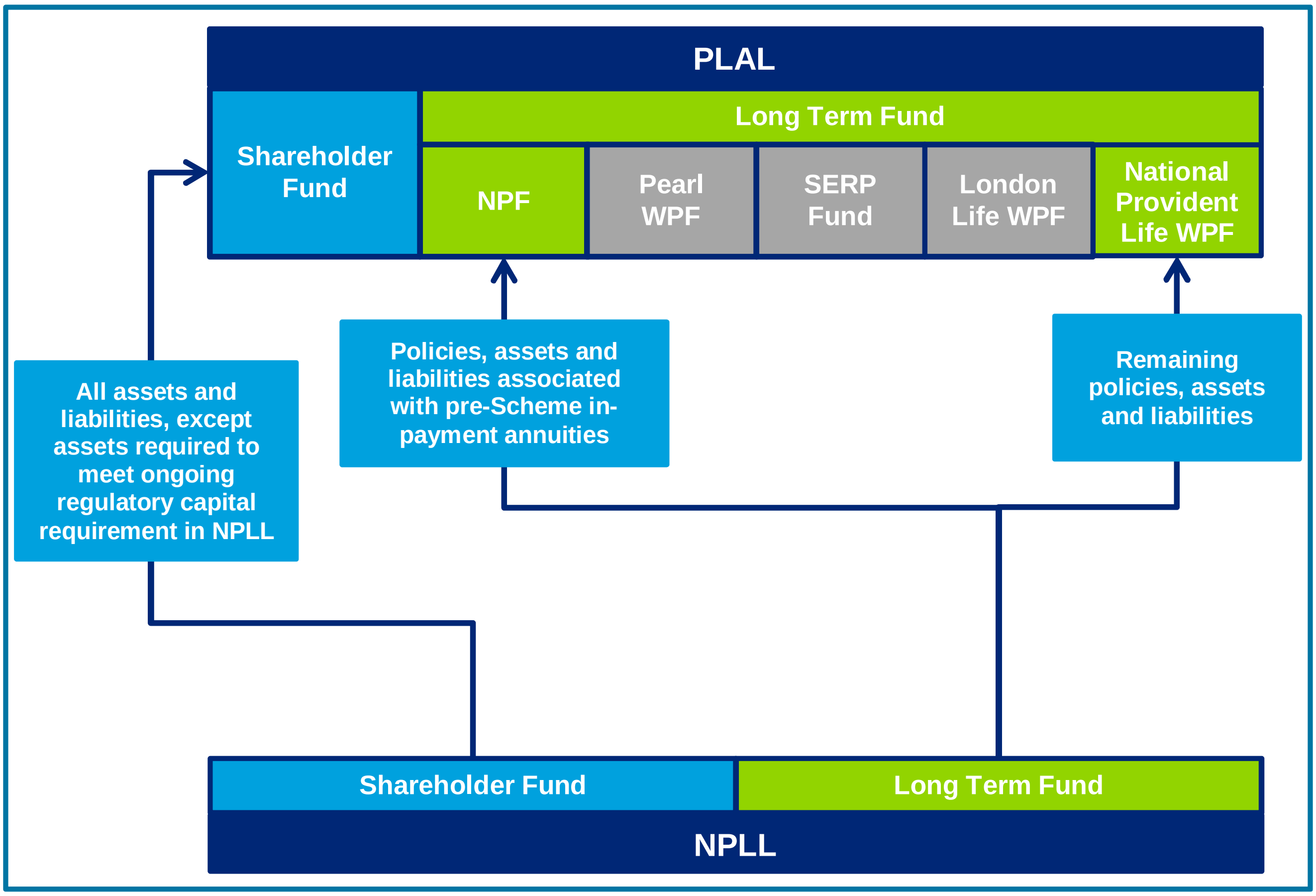
3.3. The main purpose of the Scheme is to:

- simplify the structure of the Phoenix Group by reducing the number of active life assurance companies in the group;
- improve the operational efficiency of the with-profits fund to which Transferring Policyholders are allocated and increase consistency of management practices and principles across the group, which should in turn result in efficiencies in governance, financial reporting and management information processes;
- increase the liquidity in PLAL after the transfer;
- improve the Pillar 1 capital efficiency of PLAL;
- reduce costs by simplifying the NPLL capital support structure; and
- facilitate the introduction of the Phoenix Life brand for Transferring Policyholders, bringing them in line with Phoenix Group's other long-term policyholders.

3.4. Following the Scheme, it is intended that NPLL will be de-authorised.

3.5. The effect of the Scheme is illustrated in Figure 3.1.

***Figure 3.1: Transfers under the Scheme***




3.6. I include in the remainder of this Section a more detailed outline of the Scheme, its purpose and its key features.

## Background to the Companies

3.7. PLAL is a wholly-owned indirect subsidiary of the Phoenix Group. NPLL is a wholly-owned, indirect subsidiary of PLAL.

3.8. Both PLAL and NPLL are generally closed to new business, but write limited amounts of new business in respect of increments to existing policies, the exercise of options under in-force policies and the addition of new members to existing group pension schemes. This will continue to be the case following the implementation of the Scheme.

## Previous Schemes

3.9. <u>The PLAL 2012 Scheme</u>

On 30 September 2012, a scheme was implemented (the "PLAL 2012 Scheme") under which all of the business of London Life Limited was transferred to PLAL. The Scheme also introduced some important changes to the management of PLAL:

- It established a new capital policy in PLAL. Details are contained in Section 5.

- It established four sub-funds in the PLAL long-term insurance fund (“PLAL LTF”):

  (i) The Pearl With-Profits Fund (“Pearl WPF”) – from which at least 90% of the surplus is payable to with-profits policyholders of the fund, with the balance being distributable to shareholders;

  (ii) The SERP Fund – if any surplus arises in this fund, it is payable to the policyholders in the fund;

  (iii) The London Life With-Profits Fund (the “LL WPF”) – all of the surplus of which is payable to the with-profits policyholders in the fund; and

  (iv) The Non-Profit Fund (the “PLAL NPF”) – from which all of the surplus is payable to shareholders.

- It enabled PLAL to introduce targeted asset allocation strategies within the Pearl WPF in future, notwithstanding any policy terms and conditions to the contrary, and subject to satisfaction of certain requirements and standards.

- It enabled PLAL, at a future date, to transfer non-profit policies held in PLAL WPFs to the PLAL NPF subject to specified conditions.

- It introduced provisions to allow for future wind-up or merger of the PLAL WPFs. This included the ability to close a with-profits fund and convert the remaining with-profits policies to non-profit once the fund had reduced to a certain size, subject to meeting a number of conditions designed to protect the interests of policyholders. Provisions were also included to allow for the amalgamation, wind up or division of unit-linked funds.

Further information on the PLAL 2012 Scheme can be found in Appendix 8.

3.10. <u>The NPLL Scheme</u>

On 1 January 2000, NPLL received, by way of a transfer made under Schedule 2C to the Insurance Companies Act 1982, all of the business of National Provident Institution (“NPI”). This is known as the NPLL Scheme. The NPLL Scheme sets out how the run-off of NPLL’s business should be managed. It includes provisions, for example, that cover the principles of financial management, expenses, reassurance and governance.

3.11. <u>The SERP Scheme</u>

On 15 February 2010, all of NPLL’s Self Employed Retirement Plan (“SERP”) business was transferred from the NPLL LTF to a newly created fund in PLAL, which was then called Pearl Assurance Limited, pursuant to a Part VII transfer under the FSMA. This is known as the “SERP Scheme” and the fund is now called the SERP Fund. The SERP Scheme also made amendments to the original NPLL Scheme described above, so as to provide for the creation of the Shareholders’ Equalisation Fund (“SEF”) as a separate sub-fund within the NPLL LTF. The assets in the SEF can be released to the NPLL SHF in accordance with a schedule in the NPLL Scheme. Further details about the SEF are set out in Section 5.

3.12. Under the terms of the Scheme, the NPLL Scheme will be disapplied and cease to have effect. This is because many of its provisions are no longer relevant or will be replicated by equivalent provisions in the Scheme.

3.13. Further information on the NPLL Scheme and the SERP Scheme can be found in Appendix 9.

## Transferring Policies

3.14. NPLL has generally been closed to new business since the implementation of the NPLL Scheme in January 2000, although it has issued 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.

3.15. The majority of the business in the NPLL LTF consists of unitised with-profits and unit-linked pensions, much of which contains guarantees. Table 3.2 below shows the current business held in NPLL. Note that figures may not always add up to totals exactly due to rounding.

***Table 3.2 – Business in NPLL as at 31 December 2013***

| Product Type | Number of policies | Gross Mathematical Reserves (£m) | Reinsured Mathematical reserves (£m) | Net Mathematical reserves (£m) |
|---|---|---|---|---|
| Non-profit annuities | 13,300 | 200 | 128 | 72 |
| Life (conventional with-profits) | 1,504 | 19 | 0 | 19 |
| Pensions (conventional with-profits) | 6,818 | 372 | 0 | 372 |
| Life (unitised with-profits) | 8,963 | 171 | 11 | 160 |
| Pensions (unitised with-profits) | 108,067 | 2,135 | 4 | 2,131 |
| Deposit administration | 922 | 22 | 0 | 22 |
| Life (unit-linked) | 4,993 | 76 | 75 | 1 |
| Pensions (unit-linked) | 121,203 | 1,715 | 1,672 | 43 |
| Life (index-linked) | 22 | 0 | 0 | 0 |
| Pension (index-linked) | 115 | 3 | 2 | 0 |
| Miscellaneous | 5,919 | 15 | 1 | 13 |
| **Total** | **271,826** | **4,728** | **1,895** | **2,834** |

*Source: NPLL PRA returns 2013*

## Excluded Policies

3.16. It is intended that all of NPLL's policies will be transferred under the Scheme. However, if it is not possible to transfer particular policies at the time the Scheme is implemented due to a legal or regulatory impediment, these Excluded Policies will be subject to an "Excluded Policies Reassurance Arrangement" provided for under the terms of the Scheme. Under this arrangement, the relevant policies will be treated for all practical purposes in the same way as if they had transferred to PLAL until such policies are, in each case, separately novated or otherwise transferred to PLAL.

### Overseas Policies

3.17. It is proposed that the transfer of any business written by NPLL in Guernsey or Jersey (and, in the case of Guernsey, to policyholders resident in Guernsey) (the "Overseas Policies") will be effected by way of separate Overseas Schemes in each of those jurisdictions. These schemes provide for the transfer of policies on the same terms as the Scheme and are expected to have the same Transfer and Effective Dates as the Scheme.

3.18. In the event that any Overseas Scheme is not sanctioned, then the Overseas Policies covered by the relevant Overseas Scheme will become subject to the Excluded Policies Reassurance Arrangement described in 3.16 above. The sanction of the Scheme is not dependent on the sanction of the Overseas Schemes.

### Allocation of Assets and Liabilities

3.19. Under the terms of the Scheme, all in-payment annuities in the NPLL LTF, together with all assets and liabilities relating to this business, will be transferred to the PLAL NPF. This includes certain annuity policies that are currently reinsured to the PLAL NPF, although in relation to these policies, apart from rights and obligations under the reinsurance, the only assets that will transfer to the PLAL NPF in respect of these annuities will be assets equal to the value of the realistic reserves held by NPLL for the expense risk in relation to these annuities (all other risks under this business being reassured to the PLAL NPF currently). The reinsurance arrangements in respect of these policies will collapse as a result of the Scheme.

3.20. All policies, assets and liabilities of the remaining long-term insurance business of NPLL will transfer to a new with-profits fund in PLAL, to be named the National Provident Life With-Profits Fund (the NPL WPF). This will include all of the assets and liabilities in respect of the Securitised Loan, which PLAL will assume under the terms of the Scheme.

3.21. The assets and liabilities of the NPLL SHF will transfer to the PLAL SHF under the Scheme. As a result, the subordinated loans referred to in paragraph 3.51 will collapse. Sufficient assets will, however, be left in the NPLL SHF to meet NPLL's remaining regulatory capital requirement (approximately £4m). These assets will be transferred to PLAL under the terms of the Scheme once the PRA has de-authorised NPLL.

## Changes to terms and conditions

### Transferring Policies

### Merger and closure of unit-linked funds

3.22. Under the terms of the NPLL Scheme, NPLL is currently entitled to close or amalgamate the whole or part of any linked fund, subject to policy terms and conditions.

3.23. Following the transfer, former NPLL unit-linked funds will be subject to the terms of the PLAL 2012 Scheme regarding unit-linked funds. In particular, this means that:

- PLAL will have the additional power to modify or enlarge the investment objectives of any former NPLL linked funds, this not being precluded by policy terms and conditions and having considered the interests of affected policyholders; and
- PLAL will be entitled to close any former NPLL linked fund where the assets in it fall below £5.9m, increased in line with inflation since 31 December 2011 (although the PLAL Board is given the discretion to close any such funds in other circumstances where it is administratively unfeasible to continue to maintain it), notwithstanding that such closure may be contrary to policy terms.

The PLAL 2012 Scheme provides that the Board must obtain the advice of the Actuarial Function Holder of PLAL as part of the process for exercising the power related to the investment objectives or their discretion in relation to the size at which a fund is closed. This is in addition to the Board's obligations under the TCF regulations. When a linked fund is closed, the standard provisions in the PLAL 2012 Scheme provide for affected policyholders to be given new units of an equal value in a different linked fund which, in the opinion of the PLAL Board, provides reasonably equivalent investment exposure. In addition, during the 12 months after the fund is closed, the policyholder is entitled to a free switch, even where such a switch is not permitted under the policy terms, into one or more funds which are available to their policy. PLAL must also consider whether compensation should be paid to any policyholders who were disadvantaged as a result of the closure, merger or other alteration of the linked fund.

## Merger and closure of the NPL WPF

3.24. NPLL is currently entitled to cease to maintain the NPLL LTF as a separate with-profits fund once the assets backing with-profits liabilities in the fund fall below a specified threshold (£500 million increased by RPI since 31 December 1999). The Scheme includes equivalent provisions by which the NPL WPF could be merged with another with-profits fund once the with-profits liabilities (gross of any reinsurance) fall below £750m, indexed in line with RPI from a base of 31 December 2013.

3.25. The Scheme incorporates winding-up provisions by which PLAL will be required to close the NPL WPF once its with-profits liabilities (gross of reassurance) fall below a certain threshold amount and convert the with-profits policies to non-profit policies. This threshold amount will be the same as applies to other with-profits funds within PLAL, namely £50m.

3.26. The ability to close a fund in this way is viewed by the Companies as a way of helping to ensure that policyholders are treated fairly, both in terms of the expenses they are charged and the way surplus in the fund can be distributed, when a with-profits fund has significantly run off. The Scheme and the PLAL 2012 Scheme include protections to ensure that the way in which policies are converted and the fund closed is fair, including the requirement for approval from PLAL's regulators and the requirement to pay a closure bonus. The closure bonus is a scale of guaranteed increases to the level of policyholder benefits, set at a level to distribute any surplus existing in the fund or that is likely to arise (calculated by the PLAL Board having obtained appropriate actuarial advice).

## Non-profit policies

3.27. Under the Scheme, annuities in payment in the NPLL LTF, including those which are currently reinsured to the PLAL NPF, will transfer to the PLAL NPF. There will be no changes to the terms and conditions of these or any other non-profit Transferring Policies.

## Existing PLAL Policies

3.28. The Scheme does not change the terms and conditions of any of the Existing PLAL Policies.

## Changes to NPLL Governance

3.29. Under the governance arrangements set out in the NPLL Scheme, a committee of the Board of NPLL called the National Provident Life Fund Supervisory Board (the "Supervisory Board") has to be appointed and maintained and has responsibility for the management of the NPLL LTF, including the investment and bonus policies.

3.30. Under the Scheme, the Supervisory Board will cease to exist.

3.31. Many of the rights and responsibilities of the Supervisory Board will be carried over by the Scheme as rights and responsibilities of the PLAL WPC in relation to the NPL WPF. These include the Supervisory Board's power to manage both the investment policy and the bonus policy of the transferring with-profits business. The PLAL Board will also have to obtain the prior consent of the PLAL WPC in respect of certain reserved matters, including those relating to the acquisition or disposal of assets and business by the NPL WPF other than for investment purposes. Various provisions governing the rights and obligations of the Supervisory Board are also replicated in the Scheme. These include requirements relating to the composition of the Supervisory Board, which will apply to the PLAL WPC following the implementation of the Scheme, including the requirement for a majority of non-executive members.

3.32. However, under the Scheme, responsibility for the management of the NPL WPF will, in general, lie with the PLAL Board rather than the PLAL WPC, although the management of the fund will still be subject to oversight by the PLAL WPC. This will bring the management of the NPL WPF in line with the way the other with-profits funds in PLAL are managed. It will also bring the management of the fund in line with the current legal and regulatory framework (under which responsibility for the management of a regulated business is allocated to the board of directors).

3.33. I note that the PLAL WPC and the Supervisory Board are currently made up of the same members.

3.34. A more detailed summary of these changes can be found in Appendix 11.

## Operation of the WPFs

### NPLL PPFM

3.35. The NPLL PPFM covers the with-profits business of the NPLL LTF, the sole long-term insurance fund of the company. After the Scheme, the PLAL PPFM will be amended to include a separate chapter relating to the NPL WPF. These changes are not specified by the Scheme itself, but I consider them to be directly related to the Scheme and, consequently, relevant for my consideration.

3.36. The NPL WPF will be operated largely in the same manner as the NPLL LTF following the Scheme and policyholders who were eligible to share in the distribution of surplus from the NPLL LTF will be eligible to share in all of the distributable surplus of the NPL WPF in the same way, should any surplus arise. The PLAL PPFM will describe how the NPL WPF will operate and will be updated to bring it into line with the requirements of the Scheme, which includes the following changes from the NPLL PPFM:

- policyholders who were eligible to share in the distribution of surplus from the NPLL LTF will be eligible to share in all of the distributable surplus of the NPL WPF in the same way, should any surplus arise;
- since the “Asset Share Charge Fund” and the “Capital Funds” will be combined into the estate as a result of the Scheme (as described in paragraph 3.50), the shareholder will give up the right to receive any support charges payable in respect of the Capital Funds and the right to receive any of the Capital Funds not required to help meet policyholders’ reasonable expectations (“PRE”);
- the other existing capital support arrangements (as outlined in paragraphs 3.46 – 3.48) will be changed immediately after the Effective Date so that they are treated as capital support drawn down, in the form of a loan, from the PLAL SHF into the NPL WPF in accordance with the PLAL Capital Policy. Subsequent support can then come from either the PLAL NPF or the PLAL SHF;
- although general responsibility for the management of the fund will lie with the PLAL Board, the PLAL WPC will have the right to determine bonus policy for the NPL WPF (consistent with the Supervisory Board’s powers in respect of the NPLL LTF); and
- post-transfer, the PLAL WPC will be responsible for setting investment strategy for the NPL WPF, consistent with the role of the Supervisory Board in respect of the NPLL LTF.

3.37. Other than the changes required as a result of the implementation of the Scheme and commented on in this report, the PPFM for the NPL WPF within PLAL will replicate all the key aspects of the current PPFM of NPLL. In particular, I note that:

- the assets in the NPL WPF will continue to be managed in the asset pools currently defined. Asset shares, asset pools, bonus rates and surrender values will continue to be calculated in the same way as they are currently. The process for allocating investment returns to asset shares set out in the PPFM will continue to apply and there will be no change to the principles relating to taking discretionary charges from asset shares;
- the Scheme will not change the investment policy for the NPL WPF. In particular the Scheme will not affect the asset mix for asset shares and will not change the way in which the assets backing the guaranteed benefits are invested; and
- tax will be allocated to the NPL WPF as if the life business within the fund formed a standalone mutual life assurance company. This is in line with current practice for the NPLL LTF and will not result in any change in the tax allocated to the fund or the asset shares. Any proposal to change the basis of this allocation would require the consent of the PLAL WPC

## PLAL PPFM

3.38. After the implementation of the Scheme, the Pearl WPF, the SERP Fund and the LL WPF will operate in the same way as they currently operate.

## Additional workings of the NPL WPF

### Reallocation of non-profit policies

3.39. The Scheme will allow PLAL to re-allocate non-profit vesting annuities and other non-profit policies from the NPL WPF to the PLAL NPF. I understand that it is management's intention that this power will be used in future to set up new annuities in the PLAL NPF, subject to the constraints below, rather than wholly reassuring the policies to the PLAL NPF, as happens now. Any such reallocation will only be done provided that:

- the reallocation is not contrary to policy terms and conditions; and
- assets with a market value which is fair and equitable (in the opinion of the PLAL Board, having obtained appropriate actuarial advice) are also transferred from the NPL WPF to the PLAL NPF.

### Allocation of expenses and charges

3.40. The NPLL Scheme includes a requirement to apply charges and expenses to the NPLL LTF on a specified basis for ten years following the implementation of the NPLL Scheme. This requirement expired on 31 December 2009 and, following that date, the NPLL Scheme provides that the amounts charged in respect of administration and investment management should at no time exceed the charges for similar services made by third party companies or significantly exceed the costs which NPLL would incur in carrying out such services itself. Such an assessment is difficult to make accurately and, in practice, this requirement in respect of administration expenses has been met by continuing the previous rate of increase (RPI + 1%).

3.41. The Scheme provides for administration expenses to be set at their level immediately prior to implementation of the Scheme and then continue to increase in line with inflation (RPI plus 1%). However, the Scheme also provides that, at any time following the Transfer Date, the PLAL Board may, and shall where so requested by the PLAL WPC, review those expenses and make such changes as are approved by the PLAL WPC. The Scheme also provides for investment management expenses to be charged on a basis agreed by the PLAL WPC. In each case, these provisions also remain subject to applicable laws and regulations from time to time (including any regulations made by the Regulators regarding the allocation of costs and charges to with-profits funds).

3.42. Aside from the above, the Scheme provides that, subject to applicable laws and regulations from time to time (including any regulations made by the Regulators regarding the allocation of costs and charges to with-profits funds), the PLAL Board, having obtained appropriate actuarial advice, will generally determine the expenses and charges relating to the operation of the NPL WPF.

## Changes to the Capital Policies

### NPLL Capital Policy

3.43. The NPLL Capital Policy currently applies to the Transferring Policies. Following the implementation of the Scheme, the PLAL Capital Policy will apply to the transferring business. I discuss the capital policies in detail in Section 5.

3.44. Under the NPLL Capital Policy, the levels of capital targeted in excess of the regulatory capital required for two of the tests are expressed as absolute amounts. Based on the financial position as at 31 October 2014, these absolute amounts represented a lower percentage margin over the Pillar 1 Capital Resource Requirement ("CRR") and the Pillar 2 Individual Capital Assessment ("ICA") than targeted under the PLAL Capital Policy.

