PHOENIX GROUP

NATIONAL PROVIDENT LIFE LIMITED

Proposed Scheme to Transfer Long-Term Insurance Business

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

20 April 2015

1. Introduction

In my report entitled 'Report by the Actuarial Function Holder on the Impact of the Scheme on Policyholders of National Provident Life Limited, dated 15 December 2014 ("my report"), I concluded that the Scheme will not adversely affect the interests and reasonable expectations of NPLL policyholders and that the protections offered to these policyholders, whether pursuant to the NPLL Scheme or otherwise, will not, in aggregate be reduced by the Scheme. I also concluded that the Scheme should have no adverse impact on the security of policyholders' benefits and that it was consistent with NPLL's obligation to treat customers fairly.

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

As part of my consideration of the Scheme, I have updated the financial analysis to use financial information as at 31 December 2014 and considered whether the impact of the Scheme on the security and benefits of NPLL policyholders would be affected in light of that updated information.

My conclusions are given in section 6. Appendix 1 includes a statement made by the With Profits Actuary giving his support to these conclusions.

This supplementary report is written for the NPLL Board in my capacity as Actuarial Function Holder for NPLL, but may, like my report, be made available to the High Court, the Independent Expert, the Royal Courts in Jersey and Guernsey, the PRA, the FCA, the insurance regulators in Jersey and Guernsey and the National Provident Life Fund Supervisory Board (the "Supervisory Board") to assist them in making their judgements about the Scheme. It is supplementary to my report and should accordingly be read alongside my report. All definitions and abbreviations used in my report apply also to this supplementary report.

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

2. Developments since my report

2.1 Changes to the Scheme

It was initially proposed that, while the Scheme would become operative at a date following the final hearing (the Transfer Date), it would take effect, insofar as it creates rights and obligations that exist only between PLAL and NPLL, on 1 January 2015 (the Effective Date), including for the purpose of the companies' financial statements. Because the final hearing has now been delayed, it is no longer considered feasible to apply this split Transfer Date / Effective Date structure. It is accordingly proposed that the Scheme will become operative and take effect on the same date, namely 30 June 2015. The Scheme has been amended to reflect this and to delete references to the "Effective Date". These changes do not affect the impact of the Scheme on policyholders.

Apart from these, no other changes are proposed to the terms of the Scheme.

I note the arrangements that have been undertaken to bring the adjournment and new hearing date to the attention of policyholders. I am happy that these are appropriate.

2.2 Developments affecting the financial position of NPLL

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

2.2.1 Economic Conditions – The financial analysis in my report was prepared as at 31 October 2014. The following table sets out the movement in some key indicators of economic conditions over the last half of 2014.

	30/06/2014	30/10/2014	31/12/2014
FTSE-100	6,743.9	6,546.5	6,566.1
Change since end June		*-2.9%*	*-2.6%*
Corporate Bond Spreads (basis points over gilts)			
AAA	0.41%	0.38%	0.40%
AA	0.72%	0.74%	0.80%
A	1.16%	1.34%	1.40%
BBB	1.72%	2.00%	2.08%
Property Index	1,013.3	1,083.4	1,113.7
Change since end June		*7%*	*10%*
15 year gilt yield	3.24%	2.73%	2.21%

NPLL's capital position is affected by the performance of its investments – particularly in corporate bonds and gilts and any hedges it has taken against movements in these. The overall investment performance will have different impacts for Pillar 1 and Pillar 2 and these are reflected in the analysis shown in section 3.

2.2.2 Valuation as at 31 December 2014 – NPLL has undertaken a valuation of its assets and liabilities on both Pillar 1 and Pillar 2 as at 31 December 2014. This is based on financial information as at 31 December 2014 (as illustrated above), the actual policies in-force at that date and takes into account the experience during 2014. As part of this and in line with established practice, the assumptions and methodology were reviewed and, where appropriate, the Board approved changes to these, which resulted in a small reduction in liabilities. The results of the valuation are shown in section 3.

2.2.3 Update on Pillar 2 Capital requirements – NPLL and PLAL have undertaken an update of their ICA capital requirements under Pillar 2 using data as at 31 December 2014. These results were approved by the respective boards at their meeting on 14 April 2015. The ICA capital requirements for both companies had increased during the second half of 2014 as a result of falling yields. PLAL met both its Pillar 2 capital requirements and its own capital policy following this update. NPLL met its Pillar 2 capital requirements, but would have had a small shortfall against its own capital policy requirements. The PLAL Board on 14 April 2015 agreed to provide £20m of capital to NPLL under the terms of the agreement referred to in my report whereby PLAL will provide additional capital support to NPLL should the need arise. The capital injection was made on 17 April 2015. It is not reflected in the tables shown in section 3.

