PHOENIX LIFE ASSURANCE LIMITED

Proposed Scheme to Transfer Long-Term Insurance Business

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

15 December 2014

1. PURPOSE OF REPORT

The purpose of this report is to describe the impact of a proposed scheme under Part VII of the Financial Services and Markets Act 2000 ("FSMA") on the policyholders of Phoenix Life Assurance Limited ("PLAL"). Under this scheme (the "Scheme") the entire business of National Provident Life Limited ("NPLL") is to transfer to PLAL.

This report describes how the Scheme is expected to affect the security of benefits and the reasonable benefit expectations of policyholders of PLAL. It also sets out how the Scheme is consistent with the requirements to treat customers fairly.

The report is written for the PLAL Board in my capacity as Actuarial Function Holder for PLAL. As well as the Board, the report may be used by the independent expert, the High Court, the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA") in forming their own judgements about the Scheme.

Appendix A sets out the report by the With Profits Actuary of PLAL (the "With Profits Actuary Report").

The Financial Reporting Council is responsible for issuing and maintaining Technical Actuarial Standards ("TAS"). The standards consist of generic TAS, which apply to a wide range of actuarial work, and specific TAS, which apply to specified areas. This report and the work underlying it are intended to be compliant with the Insurance TAS, the Transformations TAS and the following generic TAS: TAS R (Reporting), TAS D (Data) and TAS M (Modelling).

2. SUMMARY

In section 3, I have provided background information on PLAL and the Phoenix Group, of which PLAL is a member.

I have given a summary of the Scheme in section 4, highlighting its effect on the existing policyholders of PLAL. The full provisions of the Scheme are set out in the scheme document.

In sections 5 and 6, I have analysed the impact of the Scheme on the existing policyholders of PLAL.

I conclude in section 7 that the Scheme will have no material adverse impact on the interests of PLAL policyholders. In particular, in my opinion, there will be no material reduction in the security and benefit expectations of PLAL policyholders.

3. BACKGROUND

3.1 Status

I am a Fellow of the Institute of Actuaries. I was appointed as Actuarial Function Holder of PLAL on 1 April 2012.

I am an employee of Pearl Group Management Services Limited, which is a wholly owned subsidiary of Phoenix Group Holdings, the ultimate parent company of PLAL. I am not a policyholder of any of the companies within the Phoenix Group, including PLAL. I currently have options on a number of Phoenix Group Holdings shares.

I confirm that I have not considered my personal interest in reaching any of the conclusions detailed in this report.

3.2 History of PLAL

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.

In 1990, Australian Mutual Provident Society ("AMP") acquired PLAL. In December 2003, PLAL, together with other UK companies owned by AMP, were de-merged to become subsidiaries of a new UK company called HHG plc.

In April 2005, Sun Capital Partners and TDR Capital bought PLAL and the other insurance companies owned by HHG plc and these companies became subsidiaries of the newly formed Pearl Group Limited. Pearl Group Limited acquired Resolution plc in May 2008 and was itself acquired by Phoenix Group Holdings, then known as Liberty Acquisitions Holdings (International) Company, in September 2009.

PLAL has been involved in four Part VII Schemes in recent years:

- Under a scheme (the "SERP Scheme"), which became effective on 15 February 2010, all NPLL's Self Employed Retirement Plan ("SERP") business was transferred from NPLL to PLAL.
- In March 2012, PLAL's general insurance business was transferred to BA (GI) Limited, at the time another company in the Phoenix Group.
- 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.
- Under a scheme, which became effective 30 September 2013, selected pension annuities in payment were transferred from PLAL's Non-Profit Fund to Guardian Assurance Limited.

PLAL comprises a shareholders fund (the "Shareholders' Fund") and a long-term insurance fund (the "Long-term Insurance Fund"). As a result of the PLAL 2012 Scheme, the Long-term Insurance Fund comprises four sub-funds:

- The Pearl With-Profits Fund – from which at least 90% of the surplus is payable to with-profits policyholders of the fund with the balance being distributable to shareholders;
- The SERP Fund – another with-profits fund; if any surplus arises in this fund, it is payable to the policyholders in the fund;
- The London Life With-Profits Fund (the "LL WP Fund") – all of the surplus of which is payable to the with-profits policyholders in the fund; and

- The Non-Profit Fund (the "NP Fund") – from which all of the surplus is payable to shareholders.

PLAL is authorised by the PRA with permission under Part 4A of FSMA to effect and carry out contracts of insurance within the United Kingdom falling within classes I, II, III, IV, VI and VII as defined in the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

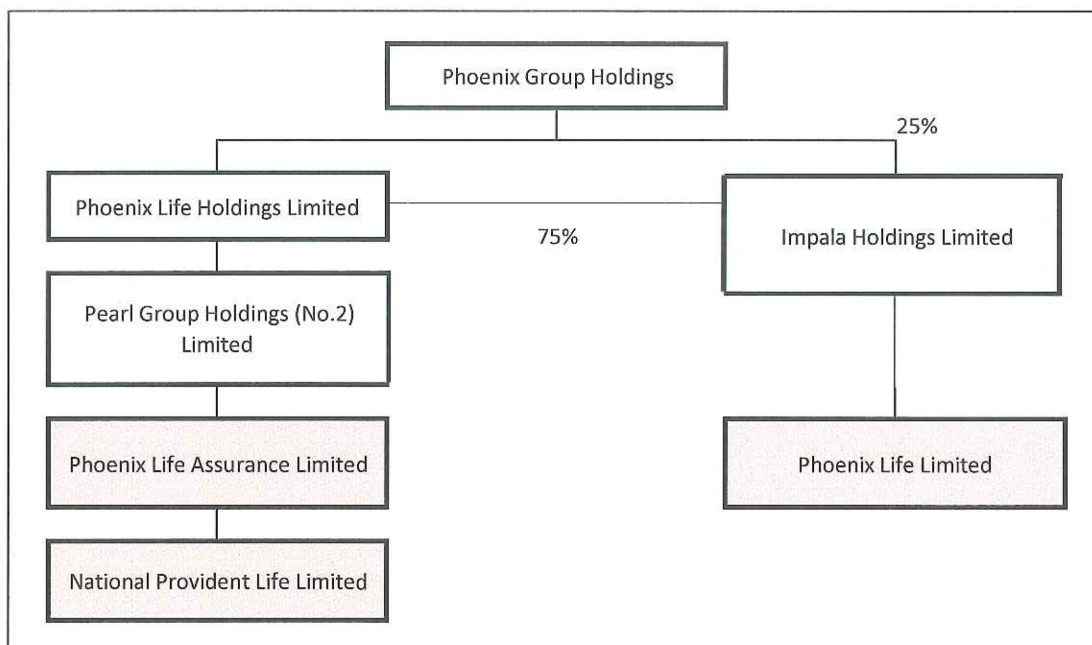
PLAL has a number of subsidiaries, including, since 1999, NP Life Holdings Limited ("NPLH"), which is the holding company of NPLL. NPLH is owned by the Shareholders' Fund. To support the solvency position of NPLL, the Shareholders' Fund has made two loans to the shareholders' fund of NPLL (together the "Subordinated Loans") – the first for £65m in 2006, under which £39m is outstanding, and the other for £50m in 2009.

