PHOENIX GROUP

ABBEY LIFE ASSURANCE COMPANY LIMITED

Proposed Scheme to transfer the entire business of Abbey Life Assurance Company Limited to Phoenix Life Limited

Report by the Chief Actuary on the impact of the Scheme on Policyholders of Abbey Life Assurance Company Limited

11 July 2018

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 Abbey Life Assurance Company Limited ("Abbey Life"). Under this scheme (the "Scheme") the business of Abbey Life is to transfer to Phoenix Life Limited ("Phoenix").

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

This report is written for the Abbey Life Board in my capacity as Chief Actuary for Abbey Life. As well as the Board, this report may be used by the Independent Expert, the High Court, the Prudential Regulation Authority ("PRA"), the Financial Conduct Authority ("FCA") and any overseas regulators and courts in forming their own judgements about the Scheme.

This report and the underlying preparation work that has been carried out is in my opinion compliant with the relevant Technical Actuarial Standards issued by the Financial Reporting Council that apply to certain types of actuarial work, namely TAS100: Principles for Actuarial Work and TAS 200: Insurance.

In my opinion there has been an appropriate level of review in the production of this report and that it is compliant with the requirements of Actuarial Practice Standard X2 as issued by the Institute and Faculty of Actuaries.

2. SUMMARY

In section 3, I have provided background information on Abbey Life and Phoenix.

I have given a summary of the Scheme in section 4, highlighting its effect on the policyholders of Abbey Life. 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 policyholders of Abbey Life.

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

Brief details of the current solvency regulatory regime are given in Appendix One in which the terms Own Funds, TMTP, RFF Restriction and ORSA are defined.

Appendix Two sets out a report by the With-Profits Actuary of Abbey Life, which considers the effect of the Scheme on the with-profits policyholders of Abbey Life.

3. BACKGROUND

3.1. Status

I am a Fellow of the Institute of Actuaries. I was appointed as Chief Actuary of Abbey Life on 11 April 2018.

I am an employee of Pearl Group Management Services Limited ("PGMS"), which is a wholly owned subsidiary of Phoenix Group Holdings ("PGH"), the ultimate parent company of Abbey Life. I am not a policyholder of any of the companies within the Phoenix Group, including Phoenix and Abbey Life. I currently have a number of Phoenix Group Holdings shares and share options.

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

3.2. History of Abbey Life

Abbey Life is a member of the Phoenix Group having been acquired from the Deutsche Bank Group ("Deutsche Bank") on 30 December 2016. The Phoenix Group, which is headed by PGH, includes three active regulated UK life companies – Abbey Life, Phoenix and Phoenix Life Assurance Limited.

Abbey Life was founded in 1961. In 1985, it was floated on the London Stock Exchange. Between 1991 and 1996, it was acquired in stages by Lloyds Bank and then sold to Deutsche Bank in 2007.

Abbey Life wrote life and pension business until it substantially closed to new business in 2000, albeit it continues to issue policies under options on existing policies, including the acceptance of new members to existing pension arrangements and the issue of immediate annuities in respect of vesting pension policies. A small number of corporate transactions were written in recent years, the last of these in 2016.

Most of Abbey Life's business was sold through its own direct salesforce and appointed representatives, but Abbey Life also accepted business via independent advisers.

In 1998 Abbey Life was party to two insurance business transfer schemes pursuant to Part I of Schedule 2C of the Insurance Companies Act 1982 under which the business of Ambassador Life Assurance Company Limited and of Hill Samuel Life Assurance Limited were transferred to it (the "Ambassador Scheme" and the "Hill Samuel Scheme" respectively).

3.3. The Business of Abbey Life

All of the long-term business of Abbey Life is held within its long-term fund, which includes the Non-Profit Fund and two small with-profits funds (the "ALAC WP Funds") – the Abbey Life Participating Business Fund (the "Abbey Life PB Fund") and the Hill Samuel Participating Business Fund (the "Hill Samuel PB Fund"). At least 90% of the surplus in each participating fund is attributable to the with-profits policyholders in that fund.

The business in the Non-Profit Fund of Abbey Life consists of:

- Annuity business;
- Unit-linked life and pension business;
- A small amount of traditional life and pension non-profit business; and
- Corporate Transactions, which consist of four arrangements with corporate pension schemes operating in a similar way to a longevity swap and a bespoke reinsurance arrangement in respect of life protection business.