2.3 Other Relevant Developments

2.3.1 PLAL Capital Policy – In March 2015, the PLAL Board approved the method to change the parameter values in Test 1 of the PLACP once the Scheme is implemented. The change will ensure that the headroom required under this test will remain the same when the Scheme is implemented. If the method had been applied as at 31 December 2014, the required capital would have been the sum of:

- in respect of each with-profits fund, the proportion of the CRR attributable to that fund, plus an amount equal to the greater of (i) the value of any positive free assets and (ii) 110% of the proportion of the LTICR attributable to that fund less its WPICC, and
- 70% of the proportion of the CRR attributable to the Non-Profit Fund, less 100% of the sum of the positive free assets of the with-profits funds, to the extent that those free assets represent the value of future transfers to the NP Fund or the PLAL Shareholders' Fund, a negative overall result being permitted.

In my report I explained that the PLAL Board had noted that an increase in the additional amount held under the liquidity test is likely to be required on implementation of the Scheme, provisionally from £60m to £76m. This is still expected to be the case.

No changes have been made to the NPLL capital policy since my report.

2.3.2 Securitisation Loan – In my report, I noted that NPLL and PLAL would need to provide the Bond Trustee with a legal opinion regarding the effectiveness of the transfer and obtain confirmation from the Rating Agents that the transfer will not result in the credit rating of the bonds being revised downwards (nor put on credit watch) and stated that I would consider whether these requirements have been satisfied closer in this supplementary report.

The legal opinion referred to above has now been received. The Rating Agents have provided a draft view that the transfer will not affect the credit rating of the bond. This will be confirmed by the Rating Agents once they receive the final versions of this report and the Independent Expert's supplementary report. As a result the Scheme will meet the Permitted Transfer definition and it is expected that the Bond Trustees will confirm that they believe that this is the case before the Final Hearing..

I am satisfied that, if this all happens, there is no reason for the Scheme not to proceed

2.3.3 Solvency II – Although further guidance and consultation papers have been issued since my report, there still remains uncertainty around the application of some of the Solvency II regulations. These uncertainties affect the whole life assurance industry.

NPLL and PLAL have done further work to estimate their likely solvency position under Solvency II and to manage the transition to implementation on 1 January 2016.

As explained in my report the Phoenix Group runs a group-wide project aimed at ensuring that all relevant entities in the group will be ready for the implementation of Solvency II in January 2016. The transfer of NPLL's business to PLAL has been allowed for in those plans. As a result both PLAL and NPLL are in the same state of readiness and there is no adverse impact for NPLL policyholders in terms of Solvency II readiness as a result of the Scheme.

2.3.4 PLAL 2012 Scheme – In my report I explained that PLAL was subject to the terms of the PLAL 2012 Scheme and that PLAL's long-term insurance fund contains a sub-fund called the SERP Fund. Schedule 3 to the PLAL 2012 Scheme includes reference to the NPLL Scheme in respect of charges and expenses that apply to the SERP Fund. Under the terms of the new Scheme, the NPLL Scheme will cease to have effect. Accordingly the PLAL 2012 Scheme will be amended to replace these references to the NPLL Scheme by references to the provisions of the C Scheme which restrict the charges which may be made to the NPL WP Fund in PLAL, as well as to make a number of other minor consequential amendments.

The changes to the PLAL 2012 Scheme do not have any impact on the benefit expectations of transferring policyholders.

2.4 Confirmation of Capital Support Arrangements

In my report I set out the different forms of support to the National Provident Life Fund. Table 1 below shows the value of each form of support as at 31 December 2014. The estimated position as at 30 June 2014 is shown in brackets:

Support Arrangement	Value (£m)
Capital Funds	181 (162)
Asset Share Charge Fund	590 (437)
Shareholder Equalisation Fund	81 (72)
Earmarked Portfolio	92 (99)

The PLAL Board has confirmed that the Shareholders' Fund of PLAL will provide capital support at the Transfer Date of the Scheme equivalent to the amounts held within the Shareholder Equalisation Fund and the Earmarked Portfolio in accordance with paragraph 13 of the Scheme.