NPLL's Board has resolved to pay any excess over its capital policy to PLAL, subject to a commitment by PLAL's Board to provide further capital to NPLL from time to time in the future in the event that further capital is needed to ensure that NPLL meets its capital policy (provided that, in so doing, PLAL continues to be able to meet its own capital policy). In practice, NPLL normally considers any payment of excess twice a year and seeks to maintain a small working buffer over its capital policy. Conversely, if solvency monitoring indicates that NPLL requires capital then in practice PLAL has provided this immediately. In line with this arrangement, PLAL contributed capital to NPLL in March 2012 and NPLL made payments to PLAL in March 2013 and October 2014.

3.3 The Phoenix Group Today

The Phoenix Group comprises three active regulated UK life companies – PLAL, Phoenix Life Limited ("PLL") and NPLL. Phoenix Life Holdings Limited ("PLHL") is the senior UK and EC insurance holding company in the group.

A simplified group structure chart is shown below. I note that recent group refinancing activity has had no impact on the ownership of the life companies. All companies are wholly owned (directly or indirectly) except where stated.



3.4 The Business of PLAL

3.4.1 The Pearl With-Profits Fund

The Pearl With-Profits Fund 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 (approximately 508,000) are non-profit with small benefits after having been made paid-up.

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

3.4.2 The SERP Fund

This fund only includes with-profits SERP policies which were originally issued by NPLL's predecessor company, National Provident Institution ("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.

3.4.3 The London Life With-Profits Fund

The LL WP Fund 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 WP 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.

3.4.4 The Non-Profit Fund

The NP Fund consists of the balance of the non-profit policies of PLAL.

The main liabilities are pension liabilities (which comprise 95% of the statutory net reserves for the fund), of which the majority are annuities in payment. The life business primarily consists of regular premium whole of life and endowments policies, term assurance and annuities in payment.

Pension business from the Pearl With-Profits Fund, the SERP Fund and the LL WP Fund currently vests into this fund. Non-profit annuities in payment written by NPLL are also reinsured to the NP Fund.

Some of the annuities in payment are reinsured to Opal Reassurance Limited ("Opal") (which is a captive reassurer within the Phoenix Group); Opal bears the longevity and investment risk of the business reinsured to it. As at 31 December 2013, the total liabilities reinsured under the Opal arrangement were £1,582m.

PLAL retains the expense risk for the business reinsured to Opal. Increments and new business are not reinsured to Opal and are retained by PLAL.

3.4.5 Overall

As at 31 December 2013, the number of policies and liabilities gross and net of reinsurance for each fund were as follows:

	No of Policies	Gross Liabilities £m	Net Liabilities £m
Pearl With-Profits Fund	1,436,000	5,417	5,409
SERP Fund	37,000	1,132	1,132
London Life With-Profits Fund	39,000	661	654
Non-Profit Fund	257,000	2,961	1,376
Total	**1,769,000**	**10,171**	**8,571**

Source – PLAL PRA Returns

3.5 PLAL Capital Policy

3.5.1 Background and Objectives

Under the terms of the PLAL 2012 Scheme, PLAL maintains a particular capital policy (the "PLACP") which is described below.

The main objective of the PLACP is to ensure that, based on various tests, the company can continue to meet the PRA's capital requirements, details of which are given in section 5.1, in internally specified stress scenarios. These stress scenarios have regard to the risk appetite that the PLAL Board has set and currently are set by reference to a risk appetite of PLAL having a 1 in 20 chance over a one year time period of failing to meet the PRA's capital requirements.

The other objective of the PLACP is to govern the way in which shareholder support is supplied to the with-profits funds should they require it.

Adherence to the PLACP results in more capital being available in PLAL than is required by the PRA's capital requirements, details of which are given in section 5.1. The PLACP is dynamic and moves in line with the amount of business in PLAL.

The PLACP operates in the context of the management of the with-profits funds contemplated by their respective Principles and Practices of Financial Management and the extent to which other actions may be taken by PLAL to meet any deficit arising in a with-profits fund in adverse circumstances.

3.5.2 Capital

The results of the scenario testing are the percentages given below. The percentages are regularly reviewed to ensure that the capital policy continues to meet its objective. As a result, the percentages change from time to time without changing the strength of the policy by reference to the scenario testing process.

The policy involves three main tests and a fourth liquidity test and provides that PLAL intends to hold the amount of capital indicated by the most onerous of these tests. At the date of this report, the tests are:

Test 1: (Based on the PRA's Pillar 1 test)

The required capital is the sum of:

- in respect of each with-profits fund, the proportion of the Capital Resources Requirement ("CRR") attributable to that fund, plus an amount equal to the greater of (i) the value of any positive free assets and (ii) 175% of the proportion of the Long-Term Insurance Capital Requirement ("LTICR") attributable to that fund less its With-Profits Insurance Capital Component ("WPICC"), and
- in respect of the NP Fund, 70% of the CRR attributable to that 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 Shareholders' Fund, a negative overall result being permitted.

Test 2: (Based on the PRA's Pillar 2 test, excluding any Individual Capital Guidance ("ICG"))

The required capital is the sum of:

- in respect of each with-profits fund, 140% of the proportion of the Individual Capital Assessment ("ICA") attributable to that fund, and
- in respect of the NP Fund, 140% of the proportion of the ICA attributable to that fund.