On 29 December 2017, Abbey Life entered into two reinsurance agreements with Phoenix under which Phoenix assumed the majority of Abbey Life's risks and liabilities, excluding the with-profits funds and unit-linked funds. Following the reinsurance with Phoenix, Abbey Life retains the relationships with all its policyholders and with its external reinsurers.

As at 31 December 2017, Abbey Life had approximately 720,000 policies in-force, The best estimate liabilities ("BEL") gross of reinsurance were £8,910m and net of reinsurance were £7,292m. This was split by product type as follows:

£m	Number of Policies	BEL Gross of Reinsurance	BEL Net of Reinsurance
Non-Profit Fund			
Annuities	259,000	2,363	(34)
Unit-Linked	446,000	7,339	7.290
Corporate Transactions	5	(863)	0
Other	13,000	33	0
Abbey Life PB Fund	89	1	1
Hill Samuel PB Fund	1,220	37	34
Total		**8,910**	**7,292**

As well as its counterparty exposure to Phoenix in respect of the reinsurance arrangements, Abbey Life currently retains the following risks:

- All risks within the with-profits funds;
- Market and capital risks for the assets backing the capital held in Abbey Life;
- The liability for any fines imposed by the FCA, although Abbey Life benefits from an agreement with its parent company, Phoenix Life Holdings Limited ("PLHL"), in respect of any money PLHL receives under indemnity protection provided by Deutsche Bank, which covers any liability resulting from FCA investigations following their thematic reviews of long-standing customers and annuity sales practice in the period prior to the date on which Abbey Life was acquired by Phoenix Group; and
- A small amount of ongoing operational risk.

3.4. Abbey Life Capital Policy

The Board of Abbey Life set a capital management policy (the "ACMP") in October 2017 under which it seeks to hold sufficient capital to be able to meet capital requirements after a 1 in 10 year all risk event, consistent with the approach adopted under the Phoenix Capital Policy (the "'PCP"), as described in section 3.5. As a result of this, the Board set an amount of 30% SCR as the amount to be held under the ACMP.

3.5. Phoenix

Like Abbey Life, Phoenix is a member of the Phoenix Group.

Phoenix traces its history back to 1971, when it was incorporated as Lloyds Life Assurance Limited. It was subsequently renamed Royal Heritage Life Assurance Limited ("RHL"), and then Royal & Sun Alliance Linked Insurances Limited in 1998. In 2005, the company's name was changed to Phoenix Life Limited in 2005.

Phoenix closed to new business in 2002, although it continued to issue policies under options on existing policies, including the acceptance of new members to existing pension arrangements and the issue of immediate annuities in respect of vesting pension policies. Phoenix has since 8 December 2017, when the business of AXA Wealth Limited ("AWL") was transferred to it, written new non-profit protection business under the SunLife brand, having reinsured all such business sold by AWL from 1 November 2016. Phoenix has recently entered the bulk purchase annuity business and wrote its first contract in March 2018.

Phoenix has been involved in a number of Part VII schemes since 2005. Of these, a scheme under which the long-term insurance businesses of Scottish Mutual Assurance Limited and Scottish Provident Limited were transferred to Phoenix (the "Phoenix 2009 Scheme") is most relevant. The Phoenix 2009 Scheme sets out various terms for the management of Phoenix's business, and will continue to do so irrespective of whether the Scheme goes ahead. The Phoenix 2009 Scheme will not be amended or modified by the Scheme.

The long-term insurance business within Phoenix is held within eleven sub-funds:
- The 100% With-Profits Fund (the "100% WPF");
- The 90% With-Profits Fund (the "90% WPF");
- The Alba With-Profits Fund (the "Alba WPF");
- The Britannic Industrial Branch Fund (the "BIB Fund");
- The Britannic With-Profits Fund (the "Britannic WPF");
- The Phoenix With-Profits Fund (the "Phoenix WPF");
- The SAL With-Profits Fund (the "SAL WPF");
- The Scottish Mutual With-Profits Fund (the "SM WPF");
- The SPI With-Profits Fund (the "SPI WPF");
- The NPI With-Profits Fund (the "NPI WPF"); and
- The Non-Profit Fund (the "NPF").