I have reviewed the terms on which that support is to be provided and I am satisfied that the terms are fair and will ensure that support will be available to the NPL WP Fund in future.

3. Review of Financial Analysis

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

3.1 Pillar 1 position before and after transfer

My report showed the projected Pillar 1 position of NPLL before and PLAL after the Scheme based on the estimated position as at 31 October 2014. The following tables and the comments in this section 3 update this analysis as at 31 December 2014, taking into account the events referred to in section 2.2 of this supplementary report and financial conditions as at 31 December 2014.

The 31 December 2014 position shown in this section and referred to in the rest of section 3 are based on the results of the audited balance sheets for NPLL and PLAL at that date.

Table 1 below shows the financial position of NPLL as at 31 December 2014. The estimated position as at 31 October 2014 in my report is shown in brackets.

Table 1	NPLL as at 31 December 2014 before the effect of the Scheme		
	Available Capital	LTICR	WPICC
	£m	£m	£m
Long-term Fund	37 (37)	124 (120)	-
Shareholders' Fund	166 (170)	-	-
Total	**203 (207)**	**124 (120)**	-
Total Free Assets (Available Capital less LTICR less WPICC)			**£79m (£86m)**
Overall Cover for CRR (= LTICR + WPICC)			**164% (172%)**
Overall Cover for LTICR			**164% (172%)**

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

Table 1 shows that since my report there has been a small decrease in the amount of Free Assets since 31 October 2014, due primarily to the impact of the changes in economic conditions referred to in section 2.2.1.

Table 2 below shows on a pro forma basis the financial position of PLAL as at 31 December 2014 as if the Scheme had been implemented on that date. The estimated position as at 31 October 2014 given in my report is shown in brackets.

Table 2	PLAL as at 31 December 2014 after the implementation of the Scheme		
	Available Capital	LTICR	WPICC
	£m	£m	£m
Pearl WP Fund	1,617 (1,489)	228 (225)	1,189 (1,053)
LL WP Fund	5 (8)	27 (26)	-
SERP Fund	5 (28)	51 (48)	-
NPL WP Fund	37 (37)	123 (120)	
Non-Profit Fund	30 (35)	64 (50)	-
Shareholders' Fund	453 (381)	3 (3)	-
Total	**2,147 (1,978)**	**496 (474)**	**1,189 (1,053)**
Total Free Assets (Available Capital less LTICR less WPICC)			**£462m (£452m)**
Overall Cover for CRR (= LTICR + WPICC)			**127% (130%)**
Overall Cover for LTICR			**433% (418%)**

This shows that the Free Assets of PLAL after the Scheme has been implemented have increased by a small amount compared to the position at 31 October 2014. The analysis continues to show that implementation of the Scheme will increase the amount by which PLAL will be able to meet its Pillar 1 capital requirements and that this will be met by a significant margin.

3.2 Pillar 2 position before and after transfer

The Pillar 2 solvency position has been calculated as at 31 December 2014 for NPLL before and PLAL after the Scheme in a similar manner to the Pillar 1 analysis above. As at 31 December 2014, NPLL met its Pillar 2 (ICA and ICG) capital requirements, albeit with a smaller amount of excess assets due to an increase in the ICA capital requirements caused by the fall in yields in the second half of 2014.

The Pillar 2 position of PLAL as at 31 December 2014, if the Scheme had been implemented at that date, shows that PLAL will continue to be able to meet its Pillar 2 capital requirements by a significant margin. This is in line with the analysis performed for my report.

3.3 Capital Policy Tests

The PLACP is described in detail in section 4.3 of my report. Based on further analysis, which is not shown here, PLAL on a pro-forma basis is expected to be able to meet the additional capital requirements imposed by its capital policy, as amended as per section 2.3.1. This is in line with the analysis performed for my report.

3.4 Group Capital Adequacy Test and Group ICA

An updated analysis shows that the implementation of the Scheme is expected to lead to an increase in the surplus under the PRA's Group Capital Adequacy Test and no material change in the position under the Group ICA Test. This is in line with the analysis performed for my report.

3.5 Economic conditions and market events since 31 December 2014

Given the timing of the final hearing of the Scheme, it will not be feasible to update the financial analysis of the impact of the Scheme beyond 31 December 2014. However, I am not aware of any subsequent events or facts, nor has anything been drawn to my attention by NPLL or its board, which would materially change the above analysis.