Test 3: (Based on the PRA's Pillar 2 test including any ICG)

The required capital is the sum of:

- in respect of each with-profits fund, 110% of the proportion of the ICA plus 110% of any additional capital which the PRA indicates via ICG should be held attributable to that fund, and
- in respect of the NP Fund, 110% of the proportion of the ICA plus 110% of ICG attributable to that fund.

For Test 1, the presence of excess capital within a with-profits fund will have the effect of reducing the capital required in the NP Fund, as described above. In all other aspects, when calculating whether the total capital available in PLAL satisfies each basis, any excess capital in a with-profits fund over the calculated minimum capital for that fund will not be taken into account.

The fourth test is a liquidity test, the objective of which is to ensure that the NP Fund and the Shareholders' Fund together have sufficient admissible assets to meet the Pillar 1 liabilities of the NP Fund and the Shareholders' Fund, together with sufficient liquid assets to meet any immediate demands from the with-profits funds for support in accordance with the PLACP (in other words, actual capital injections to meet either regulatory or realistic liabilities) plus an additional amount determined by the PLAL Board at least once a year. This additional amount (which is currently £60m) is derived by considering the ability of the NP Fund and the Shareholders' Fund to meet the same test (excluding the additional amount) in the same range of scenarios as is used to derive the parameter percentages for Tests 1, 2 and 3. For this purpose, a liquid asset is any asset which can be transferred to a with-profits fund to support it. This test means that the NP Fund and the Shareholders' Fund have sufficient assets of an appropriate quality to transfer assets to, and to meet the objectives of the PLACP in respect of, with-profits funds in a range of specified scenarios.

3.5.3 With-Profits Funds

In the event that the value of the assets of any with-profits fund 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 NP Fund or the Shareholders' Fund to the extent that the PLAL Board determines there are assets in those funds available to make such a loan. The effect of this provision is also to limit the extent to which support provided to a with-profits fund can be repaid, and ensure that each with-profits fund retains an appropriate margin of assets above the regulatory minimum value which must be held in the fund.

The PLACP states that, if any with-profits fund is unable to meet its CRR or ICA from its own capital resources, then the With-Profits Committee of PLAL (the "WPC") can recommend to the PLAL Board that the NP Fund or the Shareholders' Fund supports it. If this is agreed, then it is done by the NP Fund or the Shareholders' Fund holding additional assets sufficient to cover part or all of the capital requirements of the relevant with-profits fund. Such support is usually granted on condition that the investment policy and operation of the with-profits policy does not change and as long as this condition is met, the with-profits fund does not need to make further requests. If the PLAL Board does not or cannot make sufficient assets available, then it will be necessary to take other actions to ensure that the fund can, as far as possible, meet its CRR and ICA from its own capital resources.

Currently support is supplied to both the SERP Fund and the London Life With-Profits Fund, both in the form of a loan and by holding additional capital in the NP Fund and Shareholders' Fund.

3.5.4 Refresh of Parameters

The percentages of LTICR, ICA and the with-profits funds' free assets set out above are subject to regular review by the PLAL Board to ensure that the PLACP continues to meet its underlying objective, namely that the funds can meet Pillar 1 and Pillar 2 capital requirements in the internally specified stress scenarios.

In order to ensure that the amount held under the capital policy remains calibrated to the risk appetite statements after the Scheme is implemented, the PLAL Board has noted that a change will be required to the parameters under Test 1 which will take effect when the Scheme is implemented.

I will provide more details in my supplementary report, but the current indication is that under the revised Test 1, the required capital will be 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

- in respect of the NP Fund, 70% of the CRR attributable to that 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 Shareholders' Fund, a negative overall result being permitted.

The PLAL Board has also 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.

3.5.5 When Solvency II is implemented

When Solvency II is introduced (see section 5.1.2), changes will be required to the PLACP as terms such as LTICR, CRR and ICA will no longer exist. The PLAL 2012 Scheme outlines that PLAL will set new tests before Solvency II is implemented with the objective that PLAL can meet its Pillar 1 capital requirements (as that term is used under Solvency II) in internally stressed scenarios. The adoption of the new tests and their parameters will be subject to the PRA's non-objection. It is anticipated that the parameters of the revised test will continue to be subject to regular review on the same basis as the current test.

The PLAL Board have approved the approach they will adopt to setting the new tests under Solvency II. In particular:

- Capital policy amounts will be set by reference to the amount of capital required to meet regulatory capital requirements after a 1 in N year event;
- The 1 in N year event will be set according to the Board's risk appetite for breaching the Statutory Capital Requirement ("SCR") under Solvency II; and
- A liquidity test will also be applied.

However, the Board noted that until the Solvency II requirements are finalised, it is not possible to determine the Board's risk appetite and hence the value of N above and the likely amount of additional capital.

3.5.6 Additional Capital

PLAL has undertaken to the Court that additional capital is held available by PLAL or within the Phoenix Group to support PLAL in addition to the capital held under the terms of the PLACP. This additional capital totalled £75m as at 30 June 2012 and is reducing in line with the run-off of PLAL's liabilities to policyholders thereafter. Currently it is £70m, which comprises £50m held within the Phoenix Group to support PLAL and NPLL, and £20m held by PLAL directly within the Shareholders' Fund. The amount of this additional capital may be changed on the implementation of Solvency II or at any time after 31 December 2016, but only if such change is agreed by an independent actuary and the PRA.

Notwithstanding the above, no allowance for this additional capital is taken when considering any review of the capital policy. In addition, no benefit is taken for the additional capital in the financial analysis shown in section 5.

3.6 Background to NPLL

NPLL was established in 1998. It has been a direct subsidiary of NPLH, which in turn is owned by the Shareholders' Fund, since 1999. On 1 January 2000 NPLL received, by way of a transfer made under Schedule 2C to the Insurance Companies Act 1982 (the "NPLL Scheme"), all of the business of NPI. NPI was a mutual life insurance company, established in 1835.