The first ten funds listed above are with-profits funds ("WPFs"). All the surplus arising in the 100% WPF and the NPI WPF is attributable to the with-profits policyholders in those funds and at least 90% of the surplus in the other with-profits funds is attributable to the with-profits policyholders in the relevant fund.

The NPF consists of the balance of the policies of Phoenix and includes business originally written by Phoenix as well as business transferred as a result of the various Part VII schemes. The policies in the NPF mainly fall into the following categories:
- Unit-linked regular and single premium life and pension policies;
- Immediate, deferred and bulk purchase annuities;
- Term assurance, critical illness and income protection policies written on both guaranteed and reviewable premium bases; and
- 'Guaranteed over fifty' whole of life policies including the new business written under the SunLife brand.

The NPF is maintained for accounting and operational purposes to allow Phoenix to identify its long-term insurance business which is not allocated to its with-profits funds. Since the introduction of Solvency II, there is no legal or regulatory requirement to maintain the NPF or to separate the business allocated to the NPF from the assets and liabilities of Phoenix which are not attributable to its long-term insurance business (referred to as the "Shareholders' Fund"). For reporting purposes under Solvency II, the Shareholders' Fund is combined with the NPF.

The approximate number of policies and BEL, net of reinsurance, in each sub-fund of Phoenix as at 31 December 2017 are shown in the table below.

Fund	100% WPF	90% WPF	Alba WPF	BIB Fund	Britannic WPF	Phoenix WPF	SAL WPF	SM WPF	SPI WPF	NPI WPF	NPF
Policies (000)	0	255	86	111	351	124	96	98	66	8	2,349
BEL (£m)	51	77	786	110	3,931	2,706	3,361	1,890	1,611	0	24,902

In total, Phoenix at 31 December 2017 had approximately 3.5 million policies in force with total assets in excess of £47 billion.

Under the terms of the Phoenix 2009 Scheme, Phoenix maintains the PCP, the main objective of which is to ensure that the company can continue to meet the PRA's capital requirements in internally specified stress scenarios. The strength of the PCP is a function of these scenarios.

The scenario testing, as for Abbey Life, is currently based on holding sufficient capital to be able to meet regulatory capital requirements after a 1 in 10 year all risk event. This requirement is expressed as a percentage of the Solvency Capital Requirement ("SCR"), which is the amount of capital required to be held by insurance companies under Solvency II. The scenarios and percentage are reviewed from time to time to ensure that the capital policy continues to meet its objective. The percentage may thus change without affecting the strength of the PCP.

The PCP currently requires Phoenix to hold capital equal to 31 percent of the SCR in addition to the capital necessary to meet the SCR itself. Where a WPF has sufficient surplus, the additional capital is met by the surplus in the fund and allowance is made for management actions permitted within the PPFM. These are known as "unsupported WPFs". However, as at 31 March 2018 the Alba WPF and the SAL WPF do not have sufficient surplus and for these "supported WPFs" the additional capital is met by the NPF and Shareholders' Fund.

If at any point there is a small deficit relative to the PCP, then no action is required to be taken other than that no capital can be released (for example through the payment of dividends). However, larger deficits would require consideration of corrective action.

Under the terms of the PCP, Phoenix ensures that it holds sufficient assets that can be made available to the WPFs should they require support in the stress scenario. In addition, although not part of the PCP, Phoenix maintains a liquidity policy to ensure that it has sufficient liquid assets to meet policyholder claims, collateral requirements and any dividend payments.

4. THE PROPOSED SCHEME

4.1. Background to the Scheme

The main objective of the Scheme is to transfer the business of Abbey Life to Phoenix. This will enable Phoenix Group to make more efficient use of its capital. It will also result in the reduction of costs and operational efficiency as the current reinsurance arrangements between Abbey Life and Phoenix will cease and there will be one less regulated life company in the group.

4.2. Summary of the Scheme

4.2.1 The Transfer

Under the Scheme, the long-term insurance business of Abbey Life (the "Business") will transfer to Phoenix at the Transfer Date, which is expected to be 31 December 2018.