The estimated solvency position of NPLL is regularly monitored using the process which PLAL and NPLL use for the purposes of daily solvency monitoring, and which takes account of material transactions and changes in economic conditions that have occurred since 31 December 2014.

3.6 Solvency II

For the reasons outlined in my report and in section 2.3.3, it is not possible to place reliance on comparisons of the likely capital position of NPLL before the Scheme is implemented and PLAL afterwards. However, based on analysis of NPLL's and PLAL's estimated solvency position as at 31 December 2014, had Solvency II regulations applied at that date, PLAL's solvency position under Solvency II is likely to be at least as good as NPLL's would be and PLAL should be able to meet its regulatory capital requirements under Solvency II.

4. Effect of the Scheme on NPLL policyholders

4.1 Policyholder Security

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

- NPLL currently meets its PRA capital requirements and the additional capital requirements under its capital policy.
- The PLACP will provide a framework for support to be made available to the NPL WP Fund if required and will set a target of assets in excess of the PRA's capital requirements, which PLAL holds as an additional buffer.
- After the Scheme is implemented, PLAL on a pro-forma basis will be able to meet its Pillar 1 and Pillar 2 capital requirements and the higher requirements of the PLACP.
- I considered the level of capital support that will be available to provide security of benefits for NPLL policyholders to be at worst the same as that available currently.

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

- NPLL currently meets its Pillar 1 and Pillar 2 capital requirements.
- After the Scheme is implemented, PLAL on a pro-forma basis will be able to meet its Pillar 1 and Pillar 2 capital requirements and the higher requirements of the PLACP.
- PLAL's solvency position under Solvency II is likely to be at least as good as NPLL's would be and PLAL should be able to meet its regulatory capital requirements under Solvency II

Therefore, my opinion remains unchanged that the implementation of the Scheme will not adversely affect the security of existing NPLL policyholders.

4.2 Policyholder Benefits

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

5. Other Matters

5.1 Opinion of the With-Profits Actuary

The Appendix to this supplementary report includes a statement made by the With Profits Actuary in support of the conclusions reached in this supplementary report.

5.2 Opinion of the National Provident Life Fund Supervisory Board

My report included a section setting out the opinion of the Supervisory Board on the Scheme. The Supervisory Board have reconsidered that opinion having had access to this supplementary report and the opinion of the Supervisory Board remains that it is appropriate for the Scheme to proceed on the basis proposed.

5.3 Principles and Practices of Fund Management (PPFM)

At the transfer date, a new version of PLAL's PPFM will take effect which includes a new chapter to describe the principles and practices for managing the NPL WPF and to reflect applicable changes to PLAL as a result of the Scheme. The revised version of the PPFM was approved by the Board of PLAL on 13 March 2015

5.4 Policyholder Communications

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

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

6. Conclusion

My view is that the changes in the economic conditions and the other matters mentioned in this supplementary report have not affected the conclusions that I reached in my report. Therefore my opinion remains that the Scheme will not adversely affect the interests and reasonable expectations of NPLL policyholders and the protections afforded to these policyholders, whether pursuant to the NPLL Scheme or otherwise, will not, in aggregate, be reduced by the Scheme. In particular, I believe that the Scheme should have no adverse impact on the security of policyholders' benefits and I also believe that the Scheme is consistent with NPLL's obligation to treat customers fairly.

K.P.N. Edgington

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Fellow of the Institute of Actuaries
Actuarial Function Holder
20 April 2015

APPENDIX – Opinion of the With Profits Actuary

Introduction

This report is supplementary to my initial report dated 11 December 2014 entitled "Proposed Scheme to Transfer Long-Term Insurance Business - Report by the With Profits Actuary" and should accordingly be read alongside that report.

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

Considerations and Opinion

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

I have considered the supplementary report produced by the Actuarial Function Holder and support its conclusions.

In my opinion, for the reasons set out in the supplementary report, I remain satisfied that implementation of the Scheme will not adversely affect the interests and reasonable expectations of NPLL with-profits policyholders and the protections afforded to these policyholders, whether pursuant to the NPLL Scheme or otherwise, will not, in aggregate, be reduced by the Scheme. In particular, the Scheme will at least maintain the security of benefits for all NPLL with-profits policyholders and is consistent with the fair treatment of NPLL's with-profits policyholders.

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20 April 2015