The Part VII transfer of non-profit annuity business from The Prudential Assurance Company Limited to Rothesay Life Plc

The report of the Independent Expert

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1. Introduction

THE INDEPENDENT EXPERT

1.1 When an application is made to the High Court of Justice of England and Wales (the **"Court**") for an order to sanction the transfer of insurance business from one insurer to another, the application is subject to Part VII of the Financial Services and Markets Act 2000 ("**FSMA**") and approval by the Court under Section 111 of FSMA. FSMA requires the application to be accompanied by a report on the terms of the Scheme by an Independent Expert.

1.2 I have been instructed by The Prudential Assurance Company Limited ("**PAC**") and Rothesay Life Plc ("**Rothesay**") to report in the capacity of Independent Expert pursuant to Section 109 of FSMA on the terms of the proposed transfer of some of the non-profit annuity policies of PAC to Rothesay. PAC and Rothesay are both proprietary insurance companies.

1.3 My appointment as Independent Expert was approved by the PRA, after consulting with the FCA, in a letter to PAC dated 21 June 2018.

1.4 In this report I refer to this proposed scheme as the "**Scheme**", and throughout the remainder of this report this term is used to cover all the proposals included in the scheme, including any documents referred to in the scheme relating to its proposed implementation and operation.

1.5 The effective date of the Scheme (the "**Transfer Date**") is expected to be 26 June 2019.

THE PURPOSE AND SCOPE OF MY REPORT

1.6 The purpose of this report is to review the terms of the proposed transfer, and to consider its effects on the transferring and non-transferring policyholders of PAC and on the existing policyholders of Rothesay. The report also considers the implications for the relevant parties if the Scheme does not go ahead.

1.7 My report has been prepared under the terms of the guidance ("**Regulatory Guidance**") set out in the Policy Statement PS 7/15 "The Prudential Regulation Authority's approach to insurance business transfers" (the "**PRA Policy Statement**"), in Chapter 18 of the Supervision Manual ("**SUP 18**") contained in the FCA Handbook and in FG18/4 "The FCA's approach to the review of Part VII insurance business transfers" (the "**FCA Guidance**"). The PRA, in consultation with the FCA, has also approved the form of this report.

1.8 My report will be presented to the Court and will be made available to policyholders and others via the PAC and Rothesay websites. Both websites will also contain copies of other Scheme-related documents, including a summary of the Scheme and a summary of my report (written by me). Holders of transferring PAC policies (including relevant trustees holding policies on behalf of pension scheme beneficiaries) will be notified of the Scheme in a letter from PAC (the "**PAC policyholder pack**"), and all Rothesay policyholders will be notified of the proposed transfer in a letter from Rothesay (the "**Rothesay policyholder letter**"), as set out in Section 12. The PAC policyholder pack will contain a summary of the Scheme and a summary of this report (written by me).

1.9 In assessing the impact of the implementation of the Scheme on the policyholders of PAC and Rothesay, and whether those policyholders are being treated fairly as a result of the implementation of the Scheme, I have had regard to:

- The likely effect of the implementation of the Scheme on the security of policyholders' contractual rights and on the reasonable expectations of policyholders created by past practices employed, or statements made, by each company;
- The reports from the Chief Actuaries of PAC and Rothesay on the impact of the implementation of the Scheme; and
- The report of the With-Profits Actuary ("**WPA**") of PAC on the impact of the implementation of the Scheme.

1.10 There are no documents or other items of information that I have requested and have not been provided. Appendix 3 contains a list of the main sources of data upon which I have relied.

1.11 As far as I am aware, there are no matters that I have not taken into account in undertaking my assessment of the Scheme, and in preparing my report, which nonetheless should be drawn to the attention of the Court in its consideration of the terms of the Scheme.

1.12 I have only considered the terms of the Scheme presented to me, and am not required to consider possible alternative schemes in forming my opinions.

1.13 Similar schemes are to be presented to:

- The Royal Court of Jersey to transfer any in-scope business carried on by PAC from or within the Bailiwick of Jersey ("**the Jersey Policies**") to Rothesay; and
- The Royal Court of Guernsey to transfer any in-scope policies issued to residents of the Bailiwick of Guernsey ("**the Guernsey Policies**") from PAC to Rothesay.

1.14 The conclusions stated in this report apply equally to the Jersey Policies and the Guernsey Policies as they do to the other long-term insurance business of PAC and Rothesay, and may therefore be used to satisfy the requirement for a report by an independent actuary on the terms of the Guernsey Scheme and of the Jersey Scheme. References to the Scheme should be taken to include the local schemes in Jersey and Guernsey.

QUALIFICATIONS AND DISCLOSURES

1.15 I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1982, and hold certificates issued by the Institute and Faculty of Actuaries enabling me to discharge the roles of Chief Actuary and With-Profits Actuary.

1.16 I am a partner of Milliman LLP ("**Milliman**") and I am based in its UK Life Insurance and Financial Services practice. I am currently the Chief Actuary of one UK life company. I have fulfilled the role of Independent Expert for over 20 insurance business transfers that have been approved by the Court as listed in Appendix 2, including 5 transfers of non-profit annuity business.

1.17 A statement providing details of all connections between me and PAC and Rothesay, and between Milliman and PAC and Rothesay, is attached as Appendix 1. I confirm that I do not have any direct or indirect interest in PAC, Rothesay or other related firms that could compromise my independence.

1.18 My fees will be met equally by PAC and Rothesay, from shareholder resources.

1.19 A certificate of compliance with Part 35 of the Civil Procedure Rules is attached as Appendix 4. I confirm that I have understood my duty to the Court, the Royal Court of Guernsey and the Royal Court of Jersey.

THE PARTIES FOR WHOM THE REPORT HAS BEEN PREPARED

1.20 This report, and any extract or summary thereof has been prepared particularly for the use of the bodies or persons listed below:

- The Court;
- The Royal Court of Guernsey;
- The Royal Court of Jersey;
- The Directors and senior management of PAC;
- The Directors and senior management of Rothesay;
- The FCA and the PRA, and any other governmental department or agency having responsibility for the regulation of insurance companies in the UK;
- The Guernsey Financial Services Commission;
- The Jersey Financial Services Commission;
- The insurance regulator of any EEA country who requests a copy of the report; and
- The professional advisers of any of the above.

1.21 In accordance with the legal requirements under FSMA, copies of my report may be made available to the policyholders of PAC and Rothesay and to other interested parties.

LIMITATIONS

1.22 In preparing my report, I have had access to certain documentary evidence provided by PAC and Rothesay and I have had access to, and discussions with, senior management of PAC and Rothesay. My conclusions depend on the substantial accuracy of this information without independent verification. The principal documents which I have reviewed in respect of PAC and Rothesay are listed in Appendix 3. I have considered, and am satisfied with, the reasonableness of this information based upon my own experience of the UK life insurance industry.

1.23 This report must be considered in its entirety as individual sections, if considered in isolation, may be misleading. Draft versions of this report should not be relied upon for any purpose. I have provided a summary of my report for inclusion in the relevant policyholder packs/letters (and, where relevant distribution to any persons requesting a copy of it); other than this, no summary of my report may be made without my express consent.

1.24 This report has been prepared on an agreed basis for the Court, PAC, Rothesay and the other bodies listed in paragraph 1.20 in the context of the Scheme and must not be relied upon for any other purpose. No liability will be accepted by Milliman, or me, for any application of my report to a purpose for which it was not intended, nor for the results of any misunderstanding by any user of any aspect of the report. In particular, no liability will be accepted by Milliman or me under the terms of the Contracts (Rights of Third Parties) Act 1999.

1.25 This report, the summary report described in paragraph 1.23 and the Supplementary Report described in paragraph 1.35 do not provide financial or other advice to individual policyholders.

1.26 As far as I am aware, there are no matters that I have not taken into account in undertaking my assessment of the Scheme and in preparing my report, but that nonetheless should be drawn to the attention of policyholders in their consideration of the terms of the Scheme.

TECHNICAL ACTUARIAL STANDARDS (“**TAS**”)

1.27 This report is subject to the terms of TAS 100 (Principles for Technical Actuarial Work) and TAS 200 (Insurance) issued by the Financial Reporting Council To the extent that these Technical Actuarial Standards apply to the work done by PAC, Rothesay and their agents in order to produce the information upon which I have relied in preparing this report, I have relied without independent verification upon individuals within PAC, Rothesay and their agents to have complied with those standards in producing that information, except where non-compliance is explicitly stated. Subject to this reliance, in my opinion this report complies with TAS 100 and TAS 200.

THE ACTUARIAL PROFESSION STANDARDS (“**APS**”)

1.28 APS X2 issued by the Institute and Faculty of Actuaries requires members to consider whether their work requires an independent peer review.

1.29 In my view this report does require independent peer review, and this has been carried out by Andrew Gilchrist FIA, a senior actuary in Milliman who has not been part of the team working on this assignment.

THE STRUCTURE OF MY REPORT

1.30 Section 2 of this report provides an executive summary of the proposals and of my considerations and conclusions.

1.31 Section 3 of this report provides some information on the matters to be considered by the Independent Expert and Section 4 gives some background information on the current regulatory regime in the UK and on the UK life insurance market, including a description of the non-profit annuity product types relevant to this report.

1.32 Sections 5 and 6 of this report provide some background to PAC and Rothesay respectively, and Section 7 explains the purpose of the Scheme and summarises the key aspects of the Scheme.

1.33 The effects of the implementation of the Scheme on the transferring policies of PAC (“**Transferring Policies**”), the non-transferring policies of PAC and the policies of Rothesay, and on the holders of these policies, are covered in Sections 8, 9 and 10 respectively. Section 11 and 12 outline a number of other considerations and Section 13 contains my conclusions on the impact of implementing the Scheme.

1.34 The appendices contain my Statement of Independence, a list of my previous assignments as Independent Expert, a schedule of data relied upon in forming my conclusions, my Certificate of Compliance, a glossary of terms used throughout this report and details of how this report complies with the Regulatory Guidance.

MY SUPPLEMENTARY REPORT

1.35 As envisaged by paragraph 2.39 of the PRA Policy Statement, I will prepare a further report (the "**Supplementary Report**") prior to the Final Hearing to provide an update for the Court on my conclusions on the impact of the implementation of the Scheme on the different groups of policyholders in light of any significant events subsequent to the date of the finalisation of this report.

2. Executive summary

2.1 This section provides a summary of the proposed transfer, and a summary of my conclusions. Details and background to the information in this section, as well as definitions of some of the terms used in this section, are in the main body of this report.

SUMMARY OF PROPOSED SCHEME

2.2 On 14 March 2018, Rothesay entered into an agreement with PAC to acquire a portfolio of PAC's non-profit annuity business. Under the agreement, the annuities making up the portfolio were 100% reinsured[1] to Rothesay from PAC, with an intention by both companies to go on to formalise the transfer of economic risk through an insurance business transfer under Part VII of FSMA.

2.3 Therefore, under the Scheme, it is proposed to transfer the policies (other than a number of policies that PAC and Rothesay have agreed to exclude from the scope of the Scheme) whose benefits are in the scope of the reinsurance agreement, subject to some ongoing modifications to the scope of the reinsurance agreement, from PAC to Rothesay. Those policies that the companies have agreed to exclude from the scope of the Scheme (which include almost all of the deferred annuity policies within the scope of the reinsurance agreement) will not be transferred; these policies are described in paragraphs 7.17 to 7.19. These policies will continue to be reinsured from PAC to Rothesay. The Transfer Date is expected to be 26 June 2019.

2.4 The business reinsured to Rothesay is composed of a combination of retail annuities in payment and bulk annuities (both in payment and in deferment), comprising approximately £12.9 billion of gross Solvency II best estimate liabilities. It is estimated that approximately £1.3 billion of these liabilities will be excluded from the scope of the Scheme, as described in paragraph 2.3.

2.5 Some of the business reinsured to Rothesay is subject to existing longevity reinsurance arrangements, and it is proposed that the cedant under these reinsurance arrangements will change from PAC to Rothesay as a result of the implementation of the Scheme. Approximately £7.2 billion of the gross best estimate liabilities of the reinsured business is subject to such longevity reinsurance arrangements.

2.6 All of the business being transferred is either within PAC's shareholder-backed business or reinsured from the PAC WPSF to the PAC shareholder-backed funds.

2.7 PAC will, subject to agreement between PAC and Rothesay of a Transitional Services Agreement, continue to provide administration services (delivered by TCS/Diligenta on its behalf) to Rothesay in respect of the transferring policies for a period after the Transfer Date.

2.8 The Transitional Services Agreement is expected to be in place for 12 to 24 months after the Transfer Date. During that period, Rothesay will determine the most appropriate arrangements for administration of the Transferring Business in the long term. This is expected to involve either:

- leaving the outsourced administration in place at TCS/Diligenta, but subject to a direct contractual arrangement with Rothesay and Rothesay's governance arrangements, or
- transferring the administration to another administrator of Rothesay's choice.

2.9 Further details of the proposed Scheme are given in Section 7 of this report.

IMPACT OF THE PROPOSED TRANSFER ON TRANSFERRING POLICIES

2.10 I have considered the impact of the implementation of the Scheme on:

- the security of benefits of the transferring policies; and
- the reasonable expectations of the transferring policyholders.

[1] The reinsurance does not require Rothesay to reimburse PAC for any differences in payments to policyholders that arise as a result of differences between PAC's and Rothesay's prevailing commutation factors

2.11 I have also considered the impact of the implementation of the Scheme on holders of transferring policies that may be eligible to receive lump sums or benefit augmentations under the review currently being carried out by PAC as a result of the FCA's Thematic Review of Annuity Sales Practices ("**TRASP**").

Security of benefits of the transferring policies

2.12 While the benefits of the transferring policies are reinsured to Rothesay, PAC remains responsible for paying the benefits of these policies even in the event that Rothesay is unable to meet its obligations under the reinsurance agreement it has with PAC. Following the transfer, Rothesay would assume responsibility for paying the benefits of the transferring policies. In assessing the impact of the transfer on the security of benefits, it is therefore relevant to consider:

- the financial strength required under Solvency II for PAC and Rothesay;
- the capital policies and risk appetite statements of PAC and Rothesay, including their relative strengths, the required response to a breach and governance surrounding them;
- the impact of the cessation of the reinsurance agreement between PAC and Rothesay and of the restrictions on assets held in the associated custody accounts;
- the change in the profile of risks to which the transferring policies will be exposed as a result of the transfer;
- the quality of PAC's and Rothesay's Own Funds; and
- the financial resources available in PAC and Rothesay to provide security for the guaranteed benefits of the transferring policies.

2.13 I have considered each of these areas in the main body of this report, and in summary:

- For the purposes of the financial information in this report, which uses a reporting date of 30 June 2018, PAC calculates its Solvency Capital Requirement using an internal model, whereas Rothesay uses the Solvency II Standard Formula with a capital add-on. In December 2018, Rothesay received approval from the PRA to use a partial internal model to calculate its Solvency Capital Requirement; I will provide information on Rothesay's solvency position following the implementation of the partial internal model in my Supplementary Report.
- As at 30 June 2018, PAC's shareholder risk appetite framework and Rothesay's capital policy target a broadly comparable level of protection against the risk of regulatory insolvency, after taking account of likely management actions in the event of a deterioration in the solvency position of the companies.
- Both firms have an adequate range of actions at their disposal to mitigate a scenario in which their solvency position starts to deteriorate.
- The solvency coverage ratio of the PAC shareholder-backed business at 30 June 2018 is 207%, compared to the projected solvency coverage ratio of Rothesay at 30 June 2018 had the transfer taken place at that date of 177%. However, both companies' solvency ratios are in excess of the target range set out in their respective risk appetite/capital policy, and PAC's SCR coverage ratio will have reduced (to approximately 150% based on financial information at 30 June 2018) as a result of the transfer of the legal ownership of PAC's Hong Kong subsidiaries to Prudential Corporation Asia which took place on 14 December 2018.
- The cessation of the reinsurance agreement between PAC and Rothesay and the associated restrictions on assets held in the custody accounts will not have a material adverse effect on the security of benefits for the transferring policies.
- The change in risk profile to which the transferring policies will be exposed as a result of the implementation of the Scheme will not have a material effect on the security of benefits of the transferring policies.

2.14 Taking all of the above into account, I am satisfied that the implementation of the Scheme will not have a material adverse impact on the security of benefits of the transferring policies.

Reasonable expectations of transferring policyholders

2.15 The transferring policies are almost all non-profit in-payment annuities, and therefore policyholders' reasonable expectations in respect of their policies are principally that:

- They receive their benefits as guaranteed under the policy, on the dates specified, from the point of purchase;
- The administration, management, and governance of the policies are in line with the contractual terms under the policies; and
- The standards of service received are at least as good as those they currently receive.

2.16 With the exception of benefit commutations (described below), there are no areas of discretion involved in determining the benefits payable on the transferring policies. Therefore, policyholders' reasonable expectations in respect of their benefits (with the exception of benefit commutations) are that they receive their benefits as guaranteed under the policy. As there are no changes in the transferring policies' terms and conditions, and as I have concluded that the transfer will not have a material adverse impact on the security of benefits of the transferring policies, the transfer should have no impact on policyholders' reasonable expectations in respect of their benefits, subject to my comments on benefit commutations below.

2.17 In certain circumstances, some holders of transferring policies are entitled to elect to exchange some or all of their pension income for a lump sum through a process referred to in this report as commutation. In most cases, the amount of lump sum received per £1 p.a. of pension benefit ("**the commutation factor**") is at the discretion of the insurer. PAC is currently undertaking a project to change its prevailing commutation factors to ensure that the assumptions used in their derivation are as realistic as possible[2]. I have received an analysis of a representative sample of the prevailing commutation factors used by Rothesay, as well as PAC's future commutation factors after the expected changes to them; these factors reflect the respective views of the two companies on future investment returns, longevity and inflation. Whilst there are inevitably differences between the two sets of factors, the analysis indicates that policyholders' commuted benefits calculated on Rothesay's current factors are not likely to be systematically higher or lower to any material extent than those calculated on PAC's factors after the planned changes to those factors have been implemented.

2.18 For the 10 deferred annuity policies included within the scope of the transfer, Rothesay and PAC are performing analysis to compare Rothesay's prevailing commutation factors applicable to these policies with PAC's commutation factors, both before and after the proposed changes, to determine whether there are material differences for these 10 policies. This analysis has not been completed at the time of finalising my report. However, I have been assured by PAC and Rothesay that they will take any necessary actions to ensure that the difference in commutation factors between the two companies will not be material for these policyholders and that therefore, if these policyholders choose to commute their benefits, the lump sums they will receive will not be materially affected by the proposed transfer. I will comment on the outcome of the analysis and any resulting actions taken by the firms in my Supplementary Report.

2.19 PAC and Rothesay have agreed a process in relation to transferring policyholders whose policies fall in the scope of PAC's TRASP review. This process has been designed with the objective of ensuring that a transferring policyholder's experience would be the same as if the policy had not been transferred in all material respects. Further details of how policies affected by PAC's TRASP review are provided in Section 7.

2.20 Taking this into account, I am satisfied that the transfer will not have a material adverse impact on reasonable benefit expectations of transferring policyholders.

2.21 The administration of the transferring policies is not expected to change in the short term following the transfer due to the expected implementation of the Transitional Services Agreement. After the agreed term of this Agreement, Rothesay will be free to alter the administration applicable to the transferring policies. This could be through the establishment of a direct relationship between Rothesay and TCS/Diligenta, or through the migration of the administration to another servicer of Rothesay's choice.

2.22 I have reviewed the target service standards applicable to Rothesay's existing policies and am satisfied that there is no reason to believe that future outsourcing arrangements for the transferring business will result in a material adverse impact on service standards experienced by holders of transferring policies.

2.23 PAC and Rothesay are subject to the same regulatory requirements around the governance of their long-term insurance business, and Rothesay is experienced in the management and governance of non-profit annuity business. I am satisfied that the transfer will not materially adversely affect the standards of governance and management applicable to the transferring policies.

IMPACT OF THE PROPOSED TRANSFER ON NON-TRANSFERRING POLICIES OF PAC

2.24 I have considered the impact of the implementation of the Scheme on:

- the security of benefits of the non-transferring PAC policies; and
- the reasonable expectations of the non-transferring PAC policyholders.

[2] At time of writing this report, this project is in its early stages and the proposed changes to the commutation factors are currently going through PAC's relevant internal governance processes. Therefore, the expected changes to commutation factors with which I have been provided are provisional and are potentially subject to change as these governance processes take their course.

Security of benefits of the non-transferring PAC policies

2.25 The main change brought about by the transfer from the perspective of the non-transferring policies of the PAC shareholder-backed funds is the removal of PAC's exposure to the risk of Rothesay being unable to meet its obligations under the reinsurance agreement between PAC and Rothesay ("**counterparty default risk**") in respect of transferring policies. However, the net risk to non-transferring policyholders is currently small due to the presence of a collateral account for the reinsurance agreement with Rothesay. In addition, PAC holds capital to cover the residual counterparty default risk, calculated in accordance with its approved internal model.

2.26 Aside from the change in PAC's counterparty default risk exposure, PAC's risk exposure would be unchanged as a result of the transfer. The transfer will result in PAC's best estimate liability held in respect of the transferring policies, together with the associated value of amounts recoverable from Rothesay under the reinsurance agreement, being eliminated, the net impact of which is small. The component of PAC's risk margin and SCR that corresponds to the counterparty default risk associated with the reinsurance of the transferring policies to Rothesay will also be eliminated. The collateral account that is currently maintained in relation to the reinsurance agreement will continue to be operated for any policies within the scope of the reinsurance agreement but outside the scope of the transfer.

2.27 In aggregate this change is expected, based on financial information at 30 June 2018, to result in an improvement to the solvency coverage ratio of PAC's shareholder-backed business from 207% to 213%. Had the change in ownership of PAC's Hong Kong subsidiaries (as described in paragraph 2.13) been reflected in the financial information at 30 June 2018, the impact of the implementation of the Scheme at 30 June 2018 would have been an improvement in the solvency ratio of PAC's shareholder-backed business from 150% to 155%.

2.28 Aside from the reduced level of counterparty default risk that will be brought about by the transfer, I do not expect any material changes to the profile of risks to which the non-transferring policies of PAC are exposed as a result of the transfer.

2.29 I am therefore satisfied that the transfer will not have a material adverse effect on the security of benefits of the non-transferring PAC policies.

Reasonable expectations of the non-transferring PAC policyholders

2.30 There will be no change to the administration and governance arrangements applicable to the non-transferring PAC policies as a result of the transfer.

2.31 The transfer out of a proportion of the business of PAC's shareholder-backed business will result in an increase in the size of PAC's With-Profits Sub-Fund ("**PAC WPSF**") relative to the shareholder-backed funds. As a result, under PAC's expense allocation approach a greater proportion of PAC's fixed costs (including annuity administration expenses) will be allocated to the PAC WPSF. PAC has determined that the PAC shareholder-backed fund will meet £7 million of this increase in the allocation of annuity administration expenses to the PAC WPSF. This contribution from the PAC SHF is expected to eliminate any increase in annuity administration expenses allocated to the PAC WPSF in 2019 to 2021. Additionally, an internal transformation project is being undertaken that is intended to result in, amongst other things, a reduction in PAC's cost base that will more than offset any increase in fixed costs allocated to the PAC WPSF.

2.32 The PAC With-Profits Actuary and With-Profits Committee have confirmed that they are comfortable with this approach, and the PAC With-Profits Actuary has confirmed in his report that he does not believe that the increase in costs allocated to the PAC WPSF will have a material adverse impact on policyholders. I agree with this analysis, and given the small size of the increased fixed costs relative to the size of the PAC WPSF, I am satisfied that this will not have a material impact on the benefit expectations of the policyholders of the PAC WPSF.

2.33 Taking the above into account, I am satisfied that the transfer will not have a material adverse impact on the reasonable expectations of the non-transferring PAC policyholders.

IMPACT OF THE PROPOSED TRANSFER ON EXISTING POLICIES OF ROTHESAY

2.34 I have considered the impact of the implementation of the Scheme on:

- the security of benefits of the existing policies of Rothesay; and
- the reasonable expectations of the holders of existing policies of Rothesay.

Security of benefits of the existing policies of Rothesay

2.35 As the business to be transferred into Rothesay under the Scheme is already reinsured to Rothesay, the proposed transfer will have no impact on the financial position of Rothesay.

2.36 Although inward reinsurance business typically would rank below direct policies in terms of priority over assets in the event of insolvency, the reinsurance agreement has been set up in such a way as to ensure that PAC has recourse to the assets secured in the collateral accounts in the event of Rothesay's insolvency.

2.37 As the business to be transferred into Rothesay under the Scheme is already reinsured to Rothesay, most of the risks associated with the transferring business have already been transferred to Rothesay. However, following the transfer, Rothesay will take over some residual liabilities for future mis-selling claims in respect of the transferring policies, but I do not consider the risk to Rothesay from these mis-selling liabilities to be material.

2.38 Taking all of this into account, I am satisfied that the transfer will not have a material adverse impact on the security of benefits of existing policies of Rothesay.

Reasonable expectations of the holders of existing policies of Rothesay

2.39 The transfer will not alter the terms and conditions of existing Rothesay policies, nor will there be any change to servicing, administration or governance arrangements for existing Rothesay policies as a result of the transfer.

2.40 The transfer will have no impact on the amounts payable to existing Rothesay policyholders who elect to commute some or all of their pension benefit to a lump sum.

2.41 I am therefore satisfied that the transfer will not have a material impact on the reasonable expectations of holders of existing policies of Rothesay.

CONSIDERATION OF THE REINSURANCE AGREEMENT

2.42 In this report I have considered:

- whether my conclusions in relation to the transfer would have been different if I had considered the combined impact of the reinsurance agreement between PAC and Rothesay and the transfer; and
- the implications of the non-sanction of the Scheme.

Combined impact of the reinsurance agreement and the transfer

2.43 The reinsurance agreement between PAC and Rothesay resulted in an improvement in the financial position of PAC and, in isolation, a deterioration of the financial position of Rothesay. However, at the time of the reinsurance agreement, Rothesay raised sufficient additional capital from its shareholders for the net impact of the reinsurance agreement and the capital-raising exercise on Rothesay's financial position to be very small.

2.44 The improvement in PAC's financial position and the broadly neutral impact on Rothesay's position means that I would not have altered my conclusions in respect of non-transferring PAC policies or existing Rothesay policies had I included the effect of the reinsurance agreement between PAC and Rothesay in my considerations.

2.45 For the transferring policies, the combination of the reinsurance agreement and the transfer would have led to a less pronounced decrease in available financial strength. Accordingly, I would not have altered my conclusions in respect of transferring policies had I included the effect of the reinsurance agreement between PAC and Rothesay in my considerations.

The implications of the non-sanction of the Scheme

2.46 If the transfer is not sanctioned, the reinsurance agreement between PAC and Rothesay will remain in place. Whilst this eventuality would provide PAC with the option to terminate the reinsurance agreement, it is not expected that PAC would wish to exercise this option.

2.47 As the reinsurance agreement led to an improvement in the financial position of PAC, and no material impact on the financial position of Rothesay, I am satisfied that policyholders would not be materially adversely affected by the reinsurance agreement remaining in place if the Scheme were not sanctioned.

2.48 The termination of the reinsurance agreement would be likely to be disadvantageous to PAC's financial position, and could have a material adverse impact on the security of benefits of both the transferring policies (whose benefits would cease to be reinsured to Rothesay) and the non-transferring PAC policyholders. For this reason, I consider it highly unlikely that PAC would choose to effect such a termination in the event that the Scheme is not sanctioned. Rothesay would only be in a position to terminate the reinsurance agreement if there was a default by PAC which triggered a termination right; this is discussed in more detail in Section 6.

OTHER CONSIDERATIONS ARISING FROM THE SCHEME

2.49 In this report I have considered:

- The approach to communication with policyholders;
- The costs of the Scheme;
- External reinsurance where PAC or Rothesay is the cedant;
- Asset counterparties;
- Tax;
- Other creditors
- Future corporate transactions;
- The Financial Services Compensation Scheme and Financial Ombudsman Service;
- The effect of the proposed Scheme on previous schemes; and
- The future operation of the Scheme.

The approach to communication with policyholders

2.50 PAC and Rothesay have opted to publish legal notices in a number of national newspapers in the UK and Ireland, and will make information available on their respective websites, as well as PAC's financial adviser website.

2.51 PAC proposes to send a pack to all transferring policyholders, including relevant trustees or employers holding policies on behalf of pension scheme beneficiaries. This pack will comprise a covering letter and an information booklet containing:

- A summary of the Scheme;
- A summary of the report by the Independent Expert;
- A questions and answers section; and
- A copy of the legal notice of the transfer.

2.52 PAC expects to seek a waiver from notifying its non-transferring policyholders, as well as from notifying some categories of transferring policyholders. PAC intends to make available a web-based tool and phone line for existing annuity policyholders to use to confirm whether they are in the scope of the proposed transfer.

2.53 I am satisfied that PAC's proposed approach of not notifying non-transferring PAC policyholders is reasonable.

2.54 Rothesay expects to send a letter to all of its existing policyholders, with some minor exceptions, to notify them of the proposed transfer. I am satisfied that this is reasonable.

2.55 I have reviewed draft versions of the PAC policyholder pack and the Rothesay policyholder letter and am content that they provide a satisfactory level of information on the proposed transfer and a clear explanation of the consequences for transferring policyholders of PAC and existing policyholders of Rothesay respectively.

Other considerations

2.56 My analysis of the other areas listed in paragraph 2.49 is contained in section 12 of this report. I am satisfied that none of these areas alter my conclusions in relation to the proposed Scheme.

OVERALL CONCLUSIONS

2.57 I am satisfied that the implementation of the Scheme will not have a material adverse effect on:

- The security of benefits of the policyholders of PAC and Rothesay, including the transferring policyholders;
- The reasonable benefit expectations of the policyholders of PAC and Rothesay, including the transferring policyholders; or
- The service standards and governance applicable to the PAC and Rothesay policies, including the transferring policies.

2.58 I am satisfied that the Scheme is equitable to all classes and generations of PAC and Rothesay policyholders.

3. General considerations of the Independent Expert

THE ROLE OF THE INDEPENDENT EXPERT

3.1 As described in Section 1 of this report, the Scheme concerns two life insurance companies: PAC and Rothesay. I need to consider the terms of the Scheme generally and how the different groups of policyholders of PAC and Rothesay are likely to be affected by the implementation of the Scheme. I am required by Regulatory Guidance to consider:

- The effect of the implementation of the Scheme on the security of the policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;
- The effect of the implementation of the Scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:
  - the security of policyholders' contractual rights;
  - levels of service provided to policyholders; or
  - the reasonable expectations of policyholders; and
- The cost and tax effects of the Scheme, in so far as they may affect the security of policyholders' contractual rights or their reasonable expectations.

3.2 I am only required to comment on the effects of the implementation of the Scheme on policyholders who enter into contracts with PAC and Rothesay prior to the Transfer Date of the Scheme.

3.3 In this report I have not restricted my assessment of the Scheme to consideration of potential adverse effects.

3.4 In this report I have restricted my assessment to the proposals put forward by PAC and Rothesay, and have not considered alternative arrangements or proposals.

3.5 The type of policy held by a policyholder will be a key determinant of the risks to which the policyholder is exposed. Other than this, the key determinants of the policyholder's risk exposure will be the characteristics of the company in which the policy is held, for example:

- The size of the company;
- The amount and quality of capital resources available, other calls on those capital resources and any capital support currently available to the company;
- The internal capital policy of the company;
- The investment strategy of the company;
- The mix of business of the company;
- The company's strategy, e.g. whether the company is open or closed to new business, its acquisitions strategy; and
- Other factors, such as operational risks faced by the company, reinsurance arrangements of the company, the company's governance framework and its tax position.

THE DEFINITION OF 'POLICYHOLDER'

3.6 In this report I use the term 'policyholder' to include all of the following, whether or not they are policyholders as a matter of law:

- The holders of policies, including individual or joint life annuities (in payment and deferred), in Rothesay or PAC.
- The trustees of pension schemes where an insurance contract has been bought to cover part of the liabilities of that scheme with Rothesay, PAC or a predecessor company (commonly known as a "buy-in").
- The underlying members of these pension schemes where an insurance contract has been bought to cover part of the liabilities of that scheme with Rothesay, PAC or a predecessor company.
- The dependants of other policyholders who have contingent benefits.