The with-profits business within Abbey Life will be converted to non-profit with guaranteed future bonuses under the terms of the Scheme and all assets and liabilities of the ALAC WP Funds will be transferred to the NPF.

The assets and liabilities of the shareholders' fund of Abbey Life will transfer to the Shareholders' Fund of Phoenix and the remaining assets and liabilities of the Abbey Life long-term fund will transfer to the NPF. On the Transfer Date of the Scheme, sufficient assets will be left in Abbey Life to meet its regulatory capital requirements after the transfer. These assets will be transferred to Phoenix once the PRA has de-authorised Abbey Life.

Under the Scheme, Phoenix will become party at the Transfer Date to all external third party reinsurance treaties in relation to the business transferring to it to which Abbey Life is party, and these treaties will continue to operate in the same way as they did before the Transfer Date.

The reassurance agreements between Abbey Life and Phoenix will collapse on implementation of the Scheme as the business to which they relate will all be within the NPF.

It is proposed that the transfer of any business which may have been written by Abbey Life (or any predecessor firms) in Jersey and Guernsey or to policyholders resident in Guernsey will be effected following the approval of separate schemes in Jersey and Guernsey. These schemes will 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 policy or group of policies at the time the Scheme is implemented then such policies will be subject to an Excluded Policies Reassurance Arrangement. 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 Phoenix.

4.2.2 Impact on Abbey Life Policies

All policies of Abbey Life will be transferred to the NPF of Phoenix and become policies of Phoenix.

Abbey Life non-profit policies

No changes are being proposed to the terms and conditions of Abbey Life non-profit policies as a result of the Scheme. Changes will continue to be made to discretionary policy charges in accordance with existing practice. New unit-linked funds will be created in Phoenix corresponding to those in Abbey Life. They will have the same asset pools and charges and will be priced on the same basis as the equivalent funds immediately before the transfer. They will also immediately after the Transfer date have the same investment managers working to the same mandates.

Under the Scheme, powers will be granted to Phoenix to allow the amalgamation, division, closure and winding-up of unit-linked funds or the modification of their investment objectives, where the existing terms and conditions do not cover such events and such terms do not preclude such action. Such actions will only be taken having regard to the interests of the relevant policyholders and will have regard to the advice of the Phoenix Chief Actuary at the time. This will not apply to the policies transferred under the Hill Samuel Scheme as clauses in that scheme relating to the policies which transferred to Abbey Life under that scheme will be replicated in the Scheme to ensure that the terms and conditions of these policies are not changed as a result of the Scheme.

Abbey Life with-profits policies

With-profits policies in Abbey Life will be converted to non-profit at the time of the transfer to Phoenix pursuant to the terms of the Scheme and will cease to participate in any profits. Instead, those policies will have the rights set out below.

Policies in the Hill Samuel PB Fund will receive guaranteed bonuses in the form of an annual bonus payable on 1 April 2019 and annually thereafter, together with a fixed special bonus payable on the maturity of the policy or earlier claim.

Conventional with-profits policies in the Abbey Life PB Fund will receive guaranteed bonuses in the form of an annual bonus payable on 1 January 2019 and annually thereafter. Planned Investment Endowments in the same fund will receive annual bonuses guaranteed at the current level, a special bonus payable on the Transfer Date of the Scheme and a final bonus which will be based on the actual dividends received.

Details of the way the guaranteed bonuses will be calculated for each group are included in the Report by the With-Profits Actuary.

All policies

All previous schemes involving Abbey Life, or involving companies whose business has been transferred to Abbey Life, will be disapplied by the Scheme. Where provisions from these previous schemes need to be continued or replicated, then relevant provisions are included in this Scheme.

The PCP as described in section 3.5 will replace the ACMP.

Costs associated with the Scheme will be met by the Shareholders' Fund of Phoenix.

5. FINANCIAL POSITION BEFORE AND AFTER THE TRANSFER

5.1. Basis of calculation of the solvency position of Abbey Life before and Phoenix after the Scheme

I have shown in the tables in sections 5.2 and 5.3 the position of Abbey Life as at 31 March 2018 and of Phoenix at the same date as if the Scheme had been implemented then. The SCR for both companies is calculated using Phoenix Group's Internal Model as approved by the PRA in March 2018. The figures in respect of Phoenix have been supplied by the Chief Actuary of Phoenix. I have not independently verified these figures and I have relied on the statements made in his report.

