



PHOENIX LIFE ASSURANCE LIMITED

Proposed Scheme to Transfer Long-Term Insurance Business

Supplementary Report by the Actuarial Function Holder on the
Impact of the Scheme on Policyholders of Phoenix Life Assurance
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 Phoenix Life Assurance Limited, dated 15 December 2014 ("my report"), I concluded that no class of PLAL policyholder will be materially adversely affected by the implementation of the Scheme and, in particular, that the Scheme should have no material adverse impact on the security of PLAL's existing policyholders and that the Scheme is consistent with PLAL'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 PLAL 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 PLAL 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 (see section 3 for a full explanation of how this information has been calculated) and then considered whether the impact of the Scheme on the security and benefits of PLAL policyholders would be affected in light of that updated information.

My conclusions are given in section 6.

This supplementary report is written for the PLAL Board in my capacity as Actuarial Function Holder for PLAL, but may, like my report, be made available to the High Court, the Independent Expert, the Royal Courts of Jersey and Guernsey, the PRA, the FCA and the insurance regulators in Jersey and Guernsey 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 PLAL

The following summarises the key events that have affected the financial position of PLAL 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 course of 2014.

	30/06/2014	31/10/2014	31/12/2014
FTSE-100	6,743.9	6,546.5	6,566.19
<i>Change since end of June</i>		-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
<i>Change since end of June</i>		7%	10%
15 year gilt yield	3.24%	2.73%	2.21%

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

2.2.2 Valuation Assumptions as at 31 December 2014 – PLAL 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 increase 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 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.

2.3.2 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.

PLAL has done further work to estimate its 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.

2.3.3 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. The SERP Fund consists of Self-Employed Retirement Plan policies which were transferred from NPLL to PLAL in 2010. Consequently, 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 new Scheme which reflect the charges which may be made to the NPL WPF Fund in PLAL. In addition, further minor amendments will be made to include reference to the new NPL WP Fund and to delete references to the National Provident Life Fund, NPI and NPLL Scheme.

I do not consider the change to PLAL 2012 Scheme to have an adverse impact on the benefit expectations of PLAL policyholders.

2.4 Confirmation of Capital Support Arrangements

The PLAL Board has confirmed that the Shareholders' Fund of PLAL will provide capital support at the Transfer Date to the NPL WP Fund. I have reviewed the terms on which that support is to be provided and I am satisfied that the terms are fair. The terms under which support is provided to the existing with-profits funds of PLAL are unchanged.

3. Review of Financial Analysis

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

3.1 Pillar 1 position of PLAL before and after transfer

My report showed the projected Pillar 1 position of PLAL before and after the Scheme based on the position as at 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 PLAL as at 31 December 2014. The estimated position as at 31 October 2014 in my report is shown in brackets.

Table 1	PLAL as at 31 December 2014 before the effect 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)	-
NP Fund	30 (35)	64 (51)	-
Shareholders' Fund	461 (390)	124 (120)	-
Total	2,118 (1,950)	494 (471)	1,189 (1,053)
Total Free Assets (Available Capital less LTICR less WPICC)			£434m (£425m)
Overall Cover for CRR (= LTICR + WPICC)			126% (128%)
Overall Cover for LTICR			429% (413%)

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 increase in the amount of Free Assets compared to the position at 31 October 2014, due to the changes referred to in sections 2.2.1 and 2.2.2.

Table 2 below shows the financial position of PLAL as at 31 December 2014 on a pro forma basis 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)	-
NP Fund	30 (35)	64 (50)	-
Shareholders' Fund	453 (381)	3 (3)	-
Total	2,147 (1978)	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 also shows a small increase in the Free Assets of PLAL after the Scheme has been implemented compared to the position at 31 October 2014. The presentation 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, that this will be met by a significant margin and that the overall cover for the CRR and LTICR will be greater than the corresponding cover now.

3.2 Pillar 2 position of PLAL before and after transfer

The Pillar 2 solvency position has been calculated as at 31 December 2014 for PLAL before and after the Scheme in a similar manner to the Pillar 1 analysis above. As at 31 December 2014, PLAL met its Pillar 2 (ICA and ICG) capital requirements comfortably, 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, as if the Scheme had been implemented at that date, shows that PLAL will continue to be able to meet its Pillar 2 capital requirements with 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 3.5 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 per section 2.3.1. The excess over the capital requirement of the capital policy has fallen since my report, but as noted in my report, assets in excess of the PLACP requirements can be paid out of the company and so little reliance is placed on them in considering the impact of the Scheme on policyholder security. Policyholders remain well protected because the PLACP requirements are being met..

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 PLAL 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 under Solvency II of PLAL before and after the Scheme. However, based on analysis of 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 not expected to change materially as a result of the Scheme since NPLL is expected to be consolidated within PLAL's regulatory balance sheet in any event and PLAL should be able to meet its regulatory capital requirements under Solvency II.

4. Effect of the Scheme on PLAL policyholders

4.1 Policyholder Security

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

- PLAL currently meets its PRA capital requirements and the additional capital requirements under its capital policy.
- The financial position of PLAL and under the Group tests will be improved on Pillar 1 and broadly unchanged on Pillar 2 following implementation of the Scheme.
- This will increase the surplus in PLAL in excess of its capital policy, albeit that little reliance or benefit can be placed on this in terms of improving the security of policyholders.
- I considered the level of capital support that will be available to provide security of benefits for PLAL 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:

- PLAL 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 its capital policy.
- PLAL's solvency position under Solvency II is not expected to change materially as a result of the Scheme since NPLL is expected to be consolidated within PLAL's regulatory balance sheet in any event and PLAL should be able to meet its regulatory capital requirements under Solvency II.

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

4.2 Policyholder Benefits

In my report, I noted that the Scheme would have no impact on the benefits of PLAL policyholders. None of the developments since my report have affected the conclusions drawn by me in my report and, therefore, my opinion remains that the benefits of PLAL policyholders 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 With-Profits Committee

My report included a section setting out the opinion of the WPC on the Scheme. The WPC have reconsidered that opinion having had access to this supplementary report and the opinion of the WPC 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 PLAL Board on 13 March 2015.

5.4 Policyholder Communications

I have reviewed the Scheme guides prepared for PLAL policyholders and the related materials 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.

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 no class of PLAL policyholder will be materially adversely affected by the implementation of the Scheme and, in particular, that the Scheme should have no material adverse impact on the security of benefits of PLAL's policyholders and is consistent with PLAL's obligation to treat customers fairly.



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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 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 no class of existing PLAL with-profits policyholder will be materially adversely affected by the implementation of the Scheme and, in particular, the Scheme will maintain the security of benefits for existing PLAL with-profits policyholders and is consistent with the fair treatment of PLAL’s with-profits policyholders.



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20 April 2015