

## First Supplementary Report

For the proposed transfer of the non-life liabilities of Pearl Assurance Limited to BA (GI) Limited, both companies being part of the Phoenix Group Holdings group of companies

2 December 2011

Deloitte LLP and Mr David Hindley (Independent Expert) have prepared this First Supplementary Report ("First Supplementary Report for the proposed transfer of the non-life liabilities of Pearl Assurance Limited to BA (GI) Limited, both companies being part of the Phoenix Group Holdings group of companies " dated 2 December 2011) solely in connection with the proposed Transfer considered in the Transfer Report as required by Section 109 of the Financial Services and Markets Act 2000 ("FSMA 2000")

This First Supplementary Report is addressed to the English High Court of Justice and Pearl/BAGI/Phoenix Group.

This First Supplementary Report has been prepared for and only for the Court in accordance with Part VII of FSMA 2000 in connection with the Scheme and for no other purpose. A copy of this First Supplementary Report will be sent to the FSA and it will also be available to policyholders and other members of the public as required by the relevant applicable legislation.

The responsibilities and liabilities of Deloitte LLP and Mr Hindley are limited to the Court and the Sponsor of the Scheme and exist only in the context of their use of this First Supplementary Report for the purpose set out above. Deloitte LLP and Mr Hindley will not accept any liability or responsibility in relation to the use of this First Supplementary Report by the Court or the Sponsor of the Scheme for any other purpose.

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This First Supplementary Report must be considered in its entirety, as parts taken in isolation may be misleading.

There are restrictions on the use that may be made of this First Supplementary Report. Those restrictions are set out in Section 2.5 of the Transfer Report

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# 1 Introduction

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## 1.1 Appointment of Independent Expert

I, David Hindley, have been appointed by Pearl Assurance Limited (“Pearl”) and BA (GI) Limited (“BAGI”), both companies being part of the Phoenix Group Holdings group of companies (“Phoenix Group”), to act as the Independent Expert for the proposed transfer described in the report (“Transfer Report for the proposed transfer of the non-life liabilities of Pearl Assurance Limited to BA (GI) Limited, both companies being part of the Phoenix Group Holdings group of companies” dated 2 December 2011 (the “Transfer Report”).

I confirm that I fully understand my role as IE, as described in SUP 18 and as required by s109 of FSMA 2000 as well as my overriding duty to the Court as specified by Part 35 of the Civil Procedure Rules.

In the Transfer Report, dated 2 December 2011, I committed to provide an update to my opinion based on data and information as at 30 June 2011, and do so now in this First Supplementary Report. In addition, I have also been asked by Pearl to consider whether the volatility in the Capital Markets in 2011 has any impact on the conclusions in the Transfer Report.

This First Supplementary Report should be read in conjunction with the Transfer Report.

The Board of Actuarial Standards has issued standards that apply to certain types of actuarial work. I have prepared this First Supplementary Report, together with the Transfer Report, with the intention that they should meet the requirements of the Insurance Technical Actuarial Standard, Technical Actuarial Standard D:Data, Technical Actuarial Standard M: Modelling, Technical Actuarial Standard R:Reporting and the Transformations Technical Actuarial Standard. I believe that they do.

In Section 2 I restate my expert opinion given in the Transfer Report.

Capitalised terms not defined in this First Supplementary Report have the meaning given to them in the Transfer Report.

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## 1.2 Scope of Work

My scope is to produce a report on the impact of the proposed Transfer from the perspective of the Affected Policyholders, namely:

- the Transferring Policyholders (that is all current non-life policyholders of Pearl);
- the Receiving Policyholders (that is all current policyholders of BAGI); and
- the Remaining life assurance Policyholders of Pearl, that are not subject to the proposed Transfer.

Nothing in this First Supplementary Report or in my Transfer Report dated 2 December 2011 should be regarded as providing a legal opinion on the effectiveness of the proposed Transfer.

# 1 Introduction

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Draft versions of this report must not be relied upon by any person for any purpose. No reliance should be placed on any advice not given in writing. If reliance is placed contrary to the guidance set out above, Deloitte LLP disclaims any and all liability which may arise.

This First Supplementary Report is subject to the same restrictions on distribution and use as stated in Section 2.5 of the Transfer Report.

The FSA has confirmed that it has approved the form of this First Supplementary Report, in the context of the relevant regulations.

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## 2 Expert Opinion

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### 2.1 Confirmation of Opinion

I confirm my view that the Transfer is unlikely to have a material adverse impact on the Affected Policyholders in terms of either financial or non-financial aspects.

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### 2.2 Expert's Declaration

I confirm that I fully understand my overriding duty to the English High Court of Justice and that I must help the English High Court of Justice on matters within my expertise. I believe that I have complied, and will continue to comply, with this duty.