SECURITY OF POLICYHOLDER BENEFITS

3.7 As part of my role as Independent Expert for the Scheme, I need to consider the security of policyholders' contractual rights; that is, the effect of the implementation of the Scheme on the likelihood that policyholders will receive their guaranteed benefits when these are due.

3.8 In considering and commenting upon policyholder security, I shall primarily consider policyholders' guaranteed benefits. The regulations require insurance companies to hold a minimum amount of capital in addition to the assets backing a realistic estimate of their liabilities to policyholders. Insurance companies must also demonstrate that they can fulfil their regulatory requirements and meet policyholder claims as they become due in adverse scenarios.

3.9 Therefore, the amount by which the assets available to support the long-term insurance business exceed the long-term liabilities provides security for the guaranteed benefits.

POLICYHOLDERS' REASONABLE EXPECTATIONS

3.10 I also need to consider the proposals in the context of the regulatory obligation on both companies to treat their customers fairly and, in particular, the effect of the implementation of the Scheme on policyholders' reasonable benefit expectations.

3.11 This involves considering the effect of the implementation of the Scheme on any areas where discretion is involved on behalf of the relevant insurance company, for example in determining the charges applied to a policy and the benefits granted to a policyholder when commuting pension benefits for a lump sum, as well as consideration of the effect of the implementation of the Scheme on the management, service and governance standards of the company in question.

THE CONCLUSIONS OF THE INDEPENDENT EXPERT

3.12 My assessment of the impact of the Scheme on the various affected policies is ultimately a matter of actuarial judgement regarding the likelihood and impact of possible future events. Given the inherent uncertainty of the outcome of such future events and that the effects may differ across different groups of policies, it is not possible to be certain about their effect on the policies.

3.13 In order to acknowledge this inherent uncertainty, the conclusions of the Independent Expert in respect of Part VII transfers of long-term insurance business are usually framed using a materiality threshold. If the potential impact under consideration is very unlikely to happen and does not have a large impact, or is likely to happen but has a small impact, then it is not considered to have a material effect on the policies.

3.14 The setting of my conclusions in this framework is a consequence of the Court's consideration of prior schemes. In particular, principles stated by Mr Justice Evans-Lombe in relation to a transfer involving AXA Equity & Law Life Assurance Society plc and AXA Sun Life plc in 2001 (based on principles outlined by Mr Justice Hoffman in 1989) are often used as the basis for the consideration of insurance business transfers by the Independent Expert and by the Court.

3.15 Mr Justice Evans-Lombe stated that "the court is concerned whether a policyholder, employee or other interested person or any group of them will be adversely affected by the scheme". He went on to state: "That individual policyholders or groups of policyholders may be adversely affected does not mean that the scheme has to be rejected by the court. The fundamental question is whether the scheme as a whole is fair as between the interests of the different classes of persons affected". The most common interpretation of these (and other relevant) statements has been that a conclusion that "no group of policyholders is materially adversely affected by the Scheme" provides a sufficient condition to conclude that the fairness of the Scheme as a whole has been demonstrated.

3.16 This is therefore the framework within which I undertake my consideration of the Scheme.

THE SUPPLEMENTARY REPORT

3.17 As noted in paragraph 1.35, I will prepare a Supplementary Report prior to the final Court hearing, to provide an update for the Court on my conclusions in the light of any significant events subsequent to the date of the finalisation of this report.

3.18 The Supplementary Report will be made available on the PAC and Rothesay websites.

RELIANCE ON LEGAL ADVICE

3.19 There are some aspects of the Scheme that are legal matters which fall outside my expertise. For these areas, I have considered whether it is appropriate to take independent legal advice and I have decided that it is appropriate for me to rely on the advice provided to PAC and Rothesay by Allen & Overy LLP and Linklaters LLP respectively.

3.20 My reasons for this are:

- The relevant legal matters do not appear to be contentious; and
- The fair treatment of policyholders is not dependent on the legal advice.

3.21 I am therefore satisfied that it is appropriate for me to rely on the conclusions of Allen & Overy LLP and Linklaters LLP in forming my view on the Scheme.

4. The UK life insurance market and regulatory environment

INTRODUCTION

4.1 The regulatory regime to which UK insurers are subject, and the applicable solvency requirements, are relevant to my considerations as Independent Expert and are summarised in this section.

THE UK REGULATORS

4.2 Prior to 1 April 2013, regulation of insurance companies was the responsibility of the Financial Services Authority. Since 1 April 2013, responsibility for the regulation of such companies has been split between the PRA and the FCA.

4.3 The PRA is a part of the Bank of England, and carries out the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.

4.4 The PRA has statutory objectives to promote the safety and soundness of the insurers that it regulates, and to contribute to ensuring that policyholders are appropriately protected. More generally, these statutory objectives can be advanced by seeking to ensure that regulated insurers have resilience against failure and that disruption to the stability of the UK financial system from regulated insurers is minimised.

4.5 The FCA regulates the conduct of all financial services firms in relation to consumer protection, industry stability and the promotion of healthy competition between providers.

THE SOLVENCY II REGULATORY REGIME

Introduction

4.6 The current regulatory solvency framework for the European Economic Area ("**EEA**") insurance and reinsurance industry came into effect on 1 January 2016. This regime is known as Solvency II, and it imposes solvency requirements that reflect the specific risks faced by each insurer and reinsurer and aims to achieve consistency across the EEA. All but the smallest EEA insurance companies are required to adhere to a set of risk-based capital requirements, and to disclose their solvency position in a public document.

4.7 Solvency II is based on three pillars:

- Under Pillar 1, quantitative requirements define a market consistent[3] framework for valuing the company's assets and liabilities, the results of which will be publicly disclosed.
- Under Pillar 2, insurers must meet minimum standards for their corporate governance and their risk and capital management. There is a requirement for permanent internal audit and actuarial functions. Insurers must regularly undertake a forward looking assessment 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 actively informs business planning, management actions and risk mitigation.
- Under Pillar 3, there are explicit requirements governing disclosures to supervisors and to the public. Firms produce private reports to supervisors and a publicly available solvency and financial condition report.

The Pillar 1 requirements

4.8 The determination of a market consistent value of liabilities under Solvency II requires the insurer to calculate the best estimate liability ("**BEL**"). The expected future obligations of the insurer are projected over the lifetime of the contracts using the most up-to-date financial information and using best estimate actuarial assumptions, and the BEL represents the present value of these projected cash-flows.

4.9 Under Solvency II, a company's Pillar 1 liabilities are called the "Technical Provisions" which consist of the sum of the BEL and the "risk margin". The risk margin is an adjustment designed to bring the Technical Provisions up to the amount that

[3] A market-consistent framework requires the values placed on assets and liabilities to be consistent with the market prices of listed securities and traded derivative instruments.

another insurance or reinsurance undertaking would be expected to require in order to take over and meet the insurance obligations in an arm's length transaction.

4.10 The Pillar 1 assets are, broadly speaking, held at market value.

4.11 The Solvency Capital Requirement ("**SCR**") under Solvency II is the capital requirement under Pillar 1, and is intended to be the amount required to ensure that the firm's assets continue to exceed its Technical Provisions over a one year time frame with a probability of 99.5%.

4.12 The Minimum Capital Requirement ("**MCR**"), which is lower than the SCR, defines the point of intensive regulatory intervention. The MCR calculation is simpler, more formulaic and less risk-sensitive than the SCR calculation.

4.13 In calculating the SCR, it is expected that most firms will use the "standard formula", as prescribed by the European Insurance and Occupational Pensions Authority ("EIOPA"). However, Solvency II also permits firms to use their own internal models (or a combination of a "partial internal model" and the standard formula) to derive the SCR. These internal models and partial internal models are subject to approval by the relevant regulator: in the UK this is the PRA.

4.14 Under the Solvency II regime, the excess of assets over liabilities, plus any subordinated liabilities, is known as Own Funds. Own Funds can be thought of as the capital available in the company to cover capital requirements.

4.15 Under Solvency II, companies are required to classify their Own Funds into three tiers, which broadly represent the quality of the Own Funds in relation to their ability to absorb losses. The Own Funds of the highest quality are classified as Tier 1. In order to be classified as Tier 1, Own Funds must exhibit both of the following:

- Permanent availability, i.e. the item is available, or can be called up on demand, to fully absorb losses on a going concern basis, as well as in the case of winding up.
- Subordination, i.e. in the case of winding up, the total amount of the item is available to absorb losses and the repayment of the item is refused to its holder until all other obligations, including insurance and reinsurance obligations towards policyholders and beneficiaries of insurance and reinsurance contracts, have been met.

4.16 Own Funds that are classified as Tier 2 or Tier 3 are of a lower quality, with less ability to fully absorb losses.

4.17 Any UK firms intending to use an internal model, or any of the adjustments to the Technical Provisions discussed in paragraphs 4.18 to 4.27, must formally apply to the PRA for approval.

The matching adjustment

4.18 In calculating the BEL for certain types of business, the Solvency II rules permit firms to apply to their regulator to make use of the "matching adjustment". The matching adjustment is an increase to the discount rate used in the calculation of the BEL that allows firms to take credit for the additional investment return in excess of the risk free rate that they expect to earn from a "hold to maturity" investment strategy for their less liquid assets, which are used to back their most stable and predictable liabilities, typically non-profit in-payment annuity liabilities.

4.19 Firms using the matching adjustment are subject to various restrictions around the types of asset that are permitted to back the relevant liabilities, the circumstances in which the assets may be traded, and the extent to which mismatching of asset and liability cash flows is permitted.

The volatility adjustment

4.20 For liabilities that are not eligible for use of the matching adjustment, the Solvency II rules permit firms to apply to their regulator to make use of the "volatility adjustment". The volatility adjustment is an increase to the discount rate used in the calculation of the BEL (other than for liabilities that are subject to the matching adjustment) which aims to prevent forced sales of assets in the event of extreme bond spread movements.

4.21 The volatility adjustment is based on the spreads on a representative portfolio of assets for each relevant currency, and "risk-free" discount curves which include the volatility adjustment are published by EIOPA.

The transitional measures

4.22 Insurers are also permitted to apply to their regulator to make use of transitional measures. Transitional measures allow firms to phase in the balance sheet impact of moving from the previous Solvency I regulatory regime to the Solvency II regulatory regime. The transitional measures can be applied in one of two ways:

- The Transitional Measure on Technical Provisions ("**TMTP**") allows firms to phase in the increase in Technical Provisions that resulted from the change in regulations from Solvency I to Solvency II (only in relation to business written prior to 1 January 2016) over a sixteen year period. In the UK, the increase in Technical Provisions is measured relative to the firm's Solvency I Pillar II liabilities[4].

- The Transitional Measure on the Risk-Free Interest Rate allows firms to phase in any reduction in the discount rate used to calculate their liabilities under Solvency II relative to the current regime over a sixteen year period.

4.23 The TMTP is widely used by UK insurers. The Transitional Measure on the Risk-Free Interest Rate is not widely used by UK insurers, and in particular is not used by either party subject to the Scheme.

4.24 For a given firm, the TMTP is calculated as at the implementation date of Solvency II, i.e. 1 January 2016. The TMTP is calculated as the excess, if positive, of the firm's Technical Provisions under Solvency II over the firm's insurance liabilities under the previous Solvency I Pillar II regime.

4.25 A further test is then carried out to determine whether deducting the calculated TMTP from the firm's Solvency II Technical Provisions at 31 December 2015 would result in a Financial Resources Requirement ("**FRR**") under Solvency II that is lower than the firm's FRR under the previous Solvency I regime at the same valuation date. The FRR for a given solvency regime is calculated as the firm's total liabilities plus the firm's capital requirement under that regime. If the Solvency II FRR after deduction of the TMTP is lower than the FRR under Solvency I, the calculated TMTP must be reduced to a level that ensures that this is no longer the case.

4.26 The final calculated TMTP is deducted from the firm's Technical Provisions in its Solvency II balance sheet at 1 January 2016. For valuation dates after 1 January 2016, the TMTP that was calculated at 1 January 2016 is reduced linearly to zero over a sixteen year period.

4.27 A firm's TMTP is currently expected to be subject to recalculation every two years, subject to approval from the PRA. Regulatory guidance states that firms will be able to apply to the PRA to recalculate their TMTP every six months if they believe that their risk profile has changed materially since the previous recalculation.

Ring-fenced funds

4.28 Solvency II includes the concept of a ring-fenced fund. This refers to any arrangement where an identified set of assets and liabilities are managed as though they were a separate undertaking, meaning that there are restrictions on the extent to which surplus in the ring-fenced fund may be transferred to shareholders or used to cover losses outside the ring-fenced fund.

4.29 In the UK, many firms have set up ring-fenced funds in order to reflect the arrangements applicable to their with-profits funds (as defined under the previous regulatory regime) and the with-profits and non-profit business within the with-profits fund.

THE GOVERNANCE OF UK LONG-TERM INSURERS

4.30 For most UK long-term insurers the Board of Directors is the firm's governing body, and is ultimately responsible for setting the strategic direction of the firm, overseeing the activities of the firm's day-to-day management and approving the firm's financial statements.

4.31 Under Solvency II, all insurers are required to establish an actuarial function. The actuarial function is responsible for, amongst other things, coordinating the calculation of the Technical Provisions and providing an opinion on the firm's underwriting policy and the adequacy of the firm's reinsurance arrangements. The person having responsibility for the actuarial function under Solvency II is known in the UK as the Chief Actuary.

4.32 Since 10 December 2018, UK insurers have been subject to the Senior Managers and Certification Regime ("**SM&CR**"), operated jointly by the PRA and the FCA. This replaced the separate Senior Insurance Managers Regime, and has brought insurers under the same governance regime as other UK financial institutions. The SM&CR defines a set of senior management functions ("**SMF**"), which includes:

- Chief Executive Officer;
- Chief Financial Officer;
- Chief Risk Officer ("**CRO**");
- Chief Actuary;

[4] Solvency I Pillar II refers to the Individual Capital Adequacy Standards framework, which was similar in approach to Solvency II but without the requirement for a risk margin in the technical provisions.

- Head of Internal Audit; and
- Head of Key Business Area.

4.33 The individuals responsible for these functions are subject to PRA approval.

4.34 In addition to the roles listed above, those firms with with-profits business must appoint an actuary (or actuaries) to perform the With-Profits Actuary function. This individual is the WPA, and their responsibilities include advising the firm's management on the key aspects of the discretion to be exercised affecting those classes of the with-profits business of the firm in respect of which they have been appointed. The WPA role is one of the SMFs.

4.35 In relation to each with-profits fund, firms must appoint a With-Profits Committee ("**WPC**") (or a "with-profits advisory arrangement" if appropriate given the size, nature and complexity of the fund in question). The WPC's role is to advise and provide recommendations to the firm's governing body on the management of the with-profits business, and to act as a means by which the interests of with-profits policyholders are appropriately considered within a firm's governance structures.

A FIRM'S RISK APPETITE AND INTERNAL CAPITAL POLICY

4.36 The Board of a firm is responsible for the management of the company and for its exposure to risk. The Board will typically set out its appetite for risk in a form which references the probability that the Board is willing to accept of not being able to pay policyholder liabilities as they fall due and/or meet regulatory requirements.

4.37 In order to ensure that day-to-day fluctuations in markets and other experience do not lead to a breach of their risk appetite and regulatory capital requirements, insurers usually aim to hold more capital than strictly required to meet the regulatory minimum. The details of the target level of capital buffer are typically set out in the firm's capital management policy.

4.38 The capital management policy of a firm is set by and owned by the Board and describes the capital that the Board has determined should be held in the company. Changes to this policy usually require Board approval and appropriate consultation with the prudential regulator (the PRA in the UK).

4.39 The capital management policy is typically stated in terms of the capital requirements set down by the relevant regulations. The regulatory capital requirements typically target a particular probability of remaining solvent over a certain time horizon: for example for the Solvency II regulatory regime it is a 99.5% probability of remaining solvent over one year. By requiring additional capital to be held on top of the regulatory requirements, the capital management policy increases the probability of remaining solvent over a particular timeframe and therefore increases the security of the benefits provided under the policies subject to that policy.

4.40 The level of capital required may also be driven by the desire of the Board to maintain a certain credit rating with external credit rating agencies.

THE PRODUCTS AND LONG-TERM BUSINESS RELEVANT TO THIS REPORT

4.41 The Scheme provides for the transfer of non-profit annuity business written by PAC, consisting of:

- Retail annuities in payment; and
- Bulk annuities in payment[5].

4.42 In the context of this report, an annuity is a policy under which a regular pension is paid to a policyholder until their death. The pension amount may be fixed or may be subject to regular increases. Increases may be based on a fixed annual percentage or linked to an inflation index.

4.43 A retail annuity is an annuity policy purchased by an individual from the proceeds of their pension savings, e.g. the proceeds from defined contribution pension scheme savings.

4.44 A bulk annuity arises when the trustee of a defined benefit pension scheme enters into a buy-in or buyout contract with an insurance company to transfer some or all of its liabilities to the insurer.

4.45 Under a buy-in contract, the pension scheme trustee pays a lump sum to the insurer in return for the insurer insuring a defined subset of the scheme's liabilities. Under the terms of the contract, the insurer reimburses the pension scheme trustee for the pension benefits covered by the buy-in as they fall due. The bulk annuity is therefore an asset of the pension

[5] With the exception of 10 policies that are in deferment.

scheme, and ultimate responsibility for paying pension benefits of the scheme members remains with the pension scheme trustee.

4.46 Under a buyout contract, the pension scheme pays a lump sum to the insurer, in return for which the insurer issues individual policies to the scheme members covered by the contract and takes over responsibility from the pension scheme trustee for paying their pension benefits. The individuals covered by the buyout cease being members of the pension scheme, and responsibility for paying pension benefits to these individuals transfers to the insurer.

4.47 Under buy-in contracts, the pension scheme trustee is the policyholder of the insurer, whereas under a buyout the individuals receiving the pension benefits are the policyholders. However, as described in paragraph 3.6, in this report I consider members of pension schemes that have entered into a buy-in contract to be policyholders even if they are not policyholders of the relevant insurer in the legal sense.

4.48 Buyouts and buy-ins sometimes cover a mixture of “in-payment” and “deferred” pensions. An in-payment pension refers to the situation where the pension scheme member/policyholder is receiving their pension. A deferred pension refers to the situation where the pension scheme member/policyholder is not yet receiving their pension, but is no longer accruing pension benefits within the pension scheme.

4.49 Buyouts and buy-ins generally do not cover “active” members of the pension scheme, i.e. those members who are still accruing pension benefits.

4.50 Some of these contracts may include additional benefits, such as spouse’s or other dependants’ annuities to be paid on the death of the main policyholder, and a guaranteed return on death of the main policyholder during a specified guarantee period (typically 5 to 10 years).

4.51 For the avoidance of doubt, none of the annuities to be transferred under the Scheme include any profit-sharing or participating features.

4.52 Rothesay’s existing business is all non-profit annuity business. PAC, additionally, has the following lines of business which are not in scope of the transfer:

- Conventional non-profit life business
- Unit-linked business
- Conventional with-profits (“**CWP**”) business; and
- Accumulating with-profits (“**AWP**”) business.

4.53 Conventional non-profit life business refers to insurance business where the benefits received by policyholders are of defined monetary amounts, for example a life insurance policy that pays a fixed death benefit.

4.54 Unit-linked business is principally a type of investment product where policyholders’ premiums are used to buy units in investment funds. The value of the policyholder’s units is generally updated on a daily basis, such that it moves in line with the performance of the investments in the fund, net of any charges levied on the policy. At maturity, policyholders receive the value of their units.

4.55 CWP business typically refers to policies where policyholders’ premiums are fixed and they have a maturity benefit that is guaranteed at the outset in monetary terms. This benefit can subsequently be increased by bonuses that are awarded at the discretion of the insurer, depending upon the surplus emerging in the insurance fund in which the policies are invested. Once they have been awarded, bonuses are typically guaranteed and insurers are not able to take them away. A final bonus may also be awarded at the time of a claim.

4.56 AWP business typically refers to policies where policyholders’ premiums are used to buy units whose value is then increased through bonuses that are awarded at the discretion of the insurer, again depending on the surplus emerging in the relevant insurance fund. At maturity, policyholders typically receive the value of their units, which again may include a final bonus amount.

4.57 It is typical for insurers to target policyholder pay-outs for both CWP and AWP policies to be relatively close to the policy’s “asset share” (subject to meeting any guaranteed benefits payable under the policy), which is a measure of the true value of the policy based on actual investment returns and expenses incurred by the fund.

THE FINANCIAL INFORMATION IN THIS REPORT

4.58 The PRA has granted approval for:

- PAC to use the matching adjustment, the TMTP and the PAC internal model ("Internal Model") for Solvency II reporting; and
- Rothesay to use the matching adjustment, the TMTP and the Rothesay partial internal model ("**PIM**") for Solvency II reporting.

4.59 PAC's reported Solvency II financial information and its financial position in this report are based on the Internal Model.

4.60 Rothesay's approval to use a PIM was granted in December 2018; accordingly, Rothesay's financial position as at 30 June 2018 shown in this report is based on the Solvency II standard formula plus a capital add-on. Analysis of Rothesay's financial position as at 31 December 2018, calculated using its PIM, will be included in my supplementary report.

4.61 The financial information used in the analysis of the effects of the Scheme is set out in Sections 8, 9 and 10 of this report.

4.62 I have not carried out a full independent review of these Solvency II results as at 30 June 2018, but:

- The PAC Solvency II results as at 30 June 2018 have been reviewed by PAC's external auditors (KPMG LLP); and
- The Rothesay Solvency II results as at 30 June 2018 have been reviewed by Rothesay's external auditors (PwC LLP) and approved by the Rothesay Board.

4.63 I am satisfied that it is reasonable to rely upon these Solvency II results for the purpose of this report.

4.64 My Supplementary Report will contain Solvency II financial information as at 31 December 2018 and will provide an update on the effect of the implementation of the Scheme based upon these figures.

5. Background to PAC

BACKGROUND

5.1 PAC is a proprietary company, whose shares are wholly owned by Prudential plc.

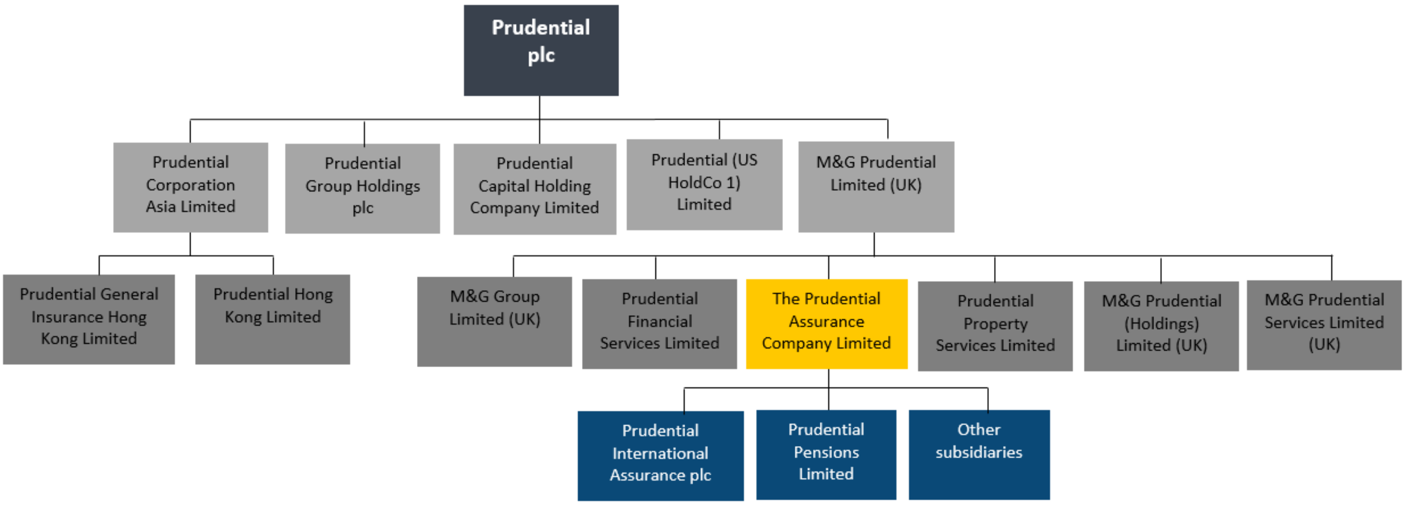
5.2 Prudential plc is an international financial services group with operations principally in Asia, Europe (predominantly the UK), the United States and Africa and is the holding company of the Prudential group.

5.3 PAC's principal activity is long-term insurance business, although PAC also has some general insurance business that is no longer sold but in relation to which there remain some contingent liability claims. This general insurance business will not be transferring under the Scheme.

5.4 PAC operates as the main insurance company in the M&G Prudential business unit of the Prudential group.

5.5 Figure 5.1 below shows the simplified current structure of the Prudential group, including where PAC (shown in yellow) sits within the group.

Figure 5.1 – Prudential's Current Group Corporate Structure



PAC'S CURRENT FUND STRUCTURE

5.6 As at 31 December 2017, PAC had £196 billion of assets[6] and over 6 million policyholders.

5.7 PAC has permission to effect and carry out long-term insurance business of Classes I (life and annuity), II (marriage and birth), III (linked long-term), IV (permanent health), VI (capital redemption) and VII (pension fund management) as set out in Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. PAC also has permission to effect and carry out all classes of general (non-life) insurance business.

5.8 PAC currently has three ring-fenced with-profits sub-funds as defined under Solvency II. These are:

- The PAC With-Profits Sub-Fund (the "**PAC WPSF**");
- The PAC Defined Charge Participating Sub-Fund (the "**PAC DCPSF**"); and
- The Scottish Amicable Insurance Fund (the "**SAIF**").

These are referred to collectively as the PAC with-profits fund.

[6] On a Solvency II basis.

5.9 Capital support arrangements exist under which support is provided by the PAC WPSF to the PAC DCPSF and the SAIF in return for charges levied on asset shares. The capital support arrangements between these ring-fenced funds do not affect, nor are they affected by, the Scheme and therefore are not covered in detail in this report.

5.10 The business outside the ring-fenced with-profits sub-funds is called the "**PAC shareholder-backed business**" as the capital for such business has been provided by PAC's shareholder. PAC also maintains a presentational division of the shareholder-backed business for reporting and management purposes between the PAC Non-Profit Sub-Fund (the "**PAC NPSF**"), which contains the long-term business of PAC and the assets allocated to that business, and the PAC Shareholder Fund ("**PAC SHF**").

5.11 The PAC shareholder-backed business consists of:

- The PAC shareholder-backed long-term insurance business in the PAC NPSF;
- The PAC shareholder-backed short-term insurance business (the "**PAC general insurance business**") in the PAC SHF; and
- All other assets and liabilities of PAC outside the PAC ring-fenced with-profits sub-funds, including the wholly owned insurance subsidiaries of PAC that have been allocated as assets of the PAC SHF:
    - Prudential Holborn Life Limited ("**PHLL**");
    - Prudential Pensions Limited ("**PPL**"); and
    - Prudential International Assurance plc ("**PIA**").

5.12 The table below shows the breakdown of the BEL of the PAC shareholder-backed business at 30 June 2018:

Table 5.2 – Split of BEL of the PAC shareholder-backed business at 30 June 2018

Component	BEL (gross of reinsurance)
	£m
PAC SHF (excl. subsidiaries)	-
PAC NPSF	44,945
PPL	11,647
PIA	6,628
Hong Kong subsidiaries – shareholder business	1,753
Other	76
Total	**56,253**

Note:
1) The total in this table does not equal to the sum of all the individual lines to avoid double-counting the impact of intra-group reinsurance arrangements
2) These figures are at 30 June 2018 and therefore include non-UK business that has subsequently been transferred out of PAC (see paragraphs 5.21 to 5.24). This does not have a material impact on the figures presented above.
3) The figures include a contribution from Prudential plc's Hong Kong insurance companies because they were subsidiaries of PAC as at 30 June 2018. Their ownership has since been transferred to Prudential Corporation Asia Limited (see paragraph 5.26).

PAC NPSF PRODUCTS

5.13 The business of the PAC NPSF is primarily comprised of non-profit annuities, unit-linked investment products and lifetime mortgage products. The non-profit annuity liabilities in the PAC NPSF include:

- Annuities originally written by Scottish Amicable Life plc ("**SAL**") that were subsequently transferred to PAC on 31 December 2002;
- Annuities written directly in the PAC NPSF; and

- Annuities originally written in Prudential Retirement Income Limited ("**PRIL**") that were subsequently transferred to PAC on 1 October 2016.

5.14 The PAC NPSF also includes PAC's "defined charge participating" business, with the exception of the business that was transferred to PAC from The Equitable Life Assurance Society ("**ELAS**") on 31 December 2007. The investment element of the defined charge participating business is allocated to the PAC DCPSF. The business transferred from ELAS is allocated to the PAC DCPSF, but the PAC NPSF bears all of the expenses of this business in return for the value of a charge levied on ELAS asset shares.

5.15 The table below shows, in summarised form, the product mix of the PAC NPSF by BEL, including the business to be transferred under the Scheme.

Table 5.3 – PAC NPSF in-force business at 30 June 2018

Product Type	BEL (gross of reinsurance)
	£m
Annuities	31,990
Unit-linked	12,974
Other	- 19
Total	**44,945**

Note: These figures are at 30 June 2018 and therefore include non-UK business that has subsequently been transferred out of PAC (see paragraphs 5.21 to 5.24). This does not have a material impact on the figures presented above.

PAC WITH-PROFITS FUND PRODUCTS

5.16 The most material product lines of the PAC with-profits fund are a large volume of traditional with-profits business, PruFund business (which provides smoothed investment returns with limited guarantees), with-profits annuities and non-profit annuities.

RECENT RELEVANT EVENTS

The sale of non-profit annuity liabilities to Rothesay

5.17 In March 2018 it was announced that PAC had entered into a transaction to transfer a portion of its shareholder-backed non-profit annuity business to Rothesay (the "**Laker Reinsured Business**"). The Laker Reinsured Business is comprised of approximately 400,000 policies, which cover both retail and bulk lines of business including deferred and in payment annuities, with a total BEL of approximately £12.9 billion (as at 30 June 2018). The Laker Reinsured Business has been reinsured to Rothesay through a collateralised reinsurance arrangement (the "**Laker Reinsurance Agreement**"). The Laker Reinsurance Agreement was entered into on 14 March 2018 and provides for the transfer of materially the whole of the economic interest in the Laker Reinsured Business from PAC to Rothesay.

5.18 Subject to some exclusions (as described in paragraphs 7.8, 7.17 and 7.18), the Scheme provides for the transfer of the policies whose benefits are covered by the Laker Reinsurance Agreement from PAC to Rothesay.

5.19 This is described in more detail in Section 6.

Previous schemes transferring long-term business into PAC

5.20 As well as the business written directly by PAC, and the business reinsured in from other PAC subsidiaries, there have been a number of transfers of long-term insurance business into PAC:

- Non-profit annuity business transferred into the PAC NPSF from PRIL on 1 October 2016.
- Non-profit annuity business transferred in from Prudential Annuities Limited ("**PAL**") on 1 October 2014. All of the long-term business of PAL was transferred into the PAC WPSF.

- Business transferred in from PHLL and from Prudential (AN) Limited ("**PANL**") on 31 October 2010. All the long-term business of PANL and PHLL was transferred to PAC. All of the non-profit business of PANL and PHLL was allocated to the PAC NPSF and all of the with-profits business of PANL was transferred to the PAC WPSF.
- With-profits annuity business transferred to PAC from ELAS on 31 December 2007 which was principally allocated to the PAC DCPSF.
- Business transferred from SAL to PAC on 31 December 2002. All of the with-profits business was allocated to the PAC WPSF and the rest was transferred to the PAC NPSF.
- Business transferred to PAC from Scottish Amicable Life Assurance Society on 30 September 1997, which was principally allocated to a newly created sub-fund, the SAIF.

Transfer of PAC's non-UK European business

5.21 PAC has recently undertaken a Part VII transfer of PAC's existing long-term insurance business in Poland, France, Malta, Ireland and Germany to PIA.

