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

Supplementary Report of the Independent Expert

Prepared by:  
**Nick Dumbreck**  
FIA, CERA

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# 1. Introduction

## BACKGROUND

- 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 long-term 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 life insurance companies.
- 1.3 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.
- 1.4 My terms of reference have been reviewed by the Prudential Regulation Authority (“**PRA**”) and the Financial Conduct Authority (“**FCA**”). My appointment as Independent Expert was approved by the PRA, after consultation with the FCA, and having given due consideration to my independence and qualifications.
- 1.5 I prepared a report dated 21 January 2019 (“**my Main Report**”) in which I considered the proposed transfer. In that report I stated that, based on the information that was available at the time, I was satisfied that the implementation of the Scheme would 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.
- I was also satisfied that the Scheme was equitable to all classes and generations of PAC and Rothesay policyholders.
- 1.6 The purpose of this report (the “**Supplementary Report**”) is to provide my updated assessment of the likely effects of the proposed transfer and to address any areas in respect of which information was not available at the time I prepared my Main Report. I also consider whether the conclusions reached in my Main Report remain valid in the light of updated financial information received, any other relevant significant events subsequent to the date of finalisation of my Main Report, and any policyholder objections to the Scheme notified to me prior to the date of this report.
- 1.7 Details of the scope of my appointment, my qualifications, disclosures and the reliances and limitations applying to my work are provided in my Main Report.
- 1.8 This Supplementary Report should be read in conjunction with my Main Report, and both should be considered in their entirety. The reliances and limitations listed in Section 1 of my Main Report also apply equally to this report. In particular, this Supplementary Report does not provide financial or other advice to individual policyholders.
- 1.9 I have received all the information I have requested from PAC and Rothesay for the purposes of preparing this Supplementary Report, and Appendix 1 contains a list of the key documents which I have considered. I have considered, and am satisfied with, the reasonableness of this information based upon my own experience of the UK life insurance industry. A glossary of terms used in this report is set out in Appendix 5 of my Main Report.
- 1.10 I understand that this Supplementary Report, as well as the supplementary report prepared by PAC’s Chief Actuary and the supplementary report prepared by PAC’s With-Profits Actuary, will be made available on the PAC website prior to the final Court hearing (the “**Final Hearing**” or “**Sanction Hearing**”), which is scheduled to take place on 10 June 2019. Rothesay will also make this Supplementary Report and the supplementary report prepared by Rothesay’s Chief Actuary available on the Rothesay website prior to the final Court hearing.
- 1.11 As described in paragraph 1.13 of my Main Report, policies in scope to be transferred under the Scheme (“**Transferring Policies**” or “**Transferring Business**”) which were issued under Guernsey law or issued to residents of the Bailiwick of

Guernsey (the "**Guernsey Policies**")<sup>1</sup> will transfer pursuant to a Guernsey Scheme of transfer (the "**Guernsey Scheme**"). In addition, Transferring Policies which were as part of the business carried on by PAC in or from within Jersey (the "**Jersey Policies**") will transfer pursuant to a Jersey Scheme of transfer (the "**Jersey Scheme**"). As was the case with my Main Report, this Supplementary Report and its conclusions apply equally to Guernsey Policies and Jersey Policies as they do to the other long-term business of PAC that is transferring to Rothesay by way of the Scheme. This Supplementary Report, along with my Main Report, may be presented to the Royal Court of Guernsey and the Royal Court of Jersey in respect of the Guernsey Scheme and Jersey Scheme respectively, as well as to the other bodies or persons listed in paragraph 1.20 of my Main Report.

## REGULATORY AND PROFESSIONAL GUIDANCE

- 1.12 This Supplementary Report has been prepared having regard to the terms of Technical Actuarial Standard ("**TAS**") 100 (Principles for Technical Actuarial Work) and TAS 200 (Insurance) issued by the Financial Reporting Council. In my opinion, my report complies with these standards. In complying with these requirements, I note that a number of the key documents listed in Appendix 1 have been prepared or reviewed by individuals who were subject to professional standards in undertaking their work, including, where appropriate, TAS requirements.
- 1.13 In the context of the TASs, my Main Report and this Supplementary Report are component communications.
- 1.14 Actuarial Profession Standard ("**APS**") X2, issued by the Institute and Faculty of Actuaries, requires members to consider whether their work requires an independent peer review. In my view this Supplementary Report does require independent peer review and this has been carried out by Andrew Gilchrist FIA, a senior actuary in Milliman LLP who has not been part of my team working on this assignment.