### PLAL Capital Policy

3.45. The Scheme itself does not change the PLAL Capital Policy, which will continue to apply to the Existing PLAL Policyholders. However, the PLAL Board intend to change the percentage target that will be applied to the Pillar 1 CRR of the with-profits funds when calculating the capital target under the PLAL Capital Policy following the Scheme. The change is designed to ensure that the overall capital targeted under the PLAL Capital Policy does not change as a result of the Scheme. The specific parameter will be calculated nearer to the point the Scheme becomes operative in order that this objective is achieved. This change does not represent a change in the overall level of protection targeted by the PLAL Capital Policy.

## NPLL capital support mechanisms

### Pre-Scheme

3.46. NPLL has two inter-group loans in force, worth a combined £89m, which are from PLAL to the NPLL SHF (the "Subordinated Loans"). The ability to recognise one of these loans as Pillar 1 capital resources is restricted, with the result that the Subordinated Loans contribute £63m of capital resources on a Pillar 1 basis. The full value is recognised on a Pillar 2 basis.

3.47. In 1998, NPI raised £260m of capital (the "Securitised Loan") secured on the emerging surplus (primarily based on annual management charges less administration expenses) relating to most of the unitised with-profits and unit-linked business then in-force (the "Securitised Portfolio"). The rights and obligations under the Securitised Loan transferred to NPLL under the NPLL Scheme. The surplus emerging each year on the Securitised Portfolio is payable to the bondholders, subject to a cap of the amount set out in a fixed schedule of repayments. There is currently £94m of this loan outstanding and the last repayments are due to be made in 2022.

3.48. In addition, there are a complex set of capital support arrangements in place for the NPLL LTF. Under these, the costs of guarantees, that cannot be met by the remaining estate, are met in turn by:

- the "Capital Funds";
- the "Asset Share Charge Fund";
- the "SEF";
- the "Original Earmarked Portfolio"; and

- the “New Earmarked Portfolio”.

With the exception of the Asset Share Charge Fund, all these capital support mechanisms represent shareholder assets which would only be repaid in the event that asset shares and any estate are sufficient to meet the guaranteed policy payouts.

3.49. Further information on the NPLL capital support mechanisms can be found in Section 5.

## Post-Scheme

3.50. The existing capital support is to be simplified by:

- combining the Capital Funds and the Asset Share Charge Fund with the NPL WPF estate; and
- collapsing the Original and New Earmarked Portfolios and the SEF so that they are treated as capital support drawn down, in the form of a loan, from the PLAL SHF into the NPL WPF in accordance with the PLAL Capital Policy.

The terms of the shareholder loan will be such that it will only be repayable if the financial condition of the NPL WPF allows it.

3.51. The Subordinated Loans will collapse on implementation of the Scheme since the assets and liabilities of the NPLL SHF will transfer to PLAL under the Scheme.

3.52. The Securitised Loan will be transferred to the new NPL WPF and continue to operate as now.

3.53. In the event that the value of the assets of the NPL WPF falls below the regulatory minimum value of assets which must be held in that fund plus 0.5% of the total retrospective reserve in respect of that fund (or £5m if greater), support will be provided to that fund by way of a loan or other contribution arrangement from the PLAL SHF or the PLAL NPF to the extent that the PLAL Board determines there are assets in those funds available to make such a loan.

## Reinsurance arrangements

3.54. The material reinsurance agreements NPLL has in-force are:

- an agreement with PLL covering incremental unit-linked business and expenses on incremental unitised with-profits business written since 1 January 2000;
- an agreement with PLL under which NPLL wholly reinsures its internal investment-linked funds;
- an agreement with PLAL under which the unitised with-profits element of the Portfolio Bond product are reinsured to the Pearl WPF of PLAL;
- an agreement with PLAL under which expenses on incremental unitised with-profits pensions business written since 1 January 2000 are reinsured to the Pearl WPF of PLAL; and
- two agreements with PLAL under which annuities set up after 31 March 2012 and before January 2000 are reinsured to the NPF of PLAL.

3.55. Since all policies, assets and liabilities relating to those annuities of NPLL that are currently reinsured to the PLAL NPF will be transferred to the PLAL NPF, the reinsurance arrangements in respect of these policies will collapse as a result of the Scheme.

3.56. Those treaties involving reinsurance of unitised with-profits business from NPLL to PLAL will be replaced by the Scheme with inter-fund agreements in PLAL, having the same financial impact as the current reassurance treaties.

3.57. Under the Scheme, PLAL will become party to both reinsurance treaties that are currently in place between NPLL and PLL. These treaties will continue to provide cover in the same way as they did before the Scheme.

3.58. See Appendix 10 for more detail of these intra-group reinsurance arrangements.

3.59. NPLL has a number of additional reinsurance agreements in-force that fall beneath the level of materiality required for them to be disclosed in the regulatory returns. Where these agreements are with PLL or an external party, they will be transferred under the Scheme. Where these agreements are with PLAL, they will collapse or be replaced with inter-fund agreements.

3.60. The Scheme will permit PLAL to put in place inwards, outwards or internal reinsurance arrangements involving the NPL WPF provided that:

(i) The PLAL Board has taken appropriate actuarial advice, and that advice has been that the proposed reassurance is unlikely to affect adversely the reasonable expectations of policyholders in any affected fund.

(ii) The terms of the reassurance have been approved by the PLAL WPC.

This is consistent with the requirements of the NPLL Scheme.

## Service arrangements

3.61. The Scheme will make no changes to the management of the assets or the servicing arrangements for Existing PLAL Policies or Transferring Policies. Following the Scheme, correspondence to Transferring Policyholders will use the Phoenix Life brand and the payee name on future payments to these policyholders will be changed. Transferring Policyholders will be directed to the Phoenix Life website which will be updated to include details relevant to NPLL business.

## Costs of the Scheme

3.62. All costs and expenses incurred in preparing and implementing the Scheme will be borne by the PLAL SHF. None of the costs will be borne by Transferring Policyholders or Existing PLAL Policyholders, or be charged to those policies in future.

## Securitised Loan requirements

3.63. In order to provide comfort for the Bond Trustee regarding the effect of the Companies making the application for approval of the Scheme, the Scheme provides that it will not become operative if it would result in a breach of a covenant in the Securitised Loan Agreement which restricts NPLL from transferring the policies comprised within the Securitised Portfolio other than with the consent of the

Issuer or in a situation where the transfer is a "Permitted Transfer". A "Permitted Transfer" is a transfer under which all or substantially all of NPLL's business will be transferred to a single legal entity (which assumes all of NPLL's obligations under the Securitised Loan Agreement) and in respect of which two conditions are satisfied, namely (i) the provision of a legal opinion to the Bond Trustee, confirming that the transferee's assumption of NPLL's obligations under the Securitised Loan Agreement will be legal, valid, binding and enforceable, and (ii) confirmation from the rating agents that the transfer will not result in a downwards revision of the credit rating of the bonds or the bonds being placed on credit watch. Under the terms of the Scheme, all of NPLL's business will transfer to PLAL and, as noted in section 3.20, PLAL will assume all of NPLL's assets and liabilities in respect of the Securitised Loan. The Companies intend to satisfy the other conditions to the transfer constituting a "Permitted Transfer" prior to the Sanctions Hearing. I will report on this in my Supplementary Report.

# 4. The Role of the Independent Expert

## Overview

4.1. For Schemes of this type, the Independent Expert is required to prepare a scheme report in a form approved by the PRA having consulted the FCA and in accordance with the guidance contained in SUP 18. Its purpose is to assist the Court in deciding whether to sanction the Scheme. This Report is the Independent Expert scheme report for the Scheme described in paragraph 1.2.

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

- Transferring Policyholders, which in the case of the Scheme are the holders of designated policies in NPLL; and
- Existing PLAL Policyholders, whose policies do not move under the Scheme.

Where relevant, I have separately considered the effect of the scheme on the holders of different types of policies within a group. In particular, in my assessment of the effect of the Scheme on the benefit expectations of policyholders, I have considered the holders of with-profits, unit-linked and non-profit non-linked policyholders separately. This reflects the different extent to which management actions can impact the level of policyholder benefits payable.

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

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

- policyholders’ benefit expectations, including the level of guaranteed benefits, charges, tax effects, preservation of any options available under a policy and, for with-profits policyholders, the expected level of discretionary benefits, investment freedom and bonus prospects. In opining on the effect on policyholders’ “benefit expectations” I have in mind what would happen in normal conditions, and typical variations in those conditions. It may be that in very extreme conditions, a fund may be forced to take unexpected actions that could change benefit levels. My opinions are not given in that context. However, I am not aware of anything in the Scheme which would cause a systematic reduction in benefit expectations in such circumstances relative to what would have happened in its absence;
- the security of policyholders’ benefits, including a review of the levels of financial support

available to the different groups;

- for unit-linked policies, the level of charges, the approach to unit pricing and any changes to the investment fund mandates or the range of choice of funds; and

- service levels.

4.5. I have also considered:

- the adequacy of safeguards in the Scheme to protect the ongoing interests of different groups of policyholders;

- the impact of the Scheme on reinsurance contracts;

- the adequacy of the communications made to policyholders concerning the Scheme; and

- any other matters drawn to my attention by the Regulators or required by the Regulators to be addressed within the Report.

4.6. The effect of the Scheme on policyholders will depend on the type of policy held and I have considered the following groups separately:

- with-profits policyholders;

- unit-linked policyholders; and

- other non-profit policyholders.

4.7. I have considered whether there are any previous Court schemes that created particular rights or protections for Transferring Policyholders which might be lost as a result of the Scheme. I discuss this in the following sections. In particular, I have considered the requirements under the NPLL Scheme as set out below.

## NPLL Scheme Requirements

4.8. I have considered the rights and protections built into the NPLL Scheme and discuss these in detail as part of my analysis of the impact of the Scheme in later sections of this Report.

4.9. I also note that paragraph 34 of the NPLL Scheme contains a provision which specifically contemplates a potential further transfer of NPLL's long-term insurance business to PLAL. This paragraph provides that NPLL and PLAL may make an application to the Court for such a transfer and the Supervisory Board shall co-operate to the extent necessary to obtain the sanction of the Court for such a transfer, provided that the interests and reasonable expectations of the NPLL policyholders would not be adversely affected by any such transfer and the protections afforded to holders of such Policies, whether pursuant to the NPLL Scheme or otherwise, would not, in aggregate, be reduced by such transfer.

4.10. My primary duty as an Independent Expert is to the Court, and notwithstanding the fact that the Supervisory Board must, and has, satisfied itself that the terms of paragraph 34 have been met, I recognise that it may help the Court for me to state my actuarial opinion on the compliance of the Scheme with the proviso set out in paragraph 34 of the NPLL Scheme. Consequently, in considering the impact of the proposed Scheme on the Transferring Policyholders, I have considered whether the proviso set out in paragraph 34 of the NPLL Scheme has been satisfied and framed my conclusions about the overall effect of the Scheme on these policyholders accordingly. I note in this context that the terms of paragraph 34 require that there is no adverse effect on the interests and reasonable expectations of the Transferring Policyholders. This might be understood to mean that no individual change brought about by the Scheme may have an adverse effect. However, as noted in paragraph 4.3 above, it is almost inevitable in the context of such a transfer that there will be some advantages and some disadvantages to the various groups of affected policyholders, and I have therefore considered the effect of the changes as a whole and, particularly when considering the effect on benefit security and benefit expectations, having regard to the materiality of the changes. However, I note that my opinion does not constitute a legal opinion on how the provision should be interpreted.

## Exclusions

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

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

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

4.14. As the Independent Expert I was not directly involved in the formulation of the proposed Scheme, although I provided guidance to the Companies during the evolution of the detailed proposals on those issues which were of concern to me, or which I considered unsatisfactory.

# 5. Capital Requirements and Capital Policies

## Introduction

5.1 In this Section, I explain the capital requirements that the Companies must satisfy under UK regulations and the internal capital policies and capital support arrangements that are in place within the Companies.

5.2 As the Independent Expert, I am required to consider the effect of the Scheme on policies transferring from NPLL, and those currently in the receiving company, PLAL. A central part of my considerations is the security of policyholder benefits and the impact of the Scheme on this security. For example, I would be concerned if the Scheme moved some policies from a financially strong fund to a weak one which might not be able to honour its obligations to policyholders.

5.3 My analysis of the impact of the Scheme on policyholder security depends heavily on the level of capital available to the Companies, and their ability to satisfy their respective solvency requirements now and in the future. In addition to holding assets sufficient to meet expected claims and payments on policies, life insurance companies maintain additional assets, known as available capital or capital resources. These resources provide additional security to policyholders by acting as a buffer against losses. If the experience of a company is worse than expected, for example due to investment losses or annuitants living longer than expected, the available capital is intended to be sufficient to absorb the resultant losses whilst still leaving sufficient assets to meet expected policyholder liabilities.

5.4 To protect policyholders, the UK regulatory system mandates certain minimum levels of capital that are required to be held at all times. The regulations place restrictions on the use of such capital (for example, it is unlikely to be permissible to distribute such capital in the form of dividends), particularly where it is part of a with-profits fund in which discretionary benefits are expected to be paid beyond the minimum policy guarantees.

5.5 I discuss these matters at an entity level in this Section of the Report, and my overall conclusions in respect of each different group of policyholders are set out in Sections 6 and 7.

## Background to the Current Supervisory Regime

5.6 The Regulators are responsible, amongst other things, for the supervision of UK authorised insurance companies. A key aim of the PRA's supervisory regime is to contribute to the securing of an appropriate degree of protection for policyholders, ensuring that there is a sufficiently high probability that an insurer is able to meet claims from, and material obligations to, policyholders as they fall due. Since life insurance business can be very long-term with some contracts lasting for 30 years or more, it is necessary to set solvency standards and monitor insurance companies regularly against those standards. No supervisory regime can ensure that every company will remain solvent in all possible circumstances, but a good one will ensure that the chance of an insurance company becoming insolvent is remote. Furthermore, a good regime acts as an early warning system, permitting remedial action to be taken if a company gets into financial difficulty.

5.7 UK insurance companies are required to report their solvency positions to the PRA in two ways, referred to as Pillar 1 and Pillar 2.

5.8 Pillar 1 is based on existing European Union regulatory requirements. Assets are taken at market value and reserves are set up to cover a fund's liabilities. These liabilities (which for the base Pillar 1 calculations exclude non-guaranteed discretionary payments) are valued using assumptions that include prudent margins. Solvency capital, expressed as a percentage of reserves and of sums at risk (the excess of guaranteed benefit over reserves held), must be held in addition to the base reserves. The additional solvency capital is known as the Long Term Insurance Capital Requirement ("LTICR"). This set of calculations is commonly referred to as the "regulatory peak", or "Peak 1".

5.9 Companies such as PLAL and NPLL, which have with-profits liabilities in excess of £500m, are also required by UK regulations to report under Pillar 1 on a "realistic basis". In this second calculation, assets are again taken at market value, while liabilities include allowance for any non-guaranteed benefits that are expected to be paid. The liabilities are valued using best estimate assumptions. A Risk Capital Margin ("RCM") is held in addition to the realistic liabilities, reflecting the additional capital that would be needed in moderately adverse scenarios specified in the regulations. These calculations are referred to as the "realistic peak", or "Peak 2".

5.10 If the excess assets under the realistic peak are less than the excess assets under the regulatory peak, then an addition, called the WPICC, is made to the regulatory peak capital requirements to ensure that the more onerous requirement of the two peaks is met under Pillar 1 reporting.

5.11 For companies subject to the realistic peak requirements, the CRR is set equal to the sum of the LTICR and any WPICC.

5.12 The main Pillar 1 focus of my analysis will be the realistic peak as the Transferring Policies are moving from a with-profits fund within NPLL to a with-profits fund within PLAL. Benefit security for policies in the latter is provided by surplus in PLAL as a whole (i.e. not just the surplus in the with-profits fund itself), and the solvency figures in this Report cover PLAL as a whole.

5.13 Pillar 2 requires that each company undertakes its own ICA. The ICA is based on an analysis of the various risks affecting the company (including market, credit, insurance, operational and liquidity risks), the strains that would arise under various stress and scenario tests, and an overall assessment of the amount and type of capital required to meet those risks. Companies can set their own risk tolerance which must be based on a confidence level at least as high as the PRA's minimum standard of a 99.5% solvency confidence level over one year. The ICA analysis is typically reported to the PRA each year. The PRA may issue Individual Capital Guidance ("ICG") if it feels that the ICA is insufficient to meet the minimum 99.5% confidence level. This adds to the company's capital requirement and may occur, for example, if the PRA is not satisfied with the severity of the stress scenarios used by the company, or if it is not satisfied that the company has fully taken into account all of its risks. This means that a company with sufficient capital to meet its ICA and ICG should (at least) be able to withstand an event, or combination of events, equivalent to a "once-in-200-year" shock, and still be able to meet its "best estimate" liabilities.

5.14 Companies are required to publish their Pillar 1 calculations each year and these are externally audited. Pillar 2 figures are not published or audited and are commercially sensitive; however, the Companies have made their Pillar 2 figures available to me in my role as the Independent Expert for the Scheme. I have reviewed the Companies' estimated Pillar 1 and Pillar 2 figures pre- and post-

Scheme as at 31 October 2014, to assess the impact of the Scheme on the security of policyholders' benefits, and I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015). Although the Pillar 2 calculations are not shown in my Report, I have included a qualitative summary of the relevant findings from the Pillar 2 analysis. I will keep this situation under review in the period leading up to the Sanction Hearing and will comment on any changes in my Supplementary Report, to the extent that they impact my conclusions.

## Comparing policyholder benefit security and capital policies

5.15 The security of policyholder benefits is related to the capital available within the Companies to meet their policyholder obligations as they fall due.

5.16 Companies will usually choose to hold a level of capital in excess of the capital requirements determined under the above Pillar 1 and Pillar 2 assessment, if only because they will want to ensure that they can continue to meet their solvency requirements after an adverse event, or in order to satisfy rating agency requirements, or their own internal capital standards. The minimum level of capital that a company wishes to hold is often set out in an internal capital policy. The capital policies of PLAL and NPLL are explained later in this Section.

5.17 I consider the use of solvency ratios, such as the ratio of available capital to capital requirements, to be a useful indicator of the immediate impact of the Scheme on the level of benefit security provided to policyholders, especially where the "before" and "after" ratios are calculated using consistent methods and assumptions, as is the case in this Report. Where these ratios increase, it might imply, other things being equal, more security for policyholders immediately following the Scheme. The Companies have estimated these ratios on a Pillar 1 and Pillar 2 basis for each Company, and I have considered these in forming my opinion, having reviewed any significant changes for reasonableness.

5.18 Whilst the impact on the solvency position at the time of the Scheme is important, I would be concerned if subsequent actions meant that any of the Companies could be weakened in future to the extent that there was a material adverse impact on the security of policyholder benefits. This could happen, for example, through the payment of excessive dividends to shareholders. The constraint on the extent of such action in any of the Companies is its capital policy, since this is in all cases stronger than the regulatory requirements. Hence, in considering the level of benefit security afforded to policyholders, I have placed heavy emphasis on the strength of the capital policies.

5.19 My assessment of the relative strength of the capital policies includes consideration not only of the level of capital targeted under each capital policy, but also the governance around future changes to the capital policies, particularly where such a change would result in a reduction in the amount of capital held.

5.20 Having capital in excess of the level required under the capital policy of any company is helpful, but where it could potentially be removed at any future point, for example, via the payment of dividends, I have placed limited weight on it. If a group of policies moves to a company with lower current solvency ratios but these are still well in excess of regulatory requirements and the new company has a stronger or equivalent capital policy, I would generally not consider that to be "materially adverse", as long as the capital policy provides a good minimum ongoing level of financial strength and cannot be weakened arbitrarily in future.

## Date of Solvency Calculations

5.21 The estimated impact of the Scheme on the Pillar 1 solvency positions of the Companies has been determined with reference to market conditions at 31 October 2014.

5.22 All Pillar 2 analysis is based on the estimated position as at 31 October 2014.

5.23 I recognise that the economic position at the Transfer Date of the Scheme cannot be predicted with certainty, and so the absolute solvency levels are likely to differ from those shown in this Report. However, I would not expect the impact of the Scheme to vary much from the estimates shown, and it is this impact which is my prime consideration (assuming that the Companies are still expected to meet their various solvency requirements, as is the case). I will keep the position under review, and will prepare further information in my Supplementary Report if appropriate.

## PLAL Capital Policy

5.24 The PLAL Capital Policy was set out in the PLAL 2012 Scheme, which was approved by the Court in 2012. Adherence to this policy results in PLAL holding more capital than the regulatory minimum amounts required by the PRA under Pillar 1 and Pillar 2. The objective of the policy is to ensure that, based on various tests, the Companies can continue to meet the PRA's capital requirements in internally specified stress scenarios. These stress scenarios have regard to the risk appetite that the PLAL Board has set, which at present is of PLAL having a 1 in 20 chance over a one year time period of failing to meet its Pillar 1 capital requirements or the PLAL Board's assessment of its capital requirements as set out in its Pillar 2 capital assessment. The results of this scenario testing are the percentages in the tests below, which are reviewed annually to ensure the capital policy continues to meet its objective. As a result, the percentages may change as the business in PLAL changes to maintain the strength of the policy.

5.25 The PLAL Capital Policy refers to the most onerous of three main tests based on:

- A margin over Pillar 1 capital requirements. This is the greater of ((175% x LTICR) – WPICC) and any positive free assets for the PLAL WPFs. The corresponding figure for the NPFs is (70% x CRR (including that of NPLL)) – (100% x sum of positive free assets for each WPF), with an overall negative result allowed for the NPF. The two requirements are then summed.
- A margin of 40% of ICA over the Pillar 2 ICA requirement.
- A margin of 10% over any Pillar 2 ICG requirement.

5.26 Additionally, the policy considers a further liquidity test under which there is a requirement to hold a certain level of liquid capital in order that there would be sufficient assets in the PLAL NPF and/or PLAL SHF to be able to cover the PLAL NPF's regulatory liabilities and to make any loans into the PLAL WPFs that would become necessary in the extreme events considered under the policy. This test currently requires liquid capital of £60m to be held.

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

5.28 The terms of the Court-approved PLAL Capital Policy also include specific provisions dealing with their future amendment. These include provisions enabling the PLAL Board to change the stress scenarios used to determine the parameters in the PLAL Capital Policy from time to time in order to reflect a change to the risk appetite which the Board has set providing that, to the extent that such a change would have the effect of reducing the amount of capital required to be held by PLAL, PLAL must obtain a certificate from an independent actuary to the effect that, in his or her opinion, the proposed change to the stress scenarios is unlikely to have a material adverse effect on the interests of PLAL policyholders.

5.29 PLAL and Phoenix Life Holdings Limited ("PLHL") have undertaken to the Court that additional capital in liquid assets is held available by PLHL and PLAL to support PLAL and NPLL in addition to the capital held under the terms of the PLAL Capital Policy. On implementation of the Scheme, this capital will become solely available for the use of PLAL, as there are not expected to be any policies retained in NPLL. It will continue to provide protection to the same groups of policyholders as before (i.e. both the Existing PLAL Policyholders and the Transferring Policyholders).