5.22 This was undertaken in order to allow more efficient operation and to simplify the management of its long-term insurance business across Europe. Although not a primary motivation, the transfer was structured so as to ensure that the PAC policies written through establishments in Europe (excluding the UK) can continue lawfully to be administered and serviced if and when the UK leaves the EU.

5.23 The transfer was presented to the Court for a Final Hearing[7] on 11 December 2018, and the Scheme became operative on 1 January 2019.

5.24 The total policyholder liabilities transferred amounted to approximately £60 million at 31 December 2017; this figure includes negative liabilities[8] of approximately £15 million in relation to PAC's Polish business. The assets which were transferred amounted to £74 million at 31 December 2017.

The demerger of M&G Prudential

5.25 In August 2017, Prudential plc announced that it was to combine two businesses within the Prudential group, Prudential UK & Europe and its asset manager, M&G, to form a business called M&G Prudential.

5.26 In March 2018, Prudential plc announced that:

- M&G Prudential would demerge from the Prudential group, resulting in two separately listed companies; and
- The legal ownership of Prudential plc's Hong Kong insurance subsidiaries, Prudential Hong Kong Limited ("**PHKL**") and Prudential General Insurance Hong Kong Limited ("**PGHKL**"), would be transferred from PAC to Prudential Corporation Asia Limited ("**PCA**"), another subsidiary of Prudential plc, by the end of 2019.

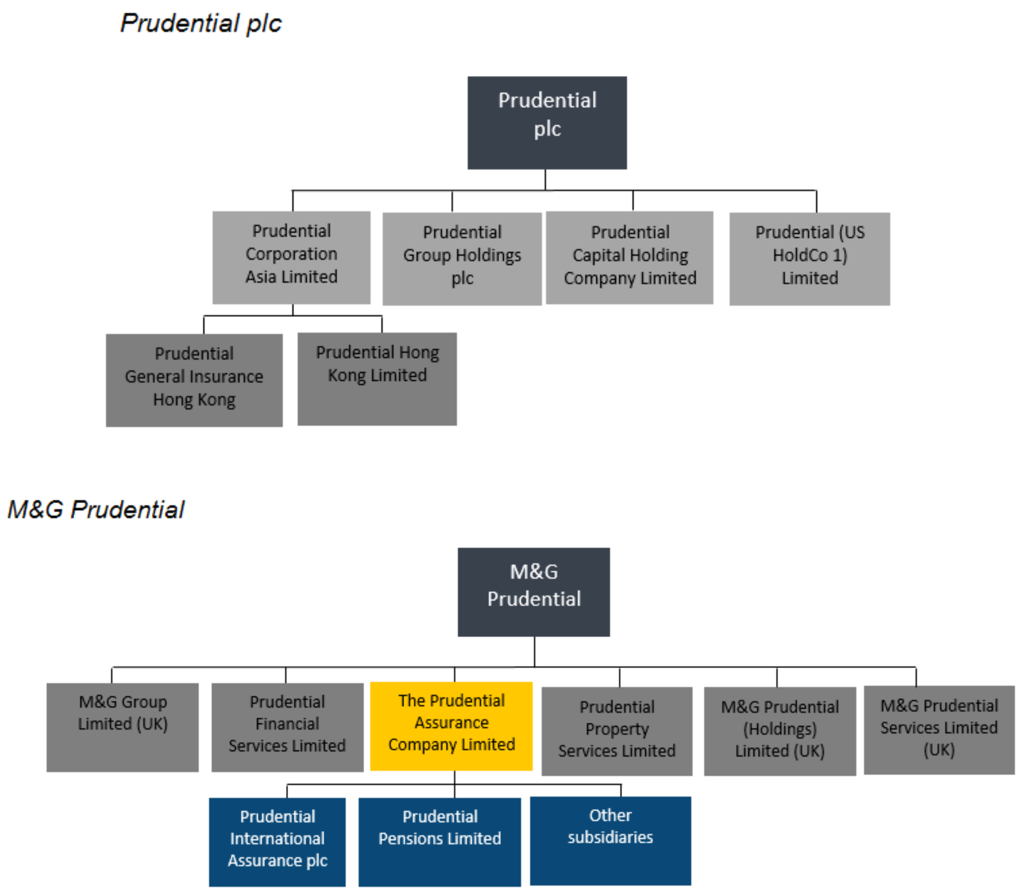
The transfer of the Hong Kong subsidiaries took place on 14 December 2018, and was effected by a share purchase agreement between PAC and PCA. Prior to this transaction, PHKL contributed around £4 billion of excess capital to PAC's Solvency II capital position. The financial impacts of the restructuring are considered in paragraph 5.36.

5.27 Figure 5.4 below shows a simplified corporate structure of the Prudential group and M&G Prudential after the demerger.

[7] A hearing of the Court to approve the terms of the Scheme

[8] Negative liabilities arise because it is estimated that the future premiums on PAC's Polish business will exceed future claims.

Figure 5.4 – Simplified corporate structure of Prudential group and M&G Prudential after the demerger



Proposed transfer of business to Vitality Life Limited

5.28 In November 2014, PAC completed the sale of its remaining stake in the PruHealth/PruProtect joint venture with Discovery Limited ("**Discovery**"). As a consequence of this, the protection business written by PAC, on behalf of the joint venture company, will be transferred to Vitality Life Limited, Discovery's UK life insurance company.

5.29 This Part VII transfer is expected to be presented to the Court for its Directions Hearing[9] in October 2019 and a Final Hearing is expected to be held in March 2020. If sanctioned by the Court, the business is expected to be transferred to Vitality Life Limited on 1 April 2020.

5.30 I have reviewed analysis that shows that this Part VII transfer is expected to have a negligible effect on the solvency of PAC.

PAC'S REINSURANCE ARRANGEMENTS

5.31 PAC has a reinsurance arrangement in place with PIA under which 100% of PIA's with-profits business, including the net cost of options and guarantees, is ceded from PIA to PAC. This reinsured with-profits business is allocated to the PAC WPSF and the PAC DCPSF.

[9] An initial Court hearing at which the companies' plans for notifying policyholders are considered

5.32 PAC has external reinsurance arrangements with the counterparties listed below[10]; these include longevity reinsurance contracts that cede a material proportion (covering approximately £14 billion of liabilities as at 31 December 2017) of the longevity risk in respect of the annuities in the PAC NPSF.

- Aberdeen Asset Management
- BlackRock Life Limited
- Gen Re
- Hannover Re
- Legal & General
- Munich Re
- Pacific Life Re
- PartnerRe
- Pinnacle Insurance Plc
- Prudential Financial[11]
- RGA
- SCOR SE
- Standard Life
- Suffolk Life Annuities Ltd
- Swiss Re

FINANCIAL CONDITION

5.33 I have considered both the Solvency II Pillar 1 and Pillar 2 financial positions of PAC in my assessment. I am unable to disclose details of the Pillar 2 financial position, as this is submitted privately to the PRA, but have used this information in my assessment of the risk profile, as well as the recent and expected future development of the business of PAC, which are covered in paragraphs 5.21 to 5.30, and paragraphs 5.53 to 5.55. I can confirm that the Pillar 2 position shows a significantly greater level of excess capital than the Pillar 1 figure, and so it is Pillar 1 that will determine the required level of Own Funds to meet capital requirements under Solvency II.

[10] Group or brand names have been used in some cases for PAC's reinsurance counterparties, rather than the name of the specific legal entity with which the reinsurance is held

[11] Prudential Financial, Inc. is a financial services group which is not connected with Prudential plc.

Table 5.5 – PAC Solvency II Pillar 1 balance sheet at 30 June 2018

PAC Solvency II Pillar 1 Balance Sheet	PAC SHF	NPSF	Value of PAC's interest in its subsidiaries	Total PAC shareholder -backed business	Total PAC with-profits fund	Consolidated PAC
	£m	£m	£m	£m	£m	£m
Solvency II Assets (net of other items)	2,414	51,533	18,597	72,544	127,025	212,834
Technical Provisions (including TMTP) [12]	-	45,635	12,002	57,637	117,107	192,722
Own Funds (A)	**2,414**	**5,898**	**6,595**	**14,907**	**9,918**	**20,112**
SCR (B)	2,362	4,095	759	7,215	3,846	12,420
Excess Capital (=A-B)	53	1,803	5,836	7,692	6,071	7,692
SCR coverage ratio (=A/B)	***102%***	***144%***	***869%***	***207%***	***258%***	***162%***

Notes:

- These figures are at 30 June 2018 and so include non-UK business that has subsequently been transferred to PIA (see paragraphs 5.21 to 5.24); moreover they do not allow for the impact of the transfer of ownership of PAC's Hong Kong subsidiaries to PCA that took place on 14 December 2018. The transfer of business to PIA does not have a material impact on the figures presented above. The Hong Kong transaction does have a material impact on PAC's solvency position, and this is considered below.
- The figures for the PAC with-profits fund represent PAC's economic view of the Solvency II balance sheet for the with-profits business, including the liability and associated capital requirements related to the present value of the future shareholder transfers.
- These figures are calculated based using PAC's reported TMTP as at 30 June 2018. Changes in economic conditions can change the TMTP but use of an updated TMTP would require a formal recalculation of the TMTP to be approved. PAC has no plans to formally recalculate the TMTP before the proposed transfer and so all figures presented will use the reported TMTP rather than a "dynamic" TMTP that moves in line with economic conditions.
- The PAC SHF does not have any technical provisions because it comprises solely:
  - the asset representing the value of the shareholder's interest in future transfers ("**SHIFT**") from the with-profits fund;
  - the value of derivatives put in place to partially hedge the value of the SHIFT asset; and
  - the accounting value of the staff pension scheme.

  The PAC SHF's SCR is primarily related to the risk of a reduction in the value of the SHIFT asset as a result of a fall in the value of equities held in the PAC WPSF. During 2018, there has been an increase in new business written into the PAC WPSF, and additionally the derivative hedges held in relation to the SHIFT asset are running down; in aggregate, these have increased the exposure of the value of the SHIFT asset to equity falls.
- The value of PAC's interest in its subsidiaries is calculated as a balancing item (i.e. the Total PAC shareholder-backed business minus the PAC SHF and NPSF). Therefore, the SCR shown is not necessarily reflective of the reported SCRs for the subsidiaries in isolation.
- Where appropriate, the impact of reinsurance arrangements and loans between PAC and its subsidiaries has been eliminated to avoid double counting of assets and liabilities.

5.34 Table 5.5 shows that PAC's solvency position as at 30 June 2018 is significantly in excess of regulatory requirements.

5.35 In presenting the solvency position of PAC, I have shown figures separately for the shareholder-backed business and the with-profits fund. This is because each of the three with-profits sub-funds that comprise the with-profits fund is a ring-fenced fund, and excess capital in a ring-fenced fund of a UK life company cannot be used to cover capital requirements relating to business outside that fund. The proposed transfer will not materially affect the solvency position of the with-profits fund, and therefore in illustrating its impact on solvency I will focus on the position of the shareholder-backed business of PAC. However, in extreme circumstances, for example, if PAC were to become insolvent, any Own Funds in the with-profits fund

[12] The Technical Provisions are calculated as BEL plus Risk Margin minus TMTP e.g. for the PAC NPSF this is calculated as the BEL of £44,945 million (as shown in Table 5.3) plus a Risk Margin of £2,245 million minus the TMTP of £1,556 million.

would become available to meet guaranteed liabilities in respect of shareholder-backed business. Because of this, it is also important to consider PAC's consolidated regulatory solvency position. At 30 June 2018, PAC's consolidated regulatory solvency coverage ratio was 162%, which is also significantly in excess of regulatory requirements.

5.36 As discussed in paragraph 5.26, the legal ownership of the Hong Kong subsidiaries of PAC was transferred to PCA on 14 December 2018. Table 5.6 below shows the expected impact of this on the solvency position of the PAC shareholder-backed business as at 30 June 2018.

Table 5.6 – PAC shareholder-backed business Solvency II Pillar 1 balance sheet at 30 June 2018

Total PAC shareholder-backed business	Pre-transfer of ownership of PAC's Hong Kong subsidiaries	Post-transfer of ownership of PAC's Hong Kong subsidiaries
	£m	£m
Solvency II Assets (net of other items)	72,544	63,990
Technical Provisions (including TMTP)	57,637	55,174
Own Funds (A)	**14,907**	**8,817**
SCR (B)	7,215	5,862
Excess Capital (=A-B)	7,692	2,955
SCR coverage ratio (=A/B)	***207%***	***150%***

5.37 Table 5.6 shows that the solvency coverage ratio of PAC's shareholder-backed business would have reduced from 207% to 150% if the transfer of the Hong Kong subsidiaries had occurred at 30 June 2018. The corresponding reduction in PAC's consolidated regulatory solvency ratio would have been from 162% to 130%. Given that the transfer of the ownership of those subsidiaries will have had a material effect on PAC's balance sheet, I will consider the impact of this transfer of ownership when assessing the financial consequences of the Scheme.

RISK AND CAPITAL MANAGEMENT

5.38 The PAC Board is responsible for the management of PAC's exposure to risk and in particular:

- Determining PAC's risk appetite and therefore its capacity for risk.
- Managing the overall risk level of the company having regard to the capacity for risk and the internal capital policy.

5.39 PAC's risk appetite statement for its shareholder-backed business is set out in PAC's Shareholder Risk Appetite ("**SRA**") Framework and defines the level of capital buffer that the PAC Board has determined that PAC should aim to hold in excess of its Solvency II Pillar 1 SCR and its Solvency II Pillar 2 economic capital requirement[13]. This level of capital is expressed as an SCR coverage ratio.

5.40 PAC's SRA Framework also includes a "solvency intervention ladder" which sets out solvency triggers to consider and initiate actions to manage and restore the capital position as solvency deteriorates. To avoid taking unnecessary pro-cyclical management action, the framework requires consideration of the point in the economic cycle and its impact on the capital position. The determination of the point in the cycle is made by the PAC Board based on a number of inputs including economic cycle indicators, which reflect the risk profile of the business, and expert advice.

5.41 The SRA Framework capital buffer and the triggers on the solvency intervention ladder are updated twice-yearly.

5.42 The PAC Board is required to approve any changes to the framework. Proposals are initially tabled at the Executive Risk Committee and Board Risk and Capital Committee ("**BRCC**", a sub-committee of the Board which assists the Board in meeting its responsibility for overseeing the effectiveness of risk and capital management). The BRCC reviews and

[13] PAC maintains an internal view of its capital needs through the calculation of its 'economic capital requirement' as part of its ORSA process

recommends proposals to the Board, which then approves any changes. Any material changes to the framework are shared with the PRA.

5.43 To help ensure that PAC remains within its risk appetite, the Board manages the type and volume of new business accepted having regard to the available capital resources in PAC.

5.44 PAC also has a risk appetite statement for its ring-fenced funds.

5.45 The SRA Framework is confidential and not in the public domain. Therefore, the specific detail of PAC's SRA Framework has not been included in this report, but I have been provided with these details by PAC and considered the SRA Framework when assessing the financial impact of the Scheme.

SHAREHOLDER EXPOSURE TO PAC'S WITH-PROFITS FUND

5.46 PAC is required to meet its obligations to policyholders of the PAC with-profits fund even if the assets allocated to this fund are insufficient for this purpose. The assets in each of the with-profits sub-funds in excess of amounts expected to be required to meet guaranteed benefits and future discretionary benefits of business in that sub-fund, as well as related shareholder transfers (the "**excess assets**"), could be materially depleted over time by, for example, significant changes in financial market conditions, costs of fundamental strategic change or a material increase in PAC's provision in relation to pensions mis-selling.

5.47 In the unlikely circumstance that the depletion of the excess assets within one or more of the ring-fenced with-profits sub-funds was such that the ability of PAC and the wider Prudential group to meet policyholders' reasonable expectations was adversely affected, it might become necessary to restrict remittances to shareholders or to provide financial support to the with-profits fund using capital resources of the shareholder-backed funds. This is considered in more detail in Sections 7 and 8.

THE PAC PENSIONS MIS-SELLING COSTS ASSURANCE

5.48 The UK insurance regulator required all UK life insurance companies to review personal pension policies sold between 29 April 1988 and 30 June 1994, and to provide redress in all cases where the policyholder was assessed to have suffered a financial loss as a result of leaving, or not joining, an alternative pension arrangement sponsored by an employer or the UK Government[14]. Compensation to all policies affected by mis-selling was provided by 30 June 2002[15]. Costs arising from the review of policies in PAC WPSF were met by excess assets of that fund and so have not been charged to the asset shares used in the determination of policyholder bonus rates.

5.49 PAC has given an assurance, known as the "Pension Mis-Selling Costs Assurance", that these deductions from excess assets will not affect its bonus or investment policy for policies within the with-profits fund that were in force at 31 December 2003. This assurance does not apply to new business since 1 January 2004. In the unlikely event that such deductions would affect the bonus or investment policy for the relevant policies, PAC has stated it would make available support to the relevant with-profits fund from shareholder resources for as long as the situation continued, so as to ensure that those policyholders were not disadvantaged.

CAPITAL SUPPORT AVAILABLE TO PAC

5.50 In 2013, PAC and Prudential plc entered into a legally enforceable capital support arrangement ("**CSA**") under which Prudential plc has an obligation to provide PAC with additional capital support, up to an agreed maximum aggregate level, in the event of PAC's solvency falling below specified levels. The CSA was amended with effect from 1 January 2016 to reflect the introduction of Solvency II (which changed the manner in which the solvency of EU insurers is assessed). The capital support provided under the CSA includes the capital support that might be required to support the PAC Pension Mis-Selling Costs Assurance in relation to with-profits business, as described in paragraphs 5.48 and 5.49.

[14] Except in the cases where the provider was able to evidence a fully compliant sales process.

[15] For some policies, the final compensation amount will be dependent on the value of the policy at retirement.

ADMINISTRATION AND OUTSOURCING

5.51 Until 30 September 2018, the policies within the scope of the transfer were administered by PAC and other group companies using in-house systems.

5.52 On 12 June 2018, PAC announced that its strategic partnership with Tata Consultancy Services ("**TCS**") and Diligenta, its UK subsidiary, would, from 1 October 2018, be extended to include PAC's annuity business. Consequently, since that date, PAC has outsourced the policy administration for the Transferring Policies to TCS/Diligenta.

RISKS INHERENT IN PAC

5.53 The shareholder-backed fund's most significant risk is market risk. This primarily arises due to equity, property, interest rate and currency risks within PHKL and the impact of market risks on the value of future shareholder transfers expected to be received from PAC's ring-fenced with-profits sub-funds.

5.54 Credit risk on debt investments is also a significant risk for the shareholder-backed fund. This is mainly due to the substantial volume of corporate bonds held to back non-profit annuity liabilities. In addition, insurance risk is a material risk, with longevity risk on non-profit annuity liabilities being the most significant component.

5.55 PAC's with-profits sub-funds are materially exposed to market risk arising from the mismatch between assets backing the asset shares and guarantees embedded in the corresponding liabilities. Credit risk within the ring-fenced funds primarily arises due to the substantial volume of corporate bonds in the capital funds, asset share funds and backing non-profit annuities that are held in the with-profits sub-funds. Insurance risk is also material to the ring-fenced funds, in particular longevity risk and expense risk.

6. Background to Rothesay

BACKGROUND

6.1 Rothesay was established as a proprietary company on 26 February 2007, as a wholly owned subsidiary of Rothesay Life (Cayman) Limited. It was previously known as Hackremco (No. 2460) Limited (until 14 March 2007) and First Premium Company Limited (until 14 May 2007) and Rothesay Life Limited (until 24 March 2016).

6.2 Until 2013, Rothesay's ultimate parent company was The Goldman Sachs Group, Inc. ("**Goldman Sachs**") but, in December 2013, Goldman Sachs completed a partial sale of Rothesay, introducing three additional shareholders. As part of the deconsolidation from Goldman Sachs, Rothesay HoldCo UK Limited ("**Rothesay HoldCo**") was introduced as a holding company between Rothesay Life (Cayman) Limited and Rothesay. During 2016 Rothesay also established an Employee Benefit Trust to purchase and hold shares of Rothesay HoldCo for delivery to employees under employee share schemes. In 2017, Goldman Sachs sold all its remaining Rothesay Life shares to The Blackstone Group L.P., Government of Singapore Investment Corporation and MassMutual. Rothesay is a subsidiary of Rothesay HoldCo, which in turn is owned by:

- The Blackstone Group L.P.;
- GIC Private Limited, previously known as Government of Singapore Investment Corporation;
- MassMutual Financial Group; and
- Management, Employees and Elian Employee Benefit Trustee Limited.

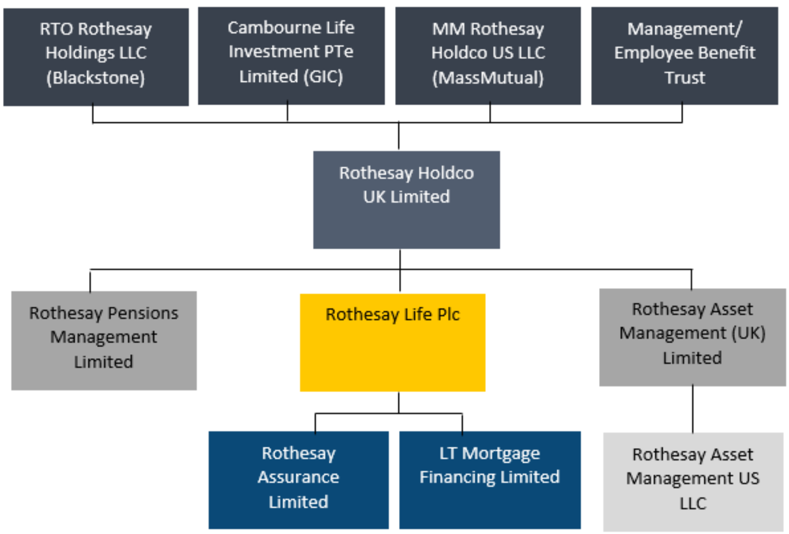
6.3 Rothesay has two subsidiaries:

- Rothesay Assurance Limited: This company was de-authorised as an insurance company following the transfer of its business into Rothesay in 2015 and is in the process of being wound up.
- LT Mortgage Financing Limited: This company was incorporated as a wholly owned subsidiary of Rothesay on 17 February 2015 and began trading in 2018.

6.4 Rothesay became a Plc in March 2016.

6.5 Rothesay's ownership structure as at 30 June 2018 is shown in the chart below.

Figure 6.1: Rothesay's ownership structure



6.6 Rothesay has permission to effect and carry out insurance business of Classes I (life and annuity), III (linked long term), IV (permanent health) and VII (pension fund management), as set out in Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001.

PRODUCTS

6.7 Rothesay's long-term insurance business comprises non-profit pension business originating in the UK; more specifically:

- Bulk purchase annuity contracts issued to trustees of UK defined benefit pension schemes by way of a buy-in policy;
- Individual policies issued to former members of UK defined benefit pension schemes as a consequence of a buyout of their benefits by Rothesay;
- Individual retail annuity policies acquired from Zurich Assurance Ltd and Scottish Equitable plc (see paragraphs 6.19 and 6.20); and
- Longevity insurance (also known as longevity swaps) provided to UK defined benefit pension schemes.

6.8 In addition, as described in the previous section and below, Rothesay has also entered into an inwards reinsurance arrangement with PAC covering certain retail and bulk annuity business, with a view to formalising the transfer of the relevant business from PAC to Rothesay via the Scheme.

6.9 Rothesay's individual policyholders and the members of occupational pension schemes subject to buy-in or longevity insurance arrangements with Rothesay are a mixture of deferred and in-payment pensioners.

6.10 Rothesay insures the pensions of approximately 350,000 individuals[16], and had Technical Provisions of £32.4 billion[17] at 30 June 2018.

6.11 The liabilities of Rothesay are generally for the payment of guaranteed annuity amounts, either level or increasing at a fixed rate or in line with a specified inflation measure, payable either for the lifetime of the original pension scheme member/insurance company policyholder or to their dependants on a contingent basis.

RECENT RELEVANT EVENTS

Reinsurance with PAC

6.12 As described in paragraphs 5.17 to 5.19, in March 2018 it was announced that PAC had entered into a transaction to transfer the Laker Reinsured Business to Rothesay. The Laker Reinsured Business comprises approximately 400,000 policies, which covers both retail and bulk lines of business including deferred and in payment annuities. The Laker Reinsured Business has been reinsured to Rothesay through a collateralised reinsurance arrangement. The Laker Reinsurance Agreement was entered into on 14 March 2018 and reinsures the policyholder benefit liabilities of the Laker Reinsured Business from PAC to Rothesay.

6.13 Assets providing collateral for Rothesay's obligations to PAC under the Laker Reinsurance Agreement are held in custody accounts. Under the terms of the Laker Reinsurance Agreement, the bulk of the assets in the custody accounts must comply with the relevant Matching Adjustment rules and tests, i.e. they must comply with Article 77b of Directive 2009/138/EC of the European Parliament and of the Council of the European Union and the relevant PRA matching tests in respect of the liabilities of the Laker Reinsured Business[18].

6.14 In addition, PAC and Rothesay entered into a transfer agreement (the "**Business Transfer Agreement**") and a supplemental agreement (the "**Supplemental Agreement**") at the same time as the Laker Reinsurance Agreement. This sets out how the Laker Reinsured Business will be transferred to Rothesay by way of a Part VII transfer under the FSMA. However, as described in Section 7, there have been some subsequent additions and exclusions to both the Laker Reinsured Business and to the business that will be transferred to Rothesay under the Scheme.

6.15 If the Scheme proceeds to completion as intended, the Laker Reinsurance Agreement will be modified to cover only the Non-transferring Reinsured Policies (which are not in scope of the Scheme) and any Excluded Policies. With the exception

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[16] Excluding the PAC policyholders whose annuities are reinsured to Rothesay from PAC.

[17] Inclusive of the c.£11.3 billion inwards reinsurance from PAC, described in paragraph 6.12. The figure of c.£11.3 billion differs from the figure of c.£12.9 billion in paragraph 5.17 because £11.3 billion is the gross BEL held by Rothesay in relation to the reinsured business, whereas £12.9 billion is PAC's gross BEL in relation to the reinsured business. The difference between these figures principally arises because the Transferring Business is not part of PAC's Matching Adjustment portfolio (and therefore its BEL is not calculated using the Matching Adjustment), whereas the inwardly reinsured business in Rothesay under the Laker Reinsurance Agreement is part of Rothesay's Matching Adjustment portfolio, which means that Rothesay's BEL is calculated using a discount curve that includes a Matching Adjustment, resulting in a higher discount rate and a lower BEL.

[18] The Laker Reinsurance Agreement specifies that the collateral must "comply with the PRA matching tests set out in the Appendix of the PRA Consultation Paper (CP 21/17) on Matching Adjustment, dated October 2017"; these rules have since been formalised, with some minor amendments, as part of the PRA Supervisory Statement (SS 7/18) dated July 2018.

of collateral required to facilitate the continuing reinsurance of the Non-transferring Reinsured Policies (see paragraph 7.17), the associated collateral held in custody will be released to Rothesay.

6.16 If the proposed transfer does not proceed to completion as intended before 31 March 2021, the Laker Reinsurance Agreement gives PAC the option of recapturing the reinsurance. In this scenario, Rothesay would pay an agreed amount to PAC and PAC would regain the economic interest in the business covered by the Laker Reinsurance Agreement. PAC also has the right to recapture the reinsurance in a number of other circumstances. The amount to be paid by Rothesay to PAC as a result of such a recapture would depend on the trigger for the recapture. Rothesay also has the right to require recapture of the reinsurance by PAC in certain circumstances.

Other recent events

6.17 In January 2011, Rothesay acquired Paternoster UK Limited ("**Paternoster**"), an insurance company specialising in bulk annuity business, and on 19 December 2011 the High Court approved the Part VII transfer of the long-term business of Paternoster into Rothesay.

6.18 On 16 May 2014, Rothesay completed the purchase of MetLife Assurance Limited ("**MAL**"), another bulk annuity specialist, from MetLife European Holdings Limited. MAL became a wholly owned subsidiary of Rothesay and changed its name to Rothesay Assurance Limited ("**RAL**") on 23 June 2014. On 30 November 2015 the business of RAL was transferred into Rothesay by way of a Part VII transfer.

6.19 In April 2015, December 2015, June 2016 and November 2016, four tranches of annuity business originally written by Zurich Assurance Ltd were reinsured by Rothesay. All Zurich policies reinsured with Rothesay were transferred to Rothesay by way of a Part VII transfer in June 2017.

6.20 On 11 April 2016 Rothesay agreed to reinsure a significant part of the non-profit annuity portfolio of Scottish Equitable plc (a subsidiary of Aegon N.V.). The transaction was completed by way of a Part VII transfer of the reinsured policies from Scottish Equitable plc to Rothesay in June 2017.

OUTWARDS REINSURANCE ARRANGEMENTS

6.21 Rothesay reinsures approximately 70% of its longevity risk through longevity reinsurance contracts with a range of reinsurers. Currently, Rothesay has outwards reinsurance agreements with the following companies:

- Pacific Life Re
- Hannover Re
- Massachusetts Mutual Life
- Munich Re
- Prudential Financial
- Royal Bank of Canada
- RGA
- XL

FINANCIAL CONDITION

6.22 I have considered both the Solvency II Pillar 1 and Pillar 2 financial positions of Rothesay in my assessment. I am unable to disclose details of the Pillar 2 financial position, as this is submitted privately to the PRA, but have used this information in my assessment of the risk profile and expected future development of Rothesay; a description of Rothesay's risk profile is provided in paragraph 6.40.

Table 6.2 – Rothesay Solvency II Pillar 1 balance sheet at 30 June 2018

	Rothesay
	£m
Solvency II Assets (net of other items)	36,315
Technical Provisions (including TMTP)	32,157
Own Funds (A)	**4,158**
SCR (B)	2,351
Excess Capital (=A-B)	1,807
***SCR coverage ratio* (=A/B)**	***177%***

6.23 The SCR coverage ratio[19] for Rothesay as at 30 June 2018 was 177% (31 December 2017: 163%). Rothesay aims to operate at a level of cover within a range of 130% to 150%, as discussed in paragraph 6.34.

6.24 The results shown in Table 6.2 are produced using the Solvency II Standard Formula to calculate the SCR. Rothesay has developed a partial internal model ("**PIM**") and has received approval from the PRA to use this PIM to produce its reported Solvency II results from 31 December 2018.

6.25 Rothesay currently holds a capital add-on to reflect risks that are not explicitly captured by the Standard Formula.

6.26 The PIM will be used to calculate relevant components of Rothesay's SCR and risk margin from 31 December 2018. The PIM will cover counterparty default risk and credit risk. All of the other components of Rothesay's SCR and risk margin will be calculated using Standard Formula methodology.

6.27 All of the financial information in this report is presented using Rothesay's reported basis as at 30 June 2018, i.e. using the Solvency II Standard Formula plus a capital add-on. Additionally, Rothesay has provided me with provisional information on its expected financial position at that date if the PIM had been approved for use. I have considered this information in my assessment of the consequences of the Scheme, but I have not included it in my report.

6.28 I will provide an updated analysis of the Scheme in my Supplementary Report based on financial information at 31 December 2018, prepared using the approved PIM.

RISK AND CAPITAL MANAGEMENT

6.29 Rothesay maintains a Risk Management Framework ("**RMF**") that is designed to identify, measure, manage, monitor and report significant risks that threaten the achievement of its business objectives.

6.30 The RMF informs and is directed by Rothesay's business strategy. Therefore, the Rothesay's risk management principles are driven by the key objectives of the business. These are:

- to ensure that Rothesay's liabilities to policyholders can be met in a full and timely manner over a very long-term;
- to maintain Rothesay's financial strength and capitalisation;
- to produce stable earnings from Rothesay's in-force business;
- to protect and increase the value of Rothesay's shareholders' investment; and
- to safeguard Rothesay's reputation.

6.31 Rothesay's risk appetite expresses the types of risk that the Board considers the company should be exposed to in pursuing its business objectives. Strategy risk[20], insurance risk and credit risk are all desired risks which are core to Rothesay's

[19] SCR coverage ratio = Own Funds divided by SCR.
[20] The risk of loss in future earnings and capital arising from changes in the competitive, economic, legal or political environment, changing customer behaviour, or a failure to select appropriate strategic or long-term business plans.

business model. Market risk is a risk which, whilst not desired, is tolerated as a result of the business model but mitigated where possible. Liquidity and operational risks are undesired and Rothesay seeks to eliminate these.