All of NPI's business was allocated by the NPLL Scheme to a sub-fund of NPLL's long-term insurance fund called the "National Provident Life Fund". The NPLL Scheme sets out how the run-off of the business in the National Provident Life Fund should be managed. It includes provisions, for example, that cover the principles of financial management, expenses, reassurance and governance.

Under the governance arrangements set out in the NPLL Scheme, a committee of the Board of NPLL, known as the National Provident Life Fund Supervisory Board (the "Supervisory Board"), had to be appointed and maintained. The Supervisory Board is responsible for the management of the National Provident Life Fund, 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.

NPLL comprises a shareholders' fund (the "NPLL Shareholders' Fund") and a long-term insurance fund, which has a single sub-fund - the National Provident Life Fund.

The majority of the business in the National Provident Life Fund consists of unitised with-profits and unit-linked pensions, much of which contains guarantees. Further details on the business of NPLL are given in section 3.4.1 of the report prepared by the NPLL Actuarial Function Holder.

The main reassurance agreements NPLL has in-force are:

- An agreement with PLL covering increments and new contracts issued as a result of options under certain contracts.

- An agreement with PLL under which NPLL wholly reinsures its internal investment linked funds.
- The unitised with-profits element of the Portfolio Bond product is reinsured to the Pearl With-Profits Fund of PLAL.
- Annuities set up after 31 March 2012 and before January 2000 are reinsured to the NP Fund of PLAL.

In 1998, NPI raised £260m of capital (the "Securitised Loan") secured on the emerging surplus (in essence, annual management charges less administration expenses) relating to most of the unitised with-profit 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 on 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 meet the schedule of repayments if the surplus emerging is insufficient in any year. The last repayments are due to be made in 2022. Following the scheduled repayments in September 2014, £94m of capital remains outstanding under this arrangement and the reserve account was £39m.

There were, on 31 December 2013, approximately 272,000 policies in this fund, with statutory net reserves of £2,834m.

The National Provident Life Fund relies on a number of capital support arrangements:

- Capital Funds: as part of the NPLL Scheme, a sum of £800m was paid to the NPLL Shareholders' Fund to provide capital support for the company (referred to as the "Capital Funds"). The Capital Funds were initially provided to support the investment policy and can be used to meet guarantee costs where they cannot be met by the estate. They were drawn down into the National Provident Life Fund a number of years ago. As part of the SERP Scheme, a proportion was transferred to the SERP Fund to cover the guarantee costs of the transferring business, but the balance remains in the National Provident Life Fund. A support charge of 1.75% per annum is payable on the balance of the Capital Funds. Repayments can only be made to the extent that a deficit will not be created in the National Provident Life Fund and the repayment will not have an adverse effect on the reasonable expectations of NPLL policyholders.

- Earmarked Portfolio: the shareholder has subsequently provided further capital support to the National Provident Life Fund, referred to as the "Earmarked Portfolio". The Earmarked Portfolio comprises two parts, referred to as the Original Earmarked Portfolio and the New Earmarked Portfolio. The Original Earmarked Portfolio comprises certain support charges on the Capital Funds whose payment has been deferred and certain tranches of support provided by the NPLL Shareholders' Fund There is no charge for this support, but interest on the Original Earmarked Portfolio is for the benefit of the shareholder The New Earmarked Portfolio is in the form of a loan, repayable in 2016 (if the solvency position of the National Provident Life Fund allows) on which interest is charged at the rate of 4.75% per annum, plus the interest earned on the assets. The Earmarked Portfolio is available to meet guarantee costs if required but does not otherwise form part of policyholders' reasonable expectations.

- Shareholder Equalisation Fund: following the transfer of part of the Capital Funds to PLAL under the SERP Scheme, no support charges are payable on the assets transferred and so an amendment was made to the NPLL Scheme in order to mitigate the potential disadvantage to NPLL's shareholders from the loss of this contingent future income stream. This amendment provided for certain assets from the estate of the National Provident Life Fund to be allocated to an account within the National Provident Life Fund called the "Shareholder Equalisation Fund". The amount of these assets was determined with the objective of compensating NPLL's shareholder for the loss of value in support charges. The assets in the Shareholder Equalisation Fund can be released to the NPLL Shareholders' Fund in accordance with a schedule in the NPLL Scheme but any release is subject to the same restrictions that apply to the repayment of the Capital Funds.

In addition, the National Provident Life Fund relies on charges to asset shares to meet the cost of guarantees. The Asset Share Charge Fund represents the accumulated value of these past asset share charges. Charges are only taken if the value of the estate, Capital Funds and the Asset Share Charge Fund is unlikely to meet the future cost of guarantees. The charge was introduced in 2007 and a charge has been taken every year since. The charge each year has been 2% of the asset share. The likelihood of future charges reducing will depend on the financial condition of the fund at the time, but in any event such charges are restricted to a maximum of 25% of asset share.

The support to the National Provident Life Fund is currently structured such that the cost of guarantees is met in turn by:

- The remaining estate
- The Capital Funds
- The Asset Share Charge Fund
- The Shareholder Equalisation Fund
- The Earmarked Portfolio

As at 30 June 2014, all of the above support, with the exception of part of the Earmarked Portfolio, was required to cover the cost of guarantees. The size of each was as follows:

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

4 THE PROPOSED SCHEME

4.1 Background to the Scheme

The aims of the transfer are to simplify the structure of the Phoenix Group by reducing the number of active life assurance companies in the group, to simplify the operation of the with-profits fund to which NPLL policyholders are allocated and to provide some benefits to those policyholders (including the benefit of being part of a well capitalised insurance company, in the form of PLAL, and a reduction in the level of charges that might be borne by the policyholders), while ensuring that the

protections from which NPLL policyholders currently benefit are not, in aggregate, reduced. The transfer will enable the Phoenix Group to make more efficient use of the capital in its life division and is also expected to result in some liquidity benefits in the Shareholders' Fund and administrative expense savings and to 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. The transfer will also provide an opportunity to move the transferring NPLL business under the Phoenix Life brand, thereby enabling a consistent brand to be used across all of the Phoenix Group's UK life insurance business.