5.30 The operation of PLAL and the funds within it are governed by the PLAL 2012 Scheme, detailed in Appendix 8, and this will continue to apply to the existing PLAL business after the Scheme has taken place.

## Capital Policy applying to Transferring Policies

### Current NPLL Capital Policy

5.31 The NPLL Capital Policy refers to the most onerous of three tests based on:

(i) an absolute margin of £50m over Pillar 1 capital requirements;

(ii) an absolute margin of £50m over the Pillar 2 ICA requirements; and

(iii) a margin of 10% over any Pillar 2 ICG requirements.

5.32 The NPLL Capital Policy is not set out in a Court-approved Scheme. It is, however, subject to annual review by the NPLL Board, targeting the same risk appetite as is used by the PLAL Board in setting the PLAL Capital Policy. As the result of an agreement with the Regulators, any changes to the NPLL Capital Policy that would reduce the amount of capital required, proposed before 31 December 2016, need to be approved in advance by the Regulators.

### PLAL Capital Policy

5.33 Following the Scheme, the PLAL Capital Policy will apply to the Transferring Policies.

5.34 Following the Scheme, it is intended that the PLAL Capital Policy will be changed so that the Scheme itself does not result in a change in the amount of capital targeted by it. Under the PLAL Capital Policy as it is currently applied, the calculation includes amounts in respect of the Pillar 1 and Pillar 2 capital requirements of NPLL. Currently, as a subsidiary of the PLAL SHF, the amount of capital targeted in respect of NPLL under the PLAL Pillar 1 test is set at 70% of its contribution to PLAL's CRR (which in the case of NPLL is equal to the LTICR). Following the Scheme and under the current PLAL Capital Policy, the contribution of the NPL WPF to the PLAL Pillar 1 target would be based on 175% of the LTICR, leading to an increase in the overall amount of capital targeted in

PLAL that is much greater than would have been implied by the immaterial change in Pillar 1 requirements expected as a direct result of the Scheme. In order to maintain the capital target in line with the approved risk appetite of PLAL, the PLAL Board intends to change the parameter used to calculate the contribution of the PLAL WPFs to ensure that the Scheme does not change the overall level of capital held in respect of PLAL, where there is not an underlying change in CRR. As at 31 October 2014, the appropriate parameter reduction would have been from 175% to 110%, which would have resulted in a £0.6m increase in the margin required under the Pillar 1 capital test. The actual change in the parameter will be calculated nearer to the Transfer Date to help ensure that the objective of maintaining a constant capital target is achieved and will be subject to approval by the PLAL Board at that time. The PLAL Board also intend to increase the amount of liquid capital that will be held in PLAL following the Scheme from £60m to £76m, reflecting the inclusion of the NPL WPF.

5.35 The amount of capital, when expressed as a percentage margin, required to be held over the Pillar 1 and Pillar 2 regulatory capital requirements is currently lower in the NPLL Capital Policy than under the PLAL Capital Policy. Under the NPLL Capital Policy, the levels of capital targeted in excess of the regulatory capital required for two of the tests are expressed as absolute amounts. Based on the financial position as at 31 October 2014, these absolute amounts represented a lower percentage margin over the Pillar 1 CRR and the Pillar 2 ICA than targeted under the PLAL Capital Policy. Given that both capital policies are set by the respective Boards to target the same risk appetite, even if the opposite were to occur at some point in the future (absent the Scheme), I would not consider it significant to considerations of relative policyholder benefit security.

5.36 The PLAL Capital Policy represents a stronger shareholder commitment in that it is contained in a Court-sanctioned scheme and is dynamic in operation, since it operates by reference to percentages over particular capital requirements, rather than by reference to fixed amounts.

## NPLL capital support mechanisms

### Current capital support mechanisms

5.37 NPLL has two inter-group loans in force which are from PLAL to the NPLL SHF (the Subordinated Loans):

- a loan of £39m from PLAL (with beneficial ownership passed to Opal Re) repayable in full in 2016, under which the aim is currently to repay £13m per annum, provided that the solvency position allows; and
- a loan of £50m from PLAL, repayable in full in 2019, which is referred to as the Liberty Loan.

5.38 In 1998, NPI raised £260m of capital (the Securitised Loan) secured on the emerging surplus (defined in essence as annual management charges less administration expenses) relating to most of the unitised with-profits and unit-linked business then in-force (the Securitised Portfolio). The rights and obligations under the Securitised Loan transferred to NPLL under the NPLL Scheme. The surplus emerging each year on the Securitised Portfolio is payable to the bondholders, subject to a cap of the amount set out in a fixed schedule of repayments. Under the Securitised Loan Agreement, NPLL holds a reserve account of surplus which has emerged to date, but has not yet been paid. This is available to help meet the schedule of repayments if the surplus emerging is insufficient in any year.

5.39 In addition, there are a complex set of capital support arrangements in place for the NPLL LTF. Under these, the costs of guarantees, once they cannot be met by the remaining estate, are met in turn by:

(i) The Capital Funds. These were set up by the NPLL Scheme. A sum of £800m was paid into the NPLL SHF by PLAL in 2000, to enable NPLL to manage the NPLL LTF in accordance with the Principles of Financial Management set out in the NPLL Scheme. This could be drawn down into the fund to meet PRE. The Capital Funds were drawn down into the NPLL LTF a number of years ago. A proportion was transferred to the SERP Fund of PLAL as part of the SERP Scheme in 2010, but the balance remains in the NPLL LTF, where they are held in a ring-fenced account called the Transfer Capital Fund. Repayments to the NPLL SHF can only be made to the extent that a deficit will not be created in the NPLL LTF and the repayment will not have an adverse effect on the reasonable expectations of NPLL policyholders. There is a support charge (1.75% pa of the balance) payable to the NPLL SHF.

(ii) The Asset Share Charge Fund, which represents the accumulated value of past asset share charges. Since 2007, 2% p.a. has been charged. Charges are only taken if the value of the estate, Capital Fund and existing Asset Share Charge Fund are unlikely to meet the future cost of guarantees. There is a cumulative cap of 25% on this (where the cumulative charge is the sum of previous charges in percentage terms net of any charges that have been allocated back to asset shares). Amounts (if any) not needed to meet the cost of guarantees are returnable to policyholders by way of a credit to asset shares.

(iii) The SEF. This was set up at the time of the SERP Scheme by means of an amendment to the NPLL Scheme, and was designed to compensate NPLL's shareholder for the potential loss of support charges payable on that part of the Capital Funds that was transferred to PLAL under the SERP Scheme. Any of this not needed to meet the cost of guarantees is repayable to the NPLL SHF, with the extent of any repayment limited by a schedule in the NPLL Scheme. Such repayments are dependent on the financial position of the NPLL LTF.

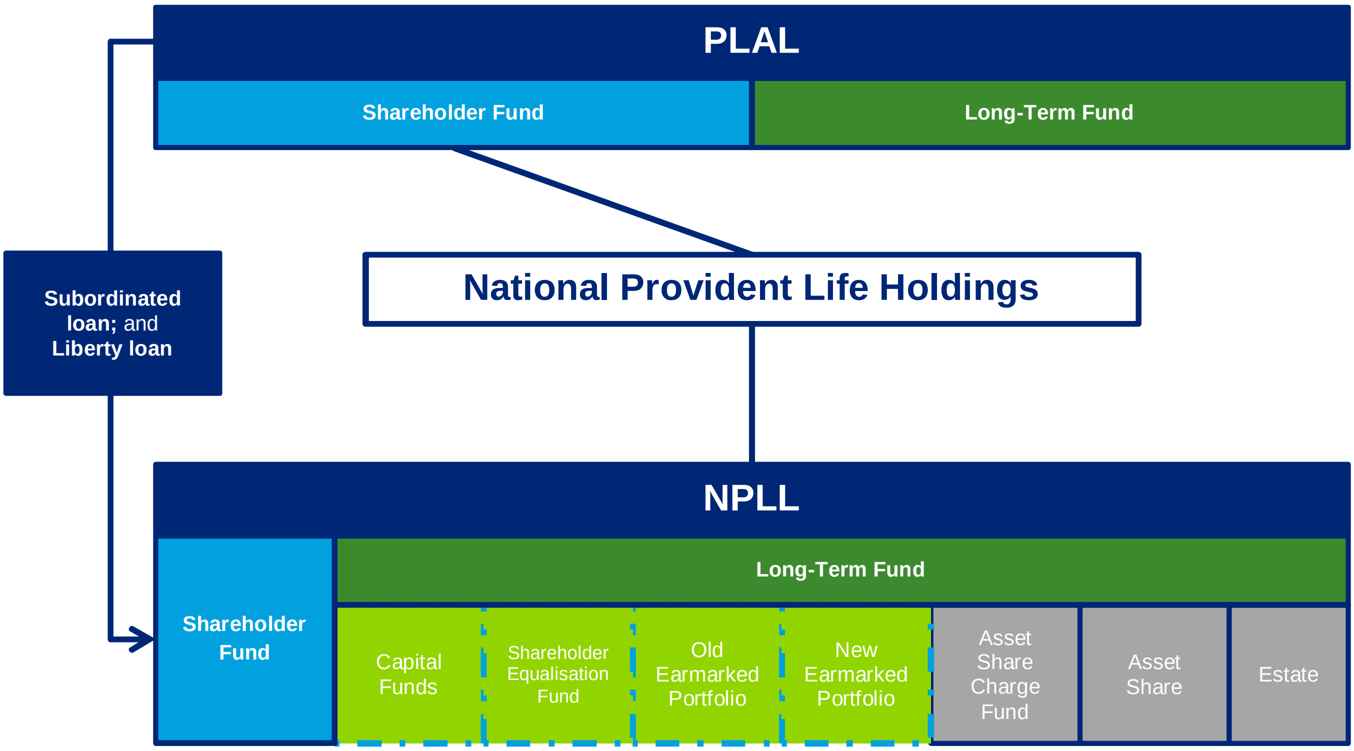
(iv) The Original Earmarked Portfolio. This consists of £53m of assets which represent charges on the Capital Funds which have not been transferred to the NPLL SHF or have been drawn down from the NPLL SHF into the NPLL LTF.

(v) The New Earmarked Portfolio. This is a loan, with an outstanding balance of £52m, from the NPLL SHF to the NPLL LTF made in June 2006 under which annual interest is payable at the rate of 4.25% plus the investment return.

5.40 The PLAL Board has given an undertaking to provide further capital to the NPLL SHF if this is required to enable NPLL to meet its capital policy, provided that in so doing PLAL remains able to meet its own capital policy.

5.41 Figure 5.1 below provides an overview of these capital support mechanisms. The items shaded in light green represent capital that is available to support policyholders, which is repayable to the NPLL SHF only in the event that a surplus over the amount required to meet guaranteed payouts arises in the fund. Items shaded in grey represent assets which would be used to enhance discretionary policyholder benefits, if they were not required to meet guaranteed payments.

***Figure 5.1: Overview of NPLL current capital support mechanisms***




- - - - - Denotes support provided by the NPLL Shareholder Fund to the NPLL Long Term Fund

## Changes to capital support mechanisms

5.42 Table 5.1 shows the value of the various capital support mechanisms at 30 June 2014. At this date, all of the support, with the exception of part of the Earmarked Portfolio, was required to cover the cost of guarantees in the NPLL LTF.

***Table 5.1: Size of capital support mechanisms as at 30 June 2014***

| Support Arrangement | Value (£m) |
|---|---|
| Capital Funds | 162 |
| Asset Share Charge Fund | 437 |
| Shareholder Equalisation Fund | 72 |
| Earmarked Portfolio | 99 |

5.43 The Scheme will amend and simplify the existing capital support provided by the NPLL SHF by:

- Combining the Capital Funds and the Asset Share Charge Fund with the NPL WPF estate. Support charges will no longer be payable on the Capital Funds. If the estate is not needed to meet the cost of guarantees and other calls on it, it will be payable to policyholders of the NPL WPF by way of distributions. This means that the shareholder will give up the right to receive the support charges on the Capital Funds or any of it which is not used to meet the cost of guarantees.

- Combining the Original and New Earmarked Portfolios and the SEF and treating the aggregate value of these as a loan from the PLAL SHF in accordance with the PLAL Capital Policy. No financing or support charges will be payable on this amount. The terms of this loan will be such that it will only be repayable if the financial condition of the NPL WPF allows it.

5.44 The Subordinated Loans will collapse since the assets and liabilities of the NPLL SHF will transfer to PLAL under the Scheme. Note that sufficient assets will be left in the NPLL SHF post-Scheme to meet the remaining regulatory capital requirement until NPLL has been de-authorised.

5.45 The Securitised Loan will be transferred to the new NPL WPF and continue to operate as now. The Scheme also includes certain additional protections (including a requirement for PLAL's parent company to provide capital support to the NPL WPF) which are designed to ensure that there is no adverse consequences for the bondholders or NPLL's counterparties under the Securitised Loan Agreement as a result of the Scheme. The Companies intend that the Scheme should constitute a "Permitted Transfer" within the terms of the Securitised Loan Agreement and are taking steps to ensure that the formalities which must be satisfied to ensure that this is the case (including obtaining confirmation from the rating agents that the transfer will not result in a downwards revision of the credit rating of the bonds or the bonds being placed on credit watch) will be satisfied prior to the Sanctions Hearing.

5.46 Under the PLAL Capital Policy set out in the PLAL 2012 Scheme, in the event that the value of the assets of the NPL WPF falls below the regulatory minimum value of assets which must be held in that fund plus 0.5% of the total retrospective reserve in respect of that fund (or £5m if greater), support will be provided to that fund by way of a loan or other contribution arrangement from the PLAL SHF or the PLAL NPF to the extent that the PLAL Board determines there are assets in those funds available to make such a loan. This formalises the shareholder commitment to the NPL WPF.

## Estimated Impact of the Scheme on solvency

5.47 The estimated impact of the Scheme on the Pillar 1 solvency position of the Companies is shown in Table 5.2 below, with a more detailed breakdown in Tables A6.1 to A6.4 of Appendix 6.

5.48 The figures in Table 5.2 are based on the total position of each company including the assets in the with-profits funds. Some of these with-profits funds had free assets at 31 October 2014, which would only be available to support the capital requirements of the Transferring Policies in the extreme event of insolvency (and even then, there is uncertainty, as detailed in paragraph 5.63, around whether these assets would be available). Consequently, I have also considered the figures in Table 5.3, which exclude the capital resources and capital requirements for those with-profits funds with surplus assets.

5.49 The NPLL post-Scheme solvency position can be ignored for the purposes of assessing policyholder benefit security as the only assets remaining in NPLL are those necessary to satisfy the remaining regulatory capital requirements.

***Table 5.2: Estimated impact of the Scheme on Pillar 1 solvency as at 31 October 2014***

| £m | Pre-Scheme | | Merged companies post-Scheme |
|---|---|---|---|
| | PLAL | NPLL | |
| Capital Resources | 1,950 | 207 | 1,978 |
| Capital Resources Requirement (including any WPICC) | 1,525 | 120 | 1,527 |
| Surplus(1) | 425 | 86 | 452 |
| **Solvency ratio(2)** | **128%** | **172%** | **130%** |

*Source: Financial analysis provided by Phoenix*

*Notes:*

*(1) Pre-Scheme PLAL figures include the capital requirements of NPLL as a subsidiary*

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

***Table 5.3: Estimated impact of the Scheme on Pillar 1 solvency, excluding with-profits funds in surplus as at 31 October 2014***

| £m | Pre-Scheme | | Merged companies post-Scheme |
|---|---|---|---|
| | PLAL | NPLL | |
| Capital Resources | 461 | 207 | 489 |
| Capital Resources Requirement (including any WPICC) | 247 | 120 | 248 |
| Surplus(1) | 214 | 86 | 241 |
| **Solvency ratio(2)** | **187%** | **172%** | **197%** |

*Source: Financial analysis provided by Phoenix*

*Notes:*

*(1) Pre-Scheme PLAL figures include the capital requirements of NPLL as a subsidiary*

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

5.50 Table 5.2 sets out an analysis of the impact of the Scheme on PLAL, had the Scheme taken effect on 31 October 2014, and shows a slight increase in the solvency position, from 128% to 130% - reflecting an increase in the value of admissible loans under the Pillar 1 rules, offset by the cost of the Scheme. This is consistent with the impact shown in Table 5.3. Consequently, based on the estimated financial position as at 31 October 2014, the Scheme will have no material impact on PLAL's Pillar 1 Solvency position. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

5.51 Table 5.2 shows that, had the Scheme taken effect on 31 October 2014, there would have been a decrease in the solvency position of NPLL pre-Scheme to the combined company following the Scheme (reduction of 172% to 130%). As discussed in paragraph 6.20, I attach limited significance to the reduction in this ratio in my consideration of the impact of the Scheme on the benefit security of Transferring Policyholders. It is, nevertheless, relevant to note that, if the capital held above the level targeted by the respective capital policies was removed the reduction in the Pillar 1 would be significantly less. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

5.52 The results of the Pillar 2 valuation and any subsequent ICG are confidential between the PRA and the Companies. I have reviewed the expected impact of the Scheme on the Pillar 2 solvency position and, based on the 31 October 2014 financial position, the Scheme will result in a slight decrease in the ratio of the capital resources to the capital requirements of PLAL, reflecting the expected cost of the Scheme. The analysis shows that, had the Scheme taken effect on 31 October 2014, PLAL would have still been able to meet its capital requirements under the PLAL Capital Policy. Removing the capital held above the level targeted under the respective capital policies, the solvency ratio of NPLL on a Pillar 2 basis pre-Scheme is lower than the equivalent ratio for the combined company post-Scheme. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

## Solvency II

5.53 The current solvency regime is expected to be replaced in January 2016 by a new regime known as Solvency II. Many of the principles of how this will operate are known, but not all the details, and there are some substantive issues that are yet to be formally approved.

5.54 It is important to realise that Solvency II does not change any of the assets, liabilities or risks in the Companies. These are the main determinants of benefit security. The new regime is intended to improve oversight of such risks, and to ensure strong minimum standards for the capital that must be held against each risk. It will also involve operational changes – for example, reporting and governance changes.

5.55 I note that Solvency II will impact the Companies irrespective of the Scheme – if it has an adverse (or positive) effect on a particular company, the effect will apply whether or not the Scheme occurs. Nevertheless, I would be concerned if a proposed Scheme meant that a group of policyholders moves into a company that will be badly affected by Solvency II to the extent that the benefit security of its policyholders was materially worse. For example, this might happen if a particular fund contained product types which incur heavier capital requirements under the new rules, meaning that its reported solvency position falls.

5.56 I have reviewed an estimate of the financial position of the Companies calculated under their current understanding of the likely Solvency II rules and estimates of the expected impact of the Scheme on this position. This analysis shows that, while both Companies are expected to be able to meet their Solvency II capital requirements, in percentage terms, the ratio of capital resources to the capital requirements is expected to be lower on a Solvency II basis than on a Pillar II basis. This partly reflects the requirement to hold a prudent risk margin under Solvency II.

5.57 The Solvency II estimates showed PLAL to have a lower solvency ratio (taken as a ratio of the available capital resources to the Solvency Capital Requirement) than NPLL as at the date used. When taken as a ratio of the available capital resources to the Minimum Capital Requirement under Solvency II, the solvency ratio of PLAL was shown to be higher than that of NPLL. Given the uncertainty around these estimates, I place limited reliance on these comparisons and will revisit the estimated relative positions of the Companies under Solvency II in my Supplementary Report.

5.58 I note that the Solvency II regulations include transitional measures, which could be used by the Companies (subject to approval from the PRA) to stagger the move from the current approach to the Solvency II approach for key elements of the solvency calculation. In addition, PLAL is investigating different actions that management can take to improve the solvency position on a Solvency II basis. PLAL has provided me with estimates of the impact of both the transitional measures (under a range of potential interpretations) and possible management actions and both are expected to improve the solvency position.

5.59 The impact of the Scheme is expected to be largely neutral on the solvency position of PLAL under Solvency II, reflecting the fact that the NPLL figures would be reflected in the PLAL Solvency II position on a look-through basis. There could be a risk to policyholders if they were moving from a company that was well-prepared for the move to Solvency II, and understood the implications for its solvency, to one that was poorly prepared. That is not the case under this Scheme. The Companies are all part of the same group and are part of the same implementation programme, and so no group of policyholders should be disadvantaged on this account.

5.60 The PLAL 2012 Scheme outlines that PLAL will set new tests before Solvency II is implemented with the objective that PLAL can meet its Solvency II Pillar 1 capital requirements in internally stressed scenarios. The adoption of the new tests and their parameters will be subject to the Regulators' non-objection. As a result, the PLAL Capital Policy will provide ongoing protection to all policyholders affected by the Scheme after Solvency II is implemented.

5.61 I will continue to monitor the impact of the Scheme in relation to Solvency II and will comment further in my Supplementary Report. In particular, I will comment on any developments concerning the PLAL Capital Policy and how it may be updated in light of Solvency II.

## Protection in the event of insolvency

5.62 In my review of policyholders' benefit security I have also considered what might happen in the unlikely event of insolvency. This is influenced by the current Financial Services Compensation Scheme and the Insurers (Winding Up) Rules 2001.

5.63 In the event of insolvency of an insurance company the Financial Services Compensation Scheme covers 90% of insurance claims on long-term life insurance policies for UK insurance policies held by individuals. The Scheme does not impact the existing cover provided by FSCS for Transferring Policies or Existing PLAL Policies.

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

- For non-linked policies (including with-profits policies) the value of the policy is the sum of the present value of guarantees including the accrued bonus; the present value of any bonus expectations; and the present value of any options, less the present value of future premiums.

- For with-profits policies, it is unclear whether bonus expectations would be considered to extend to likely distributions of the estate of a particular fund. If so, any surplus assets within the fund are unlikely to be available to support payouts to policies in other funds.

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

5.65 After the Transfer Date, the liabilities associated with the Transferring Policies would rank pari passu with the other policyholder liabilities in PLAL. Any shortfall in the assets assumed to be backing these liabilities would, therefore, reduce the level of assets to meet liabilities of Existing PLAL Policies, and vice versa.

5.66 Under the PLAL 2012 Scheme, there are protections that prevent any support being provided from a with-profits fund in PLAL to any other fund, unless the conditions set out below are satisfied:

- there are no surplus assets available in either the PLAL NPF or PLAL SHF; and

- the support is provided on terms that are no less favourable as commercially available terms and will not detrimentally impact policyholder expectations, based on a certification by the relevant With-Profits Actuary of the fund.

The Scheme extends these protections to the NPL WPF, where the Transferring Policies are to be transferred.

5.67 I consider whether this has a materially adverse impact on the benefit security of Existing PLAL Policyholders and Transferring Policyholders in Sections 6 and 7.

# 6. Implications for Transferring Policyholders

## Introduction

6.1 As discussed in Section 3, the broad effect of the Scheme will be to transfer the entire long-term insurance business and shareholders fund of NPLL to PLAL.

6.2 In this Section I consider the likely impact of the Scheme on NPLL policyholders, with particular reference to any changes in their benefit expectations and benefit security.