6.32 Rothesay's risk appetite is translated into quantifiable limits and early warning triggers that prompt management action to avoid risk exposures breaching the Rothesay Board's risk appetite.

6.33 Rothesay monitors its risk exposures against risk appetite and the effectiveness of its intended risk mitigating management actions on a regular basis. The results are reported to oversight committees and individuals with responsibility for risk management in order to inform business decisions.

6.34 The RMF is subject to regular review to ensure that it remains fit for purpose, and also to an annual confirmation by the Rothesay CRO to that effect. During 2017, several areas of the RMF were enhanced. These include liquidity risk management, operational risk and the management of non-financial risks such as model risk and outsourcing risk. Further enhancements are planned, particularly relating to the development of a PIM for operational risk. Rothesay's management aims to ensure that, while the level of surplus assets may fluctuate in the normal course of business, sufficient capital is maintained within the business. Rothesay has an internal capital policy whereby it targets a Solvency II capital position of between 130% and 150% of SCR.

6.35 Outside this target range, the following capital management actions apply:

- If coverage exceeds 150% of SCR, Rothesay considers that is has excess capital that can be deployed or returned to shareholders.
- If coverage is below 130%, then management would take actions to improve the solvency position. Such actions include changing investment mix, putting additional reinsurance in place, suspending the writing of new business, raising capital, or reducing discretionary expenses.

The capital policy remains under regular review by the Rothesay Board and any changes to this policy require consultation with the PRA and approval of the Rothesay Board.

6.36 In 2017, extensive recovery and resolution plans were developed to complement the high-level actions outlined in the capital policy. Both plans will be updated at least annually.

ADMINISTRATION AND OUTSOURCING

6.37 Rothesay's business model uses third parties in order to take advantage of economies of scale and external expertise.

6.38 Rothesay outsources (or partially outsources) the following key functions and activities:

- Risk software and some IT provision to Goldman Sachs;
- Pensions administration to Jardine Lloyd Thomson, Capita Employee Benefits and Willis Towers Watson; and
- Middle office operational activity (settlements and collateral management) to Northern Trust.

6.39 Rothesay maintains oversight of these outsourced functions with an operations team in line with its Third Party Oversight policy.

RISKS INHERENT IN ROTHESAY

6.40 Rothesay considers its main risks to be:

- Counterparty default and issuer default risk.
    - Rothesay invests in a combination of relatively illiquid secured lending assets and government-guaranteed and other highly rated bonds. It limits its exposure to default risk by investing in asset classes with suitable security and/or other structural mitigation, as well as through the use of credit protection.
    - Rothesay minimises its market risk by investing in low risk asset classes such as government bonds, and by the use of interest rate and inflation swap derivative contracts to match closely the type, amounts and durations of insurance liabilities. However, a material spread risk exists, owing to the size of its lending portfolio and a recent increase in the allocation to unsecured corporate bonds.

  - Almost all of Rothesay's longevity reinsurance arrangements are collateralised to reduce its exposure to the risk of default by the reinsurance counterparty.

- Longevity risk: Rothesay uses the reinsurance market to significantly reduce its exposure to longevity risk, with approximately 70% of the longevity risk being transferred to third party reinsurers. Nevertheless, longevity risk remains a material risk for Rothesay.
- Execution, delivery and process management risk: This is a type of operational risk relating to threats to the delivery of Rothesay's business plan.
- Regulatory environment and legal risk: This risk relates to various areas of regulatory focus.
- Business disruption and system failure risk.

6.41 Rothesay's capital structure includes debt which it has issued; as at 31 December 2017 this includes £100 million of floating rate perpetual callable loan notes, £250 million of unsecured, subordinated loan notes and £300 million of floating rate subordinated loan notes. In addition, in September 2018 Rothesay, issued £350 million of Restricted Tier 1 subordinated notes. It does not have material exposure to intra-group loans.

7. The Scheme

THE MOTIVATION FOR THE SCHEME

7.1 To facilitate the proposed separation of M&G Prudential from Prudential plc and the transfer of ownership of the Hong Kong subsidiaries from PAC to PCA (see paragraphs 5.25 to 5.27), it has been necessary to reduce the solvency capital requirements of PAC's shareholder-backed business. PAC has chosen to achieve this by selling part of its large portfolio of non-profit annuities, and has transferred most of the economic risk and reward of the relevant annuities to Rothesay by means of the Laker Reinsurance Agreement. Both companies now wish to transfer the primary obligation (payment of those annuities) to Rothesay, so that the Laker Reinsurance Agreement can be terminated[21] and the management of the business simplified. There have been many transactions involving the transfer of annuity business from one company to another that have followed the same approach; that is, a reinsurance agreement to transfer the economic interest, followed by a transfer of the policies themselves by means of a Court-approved scheme.

SUMMARY OF THE SCHEME

7.2 The Scheme is expected to be presented to the Court for a Directions Hearing on 31 January 2019 and for a Final Hearing on 10 June 2019.

7.3 If the Scheme is approved by the Court it will be implemented on the Transfer Date (expected to be 26 June 2019) and, on that date, a defined portfolio of non-profit annuity policies of PAC will transfer to Rothesay (the "**Transferring Business**"). The Transferring Business also includes the outwards longevity reinsurance arrangements that PAC has in place covering certain of the Transferring Policies, as described in paragraph 7.20; Rothesay will replace PAC as the cedant under these arrangements.

7.4 The Jersey Scheme and the Guernsey Scheme will be presented to the relevant courts in Jersey and Guernsey and will be on substantially the same terms as the Scheme. The purpose of these schemes is to ensure that the transfer of the Jersey Policies and the Guernsey Policies is effective, and they will only be effected if the Scheme itself is implemented. If the Jersey Scheme or the Guernsey Scheme is not sanctioned by the relevant court then the corresponding policies that would have been transferred will continue to be reinsured from PAC to Rothesay until such time as the scheme (amended as appropriate) is sanctioned. Implementation of the Scheme is not contingent on the sanction of either the Jersey Scheme or the Guernsey Scheme.

TRANSFERRING ASSETS AND LIABILITIES

7.5 The Laker Reinsured Business consists of certain non-profit annuities; these are primarily annuities of the PAC NPSF, although a small number of policy benefits that were originally allocated to the PAC WPSF are in the scope of the transfer, as described in paragraph 7.9. It has been notionally divided into four separate categories, as described in Table 7.1.

[21] On completion of the transfer, the Laker Reinsurance Agreement will be modified to cover only the Non-transferring Reinsured Policies and Excluded Policies, as described in paragraph 7.16 and 7.17.

Table 7.1: Breakdown of Laker Reinsured Business as at 30 June 2018

Category	Number of annuity benefits	Number of policies	Longevity reinsurance agreement in place?	Gross Solvency II BEL at 30 June 2018 (£ million)
1. Retail annuities arising from PAC's and SAL's pension business	131,462	130,809	No	3,332
2. Retail annuities primarily written before 2008 by PRIL and annuities arising from PAC's pension business.	105,990	103,569	Yes	3,005
3. Retail annuities primarily written in or after 2008 by PRIL and annuities arising from PAC's and SAL's pension business	118,035	115,956	Yes	3,215
4. Bulk annuities in payment (approximately 75% of the total number of annuity benefits) and in deferment from a range of defined benefit pension schemes written by PAC via buy-in and buy-out transactions	76,645	50,627	Yes	3,386
Total	**432,132**	**400,961**	**N/A**	**12,940**

Note: Each annuity policy can have multiple benefits and therefore the number of annuity benefits is greater than the number of policies

7.6 As discussed in paragraph 6.12, PAC reinsured the Laker Reinsured Business to Rothesay under the Laker Reinsurance Agreement. Rothesay's obligations under the Laker Reinsurance Agreement are collateralised, with the assets providing collateral being held in custody accounts. On completion of the transfer, the Laker Reinsurance Agreement will be modified to cover only the Non-transferring Reinsured Polices[22] (which are not in scope of the Scheme) and any Excluded Policies. It is envisaged that this modified version of the Laker Reinsurance Agreement will remain permanent after the Transfer Date, except in the case of any Excluded Policies that are transferred to Rothesay after the Transfer Date. At the same time the balance of the custody accounts will be released from the security arrangements, with the exception of the collateral assets required to facilitate the continuing reinsurance of the Non-transferring Reinsured Policies.

7.7 The Transferring Business will be the policies that are covered by the Laker Reinsurance Agreement immediately prior to the Transfer Date, other than Excluded Policies and Non-transferring Reinsured Polices (discussed in paragraphs 7.14 and 7.17 respectively).

7.8 Policies have been added to, or removed from, the originally agreed Laker Reinsured Business in order that the Transferring Business satisfies the following conditions:

- Policy integrity (member level): The Transferring Business must contain only whole annuity policies. In cases where one policy has multiple individual benefits, the individual benefits must all be included within the Transferring Business for it to be eligible to be transferred.
- Policy integrity (scheme level): For scheme business where multiple annuities have been issued under a single scheme policy, all of the annuities must be included within the Transferring Business for that policy to be eligible to be transferred. This includes any deferred annuities or unvested pensions covered by that policy.
- Longevity reinsurance integrity: The Transferring Business must contain all of the benefits within the scope of each of the selected longevity reinsurance contracts, and no benefits within the scope of any other longevity reinsurance contracts. This requirement created a conflict with the need for member level policy integrity described above, as certain annuity policies contain benefits covered by multiple longevity reinsurance contracts. As a result, amendments

[22] Policies that are in the scope of the Laker Reinsurance Agreement but are not in scope of the Scheme. These are described in more detail in paragraphs 7.17 and 7.18.

have been made to the scope of some longevity reinsurance contracts to ensure that all of these requirements can be met.

- Guaranteed payments: Policies that comprise only guarantees in payment (i.e. annuities certain), where those benefits are not within the scope of one of the longevity reinsurance contracts, have been excluded from the Transferring Business.
- Deaths and suspensions: Policies that terminated as a result of death prior to the date of risk transfer under the Laker Reinsurance Agreement[23] will be excluded from the Transferring Business. Where these policies were to be within the scope of one of the longevity reinsurance contracts, then those policies will be excluded from that longevity reinsurance contract, in line with the relevant contractual arrangements, prior to the proposed transfer. Suspended policies[24] not covered by one of the longevity reinsurance contracts have been removed from the business in the scope of the Laker Reinsurance Agreement and will not be transferred. Suspended policies covered by one of the longevity reinsurance contracts will remain in the scope of both the Laker Reinsurance Agreement and the Scheme.

7.9 Initially, all business selected was shareholder-backed annuity business; this includes benefits from non-profit annuities allocated to the PAC WPSF, the economic interest in which has been transferred to the PAC NPSF through an inter-fund reinsurance arrangement. However, to ensure annuity policy integrity, a small number of benefits[25] of non-profit annuities that were originally allocated to the PAC WPSF have been reallocated to the PAC NPSF and included in the Transferring Business as part of the modifications described in paragraph 7.8.

7.10 For the avoidance of doubt, the information in Table 7.1 reflects the scope of the Laker Reinsurance Agreement at 30 June 2018, but allowing for the modifications to that scope described in paragraph 7.8.

7.11 No investments will be transferred to Rothesay on the Transfer Date; the assets which back the liabilities in relation to the Transferring Business have in large part been funded by the reinsurance premium paid by PAC under the Laker Reinsurance Agreement.

7.12 The number of policies to be transferred (as at 30 June 2018) is 368,544; this is lower than the 400,961 policies shown in Table 7.1, which includes 32,417 policies that are in the Laker Reinsured Business but that will not be in the scope of the transfer (as described in paragraphs 7.17 to 7.19). The 368,544 transferring policies constitute approximately £11.7 billion of PAC's Solvency II BEL (as at 30 June 2018).

7.13 The Scheme also contains provisions to allow for the possibility that, for technical reasons, some liabilities and assets will need to be transferred after the Transfer Date. These provisions are included within the Scheme as a safeguard, but no such transfer of assets or liabilities is currently envisaged. I am satisfied that any such delays in completing the proposed transfer will not adversely affect policyholders' interests.

EXCLUDED POLICIES

7.14 There is a provision in the Scheme for "**Excluded Policies**". These are policies that are included in the Transferring Business but that are not capable of being transferred at the Transfer Date. Currently, PAC and Rothesay do not anticipate that there will be any Excluded Policies.

7.15 As noted in paragraph 7.4, if the Jersey Scheme or the Guernsey Scheme has not been sanctioned by the relevant court when the Scheme is implemented then the relevant Jersey or Guernsey policies will also be Excluded Policies and will remain reinsured to Rothesay until such time as the applicable Scheme is sanctioned and becomes effective.

7.16 Excluded Policies (if any) will remain subject to a modified version of the Laker Reinsurance Agreement (with effect from the Transfer Date), under which the liabilities of the Excluded Policies will remain reinsured from PAC to Rothesay on a long-term basis.

NON-TRANSFERRING REINSURED POLICIES

7.17 Following entry into the Business Transfer Agreement, the two parties have agreed that a group of policies currently within the Laker Reinsured Business should not transfer as part of the Transferring Business (the "**Non-transferring Reinsured Policies**") and therefore will not form part of the Transferring Policies in-scope to be transferred under the Scheme. Instead,

[23] 1 April 2018 for deferred annuities and 1 July 2018 for annuities in-payment.

[24] Suspended policies are those where annuity payments to the policyholder are paused as the insurer has reason to believe that the policyholder may have died.

[25] 181 annuity policies were transferred from the PAC WPSF to PACF NPSF. This corresponds to £740,000 in annual annuity payments.

these Non-transferring Reinsured Policies will remain reinsured from PAC to Rothesay on a long term basis under a modified version of the Laker Reinsurance Agreement (with such amendments as the parties may agree).

7.18 The Non-transferring Reinsured Policies relate primarily to the following lines of business:

- All deferred annuities within the scope of the Laker Reinsurance Agreement, with the exception of 10 deferred annuity policies. These deferred annuities all arise from one transferring pension scheme which is subject to a buy-in with PAC and which consists mainly of in-payment annuities. In order to facilitate the transfer of this pension scheme, the 10 deferred annuities will form part of the Transferring Policies.
- Annuities arising from Teachers' and NHS additional voluntary contributions ("**AVC**") contracts: For these policies, scheme members benefit from guarantees from the relevant Secretary of State that their pension payments would be protected in the event of default by PAC. This guarantee is expected to be lost in the event of the annuity policy being transferred away from PAC. To avoid this, these policies are excluded from the Transferring Business.
- Annuities arising from Master Trust schemes: There are approximately 600 annuity benefits that arise from a Master Trust scheme for which Prudential Corporate Pensions Trustee Limited acts as the trustee and that are also covered by existing longevity reinsurance contracts (described in paragraph 7.20). These policies have been excluded from the Transferring Business because of the complexity in transferring the business, which is deemed to be disproportionate for the number of policies it would affect.
- Annuities arising from defined benefit and money purchase schemes that have trustees who actively manage the scheme: Some of the benefits of these schemes are covered by the longevity reinsurance contracts that will be transferred to Rothesay as part of the Scheme (described in paragraph 7.20). Consequently, it is not possible to remove the benefits of these schemes from the business that Rothesay has purchased (as this would necessitate a change to the affected longevity reinsurance contracts) but the benefits of these schemes cannot be transferred to Rothesay as the trustees are still actively managing the schemes.

7.19 PAC and Rothesay have informed me that the Non-transferring Reinsured Policies described in paragraphs 7.17 and 7.18 are expected to account for approximately 10% (measured by PAC's Solvency II BEL) of the total business in the scope of the Laker Reinsurance Agreement and 32,417 policies.

REINSURANCE

7.20 The outwards longevity reinsurance arrangements that PAC has in place covering the Transferring Business will be transferred to Rothesay under the Scheme. These are shown in Table 7.2, along with the relevant exposure[26]:

Table 7.2 – Outwards reinsurance arrangements applicable to the Transferring Business as at 30 June 2018[27]

Reinsurer	Approximate exposure (£ billion)
Pacific Life Re Limited	1.4
Pacific Life Re Limited	1.5
SCOR Global Life SE – UK Branch	1.1
Swiss Re Europe SA – UK Branch	0.7
Prudential Retirement Insurance and Annuity Company[28]	0.5
SCOR Global Life SE – UK Branch	0.7
SCOR Global Life SE – UK Branch	1.3
Total	**7.2**

7.21 PAC's other external reinsurance arrangements, relating to non-transferring PAC policies, will remain with PAC after the Scheme has been implemented.

[26] "Exposure" refers to the amount of BEL, gross of reinsurance, covered by the longevity reinsurance

[27] Each line represents a different reinsurance treaty and therefore some reinsurers are included multiple times.

[28] Prudential Retirement Insurance and Annuity Company is part of the Prudential Financial group, which is separate from Prudential plc

THEMATIC REVIEW OF ANNUITY SALES PRACTICES LIABILITIES

7.22 In October 2016, the FCA announced the findings of TRASP, which assessed whether firms provided new annuity customers with sufficient information about enhanced annuities at the point of sale. As a result of TRASP, a small number of firms, including PAC, were asked by the FCA to review all non-advised sales from July 2008 and provide redress where appropriate.

7.23 Consequently, PAC is conducting a Past Business Review ("**TRASP PBR**") in relation to the sale of certain annuities. Depending on the outcome of this review, this may result in PAC making lump sum compensation payments ("**TRASP Lump Sums**") and/or augmenting existing annuity payments ("**TRASP Incremental Liabilities**") to certain policies.

7.24 PAC will remain responsible for the TRASP PBR in respect of the Transferring Business after implementation of the Scheme, but Rothesay will be involved in administering the payments to policyholders for TRASP Incremental Liabilities. The relevant arrangements are set out in the Business Transfer Agreement and the Supplemental Agreement. They vary depending on whether the TRASP PBR identifies an affected policy before or after the Transfer Date:

- Prior to the Transfer Date: On reviewing an in-scope policy, PAC will pay any TRASP Lump Sums that are required and if a TRASP Incremental Liability is required this will be set up and paid by PAC initially. In the period leading up to the Transfer Date, PAC will advise Rothesay of any TRASP Incremental Liabilities that need to be included within the Transferring Business and within the scope of the Laker Reinsurance Agreement. PAC will then pay Rothesay an additional premium (determined following an underwriting process) to secure these additional benefits.
- After the Transfer Date: PAC will continue with its TRASP PBR if it is not complete by the Transfer Date. If any policies that form part of the Transferring Business need to be reviewed, then PAC will conduct this review in the normal manner. However, to the extent that PAC no longer provides administration services (as described in paragraphs 7.32 to 7.34), Rothesay will need to be involved. If a policy requires a TRASP Lump Sum to be paid, this will be paid by PAC, although PAC may ask Rothesay to pass the payment on to the annuity policyholder as PAC's paying agent. Where a requirement arises for a TRASP Incremental Liability to be paid, PAC will notify Rothesay and Rothesay will set up and pay the TRASP Incremental Liability (following the payment of an interim premium from PAC to Rothesay). PAC and Rothesay will then agree a final premium (following an underwriting process), and a corresponding true-up payment will be made between PAC and Rothesay.

7.25 The way in which TRASP Incremental Liability premiums will be determined has not yet been agreed, but the Business Transfer Agreement and the Supplemental Agreement include details of the process by which this will be agreed.

MIS-SELLING LIABILITIES

7.26 Liabilities from the TRASP PBR are retained by PAC (other than any TRASP Incremental Liabilities that have been reinsured by Rothesay as at the Transfer Date) and are excluded liabilities under the Scheme.

7.27 In addition to the liabilities arising from TRASP PBR described above, PAC will also retain the following liabilities that relate to mis-selling of the Transferring Business:

- Any penalties or fines, including associated costs and expenses, arising from or in connection with any investigation or disciplinary action undertaken by any regulator;
- Any mis-selling liabilities in relation to policies in Category 1, 2 or 3 of the Transferring Business crystallising (or of which Rothesay has given notice to PAC) prior to the earlier of the 7th anniversary of the Transfer Date or 31 December 2026; and
- Any mis-selling liabilities in relation to policies in Category 4 of the Transferring Business crystallising (or of which Rothesay has given notice to PAC) prior to the earlier of the Transfer Date or 31 December 2019[29].

Categories 1, 2, 3 and 4 are defined in Table 7.1 above (which also includes summary statistics for each category before excluding the Non-Transferring Reinsured Policies).

7.28 Under the terms of the Business Transfer Agreement, residual mis-selling liabilities in respect of the Transferring Business which crystallise after the relevant date will be transferred to Rothesay (on either 31 December 2019 or 31 December 2026

[29] Category 4 exclusively contains non-retail bulk annuity business, unlike Category 1, 2 and 3 which are comprised exclusively of retail business. It has been agreed that the mis-selling liabilities in relation to policies in Category 4 will be transferred to Rothesay at an earlier date than those for the other three Categories; Rothesay considers that non-retail business has a smaller risk of mis-selling than the retail business that comprises Categories 1, 2 and 3.

depending on the Category), unless Rothesay has notified PAC before such date of the matters or circumstances leading to the relevant mis-selling liability.

EXCLUDED LIABILITIES

7.29 In addition, under the Scheme, excluded liabilities will remain with PAC. Excluded liabilities relating to the Transferring Business are defined in the Scheme to include:

- any and all excluded mis-selling liabilities (as described in paragraph 7.27 and 7.28);
- any and all losses arising in connection with a historical administration error of the Transferring Business, made prior to the Transfer Date, which is notified by Rothesay to PAC prior to an agreed date in accordance with the Laker Reinsurance Agreement;
- any and all losses arising from precursor policies[30] in Categories 1, 2 and 3;
- any and all losses arising from precursor policies in Category 4 other than any immediate and deferred annuities that were purchased by a trustee of a defined benefit scheme;
- any and all losses arising from acts or omissions by PAC or any member of the Prudential group before the Transfer Date which are identified within a period of 12 months of the Transfer Date;
- any and all liabilities of PAC under or arising from the Scheme;
- any and all losses arising from fraud by PAC or any member of the Prudential group;
- any losses of PAC in respect of taxation or any taxation arising related to the Transferring Policies that occurs on or prior to the Transfer Date;
- liabilities of PAC under or relating to any third party administration arrangements;
- any liabilities under or relating to Excluded Policies (as described in paragraph 7.16 Rothesay will be liable to PAC in respect of the reinsurance of these policies to Rothesay under a modified version of the Laker Reinsurance Agreement); and
- liabilities under the longevity reinsurance agreements which relate to an act of omission of PAC or breach of the agreements that have accrued or arise in respect of the period prior to the Transfer Date, unless such liabilities crystallise after the earlier of the 7th anniversary of the Transfer Date or 31 December 2026 (including where Rothesay has given notice to PAC prior to such date).

METHOD OF SELECTING TRANSFERRING POLICIES

7.30 The business that PAC elected to reinsure to Rothesay under the Laker Reinsurance Agreement was chosen in order to achieve a target level of capital release to support the proposed demerger of M&G Prudential. The selection criteria for each category are described below; in each case the target category size was £3 billion of Technical Provisions:

- Category 1 was designed to comprise retail, non-reinsured non-profit in-payment annuity business. Policies were selected by taking the largest “Scheme ID” categories that were suitable to be transferred, in order, until the required volume of business had been achieved.
- Category 2 was designed to comprise retail, non-profit in-payment annuity business covered by longevity reinsurance contracts. A selection of longevity reinsurances was identified from those covering business written before 2008 that most closely achieved the target category size.
- Category 3 was designed to comprise retail, non-profit in-payment annuity business, covered by longevity reinsurance contracts. A selection of longevity reinsurances was identified from those covering business written in or after 2008 that most closely achieved the target category size.
- Category 4 was designed to comprise bulk, non-profit annuities in payment and in deferment. All shareholder-backed annuity policies written before 2009 were included (with deferred annuities only included if they were administered on a specific administration system). There were also a small number of policies which were included despite being written

[30] Precursor policies are those that paid (wholly or partially) the premium of a transferring policy.

after 2009. In these cases, the policies were part of pre-2009 pension schemes. In addition some policies were excluded where there were specific circumstances that were considered likely to make it difficult to transfer the scheme.

7.31 In order to finalise the selection of transferring policyholders under the Scheme, a number of modifications have been made relative to the categories described above, to ensure that the composition of the Transferring Business meets the commercial requirements agreed between PAC and Rothesay. In addition modifications, as described in paragraph 7.8, have been made to ensure that the Transferring Business can legally and effectively be transferred by means of the Part VII transfer. This may mean the policies in each category may deviate from the selection criteria above.

ADMINISTRATION

7.32 Since 1 October 2018, PAC has outsourced policy administration for the Transferring Business to TCS/Diligenta.

7.33 In order to minimise impact on the policyholders of the Transferring Business and to avoid jeopardising the proposed transfer timelines, PAC will, subject to agreement between PAC and Rothesay of a Transitional Services Agreement, continue to provide administration services (provided by TCS/Diligenta on its behalf) to Rothesay for a period after the Transfer Date. PAC does not expect this to place any additional contractual restrictions on PAC in relation to its outsourcing arrangements for the non-transferring policies.

7.34 The Transitional Services Agreement is expected to be in place for a period of 12 to 24 months after the Transfer Date. During that period, Rothesay will determine the most appropriate arrangements for administration of the Transferring Business in the long term. This is expected to involve either:

- leaving the outsourced administration in place at TCS/Diligenta, but subject to a direct contractual arrangement with Rothesay and Rothesay's governance arrangements, or
- transferring the administration to another administrator of Rothesay's choice.

7.35 PAC will retain responsibility for the administration of the Non-transferring Reinsured Polices and any Excluded Policies after the Transfer Date.

COSTS OF THE SCHEME

7.36 Policyholders will not bear any of the costs associated with the proposed transfer. My Independent Expert fees, the Court fees and Counsel's fees will be shared equally between PAC and Rothesay, as will the costs of any advertisements in respect of the Scheme.

7.37 PAC and Rothesay will each bear the cost of notifying their own policyholders of the Scheme. All other costs associated with the proposed transfer will be borne by the party that incurs them.

8. The effect of the implementation of the Scheme on the Transferring Policies of PAC

INTRODUCTION

8.1 In this section I consider the effect of the implementation of the Scheme on the Transferring Policies of PAC.

8.2 As described in Section 6, the Transferring Business comprises non-profit annuities with a Solvency II BEL of approximately £11.7 billion[31] (as at 30 June 2018). This business is currently reinsured to Rothesay under the Laker Reinsurance Agreement. The Transferring Business does not include the Non-transferring Reinsured Policies or any Excluded Policies (as described in paragraph 7.14 and 7.17). As a result of the implementation of the Scheme, the Transferring Policies will transfer into and become direct policies of Rothesay, and Rothesay will be responsible for meeting the benefits payable under those policies. Transferring PAC policyholders will be transferred from a very large, long established company with a familiar brand name to a smaller, less well-known company founded only twelve years ago. However, the security of policyholders' benefits and their reasonable benefit expectations depend primarily on factors other than the size and age of the company. In particular, the key points to consider are:

- The financial resources available to provide security for the benefits of the Transferring Policies after the implementation of the Scheme compared to those currently available;
- Any change to the profile of risks to which the Transferring Policies will be exposed as a result of the implementation of the Scheme; and
- The effect of the implementation of the Scheme on the reasonable expectations of the transferring PAC policyholders, including benefit expectations, service standards, management and governance that these policyholders should expect for their policies after the implementation of the Scheme.

These are considered in turn below.

8.3 As part of my considerations around the impact of the Scheme on holders of Transferring Policies, I have considered the impact of the Scheme on the TRASP PBR being conducted by PAC (described in paragraphs 7.22 to 7.25) and on holders of policies that may be eligible to receive TRASP Lump Sums or benefit augmentations (as a result of TRASP Incremental Liabilities). My conclusions on this are set out in paragraph 8.80.

THE FINANCIAL RESOURCES AVAILABLE TO PROVIDE SECURITY OF BENEFITS

8.4 The Transferring Policies are currently reinsured to Rothesay. However, PAC remains responsible for paying the benefits due to policyholders, and is paid an appropriate amount from Rothesay under the Laker Reinsurance Agreement. Should Rothesay be unable to fulfil its obligations under the Laker Reinsurance Agreement, PAC would still be responsible for continuing to pay the benefits (and PAC therefore holds capital in respect of the risk that Rothesay is unable to meet its obligations under the Laker Reinsurance Agreement). Therefore the Transferring Policies currently rely on the available resources of PAC for the security of their guaranteed benefits. Those resources comprise:

- Assets backing the liabilities and capital requirements of the PAC shareholder-backed business; and
- Excess capital resources in the PAC SHF.

Excess capital resources in the PAC with-profits fund also contribute to the security of Transferring Policies to a limited extent but, as noted in paragraph 5.35, they would only become available to support liabilities in respect of those policies in an extreme scenario, for example in the event of PAC's insolvency.

8.5 The ability of Rothesay to fulfil its obligations under the Laker Reinsurance Agreement will affect the financial strength of PAC and therefore security for the benefits of the Transferring Policies will also be provided indirectly by the assets of Rothesay. In particular, the Laker Reinsurance Agreement is fully collateralised with assets that must meet certain eligibility criteria and rules which apply to the management of the collateral held in the custody accounts. If Rothesay was unable to meet its obligations under the treaty then PAC would have recourse to the collateralised assets. This contributes to the financial strength of PAC and therefore to the security of the benefits of the Transferring Policies.

[31] This figure excludes Non-transferring Reinsured Policies (as described in paragraph 7.17), and it is calculated using PAC's methodology and assumptions i.e. using discount rates equal to EIOPA's published risk-free rates that are not increased to allow for a Matching Adjustment (see footnote 17).

8.6 If the Scheme is implemented, the Laker Reinsurance Agreement will cease to apply in respect of the Transferring Policies, all related collateralisation and security features between PAC and Rothesay will fall away and the collateralised assets will revert to Rothesay. The responsibility to pay benefits of the Transferring Policies will then be with Rothesay, regardless of any onwards reinsurance of those benefits. Holders of Transferring Policies will no longer have any recourse to PAC after the transfer.

8.7 When considering the financial effect of the Scheme, the pre-Scheme balance sheets for PAC and Rothesay will include the impact of the Laker Reinsurance Agreement, under which the majority of the economic risks and rewards of the Transferring Policies have already been transferred to Rothesay.

The financial strength required under Solvency II

8.8 Under Solvency II the assets required to be held in respect of a policy or group of policies are represented by the Technical Provisions (consisting of the BEL and risk margin) and the SCR[32]. This amount is then typically increased in accordance with the firm's capital policy in order to ensure that a buffer is held over and above the minimum amount required by the Solvency II regulations. In comparing financial strength it is therefore necessary to consider:

- How the Technical Provisions and SCR are calculated by the two firms;
- The level of assets held by each firm in excess of the Technical Provisions and SCR; and
- Each firm's capital policy.

8.9 As would be expected, there are some differences in the ways that PAC and Rothesay calculate their Solvency II Technical Provisions and SCR. For the calculation of the Technical Provisions, PAC has gained approval from the PRA for the use of the matching adjustment (see paragraph 4.18) for some of its shareholder-owned immediate annuity business[33] and the volatility adjustment (see paragraph 4.20) in relation to the business of PHKL, while Rothesay has gained approval for the use of the matching adjustment for its business.

8.10 In addition, both PAC and Rothesay have approval to include the TMTP (see paragraph 4.22). The implementation of the Scheme is not expected to lead to a recalculation of the TMTP of either company as the financial positions of the firms already reflect that the risk and benefits in respect of the Transferring Business have already effectively been transferred to Rothesay. The TMTP is running off over the period from 1 January 2016 to 31 December 2031, and so the benefit of this adjustment to Rothesay's solvency position, which is currently substantial, will gradually reduce. However, I note that:

- PAC's solvency position also benefits from the use of the TMTP; and
- I have reviewed projections showing the effect of the TMTP run-off on Rothesay's solvency position; they demonstrate that the future run-off of the TMTP is expected to be more than offset by the emergence of future surplus on the business that is subject to the TMTP.

8.11 For the calculation of the SCR, PAC has approval from the PRA to use its internal model. For its SCR at 30 June 2018, Rothesay used the Solvency II Standard Formula, with a capital add-on.