I confirm that insofar as the facts stated in the Transfer Report are within my own knowledge I have made clear which they are and I believe them to be true, and that the opinions I have expressed represent my true and complete professional opinion.



David Hindley FIA

2 December 2011

## **3 Consideration of Data and Information as at 30 June 2011**

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### **3.1 Transferring Policyholders**

In the Transfer Report I considered the reserves of the Transferring Policyholders as at 31 December 2010.

For the purposes of this First Supplementary Report, for the Transferring Policyholders I have reviewed the information provided to me by Pearl in relation to both the non-life held reserves as at 30 June 2011 and the non-life claims paid during the period between 31 December 2010 and 30 June 2011.

Pearl has provided a breakdown of these amounts by portfolio within the non-life business and has also provided explanations for the more material movements (at a portfolio level). Overall, there has been virtually no change in the gross and net reserves between 31 December 2010 and 30 June 2011, with immaterial claims paid during the period.

I am satisfied that Pearl's explanations for the more material movements appear reasonable and do not invalidate my conclusions relating to the Transferring Policyholders.

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### **3.2 Receiving Policyholders**

In the Transfer Report I considered the reserves of the Receiving Policyholders as at 31 December 2010.

Pearl has provided an update of the position in respect of the Receiving Policyholders. The number of Receiving Policyholders with outstanding claims has reduced from three to two between 31 December 2010 and 30 June 2011. The corresponding total gross technical provisions, including an allowance for IBNR claims and claims handling expenses, has decreased from £2.0m to £1.9m between 31 December 2010 and 30 June 2011. Pearl has provided explanations for this movement and I am satisfied that the explanation appears reasonable and does not invalidate my conclusions relating to the Receiving Policyholders.

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### **3.3 Remaining Policyholders**

Pearl have advised me that internal monitoring of the capital position of Pearl is carried out regularly. I understand that this monitoring is updated for all material factors of which the Company is aware and I have been advised that the results of this have demonstrated that the Pearl Capital Policy has been met at all times since year end 2010.

The Capital Ratios as at 31 December 2010 for Pearl allowed for payment of a dividend which would reduce the excess capital to the level of the Pearl Capital Policy. This, combined with the relatively small size of the Transferring Liabilities and the fact that

### **3 Consideration of Data and Information as at 30 June 2011**

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Pearl have advised me that assets in Pearl remain in excess of the Pearl Capital Policy, means that whilst the ratios will have changed since 31 December 2010, such changes do not invalidate my conclusions relating to the Remaining Policyholders.

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#### **3.4 Conclusion**

Overall, I am satisfied that there are no material issues arising from the updated data and information discussed above that are likely to have any impact on the analyses underlying my opinion.

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## 4 Consideration of Current Volatility of Capital Markets

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### 4.1 Introduction

In this section of my First Supplementary Report, I have considered whether the volatility in Capital Markets during 2011 has any impact on the conclusions in the Transfer Report.

I have deemed it necessary to consider this as my conclusions are based largely on analysis of data as at 31 December 2010, and since then it has become more apparent that global economic conditions remain highly uncertain.

I refer to the above items collectively as the “Capital Markets Volatility Effect”.

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### 4.2 Remaining Policyholders

Clearly, as these are Life policyholders, the Capital Markets Volatility Effect could have a material financial impact on Pearl. However, since the proposed Transfer itself involves the removal of the Non-Life policyholders from Pearl, whose liabilities are very small relative to the Remaining Policyholders’ liabilities, I consider that the proposed Transfer itself does not change the impact of the Capital Markets Volatility Effect on the Remaining Policyholders. Therefore, I do not consider that the Capital Markets Volatility Effect has any impact on whether or not I can approve the proposed Transfer.

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### 4.3 Transferring and Receiving Policyholders

In theory, the Capital Markets Volatility Effect could cause the market risk component of BAGI’s ICA post-Transfer to change, thus impacting the security of BAGI post-Transfer. However, BAGI have advised me that:

- a) they have carried out high-level sensitivity tests and these evidence little movement in risk capital for the change in yield curve from December 2010 to June 2011; and
- b) they will re-evaluate the ICA at regular intervals and if they deem it appropriate, recalibrate the market risk component of the ICA.

The contribution of market risk to Pearl’s Non-Life ICA as at 31 December 2010 was approximately 6% (prior to any allowance for diversification between risk types). I would regard this as a suitable proxy for the contribution of market risk to BAGI’s ICA post-Transfer. Therefore, I consider that the use of a capital policy of 130% of ICA in BAGI post-Transfer provides an effective buffer against changes in the ICA caused by factors such as the Capital Markets Volatility Effect.

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## **4 Consideration of Current Volatility of Capital Markets**

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### **4.4 Conclusion**

Overall, I am satisfied that the Capital Markets Volatility Effect does not change my opinion given in the Transfer Report.

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