## Scope of Transferring Policies

6.3 The majority of the Transferring Policies are unitised with-profits pension policies, most of which contain guarantees, or unit-linked pension policies. It is intended that no long-term insurance business will remain in NPLL if the Scheme proceeds.

6.4 The Transferring Policies include some annuities in payment, a number of which are currently reinsured to the PLAL NPF. Under the Scheme all of NPLL's annuities in payment will transfer to the PLAL NPF, together with assets equal to the value of the realistic reserves held by NPLL in respect of these policies. In the case of the reinsured policies, this realistic reserve is held only in respect of the expense risk related to these policies.

6.5 All policies, assets and liabilities comprised within the remaining long-term insurance business of NPLL will transfer to a new with-profits fund in PLAL, to be named the NPL WPF.

## Benefit Expectations for Transferring Policyholders

### General considerations

6.6 The Transferring Policies include with-profits, unit-linked and non-profit policies. The factors pertinent to the benefit expectations of policyholders in each category of business are substantially different, and are considered individually below.

### With-profits policyholders

6.7 The following key considerations apply to the with-profits policies that the Scheme will transfer to the NPL WPF. Taking account of these, I am satisfied that the Scheme will not materially adversely impact the benefit expectations of these policyholders.

- There will be no change to the asset share, bonus rates and surrender value calculations, which will continue to use the current methodology. The current process for allocating investment returns to asset shares will continue to apply.

- As a result of the changes to the capital support arrangements (as outlined in Section 5), the shareholder is giving up the right to receive the support charges on the Capital Funds or any of it which is not used to meet the cost of guarantees or policyholder reasonable expectations.

While such an excess is not expected to arise, this results in a small positive impact on the benefit expectations of these policyholders.

- Although the Supervisory Board will no longer exist, its responsibility to have regard solely to the interests and reasonable expectations of NPLL policyholders when carrying out its duties, together with its power to manage investment and bonus policy, will be passed on to the PLAL WPC. The management of the NPL WPF by the PLAL Board will be subject to oversight by the PLAL WPC. This brings the management of the NPL WPF into line with the management of the other PLAL WPFs. I consider this further in Section 8.

- The Scheme will result in all of the annuities in payment and assets corresponding to the realistic reserve for this business being transferred to the PLAL NPF. Consequently, any profits arising on this business that would previously have arisen in the NPLL LTF will accrue to the PLAL NPF as a result of the Scheme. However, the majority of this business is already largely reinsured to the PLAL NPF (either fully reinsured, on original terms, for annuities written since 31 March 2012, or reinsured other than in relation to the administration expenses for certain pension annuities written before 1 January 2000), and so any profits on this reinsured business would already be expected to largely arise in the PLAL NPF. The remaining business had a realistic reserve of approximately £13.6m at 31 December 2013, and so I am satisfied that any future profits on these policies would not materially affect benefit expectations of the holders of with-profits Transferring Policies. I am also satisfied that it is appropriate to base the amount of assets to be transferred on the realistic reserve for these policies, as such a reserve is based on NPLL's best estimate of future experience. This view is consistent with the opinion expressed by the WPA in his report on the Scheme. The Companies have informed me that the assets transferred will be government bonds, selected with reference to the expected term of the liabilities. I am satisfied that this choice of assets will not have materially adversely affect the holders of with-profits Transferring Policies.

- The Scheme will allow the PLAL Board to reallocate non-profit policies within the NPL WPF to the PLAL NPF. If it wishes to go ahead, the Scheme requires the PLAL Board to seek appropriate actuarial advice and to ensure that the terms of such a reallocation are fair and equitable. I also note that any such proposal would be subject to TCF and other regulatory requirements.

  The Companies have confirmed to me that there are no current plans to reallocate any existing non-profit business using this provision, but that new annuities at vesting will be set up in the PLAL NPF, rather than reassured to it, utilising where necessary the powers under this clause. These powers provide the PLAL Board with the means to prevent the non-profit business of the NPL WPF becoming of a disproportionately large size as the fund runs off. Preventing this situation provides a benefit to with-profits policyholders by eliminating the need to hold additional capital within the NPL WPF in respect of the risks associated with these non-profit policies.

  Given the protections in place, I am satisfied that the inclusion of this provision does not materially adversely affect the benefit expectations of the with-profits Transferring Policyholders.

- Consistent with the terms of the PLAL 2012 Scheme, the Scheme will provide that PLAL must convert with-profits policies in the NPL WPF into non-profit policies when the statutory with-profits liabilities (before reinsurance) of the NPL WPF fall below £50m, and close the fund. Any such wind-up and conversion of benefits would require prior written approval from the Regulators, would be on a basis based on appropriate actuarial advice and would include the full distribution of any surplus in the fund, to help protect the interests of policyholders.

Given the protections in place and the requirement to distribute any surplus at the point of conversion, I am satisfied that the inclusion of this provision does not materially adversely affect the benefit expectations of the with-profits Transferring Policyholders.

- While the term “appropriate actuarial advice” is not clearly defined, I have discussed this with the Companies and they have confirmed my expectation that “appropriate” is likely to include independent, external actuarial review (similar to that provided by the Independent Expert in relation to the Scheme) where a particular issue is material or considered likely to be contentious.

- The Scheme allows for the future merger of the NPL WPF with another with-profits fund in PLAL when the with-profits liabilities of the NPL WPF fall below £750m, subject to future increases related to inflation. In this occurrence the Scheme also provides protection for existing policyholders by ensuring that there is a review from an independent actuary to ensure that the merger would not adversely affect their expectations. The terms of the merger would also be subject to the prior approval of the Regulators. This replaces a similar clause in the NPLL Scheme, whereby the fund could cease to be maintained as a separate fund once the with-profits assets of the fund fell below £500m, adjusted for inflation since 31 December 1999 – equivalent to £750m as at 31 December 2013.

## Changes to allocated expenses

6.8 The level of expenses allocated to the NPL WPF could impact the level of benefits payable, particularly where they are met by assets, which would otherwise form part of the benefits payable to policyholders (either within the policyholder asset share or the estate). As the NPL WPF will be, in part, dependent on shareholder support to meet PRE, changes to the expenses charged to the fund are likely to, primarily, impact the level of shareholder support required.

6.9 The NPLL Scheme contains restrictions on the type of expenses and the level of per policy and investment expenses that can be charged to the NPLL LTF. However, the relevant provisions are not easy to apply in practice now that the initial 10 year term has expired (as it requires the level of expenses to be benchmarked against rates that could be achieved externally). Therefore, the Scheme sets out a pragmatic solution:

- the types of expenses chargeable to the NPL WFP will be unaltered;

- per policy expenses in respect of non-investment services will initially remain at their current level and increase in line with RPI + 1%. This is in line with the current approach for allowing for expense inflation within the per policy expenses. However, the Scheme also provides that, at any time following the Transfer Date, the PLAL Board may (and shall where so requested by the PLAL WPC) review those expenses and make such changes as are approved by the PLAL WPC. Giving the PLAL WPC the right to require the PLAL Board to review the expenses for administrative services should ensure that the approach is changed if the fixed increases become unfair to policyholders; and

- investment management fees will be allowed to vary subject to the agreement of the PLAL WPC.

- At the same time, the Scheme includes clear statements that these expense provisions take effect subject to applicable law and regulation from time to time. The practical effect of this is that, if the expenses incurred in operating the NPL WPF were less than those set out in the Scheme, then PLAL would be required to charge the lower amount to the NPL WPF.

6.10 Aside from the above, the Scheme provides that, subject to applicable law and regulations from time to time, the PLAL Board, having obtained appropriate actuarial advice, will generally determine the expenses and charges relating to the operation of the NPL WPF. As a with-profits fund that is largely closed to new business, the level of per policy expenses would be expected to increase as the overheads associated with running the fund are spread over a reducing number of policies. Should the fixed increases become unfair to policyholders, I am satisfied that the Scheme provides a mechanism through which the approach can be reviewed and changed. Further, I note that, for unitised with-profits policies, the expense charges are taken as a percentage of each policy's fund and these will not be affected by the above changes. Consequently, I am satisfied that the above proposal is reasonable and will not lead to a materially adverse impact on policyholder benefit expectations.

## Unit-linked policyholders

6.11 The Scheme will allow PLAL to carry out the following actions on its unit-linked funds, unless prohibited from doing so by the terms and conditions of the affected policies, or unless the PLAL Board, having obtained the advice of the PLAL Actuarial Function Holder, considers it impractical or inappropriate with regards to the interests of the affected policyholders to carry out these actions. Policyholders would be entitled to a free switch to another linked fund to which their policy is linked and which the PLAL Board considers offers reasonably equivalent investment exposure in the event of any of these situations occurring:

(i) merger of any unit-linked funds within PLAL;

(ii) division of any unit-linked funds within PLAL; or

(iii) modification of investment objectives of any unit-linked fund within PLAL

6.12 The Scheme will allow PLAL, under the power of the PLAL 2012 Scheme, to wind up any unit-linked fund in PLAL if the value of assets falls below £5.9m (increased annually based on the Retail Prices Index from 31 December 2011) or, regardless of size, if the PLAL Board receive advice from the Actuarial Function Holder that the maintenance of the fund is no longer administratively feasible. In such an event, each affected policyholder would be allocated units of an equal value in an alternative fund which the PLAL Board, having obtained appropriate advice from the Actuarial Function Holder, considers provides reasonably equivalent investment exposure to the unit-linked fund being wound up. In the event of such an action, the Board must comply with TCF requirements with respect to the level of charges, and thus any change in the level of charges must be deemed to be fair to policyholders. In addition, during the 12 months after the fund is wound up, the policyholder is entitled to a free switch, even where such a switch is not permitted under the policy terms, into one or more funds to which their policy is linked.

6.13 In the event that the PLAL Board, having obtained advice from the Actuarial Function Holder, considers that any group of policyholders have been disadvantaged financially by any action outlined in paragraphs 6.11 - 6.12, it must, under the terms of the PLAL 2012 Scheme, consider whether appropriate compensation should be contributed to the relevant policyholders.

6.14 I am satisfied that none of these rights represent a materially adverse impact on policyholder benefit expectations, and that there are appropriate safeguards in place to protect the interests of these policyholders.

## Non-profit policyholders

6.15 On the basis of the analysis below, I am satisfied that the Scheme will not have any impact on the benefit expectations of these policyholders as:

- annuities in payment will transfer to the PLAL NPF. The Scheme does not change the benefits payable under these policies; and
- there will be no change to the terms and conditions of any other non-profit Transferring Policies.

## Conclusion on Benefit Expectations

6.16 Based on the factors discussed above, I am satisfied that the Scheme, of itself, does not materially adversely impact the benefit expectations of any group of the Transferring Policyholders.

## Benefit Security for Transferring Policyholders

6.17 In considering the effect of the Scheme on Transferring Policyholders I consider benefit security by comparing the applicable pre- and post-Scheme solvency positions at the company level for the Transferring Policyholders. It is also necessary to consider ongoing benefit security, the change to the ongoing availability of capital support (which will be available from the PLAL NPF and PLAL SHF post transfer, rather than from the NPLL SHF), and any contagion risk arising from the other funds within PLAL.

## Expected impact of the Scheme on the Pillar 1 and Pillar 2 Solvency position

6.18 The estimated impact of the Scheme on the Pillar 1 solvency position for the Transferring Policyholders has been determined by NPLL with reference to conditions at 31 October 2014, as shown in Table 6.1 below. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

***Table 6.1: Estimated impact of the Scheme on Pillar 1 coverage as at 31 October 2014***

| £m | NPLL Pre-Scheme | PLAL post-Scheme |
|---|---|---|
| Capital Resources | 207 | 1,978 |
| Capital Resources Requirement (including any WPICC) | 120 | 1,527 |
| Surplus | 86 | 452 |
| **Solvency ratio** | **172%** | **130%** |

6.19 Table 6.1 shows that, had the Scheme taken effect on 31 October 2014, PLAL post-Scheme would have had a lower proportionate Pillar 1 capital coverage than NPLL pre-Scheme on the measure defined by UK regulations, with the coverage ratio falling from 172% to 130%. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

6.20 Although the coverage ratio falls, a ratio of 130% is still more than that required under the regulations and PLAL is still able to meet its capital targets under the PLAL Capital Policy, immediately following the implementation of the Scheme. As discussed previously, and particularly in light of the NPLL Board's resolution mentioned in 2.38, I place limited weight on capital held above the level required by the NPLL Capital Policy. Provided this level of security is in place, I consider the incremental benefit of additional coverage is limited. The same is true of any additional capital in PLAL above its risk appetite target, a situation which also existed at the date of the above comparison. Ignoring these additional amounts of capital, the reduction in the Pillar 1 coverage ratio would have been about half that shown in Table 6.1. Given the fact that both Companies target the same risk appetite when setting the respective capital policy targets, I do not attach significant weight to the reduction in the ratio. This is reinforced by the fact that the capital held in NPLL is significantly smaller than that held in PLAL in absolute terms. This results in a gearing effect, and so relatively small changes in the capital resources (e.g. due to payment of a dividend or improved annuitant longevity) would have a high impact on the ratio.

## Estimated Pillar 2 impact

6.21 The Pillar 2 capital coverage is not published, but I have considered estimates provided by the Companies and, had the Scheme taken effect on 31 October 2014, the level of cover in PLAL immediately following the Transfer Date would have been well in excess of the minimum required and exceeded the level required under the PLAL Capital Policy, and I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

## Changes to the applicable capital policy

6.22 As a consequence of the Scheme, the PLAL Capital Policy will be applied to all Transferring Policies.

6.23 While the analysis of the immediate impact on solvency ratios is helpful, some of the policies that will transfer under the Scheme will remain in force for 20 years or more so I have also considered future solvency. The capital policies in place govern the management of capital and risks now and in the future for the Companies, as described in Section 5. Both set a minimum level of capital to be maintained, both now and in the future, including a minimum solvency requirement higher than the UK regulations. For solvency management it is effectively the biting constraint (which would limit dividend payments, for example) and I have placed considerable weight on it in reviewing policyholder security – more weight than the immediate change in coverage ratios.

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

6.25 The capital policies of the Companies operate in a similar manner to each other, with a series of tests setting out a target margin of surplus assets in excess of minimum regulatory capital requirements. Such capital policies are valuable and, through triggering management actions when the target margins are not met, act as an early warning system for remedial action before a company fails to satisfy its regulatory capital requirements. The Boards of PLAL and NPLL have adopted a risk appetite statement which, on the basis of a set of defined stress scenarios, targets a 1 in 20 chance over a one year time period of failing to meet their Pillar 1 capital requirements or the PLAL Board's assessment of its capital requirements as set out in its Pillar 2 capital requirements.

6.26 Additionally, the PLAL Capital Policy considers a further liquidity test, under which there is a requirement to hold a certain level of liquid capital in order that there would be sufficient assets in the relevant non-profit fund and/or shareholder fund to be able to cover the non-profit fund's regulatory liabilities and to make any loans into the company's with-profits funds (including the NPL WPF) that would become necessary in the extreme events considered under the policy. Thus, the liquidity requirements provide an additional measure of support for the payments under the Transferring Policies. The level of liquid capital held in PLAL under this test will increase from £60m to £76m following the Scheme.

6.27 Generally, as the margin required above minimum regulatory capital requirements increases, so does the security provided by the capital policy. However, this is not the only relevant factor. A good capital policy will have due regard to the main risks of a company and seek to ensure that sufficient capital is available to support these. Both the capital policies described above have the ability to adapt to and accommodate new or developing risks as circumstances change through the most onerous test generally being the margin above ICA, which should reflect changing risks. The PLAL Capital Policy is more dynamic than the NPLL Capital Policy, since the level of the margin in its tests is expressed as a percentage of the Pillar 1 and Pillar 2 capital requirements. The NPLL Capital Policy would not automatically do this since the excess targeted over its Pillar 1 and 2 capital requirements is expressed as a fixed amount.

6.28 The PLAL Capital Policy represents a stronger shareholder commitment than the NPLL Capital Policy in that it is contained in a Court-sanctioned scheme. The Phoenix Group must obtain the Regulators' prior written approval to any change to the PLAL Capital Policy parameters (excluding the liquidity test) that would reduce the amount of capital required to be held within the relevant company.

## Capital Support changes

6.29 NPLL currently has a variety of sources of capital support from the NPLL SHF as the estate does not sufficiently cover the cost of guarantees in the NPLL LTF. An overview and description of the current NPLL capital supports can be found in Section 5 and Figure 5.1. The Scheme results in the following changes to these arrangements:

- The Asset Share Charge Fund and the Capital Funds will be combined into the estate of the NPL WPF. Consequently the shareholder will relinquish the right to receive support charges payable in respect of the Capital Funds, and also the right to receive any of the Capital Funds that are not needed to meet PRE. This change results in a more secure capital position for the policyholders.

- The SEF and the Earmarked Portfolio will be eliminated and the assets comprised therein treated as a loan from the PLAL SHF into the NPL WPF in accordance with the terms of the PLAL Capital Policy. The terms of this loan will be such that it will only be repayable if the financial condition of the NPL WPF allows it, in line with conditions on this shareholder capital support pre-Scheme.

- The two outstanding inter-group loans from PLAL to the NPLL SHF will collapse as a result of the transfer of assets and liabilities of the NPLL SHF into PLAL. The loans, of £39m and £50m, were due to be repaid in full in 2016 and 2019 respectively.

- The Securitisation Loan will be transferred to the NPL WPF and continue in operation. A credit rating agency will be required to review the rating of the bonds and confirm that there is no adverse effect.

6.30 As these changes do not alter the overall amount of capital support available, I am satisfied that these changes do not represent a materially adverse impact on benefit security for the Transferring Policyholders. Indeed, there is the potential for benefit from the fact that no financing charges will be payable on the loan from the PLAL Shareholders' Fund that replaces the SEF and the Earmarked Portfolio.

## Contagion risk

6.31 The following key considerations relate to the level of contagion risk that the Transferring Policyholders are exposed to. Taking account of these, I am satisfied that the Scheme is not likely to materially adversely impact the benefit security of these policyholders.

- Although the Scheme will lead to the Transferring Policyholders being exposed directly to the risks within PLAL, benefits would only be theoretically at risk of being reduced in the extreme event of the insolvency of PLAL. Such an event is of very low likelihood, as a result of the existence of the PLAL Capital Policy.

- In accordance with the PLAL 2012 Scheme, each with-profits fund is operated as a standalone fund. Thus, policyholders of NPLL will not be adversely affected by any other with-profits funds when the NPL WPF is created.

- Following the Scheme, the NPL WPF will be subject to the protections in the PLAL 2012 Scheme, whereby support can only be provided by the NPL WPF to other funds in the event that there are no available surplus assets within the PLAL NPF and PLAL SHF (a scenario which I consider to be of very low likelihood) on terms which are no less favourable than arms' length commercial terms and will not detrimentally affect the reasonable expectations of the policyholders in the NPL WPF (as certified by the relevant With-Profits Actuary).

## Conclusion on benefit security

6.32 Having regard to the summary below, I am satisfied that the Scheme will not have a material adverse impact on the benefit security of the Transferring Policies.

- They will be protected by the PLAL Capital Policy which provides ongoing security well in excess of regulatory requirements. The level of protection it affords to the policies will not change as a result of the Scheme, nor will the governance processes in place to scrutinise future changes to it.

- While the Pillar 1 coverage ratio in PLAL following the Scheme may well be lower than the NPLL pre-Scheme coverage ratio (as would have been the case had the Scheme taken effect on 31 October 2014), PLAL will remain strongly capitalised and with surplus in excess of capital policy requirements. Pillar 2 analysis shows that, based on the position as at 31 October 2014, the coverage ratio in PLAL post-Scheme would have been higher than the equivalent ratio in NPLL pre-Scheme, and the absolute surplus held above Pillar 2 capital requirements much greater in PLAL post-Scheme than in NPLL pre-Scheme. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

- There are no significant changes to the level of contagion risk faced by the Transferring Policyholders and the likelihood of a contagion risk occurring remains remote.

- The Scheme will significantly simplify the capital support arrangements for the NPLL with-profits business.

## Excluded Policies

6.33 It is intended that all of NPLL's policies will be transferred under the Scheme. However, if it is not possible to transfer particular policies at the time the Scheme is implemented due to a legal or regulatory impediment, any such Excluded Policy will be treated for all practical purposes in the same way as if they had transferred to PLAL until such policies are, in each case, separately novated or otherwise transferred to PLAL. As a result, I am satisfied that my conclusions in respect of the Transferring Policies apply equally to any Excluded Policies. Subject to the PRA providing certain certificates regarding the transfer and the parallel Overseas Schemes being sanctioned by the Overseas Courts, I am also not aware of any reason why there would be any Excluded Policies. I will review this position in my Supplementary Report and comment further in the event that it appears likely that there will be any material number of Excluded Policies.

## NPLL Scheme – Paragraph 34 Requirements

6.34 Paragraph 34 of the NPLL Scheme states that:

> *"National Provident Life and [PLAL] may at any time petition the Court for the transfer to Pearl pursuant to Schedule 2C to the Act of the entire Long Term Business carried on by National Provident Life and the National Provident Life Fund Supervisory Board shall co-*

*operate to the extent necessary to obtain the sanction of the Court for and to give effect to such transfer, provided that the interests and reasonable expectations of the holders of Policies allocated to the National Provident Life Fund and Excluded Policies would not be adversely affected by any such transfer and the protections afforded to holders of such Policies, whether pursuant to [the NPLL Scheme] or otherwise, would not, in aggregate, be reduced by such transfer."*

6.35 The paragraph relates to the transfer that would be effected by the approval and completion of the Scheme. If the conditions set out in this paragraph are met, the NPLL Scheme places an obligation on the Supervisory Board to co-operate to the extent necessary to obtain the sanction of the Court in relation to the Scheme. While it is still the responsibility of the Supervisory Board to conclude whether this proviso is met (a conclusion I note the Supervisory Board has reached) I have considered this as part of my analysis of the Scheme.

6.36 For the reasons set out in my assessment of the impact of the Scheme on the benefit expectations of the Transferring Policyholders, as set out in Section 6, my opinion is that the interests and reasonable expectations of the Transferring Policyholders will not be adversely affected by the Scheme. I note that the Scheme leads to a number of potential impacts on policyholder interests and reasonable expectations, but I am satisfied that the effect of the changes as a whole does not constitute an adverse effect having regard to the materiality of the changes.

6.37 The key policyholder protections which are subject to change as a result of the Scheme are those built into the terms of the NPLL Scheme, including the governance arrangements set out in the NPLL Scheme, since the NPLL Scheme will be disapplied and cease to have effect upon the new Scheme becoming effective. I discuss the impact of the Scheme on the governance of the Transferring Policyholders in Section 8 and Appendix 11 describes these changes in more detail. Appendix 12 comprises a detailed analysis of how the provisions of the NPLL Scheme and the relevant schedule to the Articles of Association of NPLL relating to the Supervisory Board have been addressed in the new Scheme. On the basis of this analysis, and for the reasons there given, I am satisfied that the protections afforded to the Transferring Policyholders, whether pursuant to the NPLL Scheme or otherwise, will not, in aggregate, be reduced by the Scheme.