8.12 Under the Solvency II regulations, an internal model has to be calibrated such that the SCR provides a probability of at least 99.5% of remaining able to cover Technical Provisions over a one year time horizon, and the calibration of the Standard Formula stresses targets the same confidence level. A capital add-on in excess of the requirements of the Standard Formula is included within Rothesay's SCR in order to reflect some risks not adequately covered by the Standard Formula. The size of this capital add-on has been subject to review and approval by the PRA. As noted in paragraph 4.60, PRA approval was received in December 2018 for the use of a PIM (under which capital requirements for some risks will be determined using Rothesay's own internal model and capital requirements for other risks will be determining using the Standard Formula approach); this will reflect Rothesay's own view of the appropriate capital to hold against some of the risks relating to its business.

8.13 Although the approaches to calculating Technical Provisions and the SCR differ in some respects between PAC and Rothesay, both approaches are in line with the Solvency II regulations and in both cases the SCR is intended to be sufficient to cover any losses which might arise over a one year period with a probability of 99.5%.

8.14 Taking this into account, I am satisfied that any differences in the Solvency II approvals between PAC and Rothesay will not have a material adverse impact on the security of benefits of the Transferring Policies.

[32] A description of the relevant aspects of the Solvency II regime is included in Section 4.

[33] Since the inception of the Laker Reinsurance Agreement, the business reinsured to Rothesay under that Agreement is no longer included in the business of PAC to which the matching adjustment applies.

The PAC and Rothesay capital policies and risk appetite statements

8.15 The capital policy of an insurer sets out the level of capital that a company aims to hold, how it manages its business to that target and the actions it would expect to take if its capital resources were out of line with that target. Target capital is typically expressed in terms of regulatory capital requirements. The regulatory capital requirements may target a specified probability of remaining solvent over a certain time horizon: for example, for Solvency II it is a 99.5% probability of remaining able to meet Technical Provisions over one year. By committing additional capital to be held on top of the regulatory requirements, the capital policy increases the probability of remaining solvent over a particular timeframe and therefore increases the security of the benefits of business that is subject to the capital policy.

8.16 Capital policies also typically provide triggers for actions by management aimed at reducing the likelihood of a breach of regulatory capital requirements and subsequent regulatory intervention.

8.17 When considering the financial resources available to provide the security of policy benefits, greater reliance can be placed upon assets held up to the level required by the capital policy than on assets in excess of this level, since assets in the latter category are potentially available for distribution to shareholders (subject to the relevant PRA rules) or for investment in other business ventures. Therefore, the relative strength of the capital policies of PAC and Rothesay is relevant in considering the security of benefits of the Transferring Business.

8.18 Currently the security of the benefits under the Transferring Policies is provided by the assets of PAC (including the value of amounts recoverable from Rothesay through the operation of the Laker Reinsurance Agreement) held in accordance with the PAC SRA Framework as described in Section 5. Following the implementation of the Scheme, the Transferring Business will be transferred into Rothesay and security for the benefits of the Transferring Policies will subsequently be provided by the assets of Rothesay held in accordance with the Rothesay capital policy as described in Section 6.

8.19 PAC and Rothesay have both informed me that they do not expect make any changes to their risk appetite or capital policies as a result of the proposed transfer.

The relative strengths of the capital policies

8.20 PAC's SRA Framework outlines a series of threshold levels for its SCR coverage ratio (the "**solvency intervention ladder**"), each with associated actions aimed at protecting the company's solvency, with the actions becoming more severe as the coverage ratio reduces. As noted in paragraphs 5.41 and 5.45, the thresholds are reviewed regularly and are confidential.

8.21 Rothesay's capital policy on a Solvency II basis targets an SCR coverage ratio in the range 130% to 150%. Should the coverage ratio fall below 130%, Rothesay would consider a number of actions to restore the solvency position.

8.22 Although PAC appears to target a slightly higher SCR coverage ratio than Rothesay, a direct comparison is not possible given that PAC and Rothesay use different approaches to calculating their SCR (as discussed in paragraphs 8.11 to 8.13). Moreover, it is not possible to draw firm conclusions based solely on a comparison of the ranges; it is also necessary to compare the likely volatility of the SCR coverage in each company as conditions change.

8.23 Based solely on current risk levels, I consider that PAC's SRA Framework provides a slightly higher level of security for policyholder benefits than Rothesay's capital policy. However, Rothesay's practice is to vary the level of risk in its business according to the SCR cover ratio, accepting more risk when the ratio is high and reducing risk when it is lower. Allowing for this, I consider the two risk appetite frameworks to be broadly comparable in the level of protection they provide.

8.24 I am satisfied that Rothesay's capital policy will provide a high level of security for the benefits of transferring policyholders.

The required response of management to a breach of the capital policies and risk appetite

8.25 In addition to considering the actual level of capital intended to be held under the relevant capital policies, I also consider what the required management response would be to any breach.

8.26 Both PAC's SRA Framework and Rothesay's capital policy outline a range of mandatory and possible actions in response to a breach of their respective risk appetite/capital policy buffers. However, the actions available to PAC and Rothesay to improve their solvency positions in the event of a breach of their target capital range may be different. In particular, the extent to which reinsurance and other risk-mitigating transactions may be used to improve solvency will depend upon the nature of the risks in the relevant company, the availability of counterparties willing to enter into such transactions to mitigate those risks in the circumstances then prevailing, and the extent to which the company has already mitigated its risk exposures. In particular, I note that Rothesay has already reinsured a significant proportion of its longevity risk, and therefore the scope for additional reinsurance transactions in the event of a capital policy breach may be limited.

8.27 In addition, PAC is currently part of a large listed insurance group with significant financial resources that may be available to support PAC if its solvency was threatened. By contrast, whilst Rothesay is part of a group of companies, its parent is not listed and the level of financial resources within the group outside of Rothesay is relatively low. However, I note that:

- In an adverse scenario that threatened PAC's solvency, the financial resources of Prudential plc available to support PAC may be similarly constrained; and
- As described in paragraph 5.26, it is currently planned that Prudential plc will demerge its UK and European operations from its operations elsewhere, and if the demerger goes ahead as planned, it is likely that PAC will no longer benefit from parental support to the same degree as is currently the case.

8.28 Additionally, Rothesay and its parent are able to undertake capital-raising activities (as is Prudential plc, and as will M&G Prudential be after the demerger), and have done so in the past. There may therefore be external sources of capital available to Rothesay in the event of an adverse solvency scenario.

8.29 Taking these factors into account, I am satisfied that both firms have an adequate range of actions at their disposal to mitigate a scenario in which their solvency position starts to deteriorate, and therefore there is no material adverse impact on the security of benefits of the transferring policyholders arising from any change in the range of available actions in such circumstances.

Governance surrounding the capital policies and risk appetite

8.30 PAC's target capital buffers are recalculated on a half-yearly basis. PAC's SRA Framework and limits are approved by the PAC Board.

8.31 The Rothesay capital policy and associated limits are approved by the Rothesay Board; the policy is reviewed at least on an annual basis. The Scheme is expected to have no impact on Rothesay's capital policy, although the capital policy will remain under regular review by the Rothesay Board to ensure that it remains appropriate.

8.32 In theory, the PAC and Rothesay Boards are free to make changes to their respective capital policies at any time, including making them weaker in terms of the level of solvency coverage ratio that is targeted. However, in practice, I would expect the PRA to be notified in advance by each firm of any material planned changes to its capital policy. Furthermore, I consider it unlikely that PAC or Rothesay would be willing to countenance any material changes to their respective capital policies if those changes did not meet with the non-objection of the PRA.

8.33 Taking this into account, I am satisfied that appropriate safeguards are in place in Rothesay to ensure that there is no material impact on the security of benefits of the Transferring Policies arising from the change in governance applicable to the capital policy applicable to the Transferring Business.

Quality of Own Funds

8.34 As at 30 June 2018, 100% of PAC's Own Funds were Tier 1 capital. 84% of Rothesay's Own Funds were Tier 1 and 16% were Tier 2. Rothesay's Tier 2 Own Funds are all provided through the issue of subordinated debt instruments. The repayment of these creditors ranks below policyholder liabilities in the event of insolvency and therefore, from a policyholder security perspective, the debt could not, in this scenario, be repaid before all policyholder liabilities had been met.

8.35 Furthermore, under the rules of Solvency II, a company must cover at least 50% of its SCR with Tier 1 capital. As at 30 June 2018, 162% of PAC's SCR was covered by Tier 1 Capital[34] and 149% of Rothesay's SCR was covered by Tier 1 capital[35]; therefore both companies were significantly in excess of the minimum regulatory requirements.

8.36 Taking this into account, I am satisfied that the differences in the composition of the Own Funds of PAC and Rothesay set out above will not have a material adverse impact on the security of benefits of the Transferring Policies.

The security provided by the custody accounts

8.37 As described above, as part of the Laker Reinsurance Agreement, custody accounts were established to hold the assets posted as collateral in relation to this arrangement. These accounts are intended to provide security to PAC by allowing PAC to take control of the assets in the custody accounts in the event that Rothesay fails to honour its obligations under the Laker Reinsurance Agreement.

8.38 In this scenario, the transferring policyholders would not have any preferential claim on any of these assets; they would be available to support all of PAC's business.

8.39 Following the implementation of the Scheme, the security arrangements over the assets will be released, with the exception of the security arrangements required to facilitate the continuing reinsurance of the Non-transferring Reinsured Policies as

[34] This figure is based on PAC's financial position as at 30 June 2018 and therefore does not reflect the subsequent impact of the transfer of ownership of PAC's Hong Kong subsidiaries.

[35] As noted in paragraph 6.41, Rothesay has issued £350 million of Restricted Tier 1 subordinated notes since 30 June 2018.

modified by the amended version of the Laker Reinsurance Agreement. The Transferring Policies, as direct policies of Rothesay, will have security provided by the assets in Rothesay, including those currently held in the custody accounts which will be released to Rothesay after implementation of the Scheme. The eligibility criteria and rules for the management of the collateral under the Laker Reinsurance Agreement (and related security deeds) will also fall away except for assets required to support the continued reinsurance of Non-transferring Reinsured Policies.

8.40 The custody accounts currently play an important part in reducing PAC's counterparty exposure to Rothesay; if Rothesay were to become insolvent, PAC would rank behind directly written policies in terms of creditor priority upon wind-up. The purpose of the custody accounts is to ensure that assets of Rothesay would be available to meet the liabilities of the Laker Reinsured Business if Rothesay were to become insolvent. However, after the proposed transfer, the Transferring Policies will be direct policies of Rothesay and therefore will rank equally with Rothesay's other policies. As described in paragraph 8.39 above, custody assets will continue to be required to support the security arrangements for the continued reinsurance of Non-transferring Reinsured Policies, but the amount of such assets will be greatly reduced

8.41 Taking this into account, I am satisfied that the release of the custody assets and the associated changes to the custody arrangements will not have a material effect on the security of benefits for the Transferring Policies.

The financial resources available to provide security for benefits

8.42 Table 8.1 below shows the pre-Scheme financial strength of the shareholder-backed business of PAC[36] and the pro forma post-Scheme financial strength of Rothesay as at 30 June 2018 on the Solvency II Pillar 1 basis.

Table 8.1: Comparison of regulatory solvency positions of the PAC shareholder-backed business (pre-Scheme) and Rothesay (post-Scheme) at 30 June 2018

Solvency position as at 30 June 2018		
£m	PAC shareholder-backed business, pre-Scheme	Rothesay post-Scheme
Total Assets (net of other items)	72,544	36,315
Technical Provisions (including TMTP)	57,637	32,157
Own Funds (A)	**14,907**	**4,158**
SCR (B)	7,215	2,351
Excess Capital (=A-B)	7,692	1,807
SCR coverage ratio (A/B)	***207%***	***177%***

8.43 Table 8.1 shows that, on the Solvency II Pillar 1 basis, if the Scheme had been implemented on 30 June 2018, the capital resources of Rothesay would have covered its SCR with a ratio of 177%.

8.44 Although this represents a material reduction in the SCR coverage ratio from the PAC pre-Scheme position of 207% at 30 June 2018, it is important to recognise that:

- As discussed in paragraphs 8.11 to 8.13, PAC's and Rothesay's approaches to calculating their respective SCRs are not directly comparable as PAC uses an internal model whereas for its SCR at 30 June 2018 Rothesay used the Standard Formula with a capital add-on. Therefore their SCR coverage ratios are not necessarily directly comparable;
- As described in paragraph 5.35, PAC's consolidated SCR coverage ratio is 162%, which is below Rothesay's post-Scheme SCR coverage ratio;
- Post-Scheme, Rothesay's SCR coverage ratio would be significantly in excess of its target range of 130% to 150%; and
- PAC's current level of SCR coverage is in excess of its target range. PAC's SRA Framework states that PAC's Board will decide whether to return surplus capital above the internal capital target to shareholders as a dividend.

8.45 In addition, as discussed in paragraphs 5.36 and 5.37, the SCR coverage ratio of PAC's shareholder-backed business decreased as a result of the transfer of the legal ownership of PAC's Hong Kong subsidiaries to PCA on 14 December 2018.

[36] For the reasons described in paragraph 5.35.

Table 8.2 compares the regulatory solvency positions of the PAC shareholder-backed business (pre-Scheme) and Rothesay (post-Scheme) at 30 June 2018 had the transfer of the Hong Kong subsidiaries already taken place.

Table 8.2: Comparison of regulatory solvency positions of the PAC shareholder-backed business (pre-Scheme and post-transfer of Hong Kong subsidiaries) and Rothesay (post-Scheme) at 30 June 2018

Solvency position as at 30 June 2018		
£m	PAC shareholder-backed business, pre-Scheme (after transfer of ownership of PAC's Hong Kong subsidiaries)	Rothesay post-Scheme
Total Assets (net of other items)	63,990	36,315
Technical Provisions (including TMTP)	55,174	32,157
Own Funds (A)	**8,817**	**4,158**
SCR (B)	5,862	2,351
Excess Capital (=A-B)	2,955	1,807
SCR coverage ratio (A/B)	***150%***	***177%***

8.46 Table 8.2 indicates that, had the Hong Kong subsidiaries been transferred prior to 30 June 2018, the PAC shareholder-backed business SCR coverage ratio at that date would have been 150% and therefore the SCR cover ratio for transferring policyholders in Rothesay after the transfer would be higher than that in PAC before the transfer. PAC's consolidated regulatory SCR coverage ratio would have been 130% had the Hong Kong subsidiaries been transferred at 30 June 2018.

8.47 Based on the analyses above, I am satisfied that the differences in financial strength set out above will not have a material adverse impact on the security of benefits of the Transferring Policies.

THE PROFILE OF RISKS TO WHICH THE TRANSFERRING POLICIES ARE EXPOSED

8.48 After the implementation of the Scheme, the Transferring Policies will be direct policies of Rothesay and therefore directly exposed to the risk profile of a different company that has written a different mix of business, through different distribution channels, to policyholders with different demographic profiles, and that has a different investment strategy.

8.49 The dominant risks for the PAC shareholder-backed business are:

- market risks, primarily arising from the impact of market shocks on the value of future shareholder transfers expected to be received from PAC's with-profits ring-fenced funds;
- credit risk, i.e. the risk of losses arising from the default of PAC's asset counterparties, or the risk of a reduction in the value of PAC's assets due to the downgrade of its investments or a widening of credit spreads[37]; and
- Insurance risks:
  - longevity risk, i.e. the risk of an adverse financial impact arising from its policyholders (primarily recipients of annuities) living longer than expected;
  - expense risk, i.e. the risk of losses caused by differences between the actual timing and/or amount of expenses incurred and those expected; and
  - persistency risk, i.e. the risk of losses caused by deviations of the actual rates of policy lapses from their expected rates.

8.50 In addition, the transferring policyholders are exposed to contagion risk from the PAC with-profits fund. In particular, in the unlikely circumstance that the depletion of the excess assets within one or more of the ring-fenced with-profits sub-funds was such that the ability of PAC and the wider Prudential group to meet policyholders' reasonable expectations was

[37] The credit spread is the excess of the yield on an asset over the corresponding "risk-free" yield. It represents the compensation required by the investor in the yield for the risks associated with the asset.

adversely affected, it might become necessary to provide financial support to those ring-fenced sub-funds using capital resources of the shareholder-backed funds.

8.51 The Transferring Policies currently benefit from security provided by a CSA between PAC and its parent company Prudential plc, that can be called upon in certain circumstances, as described in paragraph 5.50. The Transferring Policies will lose this benefit as a result of the proposed transfer. However:

- The capital support provided under the CSA includes any support that might be required by PAC in order to discharge its obligations in relation to the PAC Pension Mis-selling Costs Assurance. After the proposed transfer, the Transferring Policies will no longer be exposed to any risks arising from the PAC Pension Mis-selling Costs Assurance;
- Rothesay has a high level of SCR cover under Solvency II and this will be unaffected by the transfer; and
- Rothesay actively manages its solvency level and has identified management actions it could take to improve its capital position if necessary, as described in paragraph 8.26. Therefore, Rothesay has tools at its disposal to reduce the likelihood of breaching its risk appetite and minimum SCR coverage ratio in the future.

Consequently I do not consider the loss of the CSA to be a material risk to the security of benefits of Transferring Policies.

8.52 Rothesay's main risks arise from its assets under management (credit and interest rate risk), pension liabilities (predominantly longevity risk) and counterparty default risk from its reinsurance and derivative counterparties.

8.53 Following the implementation of the Scheme, the Transferring Policies will no longer be exposed to risks associated with PAC's wider business and subsidiaries (including contagion risk from the PAC with-profits fund) but they will be exposed to a different range of risks. In particular, Rothesay invests in a wide range of fixed interest assets, including infrastructure debt, loans secured against portfolios of ground rents and equity release mortgages.

8.54 Rothesay's investment strategy seeks exposure to a higher proportion of unlisted and relatively illiquid assets than Prudential's. However, the nature of Rothesay's liabilities (i.e. predominantly in-payment annuities) is such that there is a limited requirement for liquidity to meet unexpected outgo to policyholders, given that policyholders do not generally have the option to surrender their annuities in exchange for a lump sum[38]. Instead, Rothesay's principal exposure to liquidity risk arises from its extensive use of derivatives to hedge some of its market risk exposures (e.g. exposures to interest rate movements); this means that, should there be a significant movement in market interest rates, market-implied inflation rates or exchange rates, there could (depending on the direction of the movement) be a requirement for Rothesay to liquidate some of its assets in order to post collateral to support its obligations under the derivative contracts.

8.55 Rothesay has an extensive range of liquidity management tools in place to ensure it is able to meet expected and unexpected liquidity requirements, including under stressed market conditions. In addition, Rothesay performs stress tests to its liquidity position on a weekly basis. The Transferring Business is similar in nature to the business that Rothesay already has, and therefore does not present any materially new or different challenges from a liquidity management perspective. Furthermore, the implementation of the Scheme will not have a material impact on Rothesay's liquidity position as any additional liquidity requirements relating to the Transferring Business have already been transferred to Rothesay under the Laker Reinsurance Agreement (which covers the Transferring Policies). Rothesay's liquidity policy specifies that, when any potential new transactions are presented to Rothesay's 'Transaction Approval Committee' or 'Working Level Risk Committee', a summary of liquidity implications must be included. For material transactions, the following information is considered; how the transaction would be funded, the impact of the activity on liquidity coverage ratios, and an assessment of the impact of any encumbrance of Rothesay's assets on Rothesay's liquidity position. Rothesay has confirmed to me that this policy was followed in relation to Laker Reinsurance Agreement, and that action was taken as necessary to protect Rothesay's liquidity position.

8.56 In view of this, and the illiquid nature of Rothesay's liabilities, I do not consider this increase in exposure to illiquid assets for Transferring Policies to be of concern.

8.57 More generally, PAC's business mix is more varied than Rothesay's and, therefore, the Transferring Policies are currently exposed to a greater variety of risks than they would be after the implementation of the Scheme. Therefore, the proposed transfer will reduce the range of risks to which the Transferring Policies are exposed, but it will also reduce the levels of risk diversification from which the Transferring Policies benefit. However, the SCR that Rothesay is required to hold under Solvency II will reflect the risk profile of the company, its business and any diversification benefits that are available.

8.58 In addition to the capital that Rothesay is required to hold:

[38] Some holders of Transferring Policies, principally holders of deferred annuities, are eligible to elect to commute some of the contractual benefits of their policy. This is described in more detail in paragraph 8.65.

- Rothesay has an internal risk management framework that documents its approach to identifying, measuring, monitoring, managing and reporting its risks.
- As part of its risk management framework, Rothesay maintains a risk appetite statement that identifies and quantifies the risk exposures that Rothesay is prepared to accept in order to meet its strategic objectives, and Rothesay carries out regular monitoring and actions to ensure that its risk exposures remain within its risk appetite.
- Rothesay has an independent Risk and Compliance Function whose role is to provide oversight, advice and challenge to management and the Board in order to ensure that business risks are managed effectively, and a Board which includes experienced non-executive directors.
- Rothesay is required to produce an ORSA on an annual basis, which describes the profile of risks to which the company and its future plans are subject, and quantifies its exposure to its key risks through extensive stress and scenario testing.[39]

8.59 All of the risk management activities described in paragraph 8.58 are common to all of the large life insurers in the UK. Nevertheless, they provide additional comfort that any differences in risk profile to which the Transferring Policies will be exposed after the implementation of the Scheme will be suitably identified, managed and protected against.

8.60 Therefore I am satisfied that the change in risk profile to which the Transferring Policies will be exposed as a result of the implementation of the Scheme will not have a material effect on the benefit security of the Transferring Policies.

Conclusion

8.61 In conclusion I am satisfied that:

- The capital policy of Rothesay will provide adequate support for the security of benefits of the Transferring Policies.
- The cessation of the Laker Reinsurance Agreement and the associated restrictions on assets held in the custody accounts will not have a material adverse effect on the security of benefits for the Transferring Business.
- Based on the position at 30 June 2018, the Scheme will not have a material adverse effect on the financial resources available to support the security of the benefits of the Transferring Business.

8.62 For these reasons, I am satisfied that the implementation of the Scheme will not have a material adverse impact on the security of benefits of the Transferring Policies.

THE REASONABLE EXPECTATIONS OF TRANSFERRING PAC POLICYHOLDERS

8.63 The Transferring Policies are non-profit in-payment annuities[40], and therefore policyholders' reasonable expectations in respect of their policies are principally that:

- They receive their benefits as guaranteed under the policy, on the dates specified, from the point of purchase;
- The administration, management, and governance of the policies are in line with the contractual terms under the policies; and
- The standards of service received are at least as good as those they currently receive.

Benefit expectations of the Transferring Policies

8.64 There are no proposed changes to the terms and conditions of the Transferring Policies and therefore the contractual benefits as set out in these terms and conditions will be unchanged by the Scheme. Additionally, as described in paragraph 8.61, I am satisfied that the implementation of the Scheme will not have a material adverse impact on the security of the contractual benefits of the Transferring Policies.

8.65 However, in certain situations, some holders of Transferring Policies are eligible to elect to commute some of the contractual benefits of their policy; that is, the policyholder may choose to forgo some or all of their annuity income in return for a lump sum payment. The circumstances in which this is permitted for in-payment annuities are limited, comprising:

[39] My assessment of the Scheme has included consideration of the most recent ORSAs prepared by Rothesay and Prudential.

[40] With the exception of 10 deferred annuities.

- Where, following the death of an annuitant, the benefits subsequently payable to a contingent beneficiary are small enough to qualify for trivial commutation[41]; or
- Where a pension sharing order[42] has been granted.

8.66 In addition, the holders of the small number of deferred annuities that are within the scope of the transfer may elect to take a Pension Commencement Lump Sum, often referred to as "tax-free cash". These policyholders may also elect to commute their benefits where they have funds below a certain size, or in cases of ill health. Commutation is also used to calculate transfer values in situations where deferred annuity policyholders choose to transfer their pension entitlements to another pension provider.

8.67 The terms on which commutation takes place are not guaranteed in the policy terms and conditions and are determined by the relevant company using its discretion, subject to the requirement to treat customers fairly.

8.68 Currently, if some or all of the benefits of a Transferring Policy were to be commuted, the lump sum payment would be calculated using PAC's prevailing commutation factors[43]. By contrast, after the proposed transfer, the Transferring Policies' commutation benefits will be calculated using Rothesay's prevailing commutation factors.

8.69 As commutation of benefits is more commonly carried out for deferred annuities than for in-payment annuities and that the vast majority of the Transferring Policies are in-payment annuities, the proportion of Transferring Policyholders likely to be affected by any differences in the companies' prevailing commutation factors is small in comparison to the number of Transferring Policies[44].

8.70 PAC is currently undertaking a project to implement a change to its commutation factors to ensure that they are calculated using assumptions that are as realistic as possible. The outcome of this project is expected to be that, by and large, PAC's prevailing commutation factors will reduce. However, any proposals to change the current assumptions as a result of this project will be subject to PAC's relevant internal governance processes; in particular, the changes will need to be approved by PAC's Executive Technical Committee. PAC expects to implement the planned changes to commutation factors during the first half of 2019.

8.71 I have reviewed analysis performed by Rothesay which compares PAC's and Rothesay's commutation factors for a sample of ages and benefit types as at 30 June 2018. I have also reviewed similar analysis as at 30 June 2018 that compares PAC's commutation factors calculated in accordance with its expected new methodology (following the implementation of the project described in paragraph 8.70) with Rothesay's commutation factors.

8.72 Both sets of factors comply with each company's interpretation of the requirement to treat customers fairly and other applicable regulations; however, there are differences in the companies' views on future mortality and inflation rates, which affect the value of policyholders' commutation benefits. In addition, the discount rates used to calculate the commutation benefits differ between the companies due to differences in the profile of assets held by each company and the associated expected returns on those assets.

8.73 The analysis I have received shows that, based on the currently applicable commutation factors, for the sample of ages and benefit types considered in the analysis, Rothesay's average commutation factors are between 2% and 12% lower than PAC's. That is, the lump sum payable by Rothesay would currently be between 2% and 12% lower than the comparable payment by PAC.

8.74 However, a similar comparison of PAC's expected future commutation basis against Rothesay's current basis indicates that, while there are differences for individual policies depending on the age of the policyholder and the policy features, Rothesay's commutation factors are typically between 6% higher and 6% lower than PAC's planned new commutation factors. Rothesay's factors are generally lower than PAC's new factors (albeit still within 6%) for policies that have fixed annuity amounts or that are subject to fixed annual increases to their annuity amount; conversely, policies with inflation-

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[41] Trivial commutation is permitted where the assessed value of the pension payable (i.e. the annual pension entitlement multiplied by 20) is less than £10,000.

[42] A pension sharing order is a court order that some or all of the policyholder's benefits are paid to the policyholder's former spouse with any remainder being paid to the policyholder

[43] A commutation factor is the lump sum received by the policyholder for each £1 p.a. of pension income forgone. For example, a commutation factor of 20 means that the policyholder would receive a £20 lump sum for each £1 p.a. of pension forgone.

[44] Between April 2018 and September 2018, 256 deferred annuity policyholders (out of approximately 10,500 deferred annuity policies within the Laker Reinsured Business) and 61 in-payment annuity policyholders (out of approximately 390,500 in-payment annuity policies within the Laker Reinsured Business) chose to commute some or all of their benefits. In percentage terms, this corresponds to approximately 2.4% of the deferred annuity policies and 0.02% of the in-payment annuity policies.

linked increases will generally be subject to higher commutation factors in Rothesay than under PAC's proposed basis (albeit still within 6%).

8.75 PAC intends to implement the expected changes to its commutation factors before the Scheme becomes effective, subject to approval from PAC's Executive Technical Committee.

8.76 The original intention of PAC and Rothesay, reflected in an early draft of the Scheme, was that all of the deferred annuity policies covered by the Laker Reinsurance Agreement would be Transferring Policies. However, I considered that the differences in current commutation factors used by PAC and Rothesay could result in a material disadvantage to holders of deferred annuities that were within the scope of the transfer under the early draft of the Scheme, and this was accepted by both companies[45]. The proposed changes to PAC's commutation basis are expected to avoid such a material disadvantage, but in view of the uncertainty over the timing and final form of those changes it has been agreed that almost all of the deferred annuities should be excluded from the transfer. However, there are 10 deferred annuities which all arise from one transferring pension scheme which is subject to a buy-in with PAC and which consists mainly of in-payment annuities. In order to facilitate the transfer of this pension scheme in its entirety, those deferred annuities will form part of the Transferring Policies. For these 10 deferred annuity policies, Rothesay and PAC are performing analysis to compare Rothesay's prevailing commutation factors applicable to these policies in the situations described in paragraphs 8.65 and 8.66 with PAC's commutation factors, both before and after the proposed changes, to determine whether there are material differences for these 10 policies. This analysis has not been completed at the time of finalising my report. However, I have been assured by PAC and Rothesay that they will take any necessary actions to ensure that the difference in commutation factors between the two companies will not be material for these policyholders and that therefore, if these policyholders choose to commute their benefits, the lump sums they will receive will not be materially affected by the proposed transfer. I will comment on the outcome of the analysis and any resulting actions taken by the firms in my Supplementary Report.

8.77 Given that:

- the differences in commutation factors produced by Rothesay's current basis and PAC's proposed new basis are relatively small;
- all but a handful of the Transferring Policies are in-payment annuities, and therefore the circumstances in which commutation of benefits may take place are limited for these policies; and
- for the 10 Transferring Policies that are deferred annuities, PAC and Rothesay have undertaken to ensure that the difference in commutation factors between PAC and Rothesay will not be material,

I am satisfied that the impact of the implementation of the Scheme on the commutation terms available to Transferring Policyholders will not materially affect the benefit expectations of Transferring Policyholders. I will comment on the final outcome of the review of PAC's commutation basis in my Supplementary Report.

8.78 It is also important to note that the commutation bases for both PAC and Rothesay are not guaranteed and may change in the future. Therefore, the differences between the respective bases may narrow, or widen, in the future. However, any substantive change to either company's approach would be subject to the obligation to treat customers fairly.

8.79 As discussed in paragraphs 7.22 to 7.25, some of the Transferring Policies may be subject to PAC's TRASP PBR. The planned processes for reviewing and, where appropriate, providing TRASP compensation have been designed with the objective that a transferring policyholder's experience would be the same in all material respects as if the policy had not been transferred. For example, the process described in paragraph 7.24 for TRASP Incremental Liabilities, whereby the policyholder benefit payments are augmented prior to a final price being agreed between PAC and Rothesay, has been designed to avoid any delays in the policyholder receiving compensation caused by negotiations between the two parties. It should be noted that PAC may, in theory, choose not to transfer to Rothesay the responsibility for processing the TRASP Incremental Liability payment; in this case PAC would not pay the interim premium (or any subsequent true-up payments) for the TRASP Incremental Liability to Rothesay and the responsibility for processing the TRASP Incremental Liability payment to the affected policyholder would remain with PAC. However, PAC has informed me that it does not intend to retain the responsibility for processing TRASP Incremental Liability payments to policyholders and therefore this is unlikely to occur in practice.

8.80 Taking the above into account, I am satisfied that the implementation of the Scheme will not have a material adverse effect on the benefit expectations of the Transferring Policies.

The administration and service standards applied to the Transferring Policies

8.81 As described in paragraphs 7.32 to 7.34, since 1 October 2018, the administration of the Transferring Business has been outsourced to TCS/Diligenta. Subject to agreement of a Transitional Services Agreement, PAC will continue to provide

[45] Although, as noted in paragraph 1.12, I am in general only required to comment on the Scheme as presented to the Court, the FCA Guidance obliges me to refer to instances where I have challenged the original proposals and this has led to changes to the Scheme.

administration services (provided by TCS/Diligenta on its behalf) in respect of the Transferring Policies to Rothesay following the Transfer Date for a period of 12 to 24 months.

8.82 Therefore, while the Transitional Services Agreement is in place, there is no reason to expect that administration and service standards will differ from those that the Transferring Business would have received if the Scheme had not been implemented.

8.83 After the agreed term of the Transitional Services Agreement, Rothesay will be free to alter the administration arrangements applicable to the Transferring Policies, in the same way that both PAC and Rothesay are currently free to do for their existing policyholders. There are two possible options:

- Rothesay moves to a direct relationship with TCS/Diligenta; or
- The administration is migrated to another servicer of Rothesay's choice.