I have commented in section 5.4 how events since 31 March 2018 are likely to have changed the figures and the conclusions that can be drawn from them.

In the tables in sections 5.2 and 5.3:

- Own Funds – these have been calculated as at 31 March 2018 using consistent methods and processes and subject to the same internal controls as the calculations done as at 31 December 2017, which were, with the exception of the TMTP for Phoenix, subject to review by Abbey Life's and Phoenix's external auditors.
- SCR – this is calculated according to the Phoenix group's internal model, which has been approved by the PRA.
- Solvency Ratio – for Phoenix, this is calculated on two bases, one including all funds and the other including unsupported WPFs only to the extent that transfers from those funds will accrue to shareholders. By excluding policyholder benefits and risks in unsupported WPFs, the latter gives an indication of the strength of the company.

5.2. Abbey Life before the Transfer

Table 1 below shows the financial position of Abbey Life and its solvency ratio as at 31 March 2018, but taking into account a dividend of £250m which was declared in June 2018.

Table 1	Abbey Life as at 31 March 2018 before the effect of the Scheme		
	Own Funds £m	RFF Restriction £m	SCR £m
WPFs	0	-	4
NPF and Shareholders' Fund	279	-	18
Total	**279**	**-**	**22**
Excess of Adjusted Own Funds over SCR	**£257m**		
Solvency Ratio – All funds	**1284%**		

Note – The numbers in the table above and elsewhere in this section may not add up due to rounding.

As stated in section 3.4, the level of capital implied by the ACMP is higher than that required by the PRA's requirements outlined above. As at 31 March 2018, Abbey Life met the higher levels implied by the ACMP.

5.3. Phoenix after the Transfer

Table 2 shows pro-forma figures for Phoenix as if the Scheme had been implemented, again as at 31 March 2018 and allowing for the dividend for ease of comparison.

Table 2	Phoenix as at 31 March 2018 after the effect of the Scheme		
	Own Funds £m	RFF Restriction £m	SCR £m
Unsupported WPFs	1,402	170	950
Supported WPFs	338	-	291
NPF and Shareholders' Fund	2,486	-	1,676
Total	**4,226**	**170**	**2,917**
Excess of Adjusted Own Funds over SCR	**£1,139m**		
Solvency Ratio – All Funds	**139%**		
Solvency Ratio excluding unsupported WPFs	**158%**		

Based on analysis of the position of Phoenix after implementation of the Scheme, Phoenix would have met the higher levels implied by the PCP on 31 March 2018.

5.4. Events since 31 March 2018

Since 31 March 2018, there have been a number of actions that have affected the financial position of Phoenix. The most significant of these to 30 June 2018 are as follows:

- Management Actions and Product Management Initiatives – The Board of Phoenix have approved two significant actions. One will lead to lower fees being paid for administration expenses on part of its business and the other will improve policyholder benefits by the implementation of caps on certain ongoing and exit charges. These changes are estimated to increase the excess of adjusted own funds by c£35m.
- Valuation Assumptions – Phoenix will undertake a further valuation as at 30 June 2018. As part of this and in line with established practice, the assumptions and methodologies have been reviewed and, where appropriate, the Board has approved changes to these, reflecting particularly: a reduction to the assumption for investment expenses as a result of lower fees to be paid to the providers of these services; and improvements to modelling. These changes are estimated to increase the excess of adjusted own funds by c£100m.

Overall taking into account the above, other actions taken, market conditions and the expected run-off of business since 31 March 2018:

- Abbey Life met its regulatory capital requirements and the more onerous requirements of the ACMP as at 30 June 2018; and

- based on the analysis of the position of Phoenix after implementation of the Scheme, Phoenix would have met its regulatory capital requirements and the more onerous requirements of the PCP.

In addition I note that the PRA issued a consultation paper, CP13/18 Solvency II: Equity Release Mortgages, on 2 July 2018. The consultation will close on 30 September 2018 and the proposed implementation date is 31 December 2018. This will not affect the business of Abbey Life. However, if the rules are implemented in line with the consultation paper, then it is currently expected that they will lead to a reduction in the solvency position of Phoenix, but that Phoenix will continue to meet its regulatory capital requirements and the more onerous requirements of the PCP after the Scheme is implemented. Therefore, I do not expect this to change the conclusions in my report.