6.38 For the reasons set out above, and considering the overall effect of the Scheme, I am satisfied that:

- the interests and reasonable expectations of the Transferring Policyholders will not be adversely affected by the Scheme; and
- the protections afforded to the Transferring Policyholders whether pursuant to the NPLL Scheme or otherwise, will not, in aggregate, be reduced by the Scheme.

## Equitability of the Scheme

6.39 As I have concluded that the Scheme will not have a material impact on any of the Transferring Policyholders, I am satisfied that the Scheme is equitable to all classes and generations of those policyholders.

# 7. Implications for Policyholders of PLAL

## Introduction

7.1 In this Section I consider the likely impact of the Scheme on PLAL policyholders, with particular reference to any changes in their benefit expectations and benefit security.

7.2 As described in Section 3, the broad effect of the Scheme will be to transfer the entire long-term insurance business of NPLL to PLAL, without materially affecting the policy benefits or changing how the Existing PLAL Policies are managed.

7.3 I consider in turn the likely impact of the Scheme on the following different groups of policyholders:

- The Existing PLAL Policyholders whose policies are held in the PLAL WPFs. This business includes both non-profit and with-profits policies and some with-profits deferred annuities.

- The Existing PLAL Policyholders whose policies are held within the PLAL NPF. These are largely non-profit protection or unit-linked policies and annuities in payment.

## Benefit Expectations

7.4 There are some further points to consider, and these vary by policy type. I discuss separately the impact of the Scheme on the benefit expectations of:

- holders of with-profits policies in the PLAL WPFs;

- holders of unit-linked policies in PLAL; and

- holders of non-profit policies in PLAL.

### With-profits policyholders

7.5 The following key considerations apply to Existing PLAL Policyholders with with-profits policies in the PLAL WPFs. Taking account of these, I am satisfied that the Scheme will not have a materially adverse impact on the benefit expectations of those policies:

- there will be no change to the basis on which asset shares are determined, the current level of asset shares and guaranteed benefits, the expected level of emerging profits or how they are shared, expected bonus rates and payout levels, or the smoothing of payouts;

- the PLAL WPFs contains non-profit business, and profits or losses from that business remain in the relevant fund for the potential benefit of the with-profits policyholders. All of the non-profit business will remain within the respective funds, and there will be no change to the basis on which profits are shared;

- some unitised with-profits Transferring Policies are already reinsured into the Pearl WPF and this will continue to be the case after the Scheme (albeit through an inter-fund agreement, rather than reinsurance). Consequently, the exposure of with-profits Existing PLAL Policyholders to the risks associated with these policies will not change as a result of the Scheme;

- with-profits policyholders have a contingent interest in any surplus assets in their particular fund, and, while they remain in the fund, will receive a share of any such assets that are distributed in the future. The level of surplus assets in each existing PLAL WPF is unchanged, and so the value of this contingent interest is unaffected in each case;

- there will be no changes to the investment policy or asset mix of any fund as a result of the Scheme;

- the Scheme will not change the PPFM for this business, nor does it impact the way in which this business is expected to be managed or the powers that PLAL has under previous schemes (for example in relation to the merger and closure of with-profits funds under certain circumstances); and

- the governance arrangements and the existing policyholder protections will be maintained and, indeed, strengthened as described in paragraphs 7.7 – 7.9 below.

7.6 The level of discretionary benefits payable under with-profits policies often relate to the financial position of the fund in which they are held (for example, the level of bonus declared). Consequently, the benefit expectations of with-profits policyholders are related to the benefit security of these policies. I consider the impact of the Scheme on policyholder benefit security in paragraphs 7.14 – 7.25 and conclude that the Scheme does not materially adversely impact on policyholder benefit security for the with-profits policyholders in PLAL.

## Changes to with-profits governance

7.7 As part of the Scheme, the governance of the NPL WPF will be assumed by the PLAL WPC, in addition to the three existing PLAL WPFs. Ultimately the Scheme will not modify the Terms of Reference of the PLAL WPC in regard to its governance of the existing PLAL WPFs, other than in relation to the requirements relating to the composition of the PLAL WPC, as discussed below.

7.8 The Scheme will introduce requirements relating to the composition and procedure of the PLAL WPC, including a requirement that the WPC at all times includes a majority of non-executive members, as explained in Appendix 11. These reflect the current requirements for the Supervisory Board but will benefit all of PLAL's existing with-profits policyholders.

7.9 In practice, the membership of the Supervisory Board and the PLAL WPC is currently the same and there will therefore not be any immediate changes to the membership of the PLAL WPC. However, including these provisions in the Scheme will ensure that the same requirements continue to apply to the composition and procedure of the PLAL WPC in the future.

7.10 I am satisfied that these changes represent a strengthening of the with-profits governance arrangements applicable to the Existing PLAL Policyholders.

## Unit-linked policies

7.11 On the basis of the analysis below, I am satisfied that the Scheme will not have an impact on the benefit expectations under unit-linked policies in PLAL:

- The unit-linked policies in PLAL will remain invested in the same unit-linked funds as previously, with the same number and value of units, and with the same range of fund choice available to them.
- The value of each policy's unit holdings will be unchanged, and the pricing principles used for each unit-linked and unitised with-profits fund will be unchanged by the Scheme. The level of fund charges will also be unchanged.
- There will be no change to the unit pricing principles, investment mandates, charges or taxation of any unit-linked fund.

## Non-profit policies

7.12 I am satisfied that the Scheme will have no impact on existing non-profit policyholders in PLAL based on the following analysis:

- The benefits payable under existing non-profit policies in PLAL are fixed, or escalate with respect to inflation or at a fixed rate. The Scheme will have no impact on the benefits or premiums payable under any non-profit policy. The terms and conditions of the existing non-profit policies in PLAL will not be changed by the Scheme.
- The Scheme will not affect the current premium levels or charges of any non-profit policies with reviewable premiums or charges. Future reviews will continue in accordance with existing practice and subject to TCF.

## Conclusion on benefit expectations

7.13 Having considered the impacts separately on each group of policyholders, I am satisfied that the Scheme is unlikely to have any impact on the benefit expectations of the existing non-profit PLAL policyholders, any material impact on the existing unit-linked PLAL policyholders and any materially adverse effect on the benefit expectations of existing PLAL with profits policyholders.

## Benefit Security for Existing PLAL Policyholders

7.14 In considering the effect of the Scheme on Existing PLAL Policyholders I consider benefit security. First, I compare the applicable pre- and post-Scheme solvency positions at the company level for the Existing PLAL Policyholders. It is also necessary to consider ongoing benefit security, any changes in the ongoing availability of capital support from the PLAL NPF and PLAL SHF, and any contagion risk or loss of capital support for the with-profits funds in PLAL post-Scheme.

## Estimated impact of the Scheme on the Pillar 1 and Pillar 2 Solvency position

7.15 The estimated impact of the Scheme on the Pillar 1 solvency position for the Existing PLAL Policyholders has been determined by PLAL with reference to conditions at 31 October 2014, as shown in Table 7.1 below. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

***Table 7.1: Estimated impact of the Scheme on Pillar 1 coverage as at 31 October 2014***

| £m | PLAL Pre-Scheme | PLAL post-Scheme |
|---|---|---|
| Capital Resources | 1,950 | 1,978 |
| Capital Resources Requirement (including any WPICC) | 1,525 | 1,527 |
| Surplus | 425 | 452 |
| **Solvency ratio** | **128%** | **130%** |

7.16 Table 7.1 shows that, had the Scheme taken effect on 31 October 2014, PLAL post-Scheme would have had a very similar level of Pillar 1 capital coverage as pre-Scheme. This reflects the fact that NPLL's capital resources and requirements are already reflected in the PLAL position on a look through basis. The slight increase relates to the increased value of admissible loans following the transfer, offset by the expected cost of the Scheme. The table also demonstrates that, as at 31 October 2014, PLAL would have been able to continue to meet the levels of capital targeted under the PLAL Capital Policy immediately following the Scheme. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

## Estimated Pillar 2 impact

7.17 The Pillar 2 capital coverage is not published, but I have reviewed the Company's estimate of the impact had the Scheme taken effect on 31 October 2014, which shows a very small reduction in the level of Pillar 2 capital coverage. This reduction reflects the expected costs of the Scheme. However, the capital available is expected to continue to be well in excess of the minimum required and to be sufficient to meet the target capital levels under the PLAL Capital Policy. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

7.18 I would not have expected the PLAL Pillar 2 solvency position to be materially altered by the Scheme, as PLAL is already indirectly exposed to the risks within NPLL, due to the fact that NPLL is an indirect subsidiary of PLAL and is included in the Pillar 2 assessment.

## Capital Policy changes

7.19 While the analysis of the immediate impact on solvency ratios is helpful, the policies will remain in force for 20 years or more, and I have also considered future solvency. In PLAL, the PLAL Capital Policy governs the management of capital and risks now and in the future, as described in Section 5. It sets a minimum level of capital to be maintained, both now and in the future, including a minimum solvency requirement that is higher than that required under the UK regulations. For solvency management it is effectively the biting constraint (which would limit dividend payments for example) and I have placed considerable weight on it in reviewing policyholder security – more weight than the immediate change is coverage ratios.

7.20 The Scheme itself does not change the PLAL Capital Policy, and all governance processes in place to change the policy in future are also unaffected. These were described in paragraphs 5.24 - 5.30.

7.21 However, as set out in paragraph 5.34, PLAL intends to update the parameter that will be used to calculate the margin over the Pillar 1 capital requirements under the PLAL Capital Policy following the Scheme. This change is intended to ensure that the Scheme does not change the overall margin targeted, without a change in the underlying CRR, and reflects the fact that the Scheme will result in a difference in the way that the Pillar 1 test is applied to the capital requirements of the Transferring Policies. Although the actual change to the parameter will be approved nearer the Transfer Date, the Companies have provided an illustration of how it would have applied had the Scheme been approved as at 31 October 2014. This shows that, had the parameter been updated at that date, the Scheme would have resulted in a £0.6m increase in the Pillar 1 margin calculated in PLAL. It is important to note that this proposed change does not change the overall level of protection targeted or the expectation of the margin calculated under this test. As a result, the Existing PLAL Policyholders continue to have a level of ongoing security targeted that is well above the regulatory requirements. The revised value of the parameter will be approved by the PLAL Board and I will comment upon this in my Supplementary Report.

7.22 The analysis demonstrates that the Scheme is not expected to have a material impact on PLAL's ability to meet the level of capital targeted under the PLAL Capital Policy. Based on the estimated financial position as at 31 October 2014, PLAL has sufficient capital to meet its capital target as specified by the PLAL Capital Policy.

## Contagion risk

7.23 Following the implementation of the Scheme, the Existing PLAL Policyholders will be directly exposed to the risks associated with the Transferring Policyholders. NPLL is currently an indirect subsidiary of PLAL and is considered in PLAL's capital assessments. In addition, the PLAL Board have also given a formal undertaking to provide further capital to the NPLL SHF if this is required to enable NPLL to meet its capital policy, provided that in doing so PLAL remains able to meet its own capital policy. Consequently, the Scheme does not materially change the risks to which the Existing PLAL Policyholders are exposed.

7.24 In addition, I consider it to be highly unlikely that PLAL, while solvent itself, would allow NPLL to become insolvent. This is partly as a result of the reputational impact which this would have on the Phoenix Group. Consequently, the effect of the Scheme is consistent with the current economic reality and I do not believe that the Scheme materially changes the risks to which PLAL is exposed.

## Conclusion on benefit security

7.25 Having regard to the summary below, I am satisfied that the Scheme is not expected to have a material adverse impact on the benefit security of the Existing PLAL Policyholders.

- These policies do not move, and will continue to have recourse to surplus in the fund they are held in, the PLAL NPF and the PLAL SHF.

- They will continue to be protected by the PLAL Capital Policy which provides ongoing security in excess of regulatory requirements. The level of protection it affords to the policies will not change as a result of the Scheme, nor will the governance processes in place to scrutinise future changes to it.

- There is no material change in the risks to which the policyholders are exposed.

- Had the Scheme taken effect on 31 October 2014, there would have been very little change to the Pillar 1 or Pillar 2 solvency coverage ratios. On both measures the analysis as at 31 October 2014 indicates that PLAL would have demonstrated coverage well in excess of minimum requirements following the implementation of the Scheme. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

- The surplus position in the existing PLAL WPFs remains unchanged by the Scheme and they will continue to have the same level of minimum capital support from the PLAL NPF and the PLAL SHF.

- The risk of contagion risk occurring does not change significantly and remains remote.

## Equitability of the Scheme

7.26 As I have concluded that the Scheme will not have a material impact on any of the Existing PLAL Policyholders, I am satisfied that the Scheme is equitable to all classes and generations of those policyholders.

# 8. Ongoing Governance, Administration and Investment Management

## Introduction

8.1 In this Section, I consider the effect of the Scheme on the ongoing governance, administration and investment management of the Existing PLAL Policies and Transferring Policies.

## Governance

8.2 The governance arrangements relating to the Existing PLAL Policyholders will not change as a result of the Scheme other than as regards certain additional requirements set out in the Scheme which will apply to the composition and procedure of the PLAL WPC and should strengthen the governance protections for Existing PLAL Policyholders with with-profits policies.

8.3 As a result of the Scheme, the PLAL Board will have overall responsibility for the management of the Transferring Policies, with the PLAL WPC providing oversight in relation to the NPL WPF.

8.4 As noted in Section 3, the PLAL WPC and the Supervisory Board are currently made up of the same members. As a result, I am satisfied that the PLAL WPC will have the same level of knowledge and expertise as the Supervisory Board immediately after the implementation of the Scheme.

8.5 However, the PLAL WPC will also have the right to determine bonus policy and set the investment strategy (consistent with the Supervisory Board's powers in respect of the NPLL LTF) for the NPL WPF. The PLAL Board will also need to obtain the consent of the PLAL WPC in respect of certain key matters relating to the management of the NPL WPF. Further details of this change are given in paragraphs 3.29 - 3.34 and in Appendix 11.

8.6 I am satisfied that under the terms of the Scheme there will be no materially adverse effect on the governance of the Transferring Policies because:

- As a result of the Scheme, the PLAL WPC receives some of the powers that the Supervisory Board previously held, as described in Section 3. The power to set bonus and investment policy for the NPL WPF and the requirement for the PLAL WPC's consent to be obtained in respect of certain reserved matters, including to approve the acquisition or disposal of any assets or business of or by the NPL WPF otherwise than for investment purposes, have been retained. However, as a result of the Scheme, the management of the NPL WPF is generally the responsibility of the PLAL Board, subject to oversight by the PLAL WPC. This brings the management of the NPL WPF into line with the management of the other PLAL WPFs and with the current legal and regulatory framework (under which responsibility for the management of a regulated business is allocated to the board of directors).

- Various provisions from the NPLL Scheme governing the rights and obligations of the Supervisory Board are also replicated in the Scheme, such as the obligation for the PLAL WPC to have regard solely to the interests and reasonable expectations of policyholders in the NPL WPF when carrying out its duties in respect of the NPL WPF.

- Some provisions that currently exist under the NPLL Scheme or the terms of NPLL's articles are not being replicated and I provide an overview of these in Appendix 11. I am satisfied that these do not have a material bearing on the effectiveness of the fund governance (for example, because they were historical provisions, which are no longer relevant).

## Service Standards and Administration

### Existing PLAL Policies

8.7 The PLAL administrative services will not change as a result of the Scheme. Existing PLAL Policies will continue to be administered on the same underlying systems by the same staff.

8.8 I note that the per policy administration expenses charged to with-profits policies under the PLAL PPFM can include an element of overhead expenses. These will not increase as a result of the Scheme and the PLAL basis for allocating overheads will not change as a result of the Scheme. Thus, I am satisfied that the Scheme will not have an impact on the quality of service standards for Existing PLAL Policyholders, or to the costs they bear.

### Transferring Policies

8.9 Immediately following the transfer, the Transferring Policies will continue to be administered in the same way on the same underlying systems by the same staff. Following the implementation of the Scheme, communications to the Transferring Policyholders will originate from PLAL rather than NPLL, and the 'Phoenix Life' branding will be introduced to the Transferring Policyholders. I also note that, reflecting certain requirements of the NPLL Scheme, the Scheme will introduce a specific requirement that service standards and the level of skill and diligence applied in investment management for the NPL WPF should be appropriate having regard to the standards applied to the equivalent business in PLAL.

8.10 I set out in paragraphs 6.9 and 6.10 my considerations on the proposed approach for allocating expenses to the NPL WPF and concluded that I am satisfied that the approach proposed by the Scheme will not have a materially adverse impact on policyholder benefit expectations for the Transferring Policyholders.

8.11 I am satisfied that the Scheme will not have an adverse impact on the quality of service standards for any group of policyholders. I am satisfied that the proposed approach to allocating the cost of the administration services will not have a materially adverse impact on the Transferring Policyholders.

## Investment Management

8.12 The Companies have informed me that there will be no changes as a result of the implementation of the Scheme to the investment management or mandate for the assets backing the Existing PLAL Policies and the Transferring Policies and, therefore, I am satisfied that there will be no impact on the management of the assets backing these policies as a result of the Scheme. I also note that, reflecting certain requirements of the NPLL Scheme, the Scheme will introduce a specific requirement that service standards and the level of skill and diligence applied in investment management for the NPL WPF should be appropriate having regard to the standards applied to the equivalent business in PLAL.

8.13 I am satisfied that there will not be any impact on the quality or cost of investment management services for any group of policyholders as a result of the Scheme.

# 9. Tax Considerations

## Introduction

9.1 In this Section, I consider the effect of the Scheme on the tax borne by policyholders, and whether policyholders might be materially adversely affected by any changes in tax charged.

9.2 I have received information from the Companies, setting out the expected tax implications of the Scheme, both for the Companies and for policyholders. I have considered whether there are any tax considerations that could have a materially adverse impact on policyholder benefit expectations or security.

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

## Company Taxation

9.4 I have considered whether the taxation position of the Companies could be changed by the Scheme so as to adversely affect policyholders, either directly as a result of the policyholders bearing the negative impact or indirectly in the unlikely event that the strength of PLAL (and therefore the support arrangements) was to be significantly weakened.

9.5 Currently, the tax charged to the NPLL LTF is equal to the tax that would be charged if the fund was a separate mutual life company. All other tax is charged to the shareholder funds. This charging basis, and the current basis of charging tax to the PLAL WPFs, will continue under the fund charging arrangements which will apply following the implementation of the Scheme. In addition, any proposal to change the basis on which tax is attributed to the NPL WPF will require the approval of the PLAL WPC. All other tax liabilities of the company are borne by the shareholder funds or the PLAL NPF.

9.6 Further, the Companies expect the Scheme to be broadly tax neutral so far as relates to UK corporation tax, although there are a number of detailed points which require further clarification and/or discussion with HM Revenue and Customs ("HMRC") before this can be confirmed.

9.7 The Companies expect to receive confirmation from HMRC that certain anti-avoidance provisions specific to transfers of life business will not apply to the Scheme. This confirmation remains outstanding.

9.8 To the extent that NPLL currently has any rights or contingent rights to repayment of UK or overseas taxes which, if received, would accrue for the benefit of the WPF, those will continue to accrue for the benefit of the NPL WPF is received following implementation of the Scheme.

## Policyholder Taxation

9.9 The Scheme should not involve any significant change to the terms and conditions of the policies, and should not affect the status of the policies (including the changes in the Finance Act 2013 as they apply to policyholder taxation, such as the premium limit on qualifying policies). The Phoenix Group has received an informal view from HMRC by letter dated 25 March 2014 in support of this.

9.10 The Phoenix Group has received confirmation from HMRC, in a letter dated 6 May 2014, that there will be no unauthorised payments or requirement for deregistration as a result of the transfer, with respect to the Finance Act 2004, and thus the status of registered pensions schemes will remain unchanged.

9.11 Hence, the Companies do not expect there to be any change to the tax status of the with-profits policies of either PLAL or NPLL, or for any unauthorised payments to arise. I see no reason to disagree, and on that basis there should be no impact on the Transferring Policyholders.

## Stamp Duty and VAT

9.12 As the Companies are under common ownership, the Phoenix Group expects that there should be no UK stamp duty or related tax costs associated with the Scheme. The Companies do not expect the Scheme to give rise to significant transaction taxes outside the UK, although this remains subject to more detailed confirmation.

9.13 As the Companies are both members of the same VAT group, no VAT costs will arise on the transfer of assets or liabilities under the Scheme.

## Tax Clearances

9.14 As noted above, I understand that the Phoenix Group intends to obtain clearances from HMRC in respect of Section 132 of the Finance Act 2012 (which would require an adjustment of income or gains chargeable to corporation tax to negate any tax advantage that may otherwise accrue from the Scheme).

9.15 I am not aware of any reason why HMRC would not provide this clearance, subject to HMRC seeing the final Scheme and the Companies carrying out the transfer in accordance with the information submitted to HMRC as part of the clearance. To the extent that any additional tax arises under Section 132 of the Finance Act 2012 this tax would not be charged to the with-profits funds.

9.16 On the basis of the circumstances and my discussions with the Companies, I understand that it is reasonable to believe that such clearances and confirmations will be forthcoming, and such clearances will be sought with a view to obtaining them in advance of the Effective Date of the Scheme.

9.17 The Phoenix Group will also be seeking tax clearances in the Channel Islands.

## Conclusion

9.18 On the basis of the information above, I conclude that there should be no adverse tax effects on Transferring Policyholders or Existing PLAL Policyholders on account of the implementation of the Scheme. This is subject to the clearances referred to above being received and other confirmatory matters being satisfactorily concluded.

# 10. Policyholder Communications

## Introduction

10.1 Parties to a Scheme made pursuant to Part VII of FSMA must comply with the notice requirements set out in the relevant regulations ("Transfer Regulations"). SUP18.2.42 – 18.2.50 provides further guidance on the form and content of policyholder communications with respect to the Scheme.

10.2 The Transfer Regulations require notice to be sent to all policyholders of the involved parties and for notice of the application to be published in, inter alia, the official gazettes and two national newspapers. The form of the notice must be approved by the relevant Regulator.

10.3 I summarise below the notifications that the Companies will send out to policyholders and my view on whether these communications are appropriate for the purpose given any practicalities and costs for the Companies and benefits to policyholders.

## Notifications to policyholders

### Existing PLAL Policyholders

10.4 PLAL are seeking dispensation from the Court from notifying PLAL policyholders of the Scheme, as required by the Transfer Regulations, since they are not transferring, there will be no change to the terms and conditions of their policies and the Scheme does not have a material impact on the financial position of PLAL.