## THE STRUCTURE OF THIS SUPPLEMENTARY REPORT

- 1.15 This Supplementary Report is structured as follows:
- Section 2 includes updates on relevant developments since I prepared my Main Report and any outstanding issues highlighted at that time;
  - Section 3 provides an update of the financial position of PAC and Rothesay;
  - Section 4 includes details of the objections to the Scheme received from policyholders;
  - Section 5 includes updates on a number of other items; and
  - Section 6 contains my overall conclusions.

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<sup>1</sup> The definition of Guernsey Policies in this Supplementary Report has been updated relative to the definition used in my Main Report; this is to ensure consistency of definitions with other Court documents. The definition now includes policies issued under Guernsey law as well as policies issued to residents of the Bailiwick of Guernsey.

## 2. Recent developments

- 2.1 Since my Main Report dated 21 January 2019 there have been a number of developments of relevance to the Scheme, which I describe below.

### TRANSFERRING BUSINESS

- 2.2 Table 2.1 shows updated figures for the volume of Transferring Business, expressed in terms of both the number of Transferring Policies and the Solvency II Best Estimate Liability (“BEL”)<sup>2</sup> of the Transferring Business based on policies in force as at 31 December 2018, and a comparison to the total volume as at 30 June 2018 (as described in paragraph 7.12 of my Main Report).

**Table 2.1: Comparison of Transferring Business at 30 June 2018 and 31 December 2018**

	Policy Count	Solvency II BEL (£bn)
<b>TOTAL (as at 30 June 2018)</b>	368,544	11.7
<b>TOTAL (as at 31 December 2018)</b>	365,791	11.2

- 2.3 The number of Transferring Policies has fallen by 2,753 between 30 June 2018 and 31 December 2018, primarily as a result of policyholders dying over the period and the transfer<sup>3</sup> or surrender of individual policies in circumstances where policyholders are permitted to request such actions. In addition, there have been a small number of cases where policies have been removed from the Transferring Business because they no longer meet the initial selection criteria agreed by PAC and Rothesay under the Laker Reinsurance Agreement. The change in BEL reflects the policyholder benefits that have been paid over the period, the reduced number of Transferring Policies and any changes in assumptions used in the BEL calculation, including the change in the shape of the risk-free interest rate curve (this is described in more detail in paragraph 3.5).

### COMMUTATION FACTORS FOR DEFERRED ANNUITY POLICIES

- 2.4 Although almost all of the Transferring Policies are annuities in-payment, there are 9 deferred annuity policies that are within the scope of the Scheme<sup>4</sup>. As described in paragraph 8.66 of my Main Report, holders of deferred annuities are able to commute<sup>5</sup> their benefits for a range of reasons, including electing to exchange a proportion of their annuity amount for a Pension Commencement Lump Sum (often referred to as “tax-free cash”), or to transfer the value of their policy to another provider. The lump sum or transfer value paid by PAC in these situations is determined using the prevailing commutation factors<sup>6</sup> of PAC. Following the implementation of the Scheme, the value of commuted benefits, and the amount of transfer values for holders of transferring deferred annuity policies, will be calculated using Rothesay’s prevailing commutation factors. PAC and Rothesay use different assumptions in the calculation of their commutation factors.
- 2.5 As described in paragraph 8.70 of my Main Report, PAC intended to implement a change to its commutation factors in the first half of 2019 to ensure that they are calculated using assumptions that are as realistic as possible. At the time of writing my Main Report, this change had not been implemented; however the change in commutation factors has now been approved by PAC’s Executive Technical Committee and the changes came into effect in April 2019.

<sup>2</sup> Section 4 of my Main Report defines the BEL and explains other relevant aspects of the regulatory regime that applies to UK insurance companies

<sup>3</sup> In this context, “transfer” refers to a situation where the policyholder is permitted to elect to transfer their policy to another pension provider and does so. This is distinct from the Part VII transfer process.

<sup>4</sup> At the time of writing my Main Report, there were 10 transferring deferred annuity policies; however one policyholder has subsequently chosen to move their policy to another provider.

<sup>5</sup> “Commutation” refers to a situation where a policyholder gives up some or all of their pension income in return for a lump sum or a transfer value paid to another pension provider.

<sup>6</sup> The commutation factor is the amount of lump sum paid by the insurer in return for £1 p.a. of pension income.