4.2 Summary of the Scheme

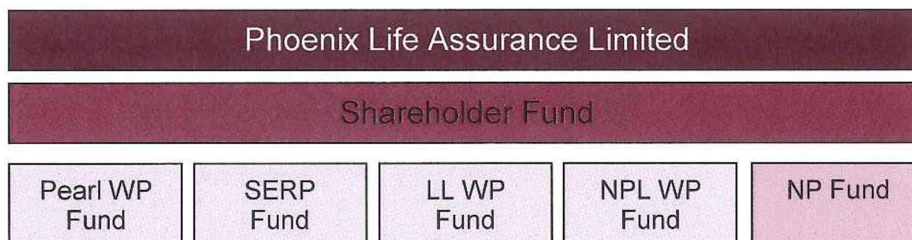
4.2.1 The Transfer

The Scheme is expected to transfer policies, assets and liabilities on 6 April 2015 (the "Transfer Date"). However, the Scheme will be effective from 1 January 2015 for accounting and financial reporting purposes. This will have no implications for policyholders.

Under the Scheme, the following will transfer to PLAL:

- The long-term insurance business of NPLL.
- The NPLL Shareholders' Fund.

Following the Scheme the structure of PLAL will be:



Under the terms of the Scheme, all of NPLL's annuity policies which are in payment, together with assets and liabilities relating to those policies will be transferred to the NP Fund. These consist of a small block of life annuities and some pension annuities that are currently reassured to the NP Fund. The assets that will transfer in respect of these annuities will be selected by the NPLL Board, having obtained appropriate actuarial advice, and are likely to consist of gilts selected having regard to the term of the liabilities being transferred. The value of the assets will equal the realistic reserves held in respect of these annuities, which were £13m as at 31 December 2013. In respect of the annuities reassured, apart from rights and obligations under the reassurance, the only assets that will transfer will be assets equal to the realistic value of the expense risk (all other risks under this business being reassured to the NP Fund currently). The reassurance arrangements in respect of these policies will collapse as a result of the Scheme.

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 WP Fund").

The National Provident Life Fund of NPLL consists of the estate, asset shares, the Asset Share Charge Fund and the capital support provided by the NPLL Shareholders' Fund. This capital support consists of the Capital Funds, the Earmarked Portfolio and the Shareholder Equalisation Fund. Under the Scheme the

Asset Share Charge Fund and the Capital Funds will be allocated to the estate of the NPL WP Fund. This means that the shareholder will give up the right to receive support charges payable in respect of the Capital Funds and the right to receive any amounts allocated to the Capital Funds not required to meet the cost of guarantees.

Following implementation of the Scheme, the capital support provided by the shareholders in the form of the Shareholder Equalisation Fund and the Earmarked Portfolio will terminate and be replaced by support under the terms of the PLACP, in the form of a loan from the Shareholders' Fund to the NPL WP Fund. The level of support provided will not change as a result of this. Further, PLAL will make available support from the NP Fund and Shareholders' Fund to allow the management of the NPL WP Fund to continue as now. This will have no impact on PLAL policyholders.

The property and liabilities of NPLL relating to the Securitisation Loan are currently allocated to the National Provident Life Fund. These will transfer to the NPL WP Fund. The transfer is expected to constitute a Permitted Transfer within the terms of the Securitisation Loan, since the transfer will happen pursuant to Part VII of FSMA, it will involve all of NPLL's business being transferred to a single entity and PLAL will (under the terms of the Scheme) assume all of NPLL's rights and obligations in respect of the Securitisation Loan. However, NPLL and PLAL will 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). I will consider whether these requirements have been satisfied closer to the final hearing of the Scheme in a supplementary report. In addition, to provide further comfort to the Bond Trustee, the terms of the Scheme provide that it will not become operative if to do so would constitute a breach of the terms of the Securitisation Loan. This is intended to address the risk that any person might claim that the application for approval of the Scheme constituted a breach of the Securitisation Loan agreement. I am satisfied that the objective nature of the tests which must be satisfied in order for the Scheme to constitute a Permitted Transfer mean that making the implementation of the Scheme conditional on meeting these requirements does not introduce any material uncertainty regarding the effectiveness of the Scheme. I also note that NPLL and PLAL have confirmed that they would not seek to proceed with the Scheme unless they have been able to satisfy these requirements.

The assets and liabilities of the NPLL Shareholders' Fund will transfer to the Shareholders' Fund of PLAL under the Scheme. As a result, the Subordinated Loans will collapse. Sufficient assets will, however, be left in the NPLL Shareholders' Fund to meet the PRA's capital requirements for NPLL following the implementation of the Scheme. These assets will be transferred to PLAL, under the terms of the Scheme, once the PRA has de-authorised NPLL.

Under the Scheme, PLAL will become party to all external reinsurance treaties in relation to the business transferring to it (including those currently in place between NPLL and Phoenix Life Limited). These treaties will continue to provide cover in the same way as they did before the Scheme. Treaties between PLAL and NPLL, including those described above, will collapse. However, where necessary, they will be replaced by internal arrangements between the relevant funds of PLAL, which will have the same financial effects as the existing arrangements.

It is proposed that the transfer of any business written by NPLL in Guernsey or Jersey (or, in the case of Guernsey, to policyholders resident in Guernsey) will be effected by way of separate 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 date as the Scheme.

Should it not be possible for technical reasons to transfer any NPLL policy or group of policies at the time the Scheme is implemented then such policies will be subject to an excluded policies reassurance arrangement under the terms of the Scheme. In effect, this arrangement will ensure that any excluded policies will be treated for all practical purposes in the same way as if they had been transferred to PLAL.

4.2.2 Impact on PLAL Policies

The policies in PLAL will be not transferred as a result of the Scheme and, except as described in this section, no changes are being made to the operation of the with-profits funds or the NP Fund and these will continue to operate as discrete funds.

The Scheme will introduce certain additional requirements regarding the composition and operation of the WPC, including an independence requirement for members of the committee. These requirements reflect the terms applying to the National Provident Life Fund Supervisory Board. In practice, since the same individuals currently act as members of the Supervisory Board and WPC, those independence criteria are already satisfied.

Whilst the WPC will have certain additional powers in respect of the NPL WP Fund, there will be no change in the way it operates with regard to the other with-profits funds in PLAL. In particular, the WPC's responsibilities with regard to oversight of investment strategy and investment management fees charged to the NPL WP Fund will have no impact on the other with-profit funds in PLAL.