10.5 All the Existing PLAL Policyholders will be able to access a guide to the Scheme prepared specifically for Existing PLAL Policyholders, the full Scheme document, my Reports and reports from Actuarial Function Holders and With-Profits Actuaries of the Companies on the Phoenix Life website, as well as other Scheme documentation, including the Scheme guide and question and answer booklets for the Transferring Policyholders. Notices on the Scheme will also be published in various places, including seven national newspapers in the UK, in addition to the official gazettes. The newspaper notices will be published in the main body of the newspapers, rather than the legal notices section (as is customary), and will also include introductory wording and relevant branding to draw readers' attention.

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

- as discussed in section 7, I am satisfied that the Scheme will not have a materially adverse effect on the benefit expectations or benefit security of any Existing PLAL Policyholders;
- costs associated with the Scheme will be met from the PLAL SHF and accordingly will not be met by the funds in PLAL that contain long-term insurance business and so any costs charged to Existing PLAL Policyholders will not change as a result of the Scheme;
- the security of the Existing PLAL Policyholders is supported by the PLAL Capital Policy which will continue to remain in force after the Scheme is implemented;
- relevant information about the Scheme, including a Scheme guide designed specifically for

Existing PLAL Policyholders, is being made publicly available on the website and through extensive advertising in the media; and

- the cost of the policyholder mailings for which an exemption is being requested would be disproportionate to any benefit gained.

## Transferring Policyholders

10.7 Transferring Policyholders whose mailing details are available on NPLL's computerised records will be sent copies of a personalised covering letter, a guide explaining the Scheme and its implications and containing a copy of the legal notice, and a question and answer booklet.

10.8 All Transferring Policyholders will be able to access the full Scheme document, my Reports and reports from the Actuarial Function Holders and With-Profits Actuaries of the Companies on NPLL's website, as well as the Scheme guide and question and answer booklet. Notices on the Scheme will also be published in various national newspapers.

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

10.10 All letters sent to the Transferring Policyholders will be branded as NPI, but the opportunity will be taken to introduce the new Phoenix Life brand to policyholders at this time.

10.11 Policyholders in the Channel Islands will be provided with additional information about their local court procedures in the appendix of the Scheme guide.

10.12 As far as NPLL is aware, it has never sold business outside the UK (other than in the Channel Islands and the Isle of Man), although a proportion of its policyholders have subsequently moved abroad. NPLL will circulate the policyholder pack as outlined in paragraph 10.8 above to those policyholders currently residing overseas and advertise the Scheme in two national newspapers in each of Ireland, France and Spain (the three EEA States in which 150 or more relevant policyholders are currently resident) but not in any other EEA states.

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

## Uncontactable policyholders and other exemptions

10.14 The Transfer Regulations require all policyholders of the Companies, which includes anyone with an indirect or beneficial interest in a policy, to be notified of this Scheme unless a dispensation is granted by the Court.

10.15 In some cases, the Companies do not hold a current address for some of the Transferring Policyholders to be mailed. These include "goneaway" policyholders who are by definition not contactable by mail. There will also be situations where a policyholder (for instance a trustee in bankruptcy) has not notified the Companies of their interest in a policy. I understand from the Phoenix Companies that the proportion of policyholders who are goneaways is currently around 20% in NPLL. The Companies have regular procedures in place to try to contact policyholders when the address provided is no longer valid. In addition, the Companies have undertaken a tracing exercise using a service provided by the Department of Work and Pensions ("DWP") in order to try and reduce this percentage further.

10.16 I note that the "goneaway" rate is high in comparison to previous Schemes that the Companies have been involved in. The Companies have set out some of the reasons why this is believed to be the case, including the relatively low number of annuities and the type of business within the fund. I note that a large number of Transferring Policyholders have a link with an IFA and that the Companies will be contacting IFAs to request that they inform policyholders of the Scheme. The Companies will also carry out a "sweep-up" mailing to any policyholders who have responded to the DWP tracing process and whose addresses have been verified prior to 31 December 2014. In addition, I note that Transferring Policyholders who do not receive an information pack may find out about the Scheme through the various newspaper advertisements and the website.

10.17 I am satisfied that, given the volumes of these policyholders, the procedures already in place to contact them and the advertising that might bring the Scheme to their attention, this is an appropriate approach to use in this situation, of an intra-group transfer of business from a subsidiary to its immediate parent company that does not materially adversely affect the policyholders concerned.

## Objections

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

## Conclusion

10.19 I am satisfied that the proposed approach to communicating the Scheme to Transferring and Existing PLAL Policyholders is reasonable and that the proposed communication pack adequately explains the material effects of the Scheme with respect to their policies.

# Appendix 1: Independent Expert Terms of Reference

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

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

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

In particular the Scheme Reports should consider the following specific matters:

- the matters listed in SUP 18.2.33G, 18.2.36G and 18.2.39G;
- the impact of the Scheme on the security of the different groups of policyholders involved in the Scheme;
- the impact of the Scheme on the benefit expectations of the different groups of policyholders involved in the Scheme;
- consideration of any change in tax that may be charged to policies or policyholder funds, or other loss of favourable tax status;
- a review of, and opinion on the adequacy of, the communications made to policyholders concerning the Scheme;
- an assessment of the Scheme on the level of service (including administration and investment management services) provided to the different groups of policyholders involved in the Scheme;
- the adequacy of any safeguards in the Scheme to protect the ongoing interests of different groups of policyholders; and
- any other matters drawn to the attention of the Independent Expert by the Regulators or required by the Regulators to be addressed within the Scheme Reports.

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

- the Memorandum and the Articles of Association, at least insofar as these affect the rights, expectations and interests of policyholders;

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

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

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

# Appendix 2: SUP 18 Cross Reference

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

***Table A2.1 – SUP 18 Cross Reference***

| SUP 18.2 item number and details | Section and paragraph reference in this Report |
|---|---|
| **SUP 18.2.33G** | |
| (1) who appointed the independent expert and who is bearing the costs of that appointment; | 1.2, 2.66 |
| (2) confirmation that the independent expert has been approved or nominated by the appropriate regulator; | 1.2 |
| (3) a statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role; | 1.5 |
| (4) whether the independent expert has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest; | 1.6 – 1.8 |
| (5) the scope of the report; | 1.11 – 1.16 |
| (6) the purpose of the scheme; | 2.7, 3.3 |
| (7) a summary of the terms of the scheme in so far as they are relevant to the report; | Section 3 |
| (8) what documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided; | 1.17 – 1.22, 5.17, Appendix 13 |
| (9) the extent to which the independent expert has relied on: | |
| (a) information provided by others; and | 1.17 – 1.22, 5.17 – 5.20, Appendix 13 |
| (b) the judgment of others; | Stated in various parts of the Report |
| (10) the people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable; | Stated in various parts of the Report |
| (11) his opinion on the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between:<br><br>(a) transferring policyholders;<br><br>(b) policyholders of the transferor whose contracts will not be transferred; and<br><br>(c) policyholders of the transferee; | Sections 6 and 7 |
| (11A) his opinion on the likely effects of the scheme on any reinsurance of the transferor, or any whose contracts of reinsurance are to be transferred by the scheme; | 3.54 – 3.60 |

| SUP 18.2 item number and details | Section and paragraph reference in this Report |
|---|---|
| (12) what matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the scheme; and | 1.14 |
| (13) for each opinion that the independent expert expresses in the Report, an outline of his reasons. | Stated in various parts of the Report |
| **SUP 18.2.35G** | |
| (1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme; and | 3.54 – 3.60, Appendix 10 |
| (2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred. | 3.16 |
| **SUP 18.2.36G** | |
| The independent expert's opinion of the likely effects of the scheme on policyholders should: | |
| (1) include a comparison of the likely effects if it is or is not implemented; | Stated throughout the Report |
| (2) state whether he considered alternative arrangements and, if so, what; | 1.13, 4.13 |
| (3) where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders; and | 4.2 – 4.6, Section 6 and 7 |
| (4) include his views on:<br>(a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;<br>(b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:<br>(i) the security of policyholders' contractual rights;<br>(ii) levels of service provided to policyholders; or<br>(iii) for long-term insurance business, the reasonable expectations of policyholders; and | Sections 5 – 7, Appendix 6 |
| (c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations. | 2.63, 2.66, Section 9 |
| **SUP 18.2.39G** | |
| For a scheme involving long-term insurance business, the report should: | |
| (1) describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits; | 3.24 – 3.26, 3.29 – 3.38, 6.7, 6.31 |
| (2) if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders; | N/A |

| SUP 18.2 item number and details | Section and paragraph reference in this Report |
|---|---|
| (3) describe the likely effect of the scheme on the approach used to determine: | |
| (a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and | 2.26, 2.29, 6.7, 7.5 – 7.6, Appendix 7 |
| (b) the levels of any discretionary charges; | 2.30, 3.40 – 3.42, 6.8 – 6.10, Appendix 7 |
| (4) describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm; | 3.28 – 3.31, 6.10, 7.7 – 7.9, 8.2 – 8.6 |
| (5) include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders; | Section 2, 6 and 7 |
| (6) state whether the independent expert is satisfied that for each firm the scheme is equitable to all classes and generations of its policyholders; and | 6.39, 7.26 |
| (7) state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented. | 6.32, 7.25 |

# Appendix 3: Background to the Phoenix Group

## Introduction

Phoenix Group Holdings ("PGH") is the ultimate parent company of the Phoenix Group. The Phoenix Group is the largest UK consolidator of closed life assurance funds. It has approximately 5 million policies in force and around £57 billion worth of assets at 30 June 2014. PGH is listed on the London Stock Exchange.

## History

The recent history of Phoenix is outlined below – details of its earlier history can be found on the Phoenix website.

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

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

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

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

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

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

In July 2014, Phoenix Group Holdings sold Ignis Asset Management Limited to Standard Life Investments.

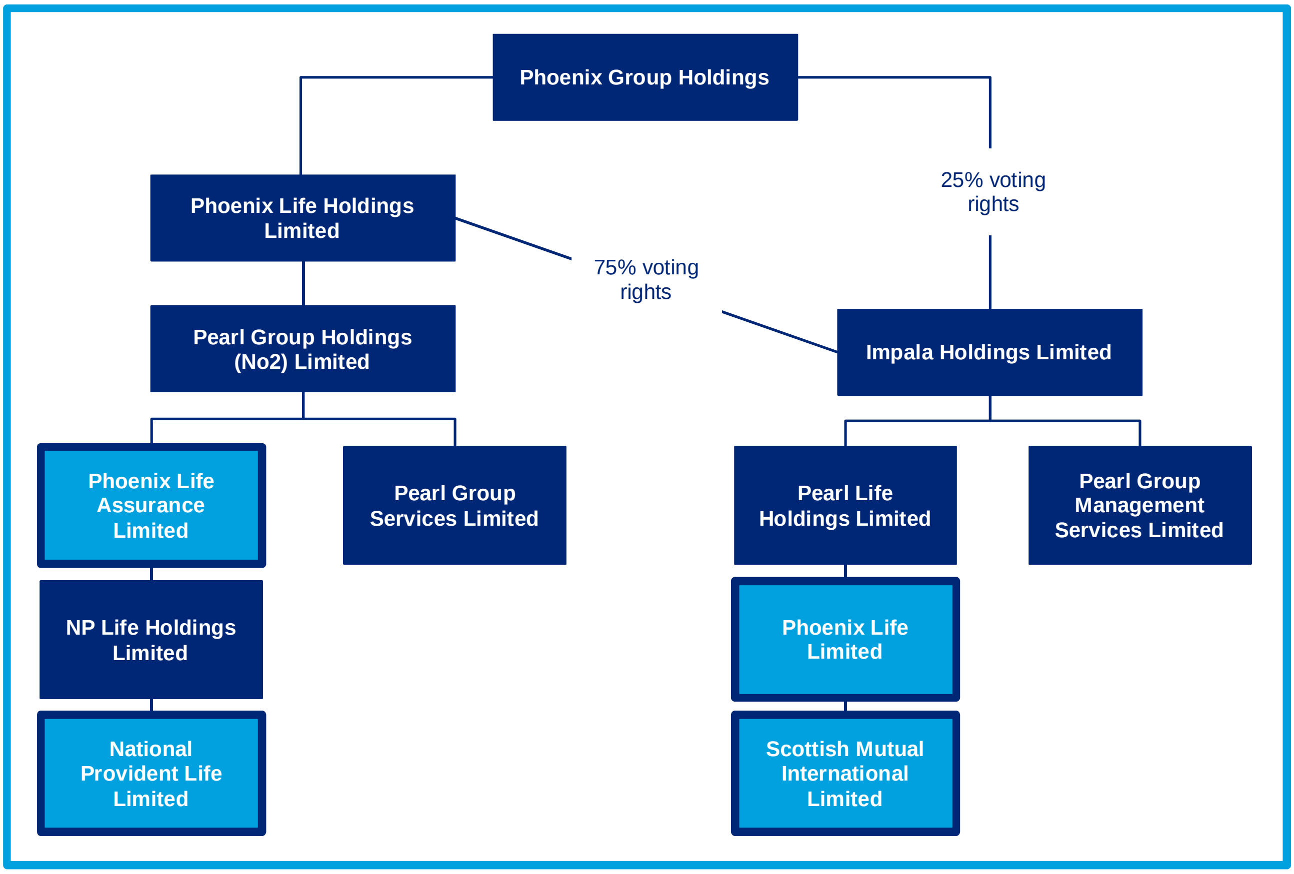
The Phoenix Group in recent years has carried out various schemes enabling it to simplify its group structure. This work has included reducing the number of regulated life insurance entities, brands and funds as well as reducing the amount of intra-group reinsurance. Some of the recent schemes are outlined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

## Current structure

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

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

***Figure A3.1 – Simplified Phoenix Life Holdings Limited Group company structure***




## Previous Schemes

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

- In 2010 SERP business was transferred from NPLL to PLAL under the SERP Scheme.
- In 2012 all of the business from NPIL and certain policies from NPLL transferred to PLL (the "Phoenix 2012 Scheme"). This transfer took place on 31 March 2012 but with an effective date for accounting purposes of 1 January 2012.
- In 2012 all of London Life Limited's business transferred to PLAL (the "PLAL 2012 Scheme").

- In September 2013 selected pension annuities in payment from PLL, PLAL and NPLL were transferred to Guardian Assurance Limited (the “Guardian Scheme”).

PLAL owns NPLL which is subject to the terms of a demutualisation scheme which was originally sanctioned in 1999 and subsequently amended in 2010 (the “NPLL Scheme”). This scheme governed the demutualisation of NPI and transferred all of NPI’s long-term insurance business into NPLL. The terms are such that the NPLL LTF continues to operate as if it were a mutual company and eligible policyholders are entitled to 100% of the profits and losses on long-term insurance business written prior to demutualisation.

# Appendix 4: Background to PLAL

## Introduction

PLAL 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.

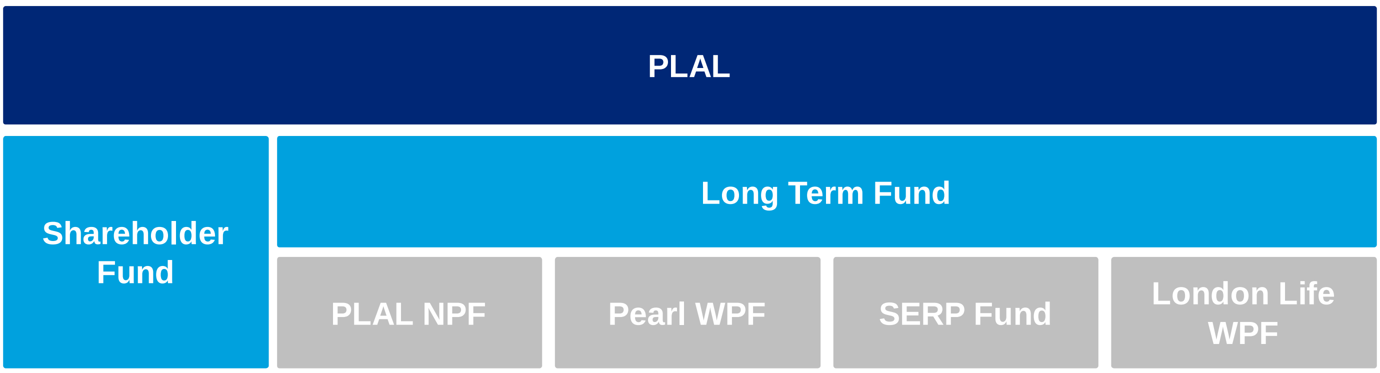
The company sold industrial and ordinary branch life and pension business and general insurance business. It ceased to sell new industrial branch business in 1997 and other business, except for increments on existing business, at the end of 2002.

## Current Structure

PLAL has a shareholders fund (the “PLAL SHF”) and a long-term insurance fund (the “PLAL LTF”). The long-term insurance fund has four sub-funds:

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

***Figure A4.1 – Fund structure of PLAL***



## Nature of Business of PLAL

The following table shows the value of business in the PLAL NPF at 31 December 2013.

***Table A4.2 – Business in PLAL NPF, values at 31 December 2013***

| Product Type | Number of policies | Gross Mathematical Reserves (£m) | Reinsured Mathematical reserves (£m) | Net Mathematical reserves (£m) |
|---|---|---|---|---|
| **Term assurance** | 47,797 | -34 | -5 | -29 |
| **Annuities in payment** | 150,913 | 2,534 | 1,577 | 957 |
| **Deferred annuities** | 2,053 | 34 | 0 | 34 |
| **Other** | 56,215 | 428 | 14 | 414 |
| **Total** | **256,978** | **2,961** | **1,586** | **1,376** |

*Source: PLAL PRA returns 2013*

Pension business from the three with-profits funds currently vests into the PLAL NPF. Non-profit annuities in payment written by NPLL are also reinsured to the PLAL NPF.

Some of the pension annuities in payment are reinsured to Opal Reassurance Limited ("Opal"), a captive reinsurer within the Phoenix Group. Opal bears the longevity and investment risk of the business reinsured to it, with PLAL retaining the expense risk. The total liabilities reinsured under the Opal arrangement at 31 December 2013 were £1,582m. Increments and new business are not accepted under the treaty, and so are retained by PLAL.

The with-profits sub-funds include a range of business, both with-profits and non-profit business. None of the Transferring Policies are to be allocated to these sub-funds under the Scheme. The with-profits funds are ring-fenced and therefore would only be impacted by the Transferring Policies in extreme scenarios (as described in paragraph 5.47).

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

***Table A4.3 – Business in PLAL with-profits funds, values at 31 December 2013***

| Fund | Number of policies | Gross Mathematical Reserves (£m) | Reinsured Mathematical reserves (£m) | Net Mathematical reserves (£m) |
|---|---|---|---|---|
| Pearl WPF | 1,435,902 | 5,417 | 7 | 5,409 |
| SERP | 37,269 | 1,132 | 0 | 1,132 |
| LL WPF | 39,196 | 661 | 7 | 654 |
| **Total** | **1,512,367** | **7,210** | **15** | **7,195** |

*Source: PLAL PRA returns 2013*

## The Pearl WPF

The Pearl WPF 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.

The unitised with-profits element of NPLL's Portfolio Bond is reinsured to the Pearl WPF.

## The SERP Fund

This fund only includes with-profits SERP policies which were originally issued by NPLL's predecessor company, NPI, and were transferred to PLAL under the SERP Scheme. The SERP policies provide a guaranteed minimum annuity payable at the vesting age specified in the policy contract. NPI 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 PLAL or another insurer, to purchase a pension at annuity rates prevailing at the time.

## The London Life WPF

The LL WPF contains the business transferred to PLAL from the Pension With-Profits Fund and the Life With-Profits Fund of London Life Limited under the PLAL 2012 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.

# Appendix 5: Background to NPLL

## Introduction

NPLL was established in 1998 and on 1 January 2000 it received, by way of a Schedule 2C transfer (the “NPLL Scheme”), all of the business of NPI. NPLL has been closed to new business since 2000. No new direct business is currently being written with the exception of incremental business and certain new business issued under options in existing contracts.

The history of NPLL within the Phoenix Group is discussed in Appendix 3 and the NPLL Scheme is discussed in Appendix 9. This appendix provides more detail on the structure within the company and the business it contains.

## Corporate Structure

NPLL is owned by NP Life Holdings Limited, which is wholly owned by the PLAL SHF. NPLL has a shareholder fund and one long-term insurance fund which is known as the NPLL LTF. It contains both with-profits and non-profit business.

Under the terms of the NPLL Scheme, with-profits policyholders allocated to the NPLL LTF are entitled to 100% of the profits and losses arising on business written in the NPLL LTF. However, all incremental business written since 1 January 2000 is reassured into Phoenix Life Limited on terms which mean that all profit and loss on this business arises in Phoenix Life Limited.

## Nature of Business of NPLL

NPLL has a range of non-profit and with-profits business, as summarised in the table below (as at 31 December 2013):

***Table A5.2 – Business in NPLL as at 31 December 2013***

| Product Type | Number of policies | Gross Mathematical Reserves (£m) | Reinsured Mathematical reserves (£m) | Net Mathematical reserves (£m) |
|---|---|---|---|---|
| Non-profit annuities | 13,300 | 200 | 128 | 72 |
| Life (conventional with-profits) | 1,504 | 19 | 0 | 19 |
| Pensions (conventional with-profits) | 6,818 | 372 | 0 | 372 |
| Life (unitised with-profits) | 8,963 | 171 | 11 | 160 |
| Pensions (unitised with-profits) | 108,067 | 2,135 | 4 | 2,131 |
| Deposit administration | 922 | 22 | 0 | 22 |
| Life (unit-linked) | 4,993 | 76 | 75 | 1 |
| Pensions (unit-linked) | 121,203 | 1,715 | 1,672 | 43 |
| Life (index-linked) | 22 | 0 | 0 | 0 |
| Pension (index-linked) | 115 | 3 | 2 | 0 |
| Miscellaneous | 5,919 | 15 | 1 | 13 |
| **Total** | **271,826** | **4,728** | **1,895** | **2,834** |

*Source: NPLL PRA returns 2013*

# Appendix 6: Summary Pillar 1 Financial Information

## Introduction

This Appendix provides a fund-level breakdown of the estimated Pillar 1 financial impact of the Scheme, had it been implemented as at 31 October 2014, as summarised in Section 5. The analysis is in accordance with the Pillar 1 reporting basis required under UK regulations. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 6 April 2015).

The LTICR is calculated at a company level; the LTICR shown for individual funds is included for additional information. The failure of an individual fund to hold sufficient capital to cover its LTICR does not mean that the company is failing to meet its regulatory capital requirements, as it is permitted to be covered from other sources.