In my supplementary report, I will provide financial information as at 30 June 2018 and comment on relevant events affecting the solvency position, including developments in the consultation process referred to above, from then to the date of that report.

6. EFFECT OF THE SCHEME ON ABBEY LIFE POLICIES

6.1. Security of Benefits

Following the implementation of the Scheme, security for the benefits of transferring policyholders will be provided by Phoenix.

I have reviewed the report prepared by the Chief Actuary of Phoenix for the Board of Phoenix. As noted above, I have not independently verified the figures and I have relied on the statements made in the report.

The report shows that Phoenix would continue to meet its regulatory capital requirements after the Scheme has been implemented and it would continue to meet the requirements of the PCP.

The security of benefits for transferring policyholders will be provided by:

- the PRA's regulatory capital requirements, which include a buffer over the policy liabilities and which are intended to ensure that Phoenix can cover its technical provisions even after a 1 in 200 year event; and
- the PCP, which provides an additional buffer over the PRA's regulatory capital requirements, together with the governance around how this operates and when changes can be made to it.

In determining whether the Scheme will materially affect the security of benefits for transferring policyholders, I note that the Solvency Ratio in Abbey Life is currently 1,284% and this would be 158% in Phoenix after the Scheme is implemented on the basis set out in table 2 in paragraph 5.3 above. However, for the reasons given below, I do not believe that a comparison of these ratios is a good indicator of the relative financial security offered by each company and instead I have considered the differences in respect of:

- the financial strength required by the PRA regulatory capital requirements for Phoenix and Abbey Life;
- the strength of the ACMP capital policy relative to the PCP; and
- the governance of and controls on the ACMP relative to the PCP.

A comparison of the Solvency Ratio does not take into account that capital that is held in excess of the requirements of the company's respective capital policy can be distributed to its shareholders. Further, such a comparison does not take into account the relative sizes of the two companies – Phoenix is larger than Abbey Life and its excess assets are, in absolute terms, much bigger; and Abbey Life's size and lower risk diversification mean that its capital position could be subject to a greater level of volatility than that of Phoenix.

I also note that in terms of policyholder security Abbey Life is reliant on Phoenix fulfilling its obligations under the reinsurance agreements. There are additional protections in those agreements so that in the unlikely event that Phoenix does run into financial difficulties the position of Abbey Life and its policyholders would not be materially different from that of Phoenix's other policyholders. As under the scheme, the Abbey Life policyholders will be put on to the same footing as the other Phoenix policyholders, there is no material loss of security as a result of the Scheme.

Therefore, although the Solvency Ratio would be less in Phoenix after the Scheme than it is in Abbey Life, this will not have a material effect on the security of the benefits of the transferring Abbey Life policyholders after the Scheme is implemented.

There are no differences in the way that Phoenix and Abbey Life calculate their Solvency II technical provisions and SCR. Whilst the risk profile of Phoenix is different from that of Abbey Life currently, the nature of the risks is reflected in the amount required to be held under the SCR. The Solvency II rules are intended to ensure that both companies will provide financial strength and security for its policies such that each can survive severe events with at least a 99.5% probability of remaining solvent over a one year time horizon.

Both the ACMP and the PCP are based on a similar approach to determining the amount to be held as both rely on a 1 in 10 year all risks assessment, calculated in the same way. Therefore, notwithstanding that they produce slightly different percentages of SCR, there is no difference in the underlying strength of the capital policies.

In terms of governance, the PCP is included in the 2009 Scheme which puts certain constraints on how the policy can be changed and therefore offers more protection than the ACMP. However, in practice the Boards of Phoenix and Abbey Life regularly review their respective capital policies and major changes would only be made following the PRA's approval or non-objection.

In addition, both companies are committed to taking actions if their capital policy is breached, unless such breach will be rectified in a short space of time by the normal operation of the business.

In conclusion, there are only small differences in approach between Phoenix and Abbey Life in calculating their technical provisions and SCR and operating their respective capital policies and these will not have a material effect on the security of the benefits of the current Abbey Life policyholders after the Scheme is implemented.