Costs associated with the Scheme will be met by the Shareholders' Fund. Therefore no costs will be met by any part of the Long-term Insurance Fund.

5 FINANCIAL POSITION BEFORE AND AFTER THE TRANSFER

5.1 Introduction

5.1.1 Current Regulatory Solvency Requirements

All insurance companies are required by the PRA to maintain a minimum level of capital calculated on two different bases.

First, companies are required to maintain capital in excess of basic policy liabilities. The amount of capital required (the CRR) to meet this test (known as Pillar 1) is calculated using a basis specified in the PRA Handbook.

Secondly, companies are required to carry out and submit to the PRA their own assessment of how much capital they need to hold. This assessment is known as the ICA and is submitted to the PRA privately. The calculation requires a company to assess the major risks it is running and the capital it requires to ensure that it remains able to meet its liabilities to policyholders in all but the most extreme circumstances. The PRA reviews the ICA and may indicate through the ICG that the company should hold additional capital over and above its ICA. This test is known as Pillar 2.

In addition, insurance groups are required to maintain overall group capital sufficient to meet the PRA's group requirements. These requirements reflect the expectation

that insurers should be part of financially stable corporate groups and prevent the double use of capital within the group. There are two tests for this as well corresponding to the Pillar 1 and Pillar 2 tests referred to above. These tests apply to the senior holding company within the group that is registered in the European Community. Within the Phoenix Group, the group tests are applied to PLHL.

The PRA can intervene if any requirement is not being met

5.1.2 Solvency II

Solvency II represents a new framework for EU insurers that will replace all existing prudential regulation including Pillar 1 and Pillar 2. It represents a fundamental review of the capital adequacy regime for the European insurance industry. It aims to establish a revised set of EU-wide capital requirements and risk management standards with the aim of increasing protection for policyholders.

On implementation, Solvency II will be adopted by all European Union ("EU") Member States. As a consistent European standard, Solvency II should protect policyholders' interests more effectively by making company failure less likely and by reducing the probability of consumer loss or market disruption.

Solvency II aims to achieve consistency across Europe and includes the following key ideas:

- Market consistent balance sheets.
- Risk-based capital.
- Own risk and solvency assessment ("ORSA").
- Senior management accountability.
- Supervisory assessment.

Implementation of Solvency II has been considerably delayed, but it is now scheduled to be introduced from 1 January 2016. However, not all of the implementing measures and guidelines have yet been published, which means that it is still not certain what the precise impact of the new requirements will be on individual insurance companies.

Solvency II requirements are split into three pillars.

Pillar 1 covers the financial requirements that Solvency II imposes. It specifies how the capital requirement is set and assessed, which may be done by using standard formulae or a company's own model, provided such has been approved by its regulator, and how the eligible capital resources of the company are determined. Pillar 1 is designed to ensure that a company is adequately capitalised to deliver policyholder protection.

Pillar 2 imposes higher standards of risk management and governance on companies. The ORSA requires a company to undertake its own forward-looking assessment of its risks, solvency needs and adequacy of capital resources.

Pillar 3 aims for greater levels of transparency for supervisors and the public. There is a private annual report to supervisors, and a public solvency and financial condition report that increases the level of disclosure required by companies. The aim is to ensure that, overall, there is better and more up-to-date information on a company's financial position.

5.1.3 What this means for PLAL

PLAL's capital policy (see section 3.5) requires PLAL to retain capital in excess of the amounts required to satisfy the regulatory requirements. This means that policyholders are and will continue to be afforded greater security than required under the PRA's rules. However, any assets in the Shareholders' Fund or the NP Fund in excess of the amount of assets required to satisfy the PLACP may be distributed and hence little reliance can be placed on this excess when assessing the security for policyholders.

5.2 Basis of calculation of the solvency position of PLAL before and after the Scheme

As NPLL is currently a subsidiary of PLAL, NPLL is consolidated in PLAL's capital position. Therefore, the impact of transferring the business of NPLL to PLAL has relatively little impact on PLAL's capital position. Nevertheless, as part of the considerations as to whether the benefit security of policyholders in PLAL will be affected by the Scheme, it is helpful to compare the solvency position of PLAL before and after the Scheme. This section describes the approach that I have taken in respect of the calculations.

In order to make this assessment using up to date information, I have considered the expected impact of the Scheme on PLAL as if the Scheme had been implemented on 31 October 2014 (updated for material transactions that have or are expected to occur before the Scheme is implemented and as described below).

The solvency position as at 31 October 2014 has been estimated using the process which PLAL and NPLL use for the purposes of daily solvency monitoring. This process uses as inputs:

- The Pillar 1 valuation results as at 31 December 2013, which were reported to the Boards in March 2014 and which were subject to a review by the auditors.
- The Pillar 1 valuation results as at 30 June 2014, which were reported to the Boards in September 2014 and which were subject to the same internal controls and review processes as the year end results. The auditors perform a high level review of the results.
- The Pillar 2 capital resources as at 31 December 2013, which were also reported to the Boards in March 2014. These figures are not directly reviewed by the auditors but are derived by adjusting the Pillar 1 and embedded value results which are reviewed by the auditors.
- The Pillar 2 ICA capital requirements which were adopted by the Boards in August 2014 and are updated for changes identified by risk owners on a monthly basis. The Boards have approved all changes.

These inputs were then adjusted to reflect material transactions that have occurred since 30 June 2014 and changes in economic conditions during the period from 30 June 2014 to 31 October 2014. The adjustment process was based on a sensitivity analysis of the impact of changes in factors such as equity values, property values, corporate bond spreads and gilt yields. The adjustment process for the ICA was based on the monthly risk budgeting process.

The adjustment process described above used approximations and therefore may have provided results as at 31 October 2014 which are different from the results

which would be obtained if the full valuation process were to be carried out as at that date. However, I am satisfied that the degree of potential mis-estimation in proportion to the overall capital established by the regulatory capital requirements and capital policies is unlikely to be significant for the purposes of determining whether the Scheme would have any material adverse impact on the overall security of policyholders.

The material transactions that have occurred since 30 June 2014 are: payment of a dividend of £90m in October 2014 and receipt of a dividend of £70m from NPLH also in October 2014.