8.84 Rothesay does not have a preconceived view as to which option will be chosen (i.e. moving to a direct relationship with TCS/Diligenta or migrating the administration to another servicer of Rothesay's choice). However, I have been informed that the decision will be made in accordance with the following process; the Chief Operating Officer's recommendation will be considered by Rothesay's internal Working Level Risk Committee, and then by the Rothesay Senior Management Committee. If approved by these committees, the recommendation will then be considered by the Rothesay Customer and Conduct Committee and then it will be submitted to the Rothesay Board for approval. Once the chosen administration arrangement is in place it will be overseen by the Rothesay Third Party Oversight Committee, with any significant issues escalated through the Rothesay Senior Management Committee.

8.85 Rothesay already manages approximately 380,000 non-profit annuities and administers these via outsourcing agreements. I have reviewed the target service standards for these policies and I consider these standards to be reasonable. There is therefore no reason to believe that the future outsourcing arrangements for the Transferring Business organised by Rothesay will result in materially different service standards from those applicable to Rothesay's existing non-profit annuities, which I consider to be reasonable.

8.86 PAC has shared with me its approach to vulnerable consumers[46] and PAC has confirmed that this approach will be maintained when administering the Transferring Policies under the Transitional Services Agreement. I have also reviewed Rothesay's approach to vulnerable customers and I consider both companies' approaches to be broadly comparable, and in particular there is no reason to believe that the treatment of vulnerable customers that hold Transferring Policies after the Transfer Date and after the agreed term of the Transitional Services Agreement will be materially different from the treatment they currently experience as policyholders of PAC.

8.87 I will comment on the outcome of the discussions surrounding the Transitional Services Agreement in my Supplementary Report. However, assuming that a suitable Transitional Services Agreement is put in place, I am satisfied that the implementation of the Scheme will not result in a material adverse impact on service standards experienced by holders of Transferring Policies.

Governance and management of the Transferring Policies

8.88 The Transferring Business is currently managed by PAC, and subject to the governance of the PAC Board.

8.89 Following the implementation of the Scheme, the Transferring Business will be managed by Rothesay and subject to the governance of the Rothesay Board. Rothesay currently manages significant volumes of non-profit annuity business, and I consider that the Rothesay Board is experienced in the management and governance of non-profit annuity business and have no reason to believe that it will treat the transferring policyholders in a materially different way to the PAC Board.

8.90 In addition, Rothesay and PAC are subject to the same regulatory requirements in relation to the governance of their long-term insurance business. In particular both companies are required by PRA rules to appoint a Chief Actuary, whose appointment is subject to PRA approval, and who is responsible for advising the company's Board of Directors, inter alia, on the reliability and adequacy of the calculation of the Technical Provisions. Unlike PAC, Rothesay is not required to appoint a WPA as it has no with-profits business, but none of the Transferring Business is with-profits and so this does not affect the governance applicable to the Transferring Business.

8.91 I am satisfied that the implementation of the Scheme will not materially adversely affect the standards of governance and management applicable to the Transferring Business.

[46] The FCA defines a vulnerable consumer as "someone who, due to their personal circumstances, is especially susceptible to detriment, particularly when a firm is not acting with appropriate levels of care" - Occasional Paper No. 8 'Consumer Vulnerability', February 2018

CONCLUSION FOR THE TRANSFERRING POLICIES

8.92 I am satisfied that the implementation of the Scheme will not have a material adverse effect on:

- The security of benefits under the Transferring Policies;
- The reasonable expectations of the transferring PAC policyholders; or
- The service standards and governance applicable to the Transferring Policies.

9. The effect of the implementation of the Scheme on the non-transferring policies of PAC

INTRODUCTION

9.1 In this section I consider the effect of the implementation of the Scheme on the non-transferring policies of PAC.

9.2 The non-transferring PAC policies comprise:

- Certain non-profit deferred and in-payment annuities in the PAC NPSF;
- Unit-linked policies in the PAC NPSF;
- With-profits policies and non-profit annuities in PAC with-profits fund; and
- General insurance policies written in the PAC SHF.

9.3 For the avoidance of doubt, the commentary and conclusions in this section apply to the Non-transferring Reinsured Policies (as described in paragraphs 7.17 to 7.19), and to any Excluded Policies (as described in paragraphs 7.14 to 7.16) while they remain policies of PAC.

THE FINANCIAL RESOURCES AVAILABLE TO PROVIDE SECURITY OF BENEFITS

9.4 The security that the holders of non-transferring policies in PAC currently enjoy with respect to their guaranteed benefits currently arises from the assets held by the company:

- Assets backing the Technical Provisions and capital requirements of the PAC shareholder-backed business; and
- Excess capital resources of the PAC SHF and PAC NPSF; and
- In certain extreme scenarios, excess capital resources of PAC's with-profits fund.

9.5 The ability of Rothesay to fulfil its obligations under the Laker Reinsurance Agreement currently affects the security for the non-transferring policies of PAC. In particular, in the event that Rothesay were unable to fulfil its obligations under this arrangement, the business of PAC as a whole would absorb any financial impact, not just the Transferring Policies. However, the Laker Reinsurance Agreement is fully collateralised, with this collateral being held in custody accounts that are subject to eligibility criteria and rules for management.

9.6 Under the Scheme, the non-transferring policies in the PAC SHF, PAC NPSF and PAC with-profits fund, and the assets of those funds, other than the value of reinsurance recoverables from Rothesay, will remain in the PAC SHF, PAC NPSF and PAC with-profits fund respectively.

9.7 The following table shows the pro-forma post-Scheme financial strength of the PAC shareholder-backed business[47] as at 30 June 2018 on the Solvency II Pillar 1 basis.

[47] For the reasons described in paragraph 5.35

Table 9.1 – The PAC shareholder-backed business pre-transfer and projected post-transfer regulatory solvency position as at 30 June 2018

	PAC shareholder-backed business, pre-Scheme	PAC shareholder-backed business, post-Scheme	Impact of Scheme
	£m	£m	£m
Solvency II Assets (net of other items)	72,544	60,782	(11,762)
Technical Provisions (including TMTP)	57,637	45,920	(11,717)
Own Funds (A)	**14,907**	**14,862**	**(45)**
SCR (B)	7,215	7,015	(200)
Excess Capital (=A-B)	7,692	7,847	155
SCR coverage ratio (A/B)	***207%***	***212%***	***5%***

9.8 Table 9.1 shows that PAC's assets and Technical Provisions are expected to decrease by a similar amount and therefore there will be no material change to PAC's Own Funds as a result of the implementation of the Scheme. This is because after the transfer, the Transferring Business's Technical Provisions will no longer be on PAC's balance sheet but neither will the value of reinsurance recoverables from Rothesay for the Transferring Business under the Laker Reinsurance Agreement.

9.9 PAC's consolidated regulatory solvency ratio was 162% as at 30 June 2018. The impact of the Scheme, if it had occurred at this date, would be to increase this ratio to 164%.

9.10 PAC's SCR will reduce as a result of the transfer due to the cessation of PAC's exposure to the risk of Rothesay's default under the Laker Reinsurance Agreement, and this leads to an increase in SCR coverage ratio of 5 percentage points.

9.11 Given the expected modest improvement in PAC's solvency coverage ratio as a result of the implementation of the Scheme, I am satisfied that the Scheme will not have a material adverse effect on the financial resources available to support the security of the benefits of the non-transferring policies of PAC. In addition, there are number of PAC subsidiaries which may look to PAC for capital support. As the proposed transfer is expected to slightly improve PAC's solvency coverage ratio, it will not have a material adverse effect on the level of support that PAC is able to offer its subsidiaries.

9.12 As described in paragraph 5.26, the ownership of PAC's Hong Kong subsidiaries transferred from PAC to PCA on 14 December 2018, and this is expected to have resulted in a decrease in solvency cover for PAC. Table 9.2 compares the regulatory solvency positions of the PAC shareholder-backed business at 30 June 2018, before and after implementation of the Scheme, had the transfer of the Hong Kong subsidiaries already taken place as described in paragraph 5.26.

Table 9.2: Comparison of pro forma regulatory solvency position of the PAC shareholder-backed business at 30 June 2018, post transfer of Hong Kong subsidiaries, before and after implementation of the Scheme

	PAC shareholder-backed business, pre-Scheme (after transfer of ownership of PAC's Hong Kong subsidiaries)	PAC shareholder-backed business, post-Scheme (after transfer of ownership of PAC's Hong Kong subsidiaries)	Impact of the Scheme
	£m	£m	£m
Solvency II Assets (net of other items)	63,990	52,228	(11,762)
Technical Provisions (including TMTP)	55,174	43,456	(11,717)
Own Funds (A)	**8,817**	**8,772**	**(45)**
SCR (B)	5,862	5,662	(200)
Excess Capital (=A-B)	2,955	3,110	155
SCR coverage ratio (A/B)	***150%***	***155%***	***5%***

9.13 Table 9.2 shows that the Scheme would be expected to lead to an improvement in the PAC shareholder-backed business if the PHKL transfer had occurred prior to the 30 June 2018.

9.14 PAC's consolidated regulatory solvency ratio would have been 130% as at 30 June 2018 if the ownership of PAC's Hong Kong subsidiaries had transferred to PCA prior to 30 June 2018. The impact of the Scheme would be to increase this ratio to 133%.

9.15 It should be noted that the financial information in Table 9.1 and 9.2 does not reflect:

- the impact of the recent Part VII transfer of PAC's non-UK European business from PAC into PIA (described in paragraphs 5.21 to 5.24); or
- the estimated impact of the planned Part VII transfer of the business written by PAC through its joint venture with the Discovery Group to Vitality Life Limited (described in paragraphs 5.28 and 5.29).

I am satisfied that this is reasonable as the impact of the implementation of the Scheme on PAC's balance sheet would be very similar to that shown in Table 9.1 and Table 9.2 in the event that one or both of the above transfers was reflected in the financial information. Moreover, the financial impact on PAC of those transfers is expected to be very small.

9.16 Accordingly, consideration of the combined impact of the Scheme and the other events described in paragraph 9.15 on PAC's financial strength would not change my conclusions in relation to the impact of the implementation of the Scheme.

APPROVALS UNDER SOLVENCY II

9.17 The Laker Reinsurance Agreement resulted in a material change in PAC's risk profile, and therefore the PAC TMTP was recalculated as at 31 March 2018 and this recalculation was approved by the PRA. Given that the implementation of the Scheme does not result in a further material change in risk profile, it is not expected that TMTP will be recalculated as a result of the implementation of the Scheme.

9.18 I am satisfied that the Scheme will not have a material impact on the regulatory approvals granted to PAC that are relevant to its financial strength, and I am therefore satisfied that the approvals assumed in calculating the pro forma post-Scheme financial position of PAC in Tables 9.1 and 9.2 above are reasonable.

THE PROFILE OF RISKS TO WHICH THE NON-TRANSFERRING POLICIES OF PAC ARE EXPOSED

9.19 The dominant risks for PAC are market risks, credit risk, longevity risk, expenses and persistency risk.

9.20 As the vast majority of the risks associated with the Transferring Business have already been transferred to Rothesay through the Laker Reinsurance Agreement, following the implementation of the Scheme, the non-transferring PAC policies will largely be exposed to the same key risk types as currently.

9.21 However, the Scheme will also reduce PAC's exposure to counterparty default risk as a result of the termination of the Laker Reinsurance Agreement. Nonetheless, the net counterparty default risk to which PAC is exposed is currently small, as the majority of the counterparty default risk to PAC is mitigated by the presence of collateral accounts for the Laker Reinsurance Agreement with Rothesay. In addition PAC holds capital to cover the residual counterparty default risk, calculated in accordance with its approved internal model. This reduction in counterparty default risk can be seen in the decrease in SCR in the pro-forma post Scheme figures shown in Tables 9.1 and 9.2. Following the implementation of the Scheme, PAC will retain some counterparty default exposure to Rothesay as a result of the continuing reinsurance of the Non-Transferring Reinsured Polices (and any Excluded Policies), as described in paragraphs 7.17 and 7.14. There will continue to be a collateral arrangement in place between Rothesay and PAC to mitigate most of the counterparty default risk in respect of the continuing reinsurance, and PAC will continue to hold an appropriate level of capital to cover any residual counterparty default risk, as determined by its approved internal model.

9.22 The policyholders of the PAC with-profits fund are exposed to contagion risk from the PAC NPSF and PAC SHF. In particular, in extreme circumstances, for example, if PAC became insolvent, the ring-fencing arrangements of the with-profits sub-funds would break down and the assets of the with-profits fund would become available to meet all of PAC's obligations. However, given that the implementation of the Scheme is expected to increase the SCR coverage ratio of the shareholder-backed business, the non-transferring policies in the PAC with-profits fund would be marginally less exposed to this contagion risk as a result of the implementation of the Scheme.

9.23 The policyholders of PAC outside of its ring-fenced with-profits sub-funds are exposed to contagion risk, i.e. in the unlikely circumstance that one or more of the ring-fenced fenced with-profits sub-funds was unable to meet its liabilities, that fund would be entitled to capital support from the shareholder-backed funds. However, given that implementation of the Scheme does not affect the SCR coverage of the PAC with-profits sub-funds, there would be no increased exposure to contagion risk as a result of the implementation of the Scheme.

9.24 As a result, I am satisfied that the implementation of the Scheme will not have a material adverse effect on the risk profile to which the non-transferring policies in PAC are exposed.

THE GOVERNANCE, MANAGEMENT AND SERVICE STANDARDS APPLICABLE TO THE NON-TRANSFERRING POLICIES OF PAC

9.25 There will be no change to the operation of PAC as a result of the Scheme. In particular:

- The non-transferring policies of PAC will continue to be serviced and administered under the same arrangements and will therefore not experience any change to service standards[48]; and
- The governance of the non-transferring policies will continue to be the responsibility of the PAC Board with additional oversight, in the case of the non-transferring policyholders in the PAC with-profits fund, of the PAC With-Profits Committee.

9.26 Hence I am satisfied that the implementation of the Scheme will not have a material effect on the governance, management and service standards of the non-transferring policies of PAC.

THE REASONABLE BENEFIT EXPECTATIONS OF THE NON-TRANSFERRING POLICYHOLDERS IN PAC

The existing policies in the PAC with-profits fund

9.27 In relation to the existing policies in the PAC with-profits fund, the implementation of the Scheme will not lead to any changes in the operation of the PAC with-profits fund, and so it should not affect the reasonable expectations of holders of policies in the fund directly.

9.28 There will be no changes to the terms and conditions of the existing policies of the PAC with-profits fund or to the PPFM. The existing policies of the PAC with-profits fund will remain in the PAC with-profits fund after the implementation of the Scheme.

9.29 I understand that a small number[49] of Transferring Policies' benefits were moved from the PAC WPSF to the PAC NPSF in order to maintain policy integrity for the transfer. The PAC WPA has stated in paragraph 3.4.4 of his report on the Scheme that he considers that the terms on which these benefits were reallocated to the PAC NPSF were fair and reasonable. Given the small benefit value concerned in the context of the large size of the PAC WPSF, I am comfortable relying on the conclusion of the PAC WPA in this regard.

9.30 As a result of the implementation of the Scheme, some of the business of the PAC NPSF will be transferred to Rothesay. This results in a relative increase in the size of the PAC WPSF compared to the NPSF, which in turn will mean that a higher proportion of PAC's fixed costs (including annuity administration expenses) will be allocated to the PAC WPSF as a result of the implementation of the Scheme. The increase in annuity administration expenses will be met by the inherited estate[50] of the PAC WPSF. I understand that this increase in the administration expenses is approximately £3 million p.a., which is very small in the context of the size of the WPSF (which has over £90 billion of assets). Additionally, it has been agreed that that the PAC SHF will contribute £7 million to offset the effect of this increase. This contribution from the PAC SHF is expected to eliminate any increase in annuity administration expenses allocated to the PAC WPSF from 2019 to 2021.

9.31 The WPA has confirmed in paragraph 4.4.4 of his report that, in his view, the amounts involved are not material in the context of the size of the PAC WPSF's inherited estate, and observes that the £7 million shareholder contribution means that, should a suitable reduction in annuity administration expenses be achieved over a three to four year period, there would be no material impact on the inherited estate. I am not able to comment on the extent to which such a reduction in administration costs is achievable, but I am satisfied that the sums in question are small enough relative to the size of the PAC WPSF's inherited estate to be able to conclude that the increase in annuity administration expenses allocated to the PAC WPSF (once the £7 million shareholder contribution is taken into account) will not have a material adverse effect on the reasonable benefit expectations of the existing policyholders of the PAC WPSF.

9.32 In addition to the annuity administration expenses, the transfer is expected to result in overhead expenses allocated to the non-transferring policies increasing by approximately 6% (as the transferring business represents approximately 6% of PAC's total business). However, PAC's overall fixed costs are expected to reduce by an amount that would more than offset the impact of increased overheads being allocated to non-transferring policies as a result of an internal PAC transformation project focused on, amongst other things, reducing PAC's cost base.

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[48] PAC does not expect that the proposed agreement between Rothesay and PAC regarding the administration of Transferring Policies after the Transfer Date (see paragraph 7.33) will place any additional contractual restrictions on PAC in relation to its outsourcing arrangements for the non-transferring policies.

[49] 181 annuity policies were transferred from the PAC WPSF to PAC NPSF. This corresponds to £740,000 in annual annuity payments.

[50] The inherited estate of a with-profits fund is the difference between the value of the assets of the fund and the sum of the fund's best estimate liabilities and any other liabilities of the fund

9.33 The WPA has confirmed in paragraph 4.4.6 of his report that he does not believe there will be a material adverse impact on policyholders from the reallocation of overheads. Assuming that the transformation project is able to achieve its target level of cost savings, I am also satisfied that the reallocation of overhead expenses will not have a material adverse impact on the reasonable benefit expectations of the existing policyholders of the PAC WPSF.

9.34 As discussed in paragraph 7.32, some of PAC's policies, including the Transferring Policies, are administered by TCS/Diligenta. The agreement with TCS/ Diligenta includes clauses that require PAC to pay compensation if PAC makes changes to its business which results in business covered by the agreement being transferred away from TCS/ Diligenta.

9.35 The proposed transfer and the associated changes to future administration arrangements of the Transferring Policies are not sufficient to trigger the compensation clauses. Furthermore, since that the Transferring Policies are all PAC shareholder-backed business, if it they were to trigger the compensation clause then the charge would be met in full by the shareholder fund. However, the compensation clauses are based on cumulative changes and therefore the proposed transfer increases the likelihood of the threshold being breached in the event of future transfers from the PAC with-profits fund.

9.36 I understand that any compensation would be allocated against any transfer that had contributed to the triggering of the compensation clause, irrespective of which transfer had actually resulted in the trigger amount being breached. The WPA has concluded in paragraph 4.5.3 of his report that the PAC WPSF will not incur any material additional costs in relation to such compensation, and I agree with this analysis. I am therefore satisfied that the increased likelihood of triggering the TCS/Diligenta compensation clauses does not have a material adverse impact on the reasonable benefit expectations of the existing policyholders of the PAC WPSF.

9.37 PAC's total SCR coverage ratio is expected to increase as a result of the implementation of the Scheme but the PAC with-profits sub-funds are ring-fenced so the assets, liabilities and risk profile of those sub-funds will not change as a result of the transfer. Consequently the PAC with-profits fund will maintain its pre-Scheme coverage ratio.

9.38 None of the costs associated with the Scheme will be borne by the PAC with-profits fund.

9.39 Hence I am satisfied that the implementation of the Scheme will not have a material effect on the reasonable benefit expectations of the policyholders of PAC's with-profits fund.

The existing policies in the PAC SHF and PAC NPSF

9.40 The PAC NPSF business is non-profit in nature (including linked and non-linked business) and, as such, policyholders' expectations in respect of their benefits are that:

- They receive their contractual benefits as set out under the policy;
- They have access to the same range of funds and investment expertise (for linked business);and
- The level of charges (for linked business) is in line with the contractual terms under the policy;

9.41 There will be no changes to the terms and conditions of the existing PAC SHF and PAC NPSF policies. The existing policies in the PAC SHF and PAC NPSF will remain in the PAC SHF and PAC NPSF respectively after the implementation of the Scheme.

9.42 There will be no reduction in the range of funds or change to the investment expertise that the existing unit-linked policies of PAC are able to access as a result of the Scheme.

9.43 The PAC NPSF includes some premium-paying policies where the level of premiums is subject to regular review and may be revised in light of emerging experience. PAC has informed me that the proposed transfer will have no impact on the outcome of these premium reviews.

9.44 The level of charges for existing PAC policies will remain in line with the contractual terms under the policies.

9.45 I also note that, as described in paragraph 7.8, the Transferring Business has been formulated in such a way to ensure that no policy benefits will be split between PAC and Rothesay.

9.46 Hence I am satisfied that the implementation of the Scheme will not have a material effect on the reasonable benefit expectations of the policyholders of PAC's SHF and NPSF.

CONCLUSION FOR THE NON-TRANSFERRING POLICIES IN PAC

9.47 I am satisfied that the implementation of the Scheme will not have a material effect on:

- The security of benefits under non-transferring policies in PAC;
- The reasonable benefit expectations of non-transferring policyholders of PAC; or

- The service standards and governance applicable to non-transferring policies of PAC.

10. The effect of the implementation of the Scheme on the existing policies of Rothesay

INTRODUCTION

10.1 In this section I consider the effect of the implementation of the Scheme on the existing Rothesay policies.

10.2 For these policies, I consider the likely effects of the implementation of the Scheme on the security of the guaranteed benefits and on the benefit expectations of the holders of those policies.

10.3 The key issues to consider are:

- The financial resources available to provide security for the benefits of the existing Rothesay policyholders after the implementation of the Scheme compared to those currently available;
- The effect on the existing Rothesay policies of any change in the risk profile of Rothesay as a result of the implementation of the Scheme; and
- The effect of the implementation of the Scheme on the reasonable expectations of the existing Rothesay policyholders.

THE FINANCIAL RESOURCES AVAILABLE TO PROVIDE SECURITY OF BENEFITS

10.4 Rothesay's capital policy, which sets out a target level of capital buffer that Rothesay holds in excess of regulatory requirements, will not be changed by the implementation of the Scheme, and so the security of existing policyholder benefits will only be affected by any changes to the company's ability to comply with this policy.

10.5 Currently, security for the guaranteed benefits of the existing policyholders of Rothesay is provided by:

- The assets in Rothesay backing the Technical Provisions held to meet the guaranteed benefits of the existing Rothesay policies;
- The assets backing the SCR of Rothesay; and
- Excess capital resources in Rothesay.

10.6 After the implementation of the Scheme, the security of the guaranteed benefits of the existing and transferring policyholders in Rothesay will be provided by these three elements, albeit that Rothesay's assets will include those to be released from the custody accounts in relation to the Laker Reinsurance Agreement and the transferring longevity reinsurance treaties listed in Table 7.2.

10.7 The implementation of the Scheme will have no impact on the Technical Provisions held in relation to the current Rothesay policies. It should be noted that the assets held in the custody accounts for the Transferring Policies will be released from the security arrangements while the Non-Transferring Reinsured Policies and the Excluded Policies will continue to be reinsured by Rothesay Life on a long term basis under a modified version of the Laker Reinsurance Agreement.

10.8 The following table shows the Solvency II Pillar 1 basis balance sheet as at 30 June 2018, both before and (on a pro forma basis) after implementation of the Scheme.

Table 10.1: Rothesay Solvency II Pillar 1 basis balance sheet as at 30 June 2018

	Rothesay pre-Scheme	Rothesay post-Scheme	Impact of Scheme
	£m	£m	£m
Solvency II Assets (net of other items)	36,315	36,315	-
Technical Provisions (including TMTP)	32,157	32,157	-
Own Funds	**4,158**	**4,158**	**-**
SCR	2,351	2,351	-
Excess Capital	1,807	1,807	-
SCR coverage ratio	***177%***	***177%***	***0%***

10.9 The table shows that if the Scheme had been effective as at 30 June 2018 there would have been no change to the excess assets in Rothesay as the Transferring Policies are already 100% reinsured to Rothesay and the transaction was fully funded at outset. Thus Rothesay would have remained in a strong financial position relative to its minimum required capitalisation under its capital policy.

10.10 I am satisfied that the implementation of the Scheme will not have a material adverse effect on the financial strength of Rothesay, and hence on the security of the benefits of the existing Rothesay policies.

APPROVALS UNDER SOLVENCY II

10.11 Upon the execution of the Laker Reinsurance Agreement, Rothesay received a reinsurance premium from PAC. The assets comprising the premium are broadly the same type of assets that Rothesay holds to back its comparable liabilities more generally. A line by line assessment of these assets was conducted by Rothesay prior to executing this transaction to determine the eligibility of the portfolio of assets for inclusion in Rothesay's Matching Adjustment fund. All assets transferred as part of the consideration had terms that fitted with Rothesay's existing Matching Adjustment framework, and so this framework did not need to be amended for the transferring assets.

10.12 Rothesay has provided evidence to the PRA that all of the assets and liabilities included within the Laker Reinsurance Agreement and the associated consideration are covered by its original matching adjustment application.

10.13 As discussed in paragraph 6.24, Rothesay has received approval from the PRA to use a PIM. In conjunction with this approval, the PRA has approved an associated update to Rothesay's matching adjustment approval and an associated recalculation of Rothesay's TMTP.

10.14 The Laker Reinsurance Agreement resulted in a material change in risk profile and therefore the Rothesay TMTP was recalculated by Rothesay and approved by the PRA with effect from 14 March 2018. As the implementation of the Scheme will not result in further material change in risk profile, the TMTP will not be recalculated as a result of the Scheme.

10.15 I am satisfied that the Scheme will not have a material impact on the PRA approvals granted to Rothesay, and I am therefore satisfied that the approvals assumed in calculating the pro forma post-Scheme financial position of Rothesay in Table 10.1 above are reasonable. I will comment on any changes to Rothesay's Solvency II approvals and their impact on the financial position of Rothesay in my Supplementary Report.

PRIORITY OF DIRECT POLICYHOLDERS RELATIVE TO INWARDS REINSURANCE

10.16 Before the implementation of the Scheme, the Transferring Policies remain policies of PAC. After the proposed transfer, the Transferring Policies will become direct policies of Rothesay rather than being treated as inwards reinsurance business. Typically, inward reinsurance business would rank below direct policies in terms of priority over assets in the event of insolvency. However, a charge has been put in place under the terms of the Laker Reinsurance Agreement, such that PAC (as the cedant) would have recourse to the assets secured in the collateral accounts in the event of certain Rothesay default events occurring (including Rothesay's insolvency).

10.17 Therefore, in an extreme scenario in which Rothesay becomes insolvent, the implementation of the Scheme will not change the status of the Transferring Policies with respect to claims on Rothesay's assets and so there will be no deterioration of existing Rothesay policyholders' benefit security.

THE PROFILE OF RISKS TO WHICH THE EXISTING ROTHESAY POLICIES ARE EXPOSED

10.18 The Laker Reinsurance Agreement has increased the absolute levels of longevity risk and credit risk in Rothesay. However:

- Relative to the size of its balance sheet, the Laker Reinsurance Agreement has not materially changed Rothesay's level of exposure to longevity or credit risk.
- Rothesay had a substantial amount of annuity business in-force before the Laker Reinsurance Agreement was entered into, although the business reinsured in from PAC under the Laker Reinsurance Agreement may have arisen from different sources and through different sales channels, and the underlying policyholder groups may have different demographic profiles from the existing policyholder group. These differences may result in some additional diversification of risk within the longevity risk exposures of Rothesay which would reduce the SCR; I understand in practice Rothesay does not plan to reflect this in its SCR in the short term.
- Since the transfer of these risks from PAC to Rothesay has already occurred through the operation of the Laker Reinsurance Agreement, the implementation of the Scheme will not in any event add to these risks.

10.19 As part of the proposed transfer, Rothesay will take over the liabilities associated with the Transferring Business. This includes some residual liabilities in relation to potential future mis-selling claims from transferring policyholders, as described in paragraph 7.28. Rothesay views the impact of this to be negligible given the period of time that has elapsed since the Transferring Policies were issued or acquired by PAC. In addition, any material exposure to these risks has already been identified by Rothesay through its due diligence work in relation to the Laker Reinsurance Agreement. The risk to Rothesay from the Transferring Policies' mis-selling liabilities is therefore not considered material, and I agree with this assessment. Furthermore, Rothesay's standard formula SCR calculation and ORSA capital calculation were updated to reflect the increased level of operational risk, including the risk associated with potential mis-selling claims, resulting from the Laker Reinsurance Agreement.

10.20 Therefore, I am satisfied that the implementation of the Scheme will not have a material effect on the profile of risks to which the existing Rothesay policyholders are exposed.

THE GOVERNANCE, MANAGEMENT AND SERVICE STANDARDS APPLICABLE TO THE EXISTING ROTHESAY POLICIES

10.21 The Scheme will not alter the terms and conditions of existing policies in Rothesay.

10.22 The implementation of the Scheme will not lead to any changes to the servicing and administration arrangements and existing Rothesay policies will continue to be serviced by Jardine Lloyd Thompson Group plc, Capita and Willis Towers Watson (with appropriate oversight by a dedicated operations team at Rothesay) as described in paragraphs 6.38 and 6.39.

10.23 As described in paragraph 8.81, subject to agreement between PAC and Rothesay of a Transitional Services Agreement, it is intended that PAC will continue to provide administration services for the Transferring Policies (provided by TCS/Diligenta on its behalf) for a period of 12 to 24 months after the Transfer Date. The administration of the Transferring Policies will, therefore, be carried out separately from the administration of Rothesay's existing policies initially and so, subject to the agreement of a Transitional Services Agreement, the proposed transfer will have no effect on the administration arrangements of the existing policies of Rothesay. During this period, Rothesay will make a decision about the long-term administration arrangements. Rothesay management has assured me that the impact on the services standards of existing policies would be considered by Rothesay when choosing a long term arrangement for the Transferring Policies.

10.24 The governance of the existing non-profit policies will continue to be the responsibility of the Rothesay Board.

10.25 I will comment on the outcome of the discussions surrounding the Transitional Services Agreement in my Supplementary Report. However, assuming that a suitable Transitional Services Agreement is put in place, I am satisfied that the implementation of the Scheme will not result in a material adverse impact on service standards experienced by holders of the existing policies of Rothesay.

THE REASONABLE EXPECTATIONS OF THE EXISTING ROTHESAY POLICYHOLDERS

10.26 As discussed in Section 6, Rothesay's long-term insurance business comprises:

- Bulk purchase annuity contracts to trustees of UK defined benefit pension schemes by way of a buy-in policy;
- Individual policies to former members of UK defined benefit pension schemes as a consequence of a buy-out of their benefits by Rothesay and individual policies acquired from other UK insurers; and
- Longevity insurance (also known as longevity reinsurance contracts or longevity swaps) provided to UK defined benefit pension schemes.

10.27 In particular, Rothesay does not have discretion over the amounts payable to its policyholders with the exception of the discretion it has to determine commutation values for policyholders who wish to exchange part of their pension income for a lump sum. Policyholders' reasonable expectations in respect of their benefits under such products are therefore that:

- Policyholders receive their income as guaranteed under the policy, on the dates specified;
- Policyholders who elect to commute part of their future pension income receive an amount that is fair; and
- The administration, servicing, management, and governance of the policies are in line with the contractual terms of the policies and regulatory and legal requirements.

10.28 As described in paragraph 10.10 above, I am satisfied that the implementation of the Scheme will not have a material adverse impact on the security of benefits under the existing Rothesay policies. Rothesay's management has also informed me that the implementation of the Scheme will not affect the approach to commutation of future pension income. As described in paragraph 10.25, I am satisfied that the implementation of the Scheme will not have a material adverse effect on the governance, management and service standards of the existing Rothesay policies. I am therefore satisfied that the implementation of the Scheme will not have a material effect on the reasonable expectations of the existing Rothesay policyholders.

CONCLUSIONS

10.29 I am satisfied that the implementation of the Scheme will not have a material effect on:

- The security of benefits of the existing policyholders of Rothesay;
- The reasonable expectations of the existing policyholders of Rothesay; or
- The service standards and governance applicable to the existing policyholders of Rothesay.