6.2. Benefit Expectations of Non-Profit Policies

No changes are being proposed under the Scheme to the policy terms and conditions of the Abbey Life non-profit transferring policies.

The benefits of the transferring policies are set out in the policy terms and conditions. The Scheme will allow Phoenix to allow the amalgamation, division, closure or winding-up of unit-linked funds or the modification of their investment objectives, where the existing terms and conditions do not cover such events and where they do not preclude such action. This will only apply to a small number of policies as most terms and conditions already cover these actions. Further, as noted above, in respect of the policies transferred to Abbey Life under the Hill Samuel Scheme the provisions of the Hill Samuel Scheme regarding such actions will be replicated in the Scheme.

Both Abbey Life and Phoenix operate the same policy with regard to the operation of changing discretionary policy charges for non-profit policies. Therefore, the implementation of the Scheme will not mean any change to practices in this regard.

The investment managers of the Abbey Life assets transferring to Phoenix and the asset selection processes will not be changed as a consequence of the Scheme.

All unit-linked funds run by Abbey Life will be replicated in Phoenix under the Scheme. It is not proposed that any changes will be made to investment strategies of the unit-linked funds or their pricing practices as a result of the transfer.

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

On this basis I consider that there will be no material reduction in the benefit expectations of current Abbey Life non-profit policyholders as a result of the Scheme.

6.3. With-Profit Policies

6.3.1. Report of the With-Profits Actuary

Appendix Two contains a report which the Abbey Life Board requested from the With-Profits Actuary of Abbey Life. The key conclusions of that report are:

In my opinion as With-Profits Actuary, taking into account the opinions set out above, no class of Abbey Life with-profits policyholder will be materially adversely affected by the implementation of the Scheme. In particular, I believe that the Scheme should not have any adverse impact on the security of benefits or benefit expectations of the Abbey Life with-profits policyholders

6.3.2. Opinion of the With-Profits Committee

The opinion of the With-Profits Committee ("WPC") on the Scheme as it effects the with-profits policyholders of Abbey Life is set out below. In arriving at this opinion, the WPC had access to and placed reliance on a near final version of 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 group of with-profits policyholder and is satisfied that no group will be materially disadvantaged;
- The WPC is satisfied that there remains adequate ongoing protection for the converting with-profits policyholders;
- The WPC considers that there will be no material change to the benefit expectations of current with-profits policyholders as a result of the Scheme;
- Overall the WPC considers the Scheme is consistent with the regulatory obligations in respect of ensuring fair outcomes for with-profits policyholders.

6.4. Quality of Administration

Policy administration is currently largely outsourced to Capita Life and Pensions Regulated Services Limited ("Capita"). Additionally, Countrywide Assurance plc ("Countrywide") carries out policy administration for a small number of policies in respect of business that Abbey Life reinsures to it. There will be no change to the terms upon which Capita and Countrywide provide these administration services as a consequence of the Scheme. Therefore, there is no reason to expect the quality of administration or the level of service provided to Abbey Life policyholders to deteriorate as a consequence of the Scheme.

6.5. New Business

I understand that Phoenix will continue to sell new business and that this will be written on terms that Phoenix expects to be profitable and within such volumes that any additional risk to Phoenix will be covered by available capital such that Phoenix continues to satisfy the requirements of its capital policy.

6.6. Brexit Contingency Planning

Abbey Life has not sold retail business in Europe using passporting or set up branches in any EU country. In line with Phoenix, it has a number of retail policyholders who bought their policy whilst living in the UK, but who are now resident in the EU. The business in Phoenix includes business that was originally sold to policyholders in the EU, virtually all of which is in Ireland and has developed a contingency plan to address this. The transfer of the business from Abbey Life does not bring new situations to Phoenix and so implementation of the Scheme will not change Phoenix's planning in this area.

6.7. Notification to Policyholders

I have reviewed the mailing packs prepared for Abbey Life policyholders, which include the Scheme guide, or, for certain categories of policyholders, a simplified version of the same and the related materials to be made available on the Abbey Life website. I am satisfied that the information regarding the proposals as contained therein adequately describes the proposals for policyholders.