- 2.6 Rothesay has also changed its commutation factors recently; this change was approved by Rothesay's Customer and Conduct Committee and came into effect in April 2019.
- 2.7 At the time of writing my Main Report, the companies were performing analysis to determine whether there was a material difference between Rothesay's commutation factors and PAC's new commutation factors that would be applicable to the 9 transferring deferred annuities in current conditions. This analysis has since been updated to consider the most up-to-date commutation factors.
- 2.8 The latest analysis shows that the commutation factors applicable to the determination of both tax-free cash and transfer values are at least as high under Rothesay's prevailing commutation basis as under PAC's prevailing basis for all of the transferring deferred annuity policies, and therefore I do not have concerns that holders of transferring deferred annuities will be adversely affected by the differences in commutation factors between PAC and Rothesay.
- 2.9 It should be noted that commutation factors are not guaranteed, and Rothesay is entitled to make changes to its commutation bases. Therefore, the commutation factors used by Rothesay in the future may vary from those that were considered in the analysis referred to in paragraph 2.8. However, any such changes in Rothesay's commutation basis would be subject to Rothesay's internal governance processes, including sign-off by its Customer and Conduct Committee (which is chaired by an independent non-executive director of Rothesay), and its obligations under the FCA's requirements for treating customers fairly. Additionally, Rothesay has assured me that it has no current plans to make further changes to its commutation bases, other than routine updates to reflect changes in economic conditions and updates to Rothesay's view of future longevity.
- 2.10 In addition, PAC is also able to alter its commutation basis in the future, and therefore if the policyholders were to remain insured by PAC there would be no guarantee that the way in which their commutation factors would be determined in the future would remain the same as at present.
- 2.11 Taking the commutation analysis described above into account, I am satisfied that the implementation of the Scheme will not have a material adverse effect on the reasonable benefit expectations of holders of transferring deferred annuities.

#### COMMUTATION FACTORS FOR IN-PAYMENT ANNUITY POLICIES

- 2.12 The circumstances in which commutation is permitted for in-payment annuities are limited, comprising the following situations:
- where, following the death of an annuitant, the benefits subsequently payable to a contingent beneficiary are small enough to qualify for trivial commutation; or
  - where a pension sharing order has been granted.
- 2.13 Whereas pension sharing orders can, in theory, apply to all policies, it is PAC's practice to only allow trivial commutation for contingent beneficiaries for group scheme policies (except where such a commutation is expressly forbidden by the rules of the pension scheme) and not for annuities arising from personal pension policies. By contrast, Rothesay's practice is to allow trivial commutation for contingent beneficiaries for both personal pensions and group scheme policies, except where such a commutation is expressly forbidden by the rules of the pension scheme. Therefore, upon transfer to Rothesay a significant number of Transferring Policies will become eligible for trivial commutation for contingent beneficiaries<sup>7</sup>.
- 2.14 PAC has provided me with analysis that estimates that of the order of 30,000 Transferring Policies could potentially meet the eligibility criteria to be able to elect to take trivial commutation for contingent beneficiaries as policies of PAC, subject to various other requirements. By contrast, upon transferring to Rothesay it is estimated that of the order of 90,000 additional Transferring Policies could potentially become eligible for trivial commutation for contingent beneficiaries owing to Rothesay's practice of allowing trivial commutation for contingent beneficiaries of holders of personal pensions.
- 2.15 As noted in paragraph 2.5 above, PAC has recently implemented a change to its commutation factors to ensure that they are calculated using assumptions that are as realistic as possible. This change came into effect in April 2019, following approval by PAC's Executive Technical Committee.

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<sup>7</sup>Neither PAC nor Rothesay permits the trivial commutation of a contingent beneficiary annuity once the main policyholder has died and the contingent beneficiary has started to receive their annuity. Therefore, contingent beneficiaries of personal pension policies who are currently receiving an annuity from a Transferring Policy will not become eligible for trivial commutation upon transfer to Rothesay.