In the tables in sections 5.3:

- The LTICR represents the capital required by the PRA to be held in respect of an insurer's liabilities over and above the assets held to back those liabilities, with both assets and liabilities being valued on the basis set out in PRA rules referred to as the "regulatory" basis. This basis generally does not reflect discretionary benefits which might be awarded to with-profits policies.
- The WPICC represents the capital required by the PRA over and above the LTICR, determined using an alternative valuation basis which reflects a "realistic" valuation of the assets and liabilities. This basis takes into account future discretionary benefits that might be awarded to with-profits policies.
- Available Capital is the excess of assets over liabilities with both assets and liabilities being valued on the basis set out in PRA rules referred to as the "regulatory" basis.
- Free Assets are the total Available Capital less the total LTICR and WPICC.
- Cover for CRR is the Available Capital divided by the CRR.
- Cover for LTICR is the Available Capital divided by the LTICR.

5.3 Pillar 1 Position before and after the Scheme

Table 1 below shows the financial position of PLAL and its CRR basis as at 31 October 2014 calculated in accordance with section 5.2.

Table 1	**PLAL as at 31 October 2014 before the effect of the Scheme**		
	Available Capital	**LTICR**	**WPICC**
	£m	£m	£m
Pearl WP Fund	1,489	225	1,053
LL WP Fund	8	26	-
SERP Fund	28	48	-
NP Fund	35	51	-
Shareholders' Fund	390	120	-
Total	**1,950**	**471**	**1,053**
Total Free Assets (Available Capital less LTICR less WPICC)			**£425m**
Overall Cover for CRR (= LTICR + WPICC)			**128%**
Overall Cover for LTICR			**413%**

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

Table 2 shows pro-forma figures for PLAL as if the Scheme had been implemented, again as at 31 October 2014 for ease of comparison.

Table 2	**PLAL as at 31 October 2014 following the implementation of the Scheme**		
	Available Capital	**LTICR**	**WPICC**
	£m	£m	£m
Pearl WP Fund	1,489	225	1,053
LL WP Fund	8	26	-
SERP Fund	28	48	-
NPL WP Fund	37	120	-
NP Fund	35	50	-
Shareholders' Fund	381	3	-
Total	**1,978**	**474**	**1,053**
Total Free Assets (Available Capital less LTICR less WPICC)			**£452m**
Overall Cover for CRR (= LTICR + WPICC)			**130%**
Overall Cover for LTICR			**418%**

The implementation of the Scheme will lead to an increase in available capital on Pillar 1 due principally to an increase in the value of group loans that can be recognised following implementation of the Scheme.

5.4 Pillar 2 position

The Pillar 2 solvency position has been calculated as at 31 October 2014 for PLAL and on a pro-forma basis after implementation of the Scheme. This shows very little change, which is as expected given that NPLL is consolidated in PLAL currently. It also shows that PLAL would continue to meet its Pillar 2 capital requirements.

5.5 PLACP tests

As stated in section 3.5, the level of capital implied by the PLACP is higher than that required by the PRA's requirements. Based on further analysis of the position of PLAL after implementation of the Scheme, PLAL on a pro-forma basis is expected to be able to meet the higher levels implied by the PLACP.

Based on the pro-forma analysis at 31 October 2014, the PLACP would have required PLAL to hold approximately £250m of assets in addition to its PRA capital requirements on a Pillar 1 basis and approximately £180m on a Pillar 2 basis. As at that date, Test 2 will be the most onerous test, but on all tests, the excess over the PLACP was over £120m. For the reasons given above, little reliance can be placed on these excess assets in assessing security for policyholders in PLAL.

5.6 Group Capital Adequacy Test and Group ICA

Implementation of the Scheme is expected to lead to an increase in the surplus under the PRA's Group Capital Adequacy Test and no material change in the Group ICA position.

5.7 Solvency II

As noted in section 5.1.2, it is still not certain what the exact capital requirements under Solvency II will be and therefore the capital requirements of PLAL under Solvency II before and after the Scheme cannot be established with any degree of reliability at this time. However, it is expected that the impact of the Scheme will be largely neutral given that NPLL will be consolidated in PLAL if the Scheme did not happen. I will provide an update in my supplementary report if further information becomes available.

6 EFFECT OF THE SCHEME ON PLAL POLICIES

6.1 Security of Benefits for all policies

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

- PLAL meeting its PRA capital requirements;
- PLHL meeting the minimum group capital requirements;
- PLAL meeting the additional capital requirements required by the PLACP;
- the strength of, and protections built into, the PLACP, including the internally specified stress scenarios that are tested and the process by which these scenarios can be changed; and
- the additional capital held under the terms of the Court undertaking.

Under the terms of the PLACP, the Shareholders' Fund currently provides support to the SERP Fund and the LL WP Fund. In addition, the Shareholders' Fund also supplies support by way of loans to NPLL, which is a subsidiary company of PLAL and is owned indirectly by the Shareholders' Fund. NPLL is consolidated into the financial reporting of PLAL, including its ICA and the PLACP.

Immediately after the Scheme is implemented the Shareholders' Fund will provide support to the NPL WP Fund by way of a loan under the terms of the PLACP. The value of the loan will equal the value of the support currently provided to the National Provident Life Fund under the Shareholder Equalisation Fund and the Earmarked Portfolio. In addition, the Shareholders' Fund will hold additional capital to meet the additional capital requirements of the NPL WP Fund. This will replicate the situation that already exists in NPLL and hence have no impact on PLAL policyholders.

Because NPLL is a subsidiary of PLAL and already consolidated into PLAL's financial reporting, implementation of the Scheme does not materially affect the financial position of PLAL as is shown in the analysis in sections 5.3 to 5.5. However, although the PLAL Board has given an undertaking to provide support to NPLL to enable NPLL to meet its capital policy, this obligation is contingent on PLAL meeting the requirements of its own capital policy. This means that, in very extreme situations, any excess capital in PLAL is available to PLAL's own policyholders in priority to NPLL's policyholders. After the Scheme is implemented the Shareholders' Fund would be required to provide support to the NPL WP Fund as long as it has surplus available and this might mean that there was less capital available to support PLAL's existing policyholders. In practice, the circumstances when this might take place are very remote given the level of protection provided by the current regulatory capital regime (including the PRA's powers of intervention) and the level of additional protection from the PLACP.