6.8. Previous Abbey Life Schemes

Under the terms of the Scheme, all previous schemes will be disapplied and cease to have effect. I have reviewed the provisions of these schemes and am satisfied that it is fair for these schemes to cease to have effect. By and large, this is because its provisions are no longer relevant or will be replicated by provisions in the Scheme that have an equivalent effect.

6.9. Treating Customers Fairly

I believe that the contents of the Scheme are consistent with the requirements to treat customers fairly with respect of the policyholders in Abbey Life. This is because the capital support that will be available to provide security for benefits of the policies held by these policyholders should be at least as much as the level of capital support currently available to provide security for benefits and because there will be no material adverse change to the benefit expectations of policyholders as a consequence of the Scheme.

6.10. Conclusions on Abbey Life Policyholders

For the reasons set out above, I consider that the Scheme will not materially adversely change the position of current policyholders of Abbey Life.

7. CONCLUSION

In my opinion as Chief Actuary, taking into account the advice and opinions set out above, no class of Abbey Life policyholder will be materially adversely affected by the implementation of the Scheme. In particular, I believe that the Scheme should not have any adverse impact on the security of benefits or benefit expectations of the Abbey Life policyholders. I also believe that the Scheme is consistent with Abbey Life's obligation to treat customers fairly and there should be no adverse effect on the levels of service provided to policyholders.

K.P.N. Edgington

K P N Edgington
Fellow of the Institute of Actuaries
11 July 2018

Appendix One – Summary of certain aspects of the current prudential regulatory regime

The prudential regulatory regime in place in the UK in respect of life insurers such as Abbey Life and Phoenix is known as Solvency II and was implemented from 1 January 2016. Requirements are commonly split into three pillars.

Pillar 1 covers the financial requirements and is designed to ensure that a company is adequately capitalised to deliver policyholder protection by ensuring the SCR is set such that a company can withstand a 1 in 200 year event and still have sufficient assets to cover its technical provisions.

Companies calculate their capital resources (known as "Own Funds") with technical provisions calculated on a best estimate basis with an additional margin for risk.

The SCR, which is the additional capital that companies must hold, can be set by using the standard formula or a company's own internal model, provided this model has been approved by the PRA.

In addition, insurance companies can make applications to the PRA for the following reliefs or adjustments, which will be taken into account in determining its Own Funds and technical provisions:

- Transitional Measures on Technical Provisions ("TMTP") – these are aimed at providing a smooth transition between the previous prudential capital regime (Solvency I) and Solvency II. Companies gain relief on the amount of technical provisions that must be held by applying TMTP and this relief is run off over 16 years from implementation of Solvency II.
- Matching Adjustment – these provisions give companies relief for holding certain long-term assets which match the cash flows of a designated portfolio of life or annuity insurance and reinsurance obligations. It does so by allowing an adjustment to the discount rate at which the company is required to value the cash flows of its (re)insurance obligations in order to determine the amount of the technical provisions it is required to hold to cover them.
- Volatility Adjustment – this is designed to protect companies from the impact of volatility on their solvency position by allowing an addition, which is provided by the regulator and which may vary from time to time, to be made to the discount rate used to calculate liabilities.

With-profits funds are known as ring-fenced funds for the purposes of Solvency II due to the participation of with-profits policyholders in the surplus arising. This means that the assets and liabilities of these funds must be separately identified, separate calculations of the solvency position of each ring-fenced fund must be undertaken and restrictions on the use of capital allocated to each ring-fenced fund must be recognised in the company's overall solvency calculations (this is known as the "RFF Restriction"). This means to the extent that the surplus in a with-profits fund that requires no shareholder support is improved, this has no impact on the overall solvency position of the company.

Pillar 2 imposes minimum standards of risk management and governance on companies. There is a requirement for permanent internal audit and actuarial functions. Insurers must also regularly undertake forward-looking assessments of risks, solvency needs and adequacy of capital resources, called the Own Risk and Solvency Assessment ("ORSA"), and senior management must demonstrate that the ORSA informs business planning, management actions and risk mitigation.

Pillar 3 aims for greater levels of transparency for regulators and the public including through a submission by companies of a private annual report to regulators, and a public solvency and financial condition report.

Appendix Two – Report by the With Profits Actuary of Abbey Life