11. Consideration of the Laker Reinsurance Agreement

CONSIDERATION OF THE COMBINED IMPACT OF THE LAKER REINSURANCE AGREEMENT AND THE SCHEME

11.1 In preparing my report, I have considered the impact of the Scheme in isolation on the various categories of policies. This reflects the fact that the Laker Reinsurance Agreement is already in place and is expected to remain in force if the Scheme is not approved by the Court.

11.2 However, the purpose of the Scheme is to complete a two-stage transaction to reallocate the Transferring Policies to Rothesay, the first stage of which involved implementation of the Laker Reinsurance Agreement, which transferred substantially all of the economic risk and reward of the Laker Reinsured Business to Rothesay and which required PRA non-objection but not Court approval. As described in paragraphs 7.17 to 7.19, some of the policies within the Laker Reinsured business (the Non-transferring Reinsured Policies) are not in the scope of the Transferring Business, and will remain reinsured to Rothesay. It is also relevant for me to consider the overall effect of this transaction on each group of policyholders.

11.3 For non-transferring PAC policies, the effect of the Laker Reinsurance Agreement is to reduce the risks and hence capital requirements in PAC. That is, while the Scheme itself results in a small improvement in the solvency position of PAC, the implementation of the Laker Reinsurance Agreement led to a material improvement in the solvency position of PAC. Therefore considering the combined impact of the Laker Reinsurance Agreement and the Scheme would have presented a more compelling picture, in terms of the improvement in the financial resources available to provide security of benefits for the non-transferring PAC policyholders, than the one discussed in the rest of this report. I would not have altered my conclusions in respect of these policies.

11.4 For the existing Rothesay policies, the Laker Reinsurance Agreement in isolation resulted in a deterioration of Rothesay's capital position due to the fact that the reinsurance premium received by Rothesay was lower than the increase in Rothesay's Technical Provisions and SCR that resulted from its implementation. However, it also resulted in a recalculation of Rothesay's TMTP, and Rothesay raised additional capital from its shareholders to support its ability to execute the transaction. This meant that, overall, the Laker Reinsurance Agreement did not have a material impact on Rothesay's solvency position. As discussed in paragraph 8.10, I have reviewed projections showing the effect of the TMTP run-off on Rothesay's solvency position; they demonstrate that the future run-off of the TMTP is expected to be more than offset by the emergence of future surplus on the business that is subject to the TMTP.

11.5 Given that there was no material change in the solvency cover of Rothesay as a result of the Laker Reinsurance Agreement, comparison of the "pre-Scheme, pre-Laker Reinsurance Agreement" and "post-Scheme, post-Laker Reinsurance Agreement" solvency positions of Rothesay has not altered my conclusions on the impact of the Scheme on the Rothesay policies.

11.6 For the Transferring Policies, the combination of the Laker Reinsurance Agreement and the Scheme would have led to a less pronounced decrease in solvency cover (before allowing for the impact of the transfer of ownership of PAC's Hong Kong subsidiaries to PCA), and so financial strength, for these policies than the Scheme in isolation. That is because implementation of the Laker Reinsurance Agreement led to an increase in the SCR cover of PAC's shareholder-backed business. If the Scheme and Laker Reinsurance Agreement had been combined, the Transferring Policies would not have benefited from this period of increased SCR cover. The SCR cover of Rothesay, which is relevant for the Transferring Policies once the Scheme takes effect, was materially unchanged as a result of the Laker Reinsurance Agreement due to the associated capital injection and TMTP recalculation. Accordingly, including the effect of the Laker Reinsurance Agreement in my considerations would not have altered my conclusions on the impact of the Scheme on the Transferring Policies.

11.7 The Laker Reinsurance Agreement had no impact on reasonable benefit expectations of holders of the Transferring Policies, non-transferring PAC policies or the existing Rothesay policies. In addition the Laker Reinsurance Agreement had no impact on the service standards and governance applicable to Transferring Policies, non-transferring PAC policies or existing Rothesay policies. Therefore, considering the combined impact of the Laker Reinsurance Agreement and the Scheme on these issues has not altered my conclusions on policyholder's reasonable benefit expectations or the service standards and governance applicable to policies (which are discussed in Sections 8, 9 and 10).

11.8 Overall, I am satisfied that my conclusions would not have been different had I considered the combined impact of the Laker Reinsurance Agreement and the Scheme.

CONSIDERATION OF THE LAKER REINSURANCE AGREEMENT IF THE SCHEME IS NOT SANCTIONED

Consideration if the Laker Reinsurance Agreement remains in place

11.9 If the Scheme does not proceed to completion as intended, the Laker Reinsurance Agreement will remain in place unless terminated by PAC. It is the current expectation of PAC that the Laker Reinsurance Agreement will not be terminated in this event and so the Transferring Business will remain reinsured to Rothesay.

11.10 As outlined in paragraphs 11.3 and 11.4, the implementation of the Laker Reinsurance Agreement led to an improvement in the solvency position of PAC and had no material impact on Rothesay's solvency position. Additionally, the custody accounts established as part of the reinsurance arrangement provide extra security to all of the PAC policyholders, including but not limited to the policyholders who would have transferred under the Scheme.

11.11 The Laker Reinsurance Agreement had a positive impact on the financial resources available to provide security for policyholder benefits for PAC, and no material impact on Rothesay's financial resources after allowance for the recalculation of Rothesay's TMTP and for the capital raised by Rothesay to support the transaction (described in paragraph 11.4). I am satisfied that policyholders of both firms will not be materially adversely affected by the Laker Reinsurance Agreement remaining in place if the Scheme is not sanctioned.

Consideration if the Laker Reinsurance Agreement is terminated

11.12 PAC has stated that, based on its current intentions, it would be unlikely to terminate the Laker Reinsurance Agreement in the event that the Scheme was not sanctioned. One reason for this is that PAC considers the terms upon which termination would take place (as set out in the Laker Reinsurance Agreement) to be generally unfavourable. In addition, the Laker Reinsurance Agreement achieves the target level of capital release that PAC had sought from the sale of the Transferring Business. However, I have considered the impact on policyholders if this were to occur.

11.13 The termination payment that PAC would receive from Rothesay differs depending on the trigger for termination and therefore both companies' financial positions would be different depending on the reason behind the termination.

11.14 While the terms of the termination will depend on the trigger for termination, it is likely that PAC's solvency ratio would reduce significantly if such a termination took place and, further, it is possible that (following the change of ownership of the Hong Kong subsidiaries) PAC's solvency ratio would fall below its target minimum level in this scenario.

11.15 In almost all circumstances, the option to terminate the Laker Reinsurance Agreement rests with PAC and I consider it very unlikely that it would choose to terminate the agreement unless Rothesay had defaulted on its obligations under the reinsurance (in which case PAC would have recourse to the collateral assets).

11.16 The termination of the Laker Reinsurance Agreement would be likely to result in an improvement to Rothesay's solvency position, depending on the amount of termination payment transferred to support the recapture of the reinsured business by PAC. This would allow Rothesay to return some or all of the capital raised to support the Laker Reinsurance Agreement should it wish to do so. However, Rothesay would only be in a position to effect the termination of the Laker Reinsurance Agreement if there was a default by PAC which triggered a termination right.

11.17 It is likely to be disadvantageous to PAC's solvency position to recapture the Laker Reinsurance Agreement in circumstances where there is no default by Rothesay, and such a development could cause PAC's solvency ratio to fall below its minimum target, thus requiring PAC to consider management actions in accordance with its SRA to restore its capital position. For this reason I consider it to be highly unlikely that PAC would choose to effect such a recapture in the event that the Scheme is not sanctioned.

12. Other considerations arising from the Scheme

THE APPROACH TO COMMUNICATION WITH POLICYHOLDERS

12.1 Regulations made under FSMA require a communication regarding the proposed transfer to be sent to every policyholder of the parties under the Scheme. However, this requirement may be waived at the discretion of the Court, which will give consideration to issues such as the practicality and costs of sending notices against the likely benefits for policyholders of receiving such communications. In order to comply with SUP 18.2.46G of the FCA Handbook, the companies are required to notify the policyholders, or interested persons, at least six weeks before the date of the Court hearing at which the application to sanction the Scheme will be heard.

12.2 Regulations require that a legal notice in a form approved by the PRA is published in the London, Edinburgh and Belfast Gazettes, as well as two national newspapers in the United Kingdom.

12.3 As well as the London, Edinburgh and Belfast Gazettes, PAC and Rothesay have opted to publish legal notices in the Irish Gazette, The Times, The Financial Times, The Daily Telegraph, The Sun, The Daily Mail and The Daily Mirror.

12.4 PAC and Rothesay intend to ask the PRA to provide notification of the Scheme to the insurance regulators in all EEA states.

12.5 Policyholders and other interested parties will be able to obtain information from the PAC and Rothesay websites as well as PAC's financial adviser website. These will contain documents regarding the Scheme, including the full Scheme document, this report, a summary of the terms of the Scheme and a summary of this report (written by me). In addition, the PAC website and PAC's financial adviser website will include copies of PAC's Chief Actuary and With-Profits Actuary reports and all the information included in the PAC policyholder pack. The Rothesay website will also include a copy of Rothesay's Chief Actuary report and a copy of the Rothesay policyholder notification letter.

Notification of transferring policyholders

12.6 PAC has proposed a communication plan, including the PAC policyholder pack, to provide notification of the proposed transfer to all transferring policyholders (including relevant trustees or employers holding policies on behalf of pension scheme beneficiaries).

12.7 It is proposed that each PAC policyholder included within the scope of the communication plan will receive a policyholder pack that comprises a covering letter and an information booklet containing:

- A summary of the terms of the Scheme;
- A summary of the report by the Independent Expert;
- A questions and answers section; and
- A copy of the legal notice of the transfer.

12.8 I have reviewed draft versions of the documents to be included in the PAC policyholder pack and have provided comments to PAC. I consider that the most recent drafts I have reviewed provide a satisfactory level of information on the proposed transfer and a clear explanation of the consequences for transferring policyholders.

12.9 PAC expects to request waivers from notifying the following groups of transferring policyholders:

- "Goneaways": Policies where PAC does not have a valid address for the policyholder or pension scheme and subsequent reasonable attempts to trace the policyholder or scheme have been unsuccessful are classed as "Goneaways". PAC will not be able to notify these policyholders or pension schemes;
- Attorney: Where PAC's database records that a policyholder has appointed an attorney in respect of the policy, the attorney will be notified instead of the policyholder;
- Beneficiaries under group schemes: In general, PAC will notify the trustees rather than beneficiaries. However, for buy-ins where PAC has an existing arrangement in place with a trustee to directly contact that trustee's beneficiaries, PAC will notify the beneficiaries instead;
- Contingent annuitants: For policies that may pay an individual an annuity in the future (but there is not yet an annuity in payment), the contingent annuitant will not be notified;
- Trustees-in-bankruptcy, receivers and administrative receivers: For policies where the policyholder has been declared bankrupt, the policyholder will be notified rather than the trustees-in-bankruptcy, receivers or administrative receivers,

unless PAC has a record in its databases of the appointment of the trustee-in-bankruptcy, receiver or administrative receiver;

- Pension sharing orders: Some policies are subject to a pension sharing order where a court has ordered that some or all of the benefits are paid to the policyholder's former spouse with any remainder being paid to the policyholder. PAC will notify policyholders with the benefit of a Pension Sharing Order where PAC's records show the existence of that Pension Sharing Order;
- Deceased policyholders: Policies for which PAC has been notified of the death of the policyholder but the benefits have not yet been settled, PAC will not attempt to notify the policyholder or the executors or personal representatives the policyholder. The policyholder's spouse will only be notified if they have a contingent benefit under the policy; and
- Accidental omissions: Some of the Transferring Policyholders may not be sent a Policyholder Pack as a result of an accidental omission or an intervening event that is outside of PAC's direct control. PAC will remedy any such failure in advance of the final Court hearing wherever possible.

12.10 PAC estimates that there are currently 5,856 policies which are goneaways or where the electronic policy records have invalid or missing addresses as at 31 August 2018. PAC performs regular exercises to ensure the accuracy of its policyholder data, using a third party tracing agency. PAC has informed me that in the most recent validation exercise, it has prioritised the annuity policyholders in order to minimise the number of goneaways and invalid addresses ahead of the policyholder mailing.

12.11 Regulations made under FSMA require that the transfer is advertised in every EEA state which is the member state of the commitment. However, PAC will seek a waiver in respect of this requirement and instead intends to undertake advertising in the EEA states where there are more than 100 transferring policyholders. PAC propose that the legal notice will be published, translated into the local language where appropriate, in two national newspapers in each of the applicable EEA states. These are Cyprus, France, Germany, Greece, Italy, Portugal, the Republic of Ireland and Spain.

12.12 I am satisfied that PAC has made sufficient efforts to ensure that the groups listed in paragraphs 12.9 and 12.10 are as small as possible, and I am therefore satisfied that the proposal to seek a waiver from notifying these groups is reasonable. In addition, I am satisfied that PAC's proposed approach to adverting the Scheme in EEA states is reasonable.

Non-notification of non-transferring policyholders of PAC

12.13 PAC intends to seek a waiver from the requirement to directly contact its non-transferring policyholders, including Non-transferring Reinsured Policies and other non-transferring PAC annuity policyholders.

12.14 PAC considers that it would be disproportionate to notify these policyholders given that PAC considers that the Scheme does not affect the security, reasonable benefit expectations or service standards of the non-transferring PAC policyholders nor the terms and conditions of their policies.

12.15 PAC has given consideration to notifying the approximately 800,000 non-transferring PAC annuity policyholders[51] of the proposed transfer in order to clarify the status of non-transferring policyholders who may have seen media coverage of the transaction with Rothesay and who may be unsure if their policy is in the scope of the transaction. However, PAC believes that the number of policyholders to whom this might apply is likely to be small, and that the benefit of clarifying their status needs to be balanced against the risk of confusion and unsettlement caused by notifying those that had not previously been aware of the Rothesay transaction, which PAC believes to be a much larger proportion of the non-transferring PAC policyholders.

12.16 I am satisfied that the non-transferring PAC policyholders, including non-transferring PAC annuity policyholders, do not need to receive formal notification of the Scheme. However, I challenged PAC on whether the non-transferring PAC annuity policyholders should nevertheless receive a brief letter confirming that they are not included in the proposed transfer. While those policyholders will not be materially affected by the proposed transfer, they will not be able to determine from any general description of the Transferring Business whether or not their policy is within the scope of the transfer as PAC did not notify any policyholders of the inception of the Laker Reinsurance Agreement (nor was it required to undertake such a notification). In response, PAC informed me that the media communications listed in paragraphs 12.2 and 12.3 will include details of a web-based tool that PAC policyholders can use to confirm whether they are in scope of the proposed transfer, and additionally a phone line for policyholders to call for more information. Therefore, policyholders who are aware of the transaction with Rothesay as a result of press coverage and who are uncertain as to whether they have a transferring policy will be able to confirm this relatively easily. In view of this, I do not consider that the likely level of awareness of the Scheme will be high enough to justify contacting each non-transferring PAC policyholder to inform them that they are not included in the Transferring Business.

[51] Holders of annuity PAC policies that are not in-scope of the Scheme. This includes Non-transferring Reinsured Policies as well as holders of PAC annuities which were not in scope of the Laker Reinsurance Agreement.

12.17 Taking this into account, I am satisfied that PAC's approach of not notifying non-transferring PAC policyholders is reasonable.

Non-notification of policyholders of Rothesay

12.18 Rothesay expects to request waivers from notifying the following groups by reference to its records as at the specified mailing extract date:

- "Goneaways": Policies where Rothesay does not have a valid address for the policyholder or pension scheme and subsequent reasonable attempts to trace the policyholder or scheme have been unsuccessful are classed as "Goneaways". Rothesay will not be able to notify these policyholders or pension schemes;
- Assignees: In cases where someone other than the original policyholder is the current legal assignee of a policy and their details appear as the contact details for the policy in Rothesay's electronic records, Rothesay will send the policyholder letter to that person instead of the original policyholder;
- Beneficiaries: Rothesay does not have a legal or contractual relationship with any beneficiary of a policy that is written in trust and therefore Rothesay will only notify the trustee of the policy;
- Scheme Beneficiaries of buy-ins: Rothesay will only notify the trustee of the Scheme and not the beneficiaries. However, for buy-ins where Rothesay has an existing arrangement in place with a trustee to directly contact that trustee's beneficiaries, Rothesay will notify the beneficiaries instead;
- Contingent annuitants: Rothesay will not notify the contingent annuitant of a policy unless they are also named as a joint policyholder;
- Pension sharing orders: Rothesay will only notify policyholders with the benefit of a Pension Sharing Order where its electronic records shows the existence of that Pension Sharing Order;
- Powers of attorney: Rothesay will notify the relevant attorney instead of the policyholder in respect of whom the power of attorney applies if Rothesay's electronic records show the existence of the power of attorney;
- Joint policyholders: If both policyholders have the same address, Rothesay will notify the first named policyholder on the policy. If the policyholders have different addresses then Rothesay will notify each policyholder on the policy;
- Receivers, administrative receivers or trustees-in-bankruptcy: Rothesay will only notify the receivers or trustees in bankruptcy if Rothesay's electronic records contain their details;
- Deceased policyholders: Rothesay will notify the executors and personal representatives of deceased policyholder if benefits remain payable. The letter will be sent to the address of the deceased policyholder held on its electronic database at the specified mailing extract date;
- Accidental omissions: Some of the existing Rothesay policyholders may not be sent a Rothesay policyholder letter as a result of an accidental omission or an intervening event that is outside of Rothesay's direct control. Rothesay will remedy any such failure in advance of the final Court hearing wherever possible.

12.19 With the exception of the groups of policyholders listed above, Rothesay intends to notify all of its existing policyholders of the Scheme by sending a policyholder notification letter to them.

12.20 I am satisfied that the proposal to seek a waiver from notifying the groups listed in paragraph 12.18 is reasonable.

12.21 I have reviewed draft versions of the Rothesay policyholder letter and have provided comments to Rothesay. I consider that the most recent drafts I have reviewed provide a satisfactory level of information on the proposed transfer and a clear explanation of the consequences for existing policyholders of Rothesay.

12.22 PAC and Rothesay have both shared with me their approaches to dealing with vulnerable consumers and they have both confirmed that their approaches will be maintained during all communications with policyholders in relation to the proposed transfer.

Overall conclusion on the approach to communication with policyholders

12.23 I am satisfied that the proposed approach to communication with policyholders is fair and reasonable.

THE COSTS OF THE SCHEME

12.24 PAC and Rothesay will each bear the cost of notifying their own policyholders of the Scheme. My Independent Expert fees, Court fees and counsel's fees will be shared equally between the parties, as will the costs of any advertisements in respect of the Scheme. All other costs will be borne by the party that incurs them.

12.25 Costs associated with the Scheme that are attributable to PAC will be met from PAC's shareholder funds and not by policyholders or the PAC with-profits fund. Costs attributable to Rothesay will be met from Rothesay's shareholder funds and not by policyholders.

12.26 I am satisfied that this approach to meeting the costs associated with the Scheme is reasonable.

EXTERNAL REINSURANCE WHERE PAC OR ROTHESAY IS THE CEDANT

12.27 Under the terms of the Scheme, there will be no change to the reinsurance contracts for which Rothesay is the cedant, or to reinsurance contracts for which PAC is the cedant and which relate to non-transferring PAC policies.

12.28 As noted in Section 7, longevity reinsurance arrangements in respect of the Transferring Business will transfer from PAC to Rothesay under the Scheme. Rothesay has informed me that, where it already has a relationship with one or more of those reinsurers, it may seek to align the terms of the relevant transferring treaties with the terms of its existing reinsurance arrangements with such reinsurer(s). I note that any such alignment would be a commercial negotiation that would be subject to the consent of the reinsurer in question.

12.29 Reinsurers are exposed to risk of default by the cedant with respect to any reinsurance premiums in excess of any collateral posted. If the Scheme is implemented, Rothesay will become the cedant for the longevity reinsurance treaties that relate to the Transferring Business. I have considered the capital policy, governance and financial strength of Rothesay in comparison to PAC in Section 8. I consider that there will be no material change to the financial strength of the cedant and therefore I conclude that the Scheme would not lead to a material change in the security of reinsurance premiums under the longevity reinsurance treaties that relate to the Transferring Business.

12.30 I am therefore satisfied that the Scheme will not have a material effect on the reinsurers of the PAC or Rothesay policies.

ASSET COUNTERPARTIES

12.31 Although there may be some adjustments to the premium paid between by PAC to Rothesay prior to the Transfer Date, the Scheme will not result in a transfer of financial assets. Therefore there will be no legal issues regarding asset counterparties.

TAX

12.32 The companies have informed me that confirmation and clearance that the transaction is not for an "unallowable purpose" for corporation tax purposes will, in due course, be sought from Her Majesty's Revenue and Customs ("**HMRC**"). I will comment further on this in my Supplementary Report.

12.33 As described in paragraphs 7.32 to 7.34, it is intended that administration services for Transferring Policies will continue to be provided by PAC for a period of 12 to 24 months after the Transfer Date. However, after the Transfer Date it will be necessary to use Rothesay's Pay As You Earn ("**PAYE**") reference for Transferring Policies. For some holders of Transferring Policies, this may trigger a change in their PAYE tax code, either at or directly after the Transfer Date. Rothesay and PAC are liaising with HMRC to establish the best approach to minimise any inconvenience for affected policyholders. I will comment further on this aspect in my Supplementary Report.

OTHER CREDITORS

12.34 PAC and Rothesay have informed me that there are no bondholders or third parties to securitisation arrangements or any other creditors of either company whose interests would be affected by the implementation of the Scheme.

FUTURE CORPORATE TRANSACTIONS

12.35 I am not aware of any future transfers or corporate transactions (other than those detailed in Sections 5 and 6), although I note that Rothesay's longstanding strategy involves the regular execution of transactions of varying sizes with defined benefit pension schemes and insurance companies, and therefore it is to be expected that such transactions will continue to take place.

12.36 Any future transfers of insurance business into or out of either company would be subject to the usual Part VII transfer process and its associated safeguards. Any future corporate transactions involving the acquisition or disposal of another insurance company would be subject to a 'Change in Control' process which requires the approval of the PRA and the FCA. In both cases the process would consider the impact of any transaction on affected policyholders.

FINANCIAL SERVICES COMPENSATION SCHEME ("**FSCS**") AND FINANCIAL OMBUDSMAN SERVICE ("**FOS**")

12.37 FSCS is a company limited by guarantee, with statutory backing, which provides compensation to customers of authorised financial institutions (such as banks and insurers) in the event the institution is in default (meaning unable to pay).

12.38 The eligibility of holders of long-term insurance policies for compensation from the FSCS, and the amount of compensation payable, are dependent upon the type of policyholder, the type of policy and where the insurer is based. The FSCS will pay compensation to eligible individual holders of long-term insurance policies issued by UK insurers in the UK or another EEA state in the event of the insurer's default. Compensation to eligible holders of annuities in payment is the full amount of the annuity, without limit.

12.39 Implementation of the Scheme will not adversely affect eligibility for compensation from the FSCS for any transferring or non-transferring PAC policyholders or for the existing Rothesay policyholders.

12.40 The FOS is an independent public body that aims to resolve disputes between individuals and UK financial services companies, and may make compensation awards in favour of policyholders. Only holders of policies that constitute business carried on in the UK are permitted to bring complaints to the FOS. In circumstances where PAC currently refers policyholders to the FOS (including, for the avoidance of doubt, Jersey and Guernsey policyholders), Rothesay will continue to do so following implementation of the Scheme. Any outstanding FOS complaints at the Transfer Date in respect of Transferring Policies will be handled and settled by PAC.

12.41 Implementation of the Scheme will not adversely affect access to the FOS for either transferring or non-transferring policyholders.

THE EFFECT OF THE PROPOSED SCHEME ON PREVIOUS SCHEMES

12.42 Allen & Overy LLP, acting for PAC, and Linklaters LLP, acting for Rothesay, have carried out legal reviews of relevant previous PAC and Rothesay schemes respectively and have confirmed that there were no enduring provisions in those schemes that would be affected by this Scheme and that I would need to consider in the context of the proposed transfer.

12.43 As discussed in Section 3, I am satisfied that it is appropriate for me to rely on the conclusions of Allen & Overy LLP and Linklaters LLP in relation to the Scheme.

THE FUTURE OPERATION OF THE SCHEME

12.44 If the Scheme is approved by the Court (and subject to any subsequent amendment of the Scheme, as considered below), the Directors of PAC and Rothesay are committed to implementing the Scheme as set out in the Scheme document (and reflected in this report) in accordance with their fiduciary responsibilities under UK company law.

12.45 At any time after the Court's sanction of the Scheme, PAC and Rothesay must apply to the Court for sanction of any amendments to it, except where the amendment is:

- Considered to be minor or technical;
- Required by law;
- Required to reflect changes in actuarial techniques and practices; or
- Required to protect the rights and reasonable expectations of policyholders.

In these cases the companies must notify the PRA and FCA.

12.46 The published financial position of PAC and Rothesay will be calculated by the firms' actuaries and accountants who are subject to professional standards, and will be subject to external audit. The business being transferred consists of non-profit business and therefore the most important aspect is that Rothesay will continue to meet any guaranteed liabilities and that sufficient resources are put aside to enable this.

12.47 In my opinion there are reasonable safeguards in place to ensure that, if approved by the Court, the Scheme will be operated as presented to the Court.

13. Conclusions

13.1 I am satisfied that the implementation of the Scheme will not have a material adverse effect on:

- The security of benefits of the policyholders of PAC and Rothesay, including the transferring policyholders;
- The reasonable benefit expectations of the policyholders of PAC and Rothesay, including the transferring policyholders; or
- The service standards and governance applicable to the PAC and Rothesay policies, including the transferring policies.

13.2 I am satisfied that the Scheme is equitable to all classes and generations of PAC and Rothesay policyholders.

Nick Dumbreck 21 January 2019

Fellow of the Institute and Faculty of Actuaries

Appendix 1: Statement of independence

The Prudential Assurance Company Limited ("**PAC**") has agreed to reinsure a block of its non-profit annuity business to Rothesay Life Plc ("**Rothesay**"). It is proposed that the reinsured business should subsequently be transferred to Rothesay under section 109 of the Financial Services and Markets Act 2000 by means of a scheme to be submitted to High Court in England and Wales for approval.

I have been appointed as the Independent Expert to report on the proposed transfer. My appointment has been approved by the PRA in consultation with the FCA.

I am a partner of Milliman LLP ("**Milliman**"), based in its UK Life Insurance practice in London. The purpose of this statement is to disclose all connections between myself and PAC and Rothesay including their respective major shareholders and subsidiaries (together "**the Companies**"), and between Milliman and the Companies.

I am not a shareholder in any of the Companies.

I do not hold any policies with any of the Companies, and am not a member of any group pension scheme or other group arrangement which holds a policy with any of the Companies.

I acted as independent expert for the transfer of non-profit annuity business from Scottish Equitable to Rothesay in 2017. My colleague Oliver Gillespie acted as independent expert for the transfer of the business of Paternoster UK Limited to Rothesay in 2011, and for the transfer of the business of Rothesay Assurance Limited to Rothesay in 2015. Oliver Gillespie also acted as independent expert for the transfer of some of the business of PAC to Prudential International Assurance plc in 2018.

I contributed to two Solvency II training sessions for the Board of Rothesay in 2013, and acted as peer reviewer of Oliver Gillespie's independent expert reports referred to above. Milliman assisted Rothesay with a Solvency II gap analysis in 2013.

Except as disclosed above, Milliman has not carried out any work for any of the Companies in the past five years. Milliman is the UK operation of Milliman Inc. Worldwide fees received by Milliman Inc. from PAC and its subsidiaries, and from Rothesay and its major shareholders, have not exceeded 1% of the firm's total revenues in any recent year.

I do not believe that any of the above adversely affects my ability to act independently in my assessment of the Scheme.

Nick Dumbreck

Fellow of the Institute and Faculty of Actuaries

21 January 2019

Appendix 2: Previous transfers for which I have acted as Independent Expert or equivalent

1995: Demutualisation of Provident Mutual

1997: Demutualisation of Norwich Union

1998: Demutualisation of Sanlam (South Africa)

1998: Transfer of the business of GAN Life & Pensions and Aegon UK to Windsor Life

1999: Transfer of business from Northern Assurance to CGU Linked Life

2001: Transfer of the pooled pensions business of Norwich Union Linked Life and General Accident Managed Pension Funds to Morley Pooled Pensions

2004: Transfer of the business of Nascent Life to St James's Place International (Ireland)

2004: Transfer of business from 8 companies within the Aviva Group to Norwich Union Life & Pensions and Norwich Union Annuities

2004: Transfer of business from Allied Dunbar and Zurich Assurance to Eagle Star Life

2005: Transfer of business from Phoenix Assurance, Swiss Life (UK) and Bradford Insurance to Royal & Sun Alliance Linked Insurances

2005: Transfer of annuity business from Phoenix & London Assurance to Canada Life (UK)

2005: Transfer of business from Reassure (UK) and Virgin Money Life to Windsor Life

2005: Transfer of business from Allied Dunbar International Assurance to Zurich International Life (Isle of Man)

2006: Transfer of annuity business from Phoenix Life & Pensions to Prudential Retirement Income Limited

2006: Transfer of business from Halifax Life to Clerical Medical and St Andrew's Life

2006: Transfer of long-term business from GE Frankona Re to Swiss Re Life & Health and Swiss Reinsurance Company

2007: Transfer of business from Swiss Re Life & Health to Swiss Re Europe

2007: Transfer of business from NM Life and NM Pensions to Windsor Life

2008: Transfer of immediate annuity business from Zurich Assurance to Windsor Life

2009: Transfer of business from CGNU Life, Commercial Union Life and Norwich Union Life (RBS) to Aviva Life and Pensions and associated inherited estate reattribution

2010: Transfer of business from Aberdeen Asset Management Pooled Pensions Limited to Aberdeen Asset Management Life and Pensions Limited

2011: Transfer of business from SLFC Assurance (UK) Limited to Sun Life Assurance Company of Canada (UK) Limited

2013: Transfer of the Hong Kong branch business of Prudential Assurance Company Limited to Prudential Hong Kong Limited

2016: Transfer of annuity business from Equitable Life Assurance Society to Canada Life Limited

2017: Transfer of non-profit annuity business from Scottish Equitable plc to Rothesay Life Plc.

2018: Transfer of the majority of BlackRock Life Limited's defined contribution pensions business to Scottish Equitable

Appendix 3: Data relied upon

In addition to discussions (both orally and electronically) with PAC and Rothesay staff, I have relied upon the following principal documents in formulating my conclusions:

- Draft PAC With-Profits Actuary report on the Scheme (received 14th September 2018, 19th December 2018,11th January 2019, 15th January 2019)
- Draft PAC Chief Actuary report on the Scheme (received 13th September 2018, 11th January 2019, 15th January 2019)
- Draft Rothesay Chief Actuary report on the Scheme (received 17th August 2018, 22nd August 2018, 20th December 2018, 11th January 2019, 15th January 2019)
- Commutation factors comparison paper (received 7th September 2018)
- PAC Executive Technical Committee draft paper on commutations proposing modifications to current commutation basis (received 18th December 2018)
- PAC ORSA 2017 (received 5th July 2018, 26th July 2018)
- Rothesay ORSA 2017 (received 13th July 2018)
- Rothesay Capital Management Policy (received 13th August 2018)
- Rothesay Liquidity Policy (received 7th December 2018)
- PAC Risk Appetite framework (received 11th July 2018)
- PAC Policyholder Communications (received 31st August 2018, 7th September 2018, 20th December 2018, 15th January 2019)
- Rothesay Policyholder Communications (received 30th August 2018 and 6th September 2018, 15th January 2019)
- Draft Scheme Document (received 31st August 2018, 20th August 2018, 21st August 2018, 20th December 2018, 15th January 2019)
- Reinsurance Agreement between PAC and Rothesay (received 13th July 2018)
- Business Transfer Agreement between PAC and Rothesay (received 18th July 2018)
- Financial Impact of Vitality Transfer (received 6th September 2018)
- Financial Impact of PAC's Hong Kong subsidiaries (received 24th August 2018)
- Financial Impact of Scheme pro forma on Rothesay (received 2nd August 2018, 17th August 2018, 22nd August 2018, 5th December 2018, 18th December 2018)
- Financial Impact of Scheme pro forma on PAC (received 8th August 2018, 10th August 2018, 13th August 2018, 23rd August 2018, 31st August 2018, 18 December 2018)
- Administration Arrangements Paper (received 4th September 2018)
- Rothesay SFCR 2017 (public document)
- PAC SFCR 2017 (public document)
- Rothesay TMTP run-off projection (received 13th September 2018)
- PAC approach to vulnerable customers (received 3rd January 2019)
- Rothesay approach to vulnerable customers (received 10th January 2019)

Appendix 4: Certificate of Compliance

I understand that my duty in preparing my report is to help the Court on all matters within my expertise and that this duty overrides any obligations I have to those instructing me and / or paying my fee. I confirm that I have complied with this duty.