My conclusion is that, following the implementation of the Scheme, the existing policies in PLAL will continue to be protected and that there will be no material adverse change to their security as a consequence of the Scheme.

6.2 Policyholder Benefit Expectations of non-profit policies

Policy Terms and Conditions
No changes are being proposed to the terms and conditions of existing non-profit policies under or as a result of the Scheme. Changes will continue to be made to discretionary policy charges for non-profit policies in line with previous practice, so that policyholders will continue to be treated fairly.

Investment Performance and Unit Pricing
The investment managers of the assets of PLAL and the asset selection processes will not be changed as a consequence of the Scheme. No changes will be made to investment strategies of the PLAL unit-linked funds or their pricing practices as a result of the transfer.

Therefore, there should be no negative effect on the potential for investment performance or on unit pricing as a consequence of the Scheme.

6.3 With-Profit Policies in the Pearl WP Fund, LL WP Fund, and SERP Fund

6.3.1 Report of the With Profits Actuary

Appendix 2 contains a report that the PLAL Board requested from With Profits Actuary of PLAL. The key conclusions of that report are:

"In my opinion [...], 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 ensure that they continue to be treated fairly."

6.3.2 Opinion of the With-Profits Committee

The opinion of the WPC on the Scheme is set out below. In arriving at this opinion, the WPC had access to the report of the With Profits Actuary referred to in section 6.3.1.

- The WPC is in agreement with the objectives of the Scheme.
- The WPC has considered each main group of with-profits policyholder and is satisfied that no group will be materially disadvantaged.
- The WPC is comfortable that there remains adequate protection in place for the with-profits policyholders.
- The WPC considers that there will be no change to the benefit expectations of with-profits policyholders as a result of the Scheme.
- Overall, the WPC considers the Scheme is consistent with the regulatory obligations in respect of treating customers fairly.

6.4 Other Considerations

6.4.1 Quality of Administration

The terms upon which services are currently provided by Pearl Group Services Limited ("PGS") to PLAL will continue to apply in respect of the existing PLAL business following the Scheme, so there is no reason to expect the quality of administration to deteriorate as a consequence of the Scheme.

The business transferring to PLAL is already administered by PGS under a separate agreement and so no additional strain will be placed on PGS as a consequence of the Scheme.

6.4.2 New Business

PLAL and NPLL write limited amounts of new business, almost exclusively in respect of increments to existing policies, the exercise of options attaching to in-force policies, and the addition of new members to existing group pension schemes or under options attaching to existing policies. The new business to be written by PLAL in respect of NPLL policies after the implementation of the Scheme will be written on terms that PLAL expects to be profitable and within volumes such that any additional risk to PLAL will be covered by the available capital so that the PLACP is maintained.

6.4.3 Solvency II readiness

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. Thus both PLAL and NPLL are in the same state of readiness and the transfer is not envisaged to have any adverse impact on PLAL's Solvency II readiness.

6.4.4 Treating Customers Fairly

I believe that implementation of the Scheme, taking into account its contents, is consistent with the requirements in respect of treating customers fairly. This is because, in my opinion, the level of capital support that will be available after the Transfer Date to provide security for benefits should not be materially different to the level of capital support available to provide security for benefits now and because there will be no changes to policyholder benefits as a consequence of the Scheme.

6.5 Notification to Policyholders

The Scheme will have only a very small effect on the security of PLAL policyholders, because:

- NPLL is a subsidiary of PLAL and is already consolidated into PLAL's financial results. Therefore, the solvency position of PLAL already takes into account the NPLL business.
- The PLAL capital policy already allows for the risks within NPLL and the total capital held within PLAL and NPLL allows for all the risks of both PLAL and NPLL.
- There is a formal PLAL Board commitment to provide further capital to NPLL if required to enable NPLL to meet its capital policy (provided there is capital available in PLAL).

- It is highly unlikely, given the wider regulatory and reputational issues this would create, that PLAL, whilst meeting its own regulatory capital requirements, would not support NPLL to prevent it becoming insolvent.

PLAL policies are not moving under the Scheme and no NPLL policies are transferring into the existing PLAL with-profits funds, which will continue to be operated separately in accordance with the terms of the 2012 PLAL Scheme.

The Scheme will not change PLAL policy terms and conditions, the PLAL capital policy, the operation and financial management of the existing PLAL funds or, in respect of the existing with-profit funds, the PLAL PPFM.

PLAL policies will continue to be administered in the same way: there will be no change to the outsourcing arrangements as a result of the Scheme. Governance will not change other than some strengthening of governance protections (for instance, regarding the membership of the PLAL with-profits committee).

With the exception of annuities in payment, all NPLL business will transfer to a new with-profits fund in PLAL, which will be operated separately from other funds in PLAL.

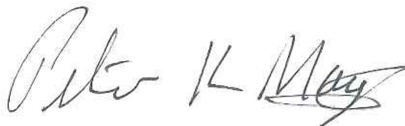
Annuities in payment will transfer to the NP Fund. However, because a substantial portion of this annuity business is already reassured to the NP Fund, most of the annuity liabilities already reside there and the assets which will transfer to the NP Fund in respect of the remaining liabilities are not significant in scale (approximately £13m).

In view of the minimal impact of the Scheme on PLAL policyholders, as described above, and the high cost of mailing PLAL policyholders and putting in place a response handling capability, I consider that it would be disproportionate to mail PLAL policyholders, and that the proposed advertising is appropriate for publicising the Scheme to PLAL policyholders.

Therefore, I am happy that no notifications in respect of the Scheme need be sent to non-transferring PLAL policyholders.

7 CONCLUSION

In my opinion as Actuarial Function Holder, taking into account the advice and opinions set out above, no class of PLAL policyholder will be materially adversely affected by the implementation of the Scheme. In particular, I believe that the Scheme should have no material adverse impact on the security of benefits of the PLAL's existing policyholders. I also believe that the Scheme is consistent with PLAL's obligation to treat customers fairly.



P. K. Mayes
Fellow of the Institute of Actuaries
15 December 2014