## Summary Pillar 1 Financial Information

### Pre-scheme Pillar 1 solvency position

***Table A6.1 – PLAL pre-scheme solvency position as at 31 October 2014***

| £m | PWP | SERP | LL WP | Non Annuity | Annuity | Opal | SHF | Total |
|---|---|---|---|---|---|---|---|---|
| **Capital Resources (1)** | **1,489** | **28** | **8** | **0** | **40** | **-5** | **390** | **1,950** |
| LTICR | 225 | 48 | 26 | 12 | 39 | 0 | 0 | 351 |
| CRR Regulated Subsidiary | 0 | 0 | 0 | 0 | 0 | 0 | 120 | 120 |
| WPICC | 1,053 | 0 | 0 | 0 | 0 | 0 | 0 | 1,053 |
| **Capital Requirement (2)** | **1,279** | **48** | **26** | **12** | **39** | **0** | **120** | **1,525** |
| **Surplus assets in excess of Capital Requirement (3)** | **211** | **-20** | **-18** | **-12** | **1** | **-5** | **269** | **425** |
| ***Cover for Capital Requirement (4)*** | | | | | | | | ***128%*** |

***Table A6.2 – NPLL pre-scheme solvency position as at 31 October 2014***

| £m | LTF | SHF | Total |
|---|---|---|---|
| **Capital Resources (1)** | **37** | **170** | **207** |
| LTICR | 120 | 0 | 120 |
| CRR Regulated Subsidiary | - | - | - |
| WPICC | - | - | - |
| **Capital Requirement (2)** | **120** | **0** | **120** |
| **Surplus assets in excess of Capital Requirement (3)** | **-83** | **170** | **86** |
| ***Cover for Capital Requirement (4)*** | | | ***172%*** |

## Post-scheme Pillar 1 solvency position

***Table A6.3 – PLAL post-scheme solvency position, estimated values at 31 October 2014***

| £m | PWP | SERP | LL WP | NPL WP | Non Annuity | Annuity | Opal | SHF | Total |
|---|---|---|---|---|---|---|---|---|---|
| **Capital Resources (1)** | **1,489** | **28** | **8** | **37** | **-0** | **40** | **-5** | **381** | **1,978** |
| LTICR | 225 | 48 | 26 | 120 | 12 | 38 | 0 | 0 | 471 |
| CRR Regulated Subsidiary | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 3 | 3 |
| WPICC | 1,053 | 0 | 0 | 0 | | | 0 | 0 | 1,053 |
| **Capital Requirement (2)** | **1,279** | **48** | **26** | **120** | **12** | **38** | **0** | **3** | **1,527** |
| **Surplus assets in excess of Capital Requirement (3)** | **211** | **-20** | **-18** | **-83** | **-12** | **2** | **-5** | **379** | **452** |
| ***Cover for Capital Requirement (4)*** | | | | | | | | | ***130%*** |

***Table A6.4 – NPLL post-scheme solvency position, estimated values at 31 October 2014***

| £m | LTF | SHF | Total |
|---|---|---|---|
| **Capital Resources (1)** | **0** | **4** | **4** |
| LTICR | 0 | 3 | **3** |
| CRR Regulated Subsidiary | 0 | 0 | **0** |
| WPICC | 0 | 0 | **0** |
| **Capital Requirement (2)** | **0** | **3** | **3** |
| **Surplus assets in excess of Capital Requirement (3)** | **0** | **2** | **2** |
| ***Cover for Capital Requirement (4)*** | | | ***160%*** |

**Notes:**

*(1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to the Regulators' rules on capital tiers.*

*(2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component plus CRR of regulated subsidiary.*

*(3) Capital Resources less Capital Requirements (where the latter is that part of the entity-level requirements that arises in respect of the relevant fund).*

*(4) Capital Resources divided by Capital Resources Requirement.*

*(5) Since there is no WPICC or CRR of regulated subsidiary for non-profit policies, this is only made up of the LTICR.*

# Appendix 7: NPLL PPFM and changes under the Scheme

UK regulations require that the way in which an insurer exercises discretion in its management of its with-profits business be set out by it in a public document, known as the Principles and Practices of Financial Management. Thus, in considering the potential impact of a scheme on the with-profits policyholders, the Independent Expert will typically pay particular attention to any situation in which the relevant PPFM document might be changed by the scheme.

| | NPLL PPFM pre-Scheme | Corresponding provisions in the PLAL PPFM post-Scheme |
|---|---|---|
| **Form of the PPFM** | The NPLL PPFM covers the with-profits business of the NPLL LTF, the sole long term fund of the company. | The PLAL PPFM will be amended to include a separate chapter for the new NPL WPF.<br><br>Within PLAL, each of the with-profits funds is operated as a stand-alone fund and investment and bonus policy set accordingly. Separate revenue accounts and balance sheets are maintained for each fund within the long-term insurance fund.<br><br>When the Scheme has been completed, a separate chapter will be included in the PLAL PPFM (and the PLAL Customer Friendly PPFM) covering the new NPL WPF, expressing in a consistent manner to the overriding principles and practices of the PLAL PPFM. These changes reflect the terms of the Scheme and consequently, I consider them relevant for my consideration. |
| **Surplus distribution** | Eligible, participating policyholders are able to share in 100% of the distributable surplus of the NPLL LTF. | Policyholders who were eligible to share in the distribution of surplus from the NPLL LTF will also be eligible to share in the distributable surplus of the NPL WPF in the same way, |

| | | |
|---|---|---|
| | | should any such surplus arise and their policy remains within the fund. |
| **In case of deficit arising** | Should a deficit arise in the estate, funds from the Capital Fund, SEF, Earmarked Portfolio, then Asset Share Charge Fund may be utilised to meet guarantee costs. When a surplus occurs in the estate, subject to minimum requirements regarding the financial position of PPFM, the Capital Fund, SEF and Earmarked Portfolio are entitled to be repaid by the NPLL LTF back to the shareholders. | Consistent with the other PLAL WPFs, assets will (if available) be loaned by, or made available by a contribution arrangement with, the PLAL NPF and PLAL SHF to eliminate any deficit in the NPL WPF. For the purposes of managing the funds the assets of the with-profits funds will be treated as being permanently increased from shareholder resources to the extent that there is no realistic prospect of the deficit being reversed. However, this does not preclude the repayment of such loans should the actual experience be such that surplus emerges and repayment becomes due under the terms of the loans.<br><br>In the highly unlikely event that the assets of a with-profits fund, the surplus assets in the PLAL NPF and the surplus assets in the PLAL SHF are insufficient to enable that with-profits fund to meet its guaranteed benefits, then assets from the other with-profits funds would be used, but only to the extent that policyholders' reasonable expectations are not detrimentally affected |
| **Bonus policy** | Annual and interim annual bonus rates are declared annually at December 31 and are not expected to increase beyond 1.5% p.a. for the benefit of the financial position of NPLL. Final bonuses are targeted so that maturity payouts are 100% of the asset share, but may differ because of the impact of smoothing or if the Board deem it necessary to hold back funds for the benefit of the financial position of NPLL. Final bonuses are reviewed twice a year. | The bonus policy will remain unchanged and the powers will be transferred from the Supervisory Board to the PLAL WPC. |

| | | |
|---|---|---|
| **Smoothing** | A smoothing account is maintained to avoid significant fluctuations in annual bonuses, with the intended expected smoothing cost to be zero over time. | The Scheme will maintain a corresponding smoothing account. |
| **Investment strategy** | The investment strategy is responsibility of the Supervisory Board with guidelines for the target asset mix set for the different high-level types of business in the fund. | The investment policy will be unchanged by the Scheme in the NPL WPF and it will be governed by the PLAL WPC. |
| **Expenses** | The NPLL Scheme sets out the type of charges that can be debited from the NPLL LTF and requires that the per policy/benefit costs and the investment management fees are fixed for a period of 10 years following demutualisation (which ended on 31 December 2009). Afterwards the NPLL Scheme states that charges "shall at no time exceed the charges for similar services made by third party companies and shall at no time significantly exceed the costs which [NPLL] would incur in undertaking such services itself". | As the comparison against third party suppliers has become increasingly more complex to evidence, under the new NPL WPF chapter in the PLAL PPFM, the per policy expenses will become fixed at their level immediately prior to implementation of the Scheme and then increased in line with inflation (RPI plus 1%). However, the Scheme also provides that, at any time following the Transfer Date, the PLAL Board may, and shall where so requested by the PLAL WPC, review those expenses and make such changes as are approved by the PLAL WPC.<br><br>The investment expenses can be altered under the authority of the PLAL WPC.<br><br>The Scheme replicates the existing restrictions on what can be debited to the NPLL LTF and introduces a further restriction that mis-selling costs cannot be debited to the NPL WPF.<br><br>In each case, these provisions also remain subject to applicable laws and regulations from time to time (including any regulations made by the Regulators regarding the allocation of costs and charges to with-profits funds). |
| **Tax** | Tax will be allocated to the NPL WPF as if the life business within the fund formed a standalone mutual life assurance | No change. |

| | | |
|---|---|---|
| | company. | |
| **Governance** | NPLL Board and Supervisory Board | Although general responsibility for management of the fund will lie with the PLAL Board, the PLAL WPC will have the right to determine bonus and investment policy (consistent with the Supervisory Board’s powers in respect of the NPLL LTF). Further detail can be found in Appendices 11 and 12. |

# Appendix 8: The PLAL 2012 Scheme

On 30 September 2012 all of London Life's long-term insurance business was transferred to PLAL pursuant to a Part VII transfer under the FSMA. PLAL changed its name from Pearl Assurance Limited around the transfer date.

The PLAL 2012 Scheme had the following effects:

- It established the LL WPF as a new with-profits sub-fund of the long-term insurance fund of PLAL. All policies, assets and liabilities of the existing with-profits sub-funds of LL were transferred into this new sub-fund with the exception of assets equivalent to all amounts owing from those sub-funds under the terms of the LL contingent loan from its parent company, Pearl Group Holdings.
- The amount injected by LL shareholders into the existing with-profits sub-funds of LL at the time of the LL's demutualisation was re-designated as shareholder assets and deemed to be support provided to the LL WPF to meet the terms of the PLAL Capital Policy. Profit sharing in the LL WPF was set to 100:0.
- All policies, assets and liabilities of LL non-profit sub-funds were allocated to PLAL NPF.
- Assets and liabilities of LL SHF were allocated to PLAL SHF.
- Amounts under the LL contingent loan were repaid and the loan was terminated.
- It established a new capital policy in PLAL. Details are contained in Section 5.
- The requirement for PLAL to maintain the Pacific Fund ceased and policyholder protection was instead provided by PLAL Capital Policy.
- It enabled PLAL to introduce targeted asset allocation strategies within the Pearl WPF in future notwithstanding any policy terms and conditions to the contrary, and subject to satisfaction of certain requirements and standards.
- It enabled PLAL to transfer certain non-profit policies held in PLAL WPFs to the PLAL NPF subject to specified conditions.
- It introduced provisions to allow for future wind-up or merger of the PLAL WPFs. Provisions were also included to allow for the amalgamation, wind-up or division of unit-linked funds.

# Appendix 9: The NPLL Scheme

NPLL was established in 1998. It has been a direct subsidiary of NP Life Holdings Limited, which in turn is owned by the PLAL SHF, since 1999. On 1 January 2000 NPLL received, by way of a transfer made under Schedule 2C to the Insurance Companies Act 1982, all of the business of NPI, a mutual life insurance company established in 1835. This is known as the NPLL Scheme.

Following the NPLL Scheme, NPIL was established to write new business under the NPI brand. As a result, NPLL has only written limited levels of new business 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.

The NPLL Scheme sets out how the run-off of NPLL's business should be managed. It includes provisions, for example, that cover the principles of financial management, expenses, reassurance and governance.

The rights and obligations under the Securitised Loan raised by NPI in 1998 were also transferred to NPLL under the NPLL Scheme.

Under the governance arrangements set out in the NPLL Scheme and the articles of NPLL, a committee of the Board of NPLL, the Supervisory Board, has to be appointed and maintained. The Supervisory Board is responsible for the management of the long-term insurance fund established by the NPLL Scheme, including the investment and bonus policy. The members of the Supervisory Board must have regard solely to the interests and reasonable expectations of NPLL policyholders and a majority of its members must be independent of any company in the Phoenix Group.

On 15 February 2010 all of NPLL's Self Employed Retirement Plan ("SERP") business was transferred from the NPLL LTF to a newly created fund in PLAL pursuant to a transfer under Part VII of the FSMA. This is known as the SERP Scheme.

The SERP Scheme also made amendments to the original NPLL Scheme described above. These amendments came into place on 15 February 2010 and are detailed below.

**<u>The Shareholders' Equalisation Fund</u>**

The amended NPLL Scheme contains a new paragraph (paragraph 10A) which requires the establishment of the SEF within the NPLL LTF. The amended NPLL Scheme also contains a new schedule (schedule 7) which contains provisions on the operation of the SEF and which puts restrictions on the amount of the SEF that can be released to the Loan Capital Fund, or otherwise as directed by Pearl, in each subsequent year.

Any such release can only occur to the extent that a deficit (as defined in the amended NPLL Scheme) would not arise and to the extent that an investigation discloses sufficient surplus.

The investment return on the SEF is retained within the SEF and it bears its own investment expenses and tax. The NPLL Board determines the investment policy of the SEF, taking into account the advice of the NPLL Actuarial Function Holder.

As a result of the creation of the SEF, the following changes were made in the amended NPLL Scheme:

- **Changes to the credits and debits permitted between the NPLL funds**

The amendments to the NPLL Scheme (paragraphs 27, 28, 36, 37 and 38) permitted the transfer of money between the NPLL Fund, the NPLL Capital Account, the NPLL Transfer Capital Fund and the NPLL Loan Capital Fund and enabled the assets of the NPLL Transfer Capital Fund to be transferred to Pearl pursuant to the scheme.

- **Changes to the Principles of Financial Management**

  The amendments to the NPLL Scheme allowed (paragraph 6 of Schedule 3), in the NPLL Fund:

  - the allocation of returns to the respective funds to be based on a notional allocation of assets backing the relevant liabilities; and
  - the hypothecation of different asset mixes (and therefore different returns) to different groups of policyholders.

  The Principles of Financial Management were also amended (paragraph 12 of Schedule 3) to recognise the setting up of the SEF and that it:

  - would form part of policyholders' reasonable expectations ("PRE") regarding security of benefits; and
  - would not form part of PRE regarding benefit expectations of anything above asset share.

  These were changes to the conditions laid down in the NPLL Scheme from 2000 and were set out in the amended NPLL Scheme.

# Appendix 10: Description of Reinsurance Arrangements

## Description of Existing Material Reinsurance Arrangements

### Reinsurance between NPLL and PLAL

| Treaty Number | Principal classes of business reinsured | Nature of cover | Extent of cover | Amount of mathematical reserves ceded (at year-end 2013, £m) | Impact of Scheme on reinsurance |
|---|---|---|---|---|---|
| INT05 | Portfolio Bond policies written by NPLL from 1 July 1999 to 31 December 1999. Covers with-profits unit liabilities, expenses and death benefit of up to 0.1%.<br>Reinsured by the Pearl WPF. | Original terms | 100% reinsurance | 11.4 | Both sides of treaty will end up in PLAL.<br>Treaty will collapse and be replaced by an inter-fund agreement in PLAL between the NPL WPF and the Pearl WPF. |
| INT08 | Immediate Annuities (pre demutualisation).<br>Reinsured by the PLAL NPF | Original terms | 100% reinsurance except for the expense of administration | 63.7 | Both sides of treaty will end up in PLAL.<br>The treaty will collapse as the business is being transferred to the PLAL NPF. |
| INT17 | Annuity Payments and expenses on NPLL annuities vesting 31/03/12 onwards.<br>Reinsured by the PLAL NPF. | Original terms | 100% reinsurance | 88.6 | Both sides of treaty will end up in PLAL.<br>The treaty will collapse as the business is being transferred to the PLAL NPF. |
| INT18 | Expenses on incremental unitised with-profits pensions business written from | Expenses only | 100% reinsurance | 2.0 | Both sides of treaty will end up in PLAL. The incremental unitised with-profits |

| Treaty Number | Principal classes of business reinsured | Nature of cover | Extent of cover | Amount of mathematical reserves ceded (at year-end 2013, £m) | Impact of Scheme on reinsurance |
|---|---|---|---|---|---|
| | 1/1/2000 | | | | business will move to the new NPL WPF in PLAL.<br>The treaty will collapse and will be replaced by an inter-fund arrangement between the NPL WPF and the PLAL NPF. |

*Sources: PRA Returns 2013, summary of Scheme provided by Phoenix*

## Reinsurance between NPLL and PLL

| Treaty Number | Principal classes of business reinsured | Nature of cover | Extent of cover | Amount of mathematical reserves ceded (at year-end 2012, £m) | Impact of scheme on reinsurance |
|---|---|---|---|---|---|
| INT06 | Increments on UL business written from 1/1/2000 are fully reinsured.<br>The expense liability on all unitised with-profits and capital account business sold post-2000 is reassured. | Original terms | 100% reinsurance | 280.6 | Treaty to remain, but will be between PLAL and PLL. |
| INT07 | Unit-linked funds on policies written prior to 1/1/2000 are ceded as investment-only reassurance. | Investment only | 100% Investment | 1,450.3 | Treaty to remain, but will be between PLAL and PLL. |

*Sources: PRA Returns 2013, summary of Scheme provided by Phoenix*

# Appendix 11: Changes to NPLL Governance

Under the governance arrangements set out in the NPLL Scheme, a committee of the Board of NPLL, known as the Supervisory Board, has to be appointed and maintained. Unlike a conventional with-profits committee, the Supervisory Board is responsible for the management of the NPLL LTF established by the NPLL Scheme, including the investment and bonus policies. The members of the Supervisory Board must have regard solely to the interests and reasonable expectations of NPLL policyholders and a majority of its members must be independent of any company in the Phoenix Group.

Under the Scheme, the Supervisory Board will cease to exist. As set out below, while the Scheme transfers a number of key rights and responsibilities of the Supervisory Board in respect of the NPLL LTF to the PLAL WPC in respect of the new NPL WPF, overall responsibility for the management of the new NPL WPF will reside with the PLAL Board. The Scheme brings the management of the NPL WPF into line with the management of the other PLAL WPFs and the current legal and regulatory framework (under which responsibility for the management of a regulated business is allocated to the board of directors).

## Rights and responsibilities of the PLAL WPC in respect of the NPL WPF

The Scheme substantially replicates a number of the provisions in the NPLL Scheme, which set out the rights and responsibilities of the Supervisory Board in respect of the NPLL LTF. Under the Scheme, these rights and responsibilities are transferred to the PLAL WPC in respect of the new NPL WPF.

- The obligation to have regard solely to the interests and reasonable expectations of policyholders in the NPL WPF when carrying out its duties.
- The requirement for the PLAL WPC to consist of a majority of Non-Executive Members who, as in the Supervisory Board, must not hold an executive or non-executive role within the Phoenix Group. The requirements in relation to the composition of the PLAL WPC also contain additional restrictions, which reflect the independence criteria used elsewhere in the Phoenix Group.
- The requirement for the chairman of the PLAL WPC to be a Non-Executive Member.
- The right to exercise all the powers of the PLAL Board in connection with both the investment and bonus policies of the NPL WPF.
- A requirement for the PLAL Board to obtain WPC approval of certain key matters relating to the NPL WPF, including the acquisition or disposal of any assets or business of the NPL WPF other than for investment purposes.
- Oversight of decisions made by the PLAL Board in relation to its management of the NPL WPF.
- Various other ancillary rights granted to the Supervisory Board, including the right to contact the regulators, to examine PLAL's books and to take professional advice.

## Rights and responsibilities of the PLAL Board in respect of the NPL WPF

Under the Scheme, overall responsibility for the management of the new NPL WPF will reside with the PLAL Board. This differs from the situation under the NPLL Scheme, where the Supervisory Board has responsibility for the management of the NPLL LTF. As noted above, several of the rights and responsibilities in relation to the management of the NPL WPF will be held by the PLAL WPC, but the following rights and responsibilities (which are held by the Supervisory Board in relation to the NPLL LTF) will be held by the Board under the Scheme.

- Any discretion in operational expenses and charges are currently agreed between the Supervisory Board and the NPLL Board. Under the Scheme, the PLAL Board will generally determine the expenses and charges relating to the operation of the NPL WPF, subject to applicable law and regulation from time to time, but the Scheme provides that the level of per-policy expenses charged to the NPL WPF will be set to their level immediately prior to implementation of the Scheme and then continue to increase in line with inflation (RPI plus 1%). The Scheme also provides that, at any time following the Transfer Date, the PLAL Board may, and shall where so requested by the PLAL WPC, review those expenses and make such changes as are approved by the PLAL WPC.

- The Supervisory Board is currently required to approve the undertaking or discharging of reassurance agreements in relation to the NPLL LTF. Under the Scheme, such decisions will reside with the PLAL Board. Nonetheless, the Scheme requires prior approval of the PLAL WPC to be sought.

- Terms of financial assistance or support in relation to the NPLL LTF are currently approved by the Supervisory Board. Under the Scheme, this is the responsibility of the PLAL Board, but they will be required to get the With-Profits Actuary to certify that the terms of any financial assistance given by the NPL WPF to any other PLAL funds are no less favourable than arm's length commercial terms and that there will be no detrimental impact on relevant with-profits policyholders, providing an equivalent level of protection to policyholders. Under the terms of the PLAL 2012 Scheme, which will be relevant under the Scheme, such assistance could only be provided once all surplus assets in the PLAL Non-Profit Fund and Shareholders' Fund were exhausted. The PLAL Capital Policy is discussed in more detail in paragraphs 5.24 – 5.30.

- Under the current arrangements, asset shares of different groups of policies in the NPLL LTF accumulate on a basis described in the PPFM and determined by the Supervisory Board following advice from the With-Profits Actuary. The Scheme contains a corresponding provision in respect of the NPL WPF, although all power to set hypothecation dates and the basis for further accumulation of asset shares will lie with the PLAL Board. The Scheme does not include any explicit requirement to use the advice of the With-Profits Actuary to set the basis, as was the case under the NPLL Scheme, or to involve the PLAL WPC. Under the Scheme, the PLAL Board is required to consider 'appropriate actuarial advice'.

## Removal of provisions

The Scheme has not replicated a number of provisions that currently exist under the NPLL Scheme, for the following reasons:

- Where the provision(s) relate to assets to be transferred under the NPLL Scheme and are therefore of no continuing relevance.

- Where the provision(s) relate to a historic arrangement that has no continuing relevance to the operation of the NPL WPF.

- Where the maximum number of years up to which membership rights entitles compensation has expired.

- Where the Scheme already includes provisions regarding the closure of linked funds, as reserved under the NPLL Scheme.

# Appendix 12: NPLL Scheme Mapping

The table below explains how each of the key provisions of the NPLL Scheme and the relevant schedule of the NPLL Articles of Association relating to the Supervisory Board will be carried forward. I have used the analysis in table A12.1 when considering the requirements of paragraph 34 of the NPLL Scheme in Section 6 of my Report. In many cases there is wording in the Scheme that has an equivalent or very similar effect, in some cases the provisions no longer have effect, and in others the Scheme has led to a change which I consider not to be materially adverse to policyholders. For this reason, I have not detailed those provisions in this Appendix.