I confirm that I am aware of the requirements applicable to experts set out in Part 35 of the Civil Procedure Rules, the Practice Direction and the Protocol for Instruction of Experts to give Evidence in Civil Claims. As required by Part 35 of the Civil Procedure Rules, I hereby confirm that I have understood my duty to the Court, the Royal Court of Guernsey and the Royal Court of Jersey.

I confirm that I have made clear which facts and matters referred to in my report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

Nick Dumbreck 21 January 2019

Fellow of the Institute and Faculty of Actuaries

Appendix 5: Glossary of terms

A glossary of abbreviations used throughout the report is given below.

A

APS	Actuarial Profession Standards
Asset Share	A measure of the value of a policy based on actual investment returns earned and expenses incurred by the fund.
AVC	Additional Voluntary Contributions
AWP	Accumulating With-Profits

B

BEL	Best Estimate Liabilities
BRCC	Board Risk and Capital Committee
Business Risk	The risk of loss due to unexpected changes to the legal conditions to which insurers are subject, changes in the economic and social environment, as well as changes in business profile and the general business cycle.
Business Transfer Agreement	The transfer agreement between PAC and Rothesay setting out how the Laker Reinsured Business will be transferred to Rothesay.

C

Counterparty default risk	Counterparty default risk, also known as default risk, is the risk that a party to a contract will default on its contractual obligations.
Court	The High Court of Justice of England and Wales
Commutation factor	The amount of lump sum received per £1 p.a. of pension benefit. This factor is used to calculate a policyholder's lump sum benefit if a policyholder chooses to commute some or part of their pension income.
Credit Risk	The risk of losses arising from the default or downgrade of asset counterparties, or from an increase in the perceived risk of default or downgrade of such asset counterparties.
CRO	Chief Risk Officer
CSA	Capital Support Arrangement
Currency risk	The risk of loss due to a change in the price of one currency in relation to another.
CWP	Conventional With-Profits

D

Deferred Pension	The situation where a pension scheme member/policyholder who is not yet receiving their pension, but is no longer accruing pension benefits within the pension scheme.
Directions Hearing	An initial Court hearing at which the companies' plans for notifying policyholders are considered.
Discovery	Discovery Limited
Dynamic TMTP	A TMTP that is calculated in line with changes to economic conditions. In contrast to the reported TMTP, which is recalculated every 24 months or when there has been a material change to the company's risk profile and which must be approved by the PRA.

E

EEA	European Economic Area
EIOPA	The European Insurance and Occupational Pensions Authority
ELAS	Equitable Life Assurance Society
Excess Assets	The assets in each of the with-profits sub-funds in excess of amounts expected to be required to meet guaranteed benefits and future discretionary benefits of business in that sub-fund, as well as related shareholder transfers
Excluded Policies	Policies in scope to be transferred by the Scheme but are not able to be transferred on the Transfer Date
Existing Policyholders	Existing policyholders of Rothesay
Expense Risk	The risk of loss caused by the fact that the timing and/or the amount of expenses incurred differs from those expected
Exposure	The amount of BEL, gross of reinsurance, covered by the longevity reinsurance

F

FCA	Financial Conduct Authority
FCA Guidance	The FCA's approach to the review of Part VII insurance business transfers published
Final Hearing	Also known as a 'Sanctions Hearing', this is a subsequent Court hearing that takes place once the notification requirements (decided in the Directions Hearing) have been met, at which the Court is asked to approve the Part VII transfer.
FOS	Financial Ombudsman Service
FRR	Financial Resources Requirement
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000

G

Goldman Sachs	The Goldman Sachs Group, Inc.
Goneaways	Policies where the company does not have a valid address for the policyholder or pension scheme and subsequent reasonable attempts to trace the policyholder or scheme have been unsuccessful.
Gross BEL	BEL which includes liabilities that have been reinsured.
Guernsey Policies	Transferring Policies which were issued to residents of the Bailiwick of Guernsey.
Guernsey Scheme	The Guernsey court-approved process that, together with the Scheme, will effect the transfer of certain Guernsey Policies of PAC to Rothesay.

H

HMRC	HM Revenue & Customs

I

In-payment Pensions	A pension scheme member/policyholder who is receiving their pension.
Interest Rate Risk	The risk of loss caused by changes in the level of market interest rates
Internal Model	The PAC internal model for Solvency II reporting

J

Jersey Policies	Transferring Policies which were issued to residents of the Bailiwick of Jersey

L

Laker Reinsurance Agreement	A collateralised reinsurance arrangement between PAC and Rothesay signed on 14 March 2018 (as amended) which transfers the policyholder benefit liabilities of the Laker Reinsured Business from PAC to Rothesay
Laker Reinsured Business	Approximately 400,000 PAC non-profit annuities which PAC agreed to sell to Rothesay. These polices are covered by the Laker Reinsurance Agreement.
Liquidity Risk	The risk of being unable to meet financial obligations as they fall due. Liquidity risk may arise due to illiquidity of the assets held to meet the cash flow requirements, but also due to insufficient funds being available to meet cash flow requirements.
Longevity Risk	The risk of loss resulting from changes in mortality rates whereby a decrease in mortality rates causes an increase in the value of insurance liabilities.

M

MAL	MetLife Assurance Limited
Master Trust	A Master Trust is a multi-employer occupational scheme where each employer has its own division within the master arrangement.
Matching Adjustment	An increase to the discount rate used in the calculation of the BEL that allows firms to take credit for the additional investment return in excess of the risk free rate (swap rates under Solvency II) that they expect to earn from a "hold to maturity" investment strategy. Its effect is to reduce the market value of the assets that must be held by an insurer to cover its Best Estimate Liabilities.
Market Risk	The risk of loss caused by market prices or volatilities of market prices differing from their expected values.
MCR	Minimum Capital Requirement
Milliman	Milliman LLP

N

NPSF	The Non-Profit Sub Fund of PAC
Non-Transferring Policies	The policies of PAC which are not transferring as a result of the Scheme
Non-transferring Reinsured Policies	Policies in scope of the Laker Reinsurance Agreement which are not in scope to be transferred under the Scheme.

O

Operational Risk	The risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events.
ORSA	Own Risk and Solvency Assessment. A requirement under SII whereby Insurers must regularly undertake a forward looking assessment of risks, solvency needs and adequacy of capital resources.
Own Funds	The excess of assets over liabilities under Solvency II

P

PAC	The Prudential Assurance Company Limited

PAC DCPSF	The PAC Defined Charge Participating Sub-Fund
PAC general insurance business	The PAC shareholder-backed short-term insurance business
PAC NPSF	The PAC Non-Profit Sub-Fund
PAC policyholder pack	The pack which will be sent to holders of Transferring Policies which includes a policyholder letter, a summary of the Scheme, a summary of the conclusions from this report and some specimen Questions and Answers.
PAC shareholder-backed business	The business outside PAC's ring-fenced with-profits sub-funds
PAC SHF	The PAC Shareholder Fund
PAC WPSF	The PAC With-Profits Sub-Fund
PAL	Prudential Annuities Limited
PANL	Prudential (AN) Limited
Partial Internal Model	A model which is used to calculate some components of the SCR that is bespoke to an individual company.
Paternoster	Paternoster UK Limited
PAYE	Pay As You Earn
PCA	Prudential Corporation Asia Limited
Pension Mis-Selling Costs Assurance	PAC's assurance that mis-selling compensation costs will not affect the bonus or investment policy for policies within the with-profits fund that were in force at 31 December 2003.
Persistency Risk	The risks of losses caused by deviations from the actual rate of policy lapses from their expected rates.
PGHKL	Prudential General Insurance Hong Kong Limited
PHLL	Prudential Holborn Life Limited
PHKL	Prudential Hong Kong Limited
PIA	Prudential International Assurance plc
PIM	Partial Internal Model
PPL	Prudential Pensions Limited
PRA	Prudential Regulation Authority
PRA Policy Statement	"Statement of Policy - The Prudential Regulation Authority's approach to insurance business transfers", April 2015
PRIL	Prudential Retirement Income Limited
PPFM	Principles and Practices of Financial Management

R

RAL	Rothesay Assurance Limited
Regulatory Guidance	The guidance set out in the PRA Policy Statement.
Risk-free rate	Theoretical rate of return of an investment with zero risk. Risk-free rates are published by EIOPA
Risk Margin	An adjustment designed to bring the Technical Provisions up to the amount that another insurance or reinsurance undertaking would be expected to require in order to take over and meet the insurance obligations in an arm's length transaction.
RMF	Risk Management Framework

Rothesay	Rothesay Life Plc
Rothesay HoldCo	Rothesay HoldCo UK Limited
Rothesay policyholder letter	The letter which Rothesay will send to its policyholders to notify them of the proposed transfer.

S

SAIF	The Scottish Amicable Insurance Fund
SAL	Scottish Amicable Life plc
Sanctions Hearing	A hearing of the Court to approve the terms of the Scheme prior to effective date of the Scheme
Scheme	The proposed scheme and all proposals included in the scheme, including any documents referred to in the scheme relating to its proposed implementation and operation.
SCR	Solvency Capital Requirement
SCR Coverage Ratio	Own Funds divided by SCR
SHF	Shareholders' fund
SHIFT	Shareholders' interest in future transfers (from PAC's with-profits fund)
SMF	Senior Management Function
SM&CR	Senior Managers and Certification Regime
Solvency II	Regulatory solvency framework for the European Economic Area insurance and reinsurance industry.
Solvency intervention ladder	Part of PAC's SRA Framework which sets out solvency triggers to consider and initiate actions to manage and restore the capital position as solvency deteriorates.
Spread Risk	The risk of loss due to a deviation of the actual market price of credit risk from the expected price of credit risk.
SRA	Shareholder Risk Appetite
Standard Formula	EIOPA prescribed method of calculating SCR.
Summary Report	An abbreviated version of the Independent Expert report prepared for policyholders interested in understanding the transfer but who may not wish to read this report in its entirety.
SUP	Supervision Manual contained in the FCA Handbook.
SUP 18	Chapter 18 of the Supervision Manual contained in the FCA Handbook.
Supplemental Agreement	The agreement between PAC and Rothesay which modifies the Business Transfer Agreement.
Supplementary Report	A further report produced prior to the final Court hearing to provide an update for the Court on the Independent Expert's conclusions in the light of any significant events subsequent to the date of the finalisation of this report.

T

TAS	Technical Actuarial Standards
TCS	Tata Consultancy Services
Technical Provisions	Pillar 1 liabilities under Solvency II consisting of BEL and Risk Margin.

TMTP	Transitional Measure on Technical Provisions. The TMTP is intended to phase in (over 16 years) any increase in reserves that must be held for business written prior to 2016 arising from the introduction of the Solvency II regime on 1 January 2016.
Transfer Date	The effective date of the Scheme which is expected to be 26th June 2019.
Transferring Business	The Transferring Policies, together with the associated assets and liabilities which will be included in the proposed transfer to Rothesay.
Transferring Policies	The transferring policies of PAC.
TRASP	The FCA's Thematic Review of Annuity Sales Practices.
TRASP PBR	TRASP Past Business review that PAC is conducting
TRASP Lump Sums	Lump sum compensation payments paid by PAC as a results of its TRASP PBR
TRASP Incremental Liabilities	Augmented existing annuity payments as a result of PAC's TRASP PBR

U

Unallowable purpose	A corporation tax purpose which is not amongst the business or other commercial purposes of the company.

V

Volatility Adjustment	An increase to the discount rate used in the calculation of the BEL (other than for liabilities that are subject to the Matching Adjustment) which aims to prevent forced sales of assets in the event of extreme bond spread movements. Its effect is to reduce the market value of the assets that must be held by an insurer to cover its Best Estimate Liabilities.

W

With-profits Advisory Arrangement	An independent person or one or more non-executive directors appointed to provide independent judgement to the firm's governing body.
WPA	With-Profits Actuary
WPC	With-Profits Committee
WPSF	With-Profits Sub-Fund

Appendix 6: Compliance with regulatory requirements

The table below indicates how I have complied with the provisions of the PRA Policy Statement, SUP 18.2 and the FCA Guidance that pertain to the form of the Scheme Report.

PRA Policy Statement Reference	Requirement	Scheme Report paragraph reference
2.30 (1)	Who appointed the independent expert and who is bearing the costs of that appointment	1.2, 1.18
2.30 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator.	1.3
2.30 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role	1.15- 1.16
2.30 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest	1.17
2.30 (5)	The scope of the report	1.6 - 1.14
2.30 (6)	The purpose of the scheme	1.6 - 1.14
2.30 (7)	A summary of the terms of the scheme in so far as they are relevant to the report	Section 7
2.30 (8)	What documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided	Appendix 3, 1.10
2.30 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgment of others	1.22
2.30 (10)	The people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable	1.22
2.30 (11)	His opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee	Sections 8, 9 and 10
2.30 (12)	His opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme	12.27 - 12.30
2.30 (13)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the scheme	1.26
2.30 (14)	For each opinion that the independent expert expresses in the report, an outline of his reasons.	Throughout report

2.32 (1)	The summary of the terms of the scheme should include a description of any reinsurance agreements that it is proposed should pass to the transferee under the scheme	7.20
2.32 (2)	The summary of the terms of the scheme should include a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	7.21
2.33 (1)	The independent expert's opinion of the likely effects of the scheme on policyholders should include a comparison of the likely effects if it is or is not implemented	Section 11
2.33 (2)	The independent expert's opinion of the likely effects of the scheme on policyholders should state whether he considered alternative arrangements and, if so, what	3.4
2.33 (3)	The independent expert's opinion of the likely effects of the scheme on policyholders should, where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders	Throughout the report
2.33 (4)	The independent expert's opinion of the likely effects of the scheme on policyholders should include his views on: (a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;	Section 8, Section 9 and Section 10
	(b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect: (i) the security of policyholders' contractual rights;	Section 8, Section 9 and Section 10
	(ii) levels of service provided to policyholders; or	Section 8, Section 9 and Section 10
	(iii) for long-term insurance business, the reasonable expectations of policyholders; and	Section 8, Section 9 and Section 10
	(c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations	12.24 - 12.26, 12.32
2.35 (1)	For any mutual company involved in the scheme, the report should describe the effect of the scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes which could affect their entitlements as policyholders	n/a
2.35 (2)	For any mutual company involved in the scheme, the report should state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights	n/a

2.35 (3)	For any mutual company involved in the scheme, the report should comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without.	n/a
2.36 (1)	For a scheme involving long-term insurance business, the report should describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits	7.9, 9.29-9.35,
2.36 (2)	For a scheme involving long-term insurance business, the report should, if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;	n/a
2.36 (3)	For a scheme involving long-term insurance business, the report should describe the likely effect of the scheme on the approach used to determine: (a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and (b) the levels of any discretionary charges	8.65 to 8.78
2.36 (4)	For a scheme involving long-term insurance business, the report should describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm	12.44 to 12.47
2.36 (5)	For a scheme involving long-term insurance business, the report should include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders	Section 8, Section 9 and Section 10
2.36 (6)	For a scheme involving long-term insurance business, the report should state whether the independent expert is satisfied that for each firm the scheme is equitable to all classes and generations of its policyholders	Section 13
2.36 (7)	For a scheme involving long-term insurance business, the report should state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented.	12.47

FCA FG18/4 reference	Requirement	IE Report paragraph reference
6.2	Report is constructed in such a way that it is easily readable and understandable by all its users, paying attention to the following: • Technical terms and acronyms should be defined on first use. • There should be an executive summary that explains, at least in outline, the proposed transfer and the IE's conclusions. • The business to be transferred should be described early in the report. • The detail given should be proportionate to the issues being discussed and the materiality of the Transfer when viewed as a whole. While all material issues must be discussed, IEs should try to avoid presenting reports that are disproportionately long. • IEs should prepare their reports in a way that makes it possible for non-technically qualified readers to understand.	Appendix 5 Executive Summary Section 6 Section 8, Section 9 and Section 10 Throughout the report
6.3	Report must consider and compare: • Reasonable benefit expectations (including impact of charges). • Type and level of service (including claims handling). • Management, administration and governance arrangements.	Section 8, Section 9 and Section 10
The level of reliance on the Applicants assessments and assertions		
6.6	Question the adequacy of assessments carried out by Applicants before relying on them to reach own conclusions (including requesting additional work and evidence from Applicants in order to support their assertions).	Throughout the report
6.7	Explain the nature of any challenges made to the Applicants and the outcome of these within the IE report, rather than just stating the final position.	8.76 and 12.16
6.8	Where conclusions are supported solely or largely by statements such as 'I have discussed with the firm's management and they tell me that…' followed by 'I have no reason to doubt what they have told me…', then: • Where a feature of the proposed transfer forms a significant part of the IE's own assessment of the Scheme's impact, the IE should review relevant underlying material, rather than relying on the Applicants' analysis of the material and subsequent assertions. • If there are concerns about matters that fall outside the IE's sphere of expertise, such as legal issues, the Applicants must provide the IE with any advice that they have received. If the issue is significant or remains uncertain, the IE must ensure that the Applicants had obtained appropriate advice from a suitably qualified independent subject matter expert.	Throughout the report 3.19 - 3.21
6.9	IE has challenged calculations carried out by the Applicants if there is cause for doubt on review of the Scheme and supporting documents. As a minimum, the IE should: • review the methodology used and any assumptions made to satisfy themselves that the information is likely to be accurate and to challenge it where appropriate • challenge the factual accuracy of matters that, on the face of the documents or considering the IE's knowledge and experience, appear inconsistent, confusing or incomplete	4.62 n/a
6.10	Documents provided by the Applicants have been challenged where they contain an insufficient level of detail or analysis. For example: • Applicants' assertions that service levels will be maintained to at least the pre-transfer standard: IE should include not only details of the Applicant's plans and any gap analyses that have been produced but also include their view of their adequacy.	Section 8

	• Change in governance arrangements in the Transferee that may lead to poorer customer outcomes: the IE must review and compare the governance arrangements in the Transferor which produce good customer outcomes (e.g. any committees with conduct responsibilities) within the Transferee's governance arrangements. • Consideration of the strain on resources that may occur post-transfer and that could impact on the service standards of the Transferee's existing customers and/or control over conduct of business risk. The IE report should include a review of relevant management information indicators and related contingency planning.	Section 8 Section 8
Sufficient comparative regulatory framework analysis		
6.11	Where the regulatory framework is different for the Transferor and Transferee, the IE has carried out sufficient analysis of the differences including, where appropriate, taking independent advice.	n/a
6.12	For cross-border transfers ensure there is a sufficiently detailed analysis of regulatory protections post-transfer. This can include: • The extent to which existing regulatory requirements and protections continue, including whether there is continued access to the Financial Ombudsman Service and the Financial Services Compensation Scheme. In the context of EU withdrawal this is expected at least until the point of policy renewal. • The comparative regulatory requirements and conduct protections across any relevant jurisdictions, including but not limited to complaints or compensation bodies compared to the UK. • Post EU Withdrawal, non-UK EEA customers may be subject to the local conduct of business rules regime, which may not include FOS or FSCS issues. In these cases, firms taking proportionate approaches to compare regimes are likely to be accepted. For example a high level analysis may be appropriate, selecting key UK protections for consumers that are not harmonised in the EEA, and that could be relevant to servicing contracts. This could be accompanied by an explanation that a full gap analysis has not been carried out, but that policyholders can contact the Applicants if they are concerned. Some firms are able to continue to service contracts from UK branches to preserve continuity of regime at least until renewal.	n/a n/a n/a
6.13	The IE report must contain a statement describing the two regimes as well as a considered comparison, highlighting points of significant difference that could adversely impact Policyholders. The level of detail to be included must be sufficient for the Court to be in a position to be satisfied.	Section 4
6.14	If the IE's analysis is inconclusive or there are potential conduct risks due to differences in the regulatory framework, we expect to see sufficient explanation of how Policyholders may be affected and the Applicant's proposals to mitigate these risks.	n/a
6.15	When stating that the IE is satisfied by referencing the Scheme, the IE must adequately explain how the features have led to their satisfaction. The IE must include both the evidence and their reasoning.	Section 8 – Section 12
Balanced judgements and sufficient reasoning		
6.16	The IE must state in their report whether they are certain there will be no material adverse impact to Policyholders or whether this is their best judgement, but lacks certainty. In these instances, the IE must consider the following: • Where the IE takes the view that there is probably no material adverse impact, the IE must challenge the Applicants about further work the Applicants could undertake to enable the IE to be satisfied to a greater degree.	n/a

	• The IE should challenge the Applicants in order to gain the necessary level of confidence that their report's conclusions are robust. Applicants and IEs should be aware that they will need to consider how any proposed changes/mitigations will impact all Policyholder groups.	n/a
6.17	The IE must check that the documents they are relying, and forming judgements, on are the most up-to-date available when finalising their report.	Appendix 3
6.18	If market conditions have changed significantly since the IE's analysis was carried out and they formed their judgement, the Applicants must discuss any changes with the IE and for the IE to update their report as necessary. If the Scheme document has been finalised, the IE should comment in more detail in their Supplementary Report or by issuing supplementary letters to the Court to confirm whether their judgement is unchanged.	n/a
Sufficient regard to relevant considerations affecting Policyholders		
6.19	Consider all relevant issues for each individual group of Policyholders in both firms, as well as how an issue may impact each group. The IE is expected, when giving their opinion, to consider the: • Current and proposed future position of each Policyholder group • Potential effects of the transfer on each of the different Policyholder groups • Potential material adverse impacts that may affect each group of Policyholders, how these impacts are inter-related and how they will be mitigated	Section 8 to Section 10
6.20	Consider whether the groups of affected Policyholders have been identified appropriately. For example, this could include instances where certain Policyholder groups' services are provided by an outsourced function which is changing, but other Policyholder groups do not.	Section 13
6.21	Review and give opinion on administrative changes affecting Policyholders, including: • Consideration of the impact of an outsourcing agreement entered into by the parties before the Part VII process began, where the administration duty 'moved' from the Transferor to the Transferee in preparation for the transfer. Provide a comparison of the pre and post-outsourced administration arrangements so the IE can clearly review and compare any changes to Policyholder positions and service expectations. • For the case where the IE concludes that because the transfer will not create any change to the administrative arrangements, there will be no material impact on Policyholders: consider what might happen if the Transfer does not proceed and the possibility that the outsourcing agreement could be cancelled, returning the administrative arrangements to the original state. In such circumstances, consider the impact on Policyholders and claimants of the outsourcing agreement as part of the Part VII process.	n/a n/a
6.22	Review and provide opinion on all relevant issues for all Policyholder groups where reinsurance was entered into in anticipation of a transfer: • Some firms pre-empt regulatory scrutiny by buying reinsurance against risks before they begin the transfer process. In these instances, consider if it is appropriate to compare the proposed Scheme with the position the Transferor would be in if they did not benefit from the reinsurance contract. • If the transfer is not sanctioned and the reinsurance either terminates automatically or can be terminated by the Transferee, consider the Scheme as if the reinsurance was not in place.	Section 11

6.23	If the IE identifies particular sub-groups of Policyholders whose benefits, without other compensating factors, are likely to be adversely affected, the IE should take into account the Transferor's obligations under Principle 6 (Customers' interests) of the FCA's Principles for Businesses.	n/a
6.24	Ensure there is consideration and analysis of alternatives when a loss is expected for a particular subgroup of Policyholders, even if the IE does not consider this loss to be material.	n/a
6.25	Provide the analysis outlined in 6.24 even if the IE is able to conclude that the Policyholder group as a whole is not likely to suffer material adverse impact, even if a minority may. For example where: • Some Policyholders within a group/sub-group will suffer higher charges post-transfer because the Transferee has a different charging structure. • Some Policyholders within a group/sub-group had free access to helplines that will no longer be available or have a significantly altered service after the transfer.	n/a n/a
6.26	Ensure that no conclusions are reached based on the balance of probabilities and without adequately considering the possible impact on all affected Policyholder groups.	n/a
6.28	Present the consideration, evidence and reasoning to support the IE's opinion that a change due to the Part VII Transfer will not materially adversely impact a group of Policyholders.	Section 8, Section 9 and Section 10
Commercially sensitive or confidential information		
6.29	When considering commercially sensitive information, consider Policyholders interests as the information will not be publically available.	Risk Appetite Statements and Pillar 2 5.33, 5.45,6.22
6.30	In these situations, document the analysis and the information relied upon. Consider sending a separate document with further details, solely for the Court's use and not for public disclosure	Appendix 3
The level of reliance on the work of other experts		
6.31	For large scale and complex insurance business transfers, if relying on the analytical work of other qualified professionals, it is still expected the IE to have carried out their own review of this analysis to ensure they have confidence in, and can place informed reliance on, the opinions they draw from another professional's work.	4.62 - 4.63
6.32	Obtain a copy of any legal advice given to the Applicants. This should be in writing or transcribed, and approved by the advisor. It should also be in a sufficiently final form for the IE to be able to review and rely on it. The IE should reflect this review, and the opinions drawn from the advice, within their report.	12.42
6.33	If referring to factors outside of expertise and relying on advice received by the Applicants, the IE should consider whether or not to obtain their own independent advice on the relevant issue.	3.19 - 3.21
6.34	Consider if the IE needs to obtain separate legal advice, this will depend on the significance and materiality of the issue.	3.19 - 3.21
6.35	Consider whether it is reasonable for the IE to rely on advice and whether their independence is compromised by doing so. Whether or not the legal advisor has acknowledged that it owes a duty of care to the IE will be relevant to this consideration. Depending on how complex the legal issue is, IEs who rely on the Applicants' legal advice and merely state that they have no reason to doubt the advice and/or that it is consistent with their understanding of the position or experience of similar business transfers may be challenged.	2.18 – 2.20
6.36	When deciding whether to obtain independent legal advice, the IE should consider, amongst other things, the following:	

	• The significance of the issue and the degree of potential adverse impacts to Policyholders if the position turns out to be different from that considered likely in the legal advice. • How much the IE relies on the legal advice to reach their conclusions and, if they did not rely on the legal advice, would the report contain too little information to justify the view that there is no material adverse impact? • The difficulty, novelty or peculiarity of the issue to the Applicants' own circumstances. • Applicants' proposals to explain to Policyholders in communication documents the issues involved, any uncertainty, and any residual risks. • Whether, depending on the issue's significance or uncertainty, the Applicants have obtained an adequate level of advice. Where relevant, whether the Applicants have engaged external advisors with the appropriate expertise and qualifications for the specific subject or jurisdiction. • Whether any advice already received is heavily caveated, qualified or there is a significant degree of uncertainty.	Section 3
6.37	The IE may need to explain why they consider that they do not need to get independent advice to be adequately satisfied on a point. The IE's assessment should consider whether there are credible alternative arguments that could be made, whether identified in the Applicant's advice or otherwise. Consider where risks are identified with no suggestion about how they can be mitigated, or what the impact on Policyholders may be if the risks do occur. These considerations would allow the IE to consider the worst case scenario of these impacts.	3.19 - 3.21
6.38	Consider the Applicant's contingency plans if the risks identified in the legal advice occur and whether this may create negative consequences for Policyholders.	n/a
6.40	Consider obtaining a legal opinion on whether a transfer involving overseas Policyholders will be recognised in non-EEA jurisdictions. The IE may take that advice into account but there may be some material doubt as to whether a court would adopt the approach set out in the advice. In that case, the IE should not use such advice as the sole basis of their conclusion that there are no materially adverse effects. IE should consider and be satisfied of the position if the advice turns out not to be the position taken by the relevant court. The legal advice itself should address this and suggest ways of mitigating this risk.	n/a
6.41	If the IE is uncertain, for example, because the legal advice is heavily qualified or uncertain and cannot form a conclusion on an issue. In this case, they may wish to get their own independent legal advice to ensure they can reach a more considered conclusion.	n/a
6.42	The position may be different depending on whether the Transferor remains authorised/in existence. So: • If the Transferor's authorisations are to be cancelled and it could wind up or is planning to do so eventually, acceptable mitigations include the Transferee making a deed poll which is directly enforceable by Policyholders in either the UK or the relevant jurisdiction. It is unlikely that treating these policies as excluded policies is itself an adequate mitigation. Even if the IE has received advice that, even if the Scheme is not formally recognised in another jurisdiction, the Courts of that jurisdiction would still act to prevent the Transferee from denying that it is liable, the IE should still assess any material possibility, and any mitigations if it is not • Where the Transferor is expected to remain in existence for the foreseeable future, the position is less likely to have an adverse impact. This is because Policyholders will still be able to claim against the Transferor as an excluded policy. The IE should still examine what possible material adverse impact this could have on policyholders. For	n/a Section 8

	example, any delay in dealing with claims, and any risk that the Transferor changes their approach to dealing with claims because of uncertainty around the Transferee indemnifying the Transferor in full. Mitigations could include some clear commitment be both Transferor in full. Mitigations could include some clear commitment by both Transferor and Transferee in the Scheme, enforceable be Policyholders claims will not be affected or delayed because of the excluded policy and indemnity arrangements.	
6.43	How the IE satisfied themselves about the identified uncertainty and formed an opinion on any potential impact.	3.12 - 3.16
6.45	At the start of the document, the IE should provide a description of where they propose to rely on information provided by the Applicants. Overly general reliance will indicate a lack of critical assessment or challenge.	1.22,4.62 - 4.63
6.47	If the report does not reach a clear conclusion, either generally or on a specific issue, the IE report should state clearly: • That the IE has considered and is satisfied about the likely level of impact on a particular point. Where uncertainty remains, the IE report needs to include details of, and reasons for, this uncertainty as well as any further steps the IE has taken to get clarification, such as seeking further advice from a subject matter expert. • How the IE satisfied themselves about the identified uncertainty and formed an opinion on any potential impact.	3.12 - 3.16 3.12 - 3.16
Demonstrating challenge		
6.48	To ensure the IE report is complete and considered there should be challenge from all involved parties. Including evidence that Applicants have made appropriate challenges, particularly when believed that the IE has not fully addressed issues. Applicants have an interest in ensuring that the Court, regulators and Policyholders are able to rely on the IE report, taking into account to the IE's disclaimers. Applicants should make the challenges without compromising the IE's independence. It should be confirmed that the near-final version of the IE's report had the relevant challenge at the time it was submitted.	1.7
6.49	To ensure effective two-way challenge it is expected the IE engages with FCA or PRA approved persons of sufficient seniority at the Applicant firm, such as senior actuaries, including possibly the Chief Actuary, the Chief Financial Officer, Senior Underwriters and so on.	1.22
6.50	IEs who are members of the Institute & Faculty of Actuaries should pay proper regard to the Technical Actuarial Standards (TAS) published by the Financial Reporting Council,10 particularly those for compiling actuarial reports.	1.27
6.51	IEs should be aware of TAS (TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance) specifically apply to technical actuarial work to support Part VII Transfers.	1.27
6.52	Ensure compliance with paragraph 5 of TAS 100 which states that actuarial communications should be 'clear, comprehensive and comprehensible so that users are able to make informed decisions understanding the matters relevant to the actuarial information' and to paragraph 5.2 of TAS 100 which states that 'the style, structure and content of communications shall be suited to the skills, understanding and levels of relevant technical knowledge of users'.	1.27
6.53	Actuarially qualified IEs and peer reviewers should also bear in mind the Actuaries' Code and Actuarial Profession Standards documents APS X2: Review of Actuarial Work and APS L1: Duties and Responsibilities of Life Assurance Actuaries.	1.27 - 1.29
Review of the communications strategy		

7.3	IEs should include consideration of the proposed communications strategy and any supporting requests for dispensations from the Transfer Regulations in their report. There should be evidence that the IE has challenged proposed communications that are not clear and fair and do not adequately explain the transfer and the potential impacts on Policyholders and how these have been addressed.	12.23