***Table A12.1: Changes that the Scheme makes to the NPLL Scheme***

| Articles of NPLL Scheme | Original Provision - What the NPLL Scheme says | Section of Scheme | Changes from the NPLL Scheme to the Scheme (which is set out in this Report) |
|---|---|---|---|
| **SCHEDULE FOR THE NPLL SUPERVISORY BOARD** | 1. Definitions<br><br>1.1 Definitions of reserved matters that the NPLL Supervisory Board has a say in. There are ten matters in total. | **SCHEDULE 4: PLAL WITH-PROFITS COMMITTEE DUTIES AND POWERS IN RESPECT OF THE NPL WPF** | 1.1 Four out of ten of the reserved matters ((a) – d)) have been replicated (subject to necessary definitional amendments). These include, in particular, those reserved matters relating to the acquisition or disposal of assets/business other than for investment purposes.<br><br>A further 4 of the reserved matters have been removed, because they represent activities that neither NPLL or PLAL would carry out or are not applicable to the NPL WPF (items (e), (f), (g) and (i))<br><br>The remaining 2 reserved matters, (h) and (j) are not replicated:<br><br>(h) the borrowing of any money for the account of the National Provident Life Fund (“NPLF”);<br><br>(j) taking any steps to mitigate taxation<br><br>This is because they are considered to be related to the general management of the fund and hence fall within the remit of the PLAL Board rather than the PLAL With-Profits Committee. This is consistent with the wider change that the Scheme will effect in respect of the transferring business, by making the PLAL WPC responsible for managing the investment and bonus policy of the NPL WPF, but making the PLAL Board responsible for the general management of the fund, subject to oversight from the PLAL WPC. |
| | 1.2 – 1.17 Other definitions | | 1.2 – 1.17 The remaining definitions have either been:<br><br>a) replicated, subject to definitional amendments;<br><br>b) expanded for consistency with terms with the PLAL WPC terms of reference; or<br><br>c) removed, as no longer deemed relevant. |

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| **25. Allocation of expenses and charges** | Any discretion in expenses/charges (in respect of the acquisition, set up, maintenance or termination of policies in the NPLF) that was to be charged to the NPLF was agreed between the Supervisory Board and the NPL Board. | **20. Allocation of expenses and charges** | The Scheme provides that the PLAL Board will generally determine the expenses and charges relating to the operation of the NPL WPF, subject to applicable law and regulations, but that expenses and charges relating to administration and investment management are to be determined in accordance with Schedule 2 of the Scheme. Schedule 2 provides, subject to applicable law and regulation:<br><br>For administration expenses to be set initially at current levels and then to increase in line with RPI + 1%, subject to provisions enabling the PLAL Board to review the expenses, and the PLAL WPC to require the PLAL Board to do so, and for any replacement arrangements to be subject to approval by the PLAL WPC.<br><br>For investment management expenses to be approved by the PLAL With-Profits Committee. |
| **26. Linked funds** | NPLL and NPIL entered into the Linked Reassurance Agreement, in relation to the Linked Funds in NPLF for the purpose of achieving continuity of treatment of unit liabilities. This was to ensure that there is no reduction in the surplus arising in the NPLF and to protect PRE. No other version of this arrangement could be entered into without prior approval of the Supervisory Board | **32. Inwards, outwards and internal reassurance** | The PLAL 2012 Scheme states that the approval of the PLAL WPC is needed if entering into any variation of this linked reassurance agreement. Nonetheless, the PLAL Board will be the ones who decide whether or not to enter into these arrangements (having obtained actuarial advice). |
| **31. Reassurance by and of the NPLF** | Any terms of internal/external insurance or amendment to these terms to be approved by the Supervisory Board first. | **32. Inwards, outwards and internal reassurance** | PLAL Board will be in charge of any undertaking or discharging of reinsurance, as is stated in the PLAL 2012 Scheme. But an extra clause has been added in the Scheme so that the PLAL WPC has to approve the terms of any reassurance. This applies to both internal and external reassurance. |
| **32. Miscellaneous Provisions regarding the NPLF** | Terms of any such financial assistance or support (and the terms of any amendment or termination thereof) shall first have been approved by the Supervisory Board after having been advised by the Appointed Actuary that the terms don't adversely affect policyholders. | **Paragraph 18.2 of the Scheme.**<br><br>**Paragraph 26 of the PLAL 2012 Scheme:** | This topic of capital support is covered elsewhere in the report, not under governance.<br><br>The Scheme provides for the standard capital support provisions applicable under the general PLAL Capital Policy to apply to the NPL WPF.<br><br>In distinction from the NPLL Scheme, the PLAL Capital Policy does not require the PLAL WPC to approve the terms of the assistance given by the NPL WPF. However, by requiring the WP Actuary to certify that the terms of any financial assistance given by the NPL WPF to any other PLAL funds are no less favourable than arm's length commercial terms and that there will be no detrimental impact on relevant with-profits policyholders, an equivalent level of protection is provided. In any event, such assistance could only be provided once all surplus assets in the PLAL NPF and SHF were exhausted. |
| **33. Provision for cessation of the NPLF** | If the with-profits amount of the NPLF falls below £500m (which is to be adjusted by inflation each year as agreed by the Supervisory Board having been advised by the Appointed Actuary) then subject to agreement by, and on terms approved by, the Supervisory Board and the Insurance Regulators, NPL may cease to maintain NPLF as a separate fund and the provisions of the Scheme relating to the Supervisory Board may cease to apply provided the Appointed Actuary agrees it does not adversely affect | **21. Merger and closure of the NPL WPF** | Again, this is covered elsewhere in the Scheme, not under governance.<br><br>It is proposed that the closure provisions for the NPL WPF are substantially conformed to the terms for closure for other PLAL funds/the Phoenix group norm.<br><br>In particular, this means that PLAL will be obliged (subject to approval from the regulators) to convert the with-profits policies in the NPL WPF into non-profit policies and close the fund once the with-profits liabilities of the fund fall below |

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| | policyholder reasonable expectations. | | £50 million – this will represent a new power in respect of NPLL policies.<br><br>PLAL will have a similar right to merge the NPL WPF with another WPF once the with-profits liabilities of the fund have fallen below an equivalent threshold (updated to £750 million increased by RPI since 31 December 2013). |
| **49. NPLF Supervisory Board** | Appointment of the Supervisory Board which shall be solely responsible for the management (including, subject to the express terms of this Scheme, investment and bonus policy) of the NPLF (except the Capital Funds). The members of the Supervisory Board shall, in carrying out their duties, have regard solely to the interests and reasonable expectations of the NPLF policyholders.<br><br>Note: The current situation, under which the management of the NPLF is vested in the Supervisory Board, conflicts with the position under regulation, under which responsibility for the management of a regulated business is allocated to the board of directors. This effectively means that both the NPLL board (as a matter of regulation) and the Supervisory Board (under the NPLL Scheme) are responsible for the management of the NPLF. | **26. PLAL With-Profits Committee** | This has already been mentioned in other sections of this table.<br><br>Under the Scheme, responsibility for the management of the NPL WPF will, in general, lie with the PLAL board rather than the Supervisory Board/PLAL WPC. This will bring the management of the NPL WPF in line with the current legal and regulatory framework and the way the other with-profits funds in PLAL are managed.<br><br>Under the terms of the Scheme the PLAL WPC will inherit the Supervisory Board's power to manage the investment and bonus policy of the NPL WPF. The PLAL WPC's agreement will also need to be obtained in respect of some (but not all) reserved matters which formerly required the approval of the Supervisory Board. The retention of these key powers, combined with the PLAL WPC's ability to oversee the management of the NPL WPF (both as a result of the specific provisions replicated in the Scheme and the general provisions of UK regulation), is intended to ensure that there is no adverse impact on the protections for former NPLL policyholders. |
| **53. Modifications or additions** | If at any time the provisions of this Scheme prove impossible, impracticable or inequitable to implement, NPL shall be at liberty, with the consent of the Supervisory Board, to apply to the Court for consent to amend its terms, provided that in any such case:<br><br>(a) the Insurance Regulator shall be notified of and have the right to be heard at any Court Hearing<br><br>(b) such application shall be accompanied by a certificate from an independent actuary saying that it will not adversely affect policyholder reasonable expectations. | **35. Modification or additions** | Replicated subject to minor definitional amendments.<br><br>There is an inclusion of a power for PLAL to make minor/technical amendments without obtaining the approval of the Court, as long as the regulator does not object. This is included for pragmatic reasons. |
| **Schedule 3 - Principles of Financial Management** | 3. The investment policy for the NPLF shall have regard to the nature of the liabilities of the NPLF, and seek to maximise the investment return on the property of the National Provident Life Fund attributable to With Profits Policies, whilst recognising the need to safeguard the financial security of the National Provident Life Fund. | **Schedule 1: Scheme Principles for the Financial Management of the NPL WPF** | Amended to make clear that the investment policy of the NPL WPF should not be set on the basis that assets in the SHF or NPF are available to provide support except to the extent that they are transferred into the fund at the Transfer Date or the PLAL Board subsequently agrees to make support available in accordance with the PLAL Capital Policy. This is consistent with the current position, where the Supervisory Board is able to set the investment policy of the National Provident Life Fund on the basis of existing support, but not on the basis that further support may be provided by NPLL's shareholder. |
| | Asset Share calculations shall be referred to in setting bonus rates in order to ensure equity between different groups of policyholders. Asset Shares shall be determined by the Appointed Actuary as at the Effective Date using NPI's approach at 31st December 1998. Thereafter, and until the Hypothecation Date referred to below, those Asset Shares shall be accumulated by reference to the financial position, performance and experience of the National | | The first Hypothecation Date occurred on 1 February 2014. Following the Transfer Date, until such further Hypothecation Date (if any) as the PLAL Board may select, asset shares shall continue to be accumulated on a basis consistent with that described in the PPFM for the NPLF immediately prior to the Transfer Date.<br><br>This provision has been replicated, although all power to set hypothecation dates |

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|---|---|---|---|
| | Provident Life Fund. With effect from the Hypothecation Date referred to below, Asset Shares of different groups of Policies shall accumulate on a basis described in the relevant PPFM and determined by the Supervisory Board following advice from the WPA. Without limitation, such basis may include an allocation of investment return as if distinct and different asset mixes had been allocated to identified groups of Policies, whether or not the NPLF in fact holds such assets. For this purpose the Hypothecation Date shall be a date or (in the event further changes are to be made to the basis for the future accumulation of Asset Shares after an earlier Hypothecation Date) dates selected by the Supervisory Board. The Supervisory Board shall give written notice to the Insurance Regulator of, and consult with the Regulator about, such proposed basis for the future accumulation of Asset Shares. NPL shall not be entitled to implement the proposed basis for the future accumulation of Asset Shares until it has received notice in writing of the Regulator's non-objection to such proposal. | | and the basis for further accumulation of Asset Shares will lie with the PLAL Board instead of the Supervisory Board and there will be no explicit requirement to use advice of a WPA to set the basis, or to involve the PLAL WPC. The WPA requirement that there was previously has been replaced by the PLAL Board using 'appropriate actuarial advice', see the exact wording below:<br>"asset shares of different groups of Policies shall accumulate on a basis described in the relevant PPFM and determined by the PLAL Board, having obtained appropriate actuarial advice."<br>The requirement to give notice to the regulator about the proposed basis for the future accumulation of asset shares is still in place. |
| | N/A | | Closure bonus is introduced to reflect the new fund merger provisions. Any surplus on closure would be distributed to increase guarantees for WP policyholders. |
| **N/A** | N/A | | Introduces a restriction so that any mis-selling compensation or redress or other costs cannot come from the NPL WPF. |

# Appendix 13: Data and Reliances

The following section lists the items of information that I have received, reviewed and relied upon in relation to the preparation of this Report. This includes various emails and documents received from management of the Companies and publicly available information.

| Scheme documents | Date of document | Company relating to |
|---|---|---|
| Draft Scheme document | 04/12/2014 | Both |
| Scheme Order | 06/12/2014 | Both |
| Notice of the Scheme | 20/11/2014 | Both |
| Summary of the main features of the Scheme | 17/01/2014 | Both |
| Comparison of the Scheme to the NPLL Scheme | 29/08/2014 | NPLL |
| An overview of policyholder impacts from Phoenix | 29/08/2014 | Both |
| Draft Scheme Witness Statement (Andrew Moss) | 12/12/2014 | Both |
| **Company background** | | |
| NPLL Memorandum and Articles | 01/10/1999 | NPLL |
| PLAL Memorandum and Articles | 25/09/2012 | PLAL |
| NPLL Scheme and amendment – Court approved | 09/02/2010 | NPLL |
| PLAL 2012 Scheme - Court approved | 24/09/2012 | PLAL |
| PLAL 2012 Scheme IE report | 24/05/2012 | PLAL |
| PLAL 2012 Scheme supplementary IE report | 17/09/2012 | PLAL |
| SERP Scheme - Court approved | 09/02/2010 | PLAL |
| SERP Scheme IE report | October 2009 | PLAL |
| SERP Scheme supplementary IE report | January 2010 | PLAL |
| NPLL YE13 Report and Accounts | 31/13/2013 | NPLL |
| **PPFM** | | |
| NPLL Principles and Practices of Financial Management | July 2014 | NPLL |
| PLAL Principles and Practices of Financial Management | July 2014 | PLAL |
| **Regulatory returns** | | |
| NPLL PRA returns for year ending 2013 | 31/12/2013 | NPLL |

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| PLAL PRA returns for year ending 2013 | 31/12/2013 | PLAL |
| **Actuarial Function Holder and With Profit Actuary reports on the Scheme** | | |
| Report by the NPLL AFH on the impact of the proposed transfer on its policyholders | 12/12/2014 | NPLL |
| Report by the PLAL AFH on the impact of the proposed transfer on its policyholders | 12/12/2014 | PLAL |
| Report by the NPLL WPA on the impact of the proposed transfer on its with-profit policyholders | 21/11/2014 | NPLL |
| Report by the PLAL WPA on the impact of the proposed transfer on its with-profit policyholders | 21/11/2014 | PLAL |
| **Reinsurance agreements** | | |
| NPLL to Pearl Pension Annuity Reinsurance Agreement | 2001 | NPLL |
| NPLL to Pearl Unitised With-Profits Reinsurance Agreement | 05/01/1999 | NPLL |
| NPLL to Pearl New Annuity Reinsurance Agreement | 31/03/2012 | NPLL |
| NPLL to Pearl Incremental Business Reinsurance Agreement | 15/10/2013 | NPLL |
| **Capital policies** | | |
| NPLL and PLAL Capital Policy Review (presented to Boards on 2 December 2014) | 18/11/2013 | Both |
| **Governance** | | |
| Supervisory Board proposal | August 2014 | Both |
| **ICA reports** | | |
| ICA Coverage Note | 08/08/2013 | Both |
| PLAL ICA Report 2012 | 31/12/2012 | PLAL |
| NPLL ICA Report 2012 | 31/12/2012 | NPLL |
| **Tax** | | |
| Summary Tax report | 11/09/2014 | Both |
| HMRC tax clearances | March – May 2014 | Both |
| **Scheme related financials** | | |
| NPLL and PLAL pre and post scheme financials | 29/08/2014 | Both |

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|---|---|---|
| Impact of Solvency II | 10/09/2014 | Both |
| Summary of how the Scheme will simplify the capital support | 29/08/2014 | Both |
| Summary of the collapse of the subordinated NPLL loans following the Scheme | 24/09/2014 | Both |
| Estimated value of shareholder support at December 2013 | 31/12/2013 | NPLL |
| **Customer information** | | |
| Details of NPLL goneaways | 08/09/204 | NPLL |
| Draft scheme covering letter for transferring NPLL policyholders | 20/11/2014 | NPLL |
| Draft of scheme QA for transferring NPLL policyholders | 20/11/2014 | NPLL |
| Draft Scheme guide for transferring NPLL policyholders | 20/11/2014 | NPLL |
| Draft Scheme guide for PLAL policyholders | January 2014 | PLAL |
| **Other** | | |
| Reply to IE Information request - direct costs | 05/12/2013 | Both |
| Information on the Companies' Solvency II positions | 10/09/2014 | Both |
| Attendance at the Supervisory Board meeting, where the Scheme was discussed | 03/11/2014 | NPLL |
| Regulatory correspondence | October 2014 – November 2014 | Both |
| Annuities in payment in NPLL | 04/11/2014 | NPLL |
| Bond Trustee correspondence | 04/12/2014 | Both |

# Appendix 14: Glossary

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

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

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

**Asset Share Charge Fund** is an NPLL fund of accumulated charges from asset shares which is used to meet the guarantee costs of policies when the NPLL LTF is insufficient.

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

**Board** means the board of directors of the relevant entity from time to time.

**Bond Trustee** is the trustee of the bonds issued by the lender under the Securitised Loan Agreement.

**Capital Funds** is an NPLL fund created, from a transfer from the NPLL SHF, to meet policy guarantee costs when the NPLL LTF is insufficient.

**Capital Resources** is the excess of Pillar 1 admissible assets over Pillar 1 regulatory liabilities under the regulatory capital framework specified in the Regulators' Handbooks.

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

**Civil Procedure Rules** are the rules of civil procedure used by the High Court of Justice in civil cases in England and Wales.

**Companies** mean PLAL and NPLL.

**Contracts (Rights of Third Parties) Act** allows third parties to enforce terms of contracts that benefit them in some way, or which the contract allows them to enforce. It also grants them access to a range of remedies if the terms are breached. The Act also limits the ways in which a contract can be changed without the permission of an involved third party.

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

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

**Department for Work and Pensions (DWP)** is the department of the UK Government that is responsible for welfare, pensions and child maintenance policy.

**Earmarked Portfolio** is a loan from the NPLL SHF to the NPLL LTF.

**Effective Date** is 1 January 2015, the date to which the actual transfer will be back dated for accounting purposes

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

**Excluded Policies** are any policies of NPLL which do not transfer under the Scheme.

**Excluded Policyholders** are the holders of the Excluded Policies.

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

**Existing PLAL Policyholders** are the policyholders in the PLAL long-term insurance fund prior to the Transfer Date.

**FCA** is the Financial Conduct Authority which replaced the FSA on 1 April 2013 and has an objective to protect consumers of financial services, ensure the financial services industry remains stable and promote healthy competition between financial services providers.

**FRC** is the Financial Reporting Council, the UK's independent regulator who is responsible for setting standards for corporate reporting and actuarial practice and monitoring and enforcing accounting and auditing standards.

**FSA** is the Financial Services Authority, which was the independent, non-governmental body that regulated the UK insurance industry which was replaced by the FCA and PRA from 1 April 2013.

**FSMA** is the Financial Services and Markets Act 2000.

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

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

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

**Individual Capital Guidance (ICG)** is any additional amount of capital which the Regulator may require a company to hold in addition to its ICA.

**Individual Capital Adequacy Standards (ICAS)** are standards relating to the Pillar 2 capital requirements.

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

**Issuer** is the lender under the Securitised Loan Agreement.

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

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

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

**NPLL Scheme** was a scheme implemented in January 2000 which transferred all of the insurance business from National Provident Institution to NPLL.

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

**Peak 1** or the regulatory peak is a calculation performed under Pillar 1 where asset values are based on market value, liabilities are valued with prudential margins, and solvency capital, expressed as a percentage of liabilities and a rate per mille of sums at risk, is required in addition to the liabilities.

**Peak 2** or the realistic peak is a calculation performed under Pillar 1 by companies which have with-profits liabilities in excess of £500m. In this calculation, liabilities are valued using best estimate assumptions and an extra margin is held in addition to the realistic liabilities reflecting the additional capital that would be needed in moderately adverse scenarios specified by regulations.

**Permitted Transfer** is a transfer of the Securitised Loan that meets the relevant requirements set out in the Securitised Loan Agreement.

**Phoenix Group Holdings (PGH)** is the ultimate parent company of several authorised life assurance companies collectively known as the Phoenix Group. Registered in the Cayman Islands with registered number 202172.

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

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

**PLAL** is Phoenix Life Assurance Limited is an authorised life assurance company registered in England and Wales with registered number 1419.

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

**PLAL 2012 Scheme** is a scheme implemented in September 2012 which transferred all of the insurance business from London Life Limited to PLAL.

**PRA** is the Prudential Regulation Authority which replaced the FSA on 1 April 2013. The PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

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

**Realistic Basis** is where a valuation is performed using 'best estimate' assumptions for future uncertainties.

**Realistic Peak** is a calculation performed on a realistic, market consistent basis, with an RCM, as a regulatory requirement under the Pillar 1 basis for life insurance companies with a with-profits fund in excess of £500m.

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

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

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

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

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

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

**Sanction Hearing** is the hearing at the High Court of Justice of England and Wales at which the final decision to approve or disapprove the Scheme is made.

**Scheme** is the proposed transfer of long-term insurance business from NPLL to PLAL under Part VII of the FSMA.

**Securitised Loan** is the capital raised by NPI and secured on the emerging surplus of the Securitised Portfolio. The rights and obligations under the Securitised Loan transferred to NPLL under the NPLL Scheme.

**Securitised Loan Agreement** is the agreement setting out the terms and restrictions relating to the Securitised Loan.

**Securitised Portfolio** is the portfolio of business, the emerging surplus of which was used to secure the Securitised Loan. It consists of most of the unitised with-profits and unit-linked business in-force (in NPI, the original issuing company) when the Securitised Loan was issued.

**SERP Scheme** was a scheme implemented in February 2010 which transferred all of NPLL's Self Employed

Retirement Plan business to a new fund in PAL, the SERP Fund.

**Shareholder Equalisation Fund (SEF)** is a fund in NPLL which pays into the NPLL SHF when there is a sufficient surplus in the NPLL LTF and the policyholders guarantee costs have been met.

**Solvency II** is the new solvency regime for all EU insurers and reinsurers, due to come into effect on 1 January 2016, though parts of the regime have yet to be settled.

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

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

**TAS D** is the Technical Actuarial Standard D: Data defined in the Scope and Authority of Technical Standards of the FRC.

**TAS M** is the Technical Actuarial Standard M: Modelling defined in the Scope and Authority of Technical Standards of the FRC.

**TAS R** is the Technical Actuarial Standard R: Reporting Actuarial Information defined in the Scope and Authority of Technical Standards of the FRC.

**Transformations TAS** is the Technical Actuarial Standard T: Transformations defined in the Scope and Authority of Technical Standards of the FRC.

**Transfer Date** is the date on which the Scheme is expected to become operative (subject to the approval of the Court), which is expected to be 6 April 2015.

**Transferring Policies** are all transferring NPLL Policies.

**Transferring Policyholders** are the holders of the Transferring Policies.

**Transferor** is NPLL.

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

**Umpire** refers to the actuary or firm of consulting actuaries or, as the case may be, chartered accountant or firm of chartered accountants appointed pursuant to Schedule 1 of the NPLL Scheme.

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

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

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

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

**With-Profits Insurance Capital Component (WPICC)** is an addition made to the Pillar 1 regulatory peak capital requirements to account for the difference if excess assets after the RCM on the realistic peak are less than those under the regulatory peak, less an allowance to reflect any liability to pay shareholder transfers.

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