- 2.16 As noted in paragraph 2.6 above, Rothesay has also changed its commutation factors recently; this change was approved by Rothesay's Customer and Conduct Committee and came into effect in April 2019.
- 2.17 I have received updated analysis from PAC and Rothesay that considers the differences in commutation factors that would apply for trivial commutation for contingent beneficiaries between the two companies for a sample of ages and benefit types for group pension policies<sup>8</sup>. The updated analysis shows different results from those included in paragraph 8.74 of my Main Report owing to the recent changes in both companies' commutation bases (as described in paragraphs 2.15 and 2.16). In particular, a comparison of PAC's prevailing commutation basis against Rothesay's prevailing basis indicates that, for the sample of ages and benefit types considered in the group pension scheme analysis, Rothesay's commutation factors for trivial commutation are typically between 11.1% higher and 3.9% lower than PAC's commutation factors. For the majority of the sample of ages and benefits that the analysis considered, Rothesay's factors are slightly higher than PAC's factors. Consequently I do not have concerns that any Transferring Policyholder will be adversely affected to a material extent by the differences in commutation factors available for trivial commutation of contingent benefits.
- 2.18 Rothesay has informed me that, in the event of commutation due to the issuance of a pension sharing order, Rothesay's commutation factors are, on average, lower than PAC's by between 5% and 10%. That is, the value of the lump sum payable to the spouse would be lower by 5% to 10% than the comparable payment by PAC. However, pension sharing orders are an infrequent occurrence; in 2018, approximately 0.005% of policies within the business covered by the Laker Reinsurance Agreement were subject to a pension sharing order<sup>9</sup>. Moreover, the differences in commutation factors will have no effect if the spouse elects to receive an annuity rather than a lump sum. Therefore, given the very small number of affected policyholders and that there will be no effect should the spouse elect to receive an annuity, I do not consider the generally lower commutation factors offered by Rothesay to be of material detriment to Transferring Policyholders.
- 2.19 It should be noted that commutation factors are not guaranteed, and Rothesay is entitled to make changes to its commutation bases. Therefore, the commutation factors used by Rothesay in the future may vary from those that were considered in the analysis referred to in paragraphs 2.17 and 2.18. However, any such changes in Rothesay's commutation basis would be subject to Rothesay's internal governance processes, including sign-off by its Customer and Conduct Committee (which is chaired by an independent non-executive director of Rothesay), and its obligations under the FCA's requirements for treating customers fairly. Additionally, Rothesay has assured me that it has no current plans to make further changes to its commutation bases, other than routine updates to reflect changes in economic conditions and updates to Rothesay's view of future longevity.
- 2.20 In addition, PAC is also able alter its commutation basis in the future, and therefore if the transferring in-payment annuity policyholders were to remain insured by PAC there would be no guarantee that the way in which their commutation factors would be determined in the future would remain the same as at present.
- 2.21 Taking the commutation analysis described above into account, I am satisfied that the implementation of the Scheme will not have a material adverse effect on the reasonable benefit expectations of holders of transferring in-payment annuities.

## TRANSITIONAL SERVICES AGREEMENT

- 2.22 As described in paragraphs 7.33 and 7.34 of my Main Report, in order to minimise impact on the policyholders of the Transferring Business and to avoid jeopardising the proposed transfer timelines, PAC will continue to provide administration services (the majority of which are delivered by TCS/Diligenta on its behalf) for a period after the Transfer Date. This arrangement is documented in a draft Transitional Services Agreement between PAC and Rothesay. PAC has informed me that this arrangement is expected to last for a period of 12 to 24 months following the Transfer Date; however it is PAC's and Rothesay's intention to transfer the provision of administration services from PAC to Rothesay as quickly as possible, and therefore the duration of the arrangement could be less than 12 months. The Transitional Services Agreement was not in place at the time of writing my Main Report, but I have now reviewed an advanced draft of this agreement and am satisfied that, for the duration of this Agreement, 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. In particular the draft

<sup>8</sup> PAC does not allow trivial commutation for contingent beneficiaries of holders of personal pensions and therefore there is no comparison for Rothesay's commutation factors.

<sup>9</sup> In 2018, there were 124 instances of a policyholder requesting a pension sharing commutation quote out of the approximately 400,000 policies within the business covered by the Laker Reinsurance Agreement. 104 of these cases did not lead to a pension sharing order, and of the remaining 20 cases, 11 resulted in the payment of a lump sum and 9 resulted in a pension being paid to the spouse.

Transitional Services Agreement states that services provided by PAC during the period of the agreement must be at least to the same standard as the services provided by PAC in the twelve months prior to the Transfer Date.

- 2.23 The draft Transitional Services Agreement states that PAC and Rothesay must jointly agree a migration plan within 30 days of the Transfer Date which details how the provision of administration services will be transferred from PAC to Rothesay once the Transitional Services Agreement expires. In accordance with the draft Transitional Services Agreement, the migration plan must include timetables and milestones relating to the steps required to effect the transfer of the transferring policyholder records, the testing of systems and the mapping and loading of data extracts onto Rothesay's administration system. It must also include safeguards to ensure minimal disruption to PAC's and Rothesay's businesses as well as details of appropriate escalation and governance processes to review and monitor progress of the implementation of the migration plan and any issues encountered. The migration plan must also include an appropriate policyholder communications strategy as well as a process for dealing with complaints, claims or legal action through the period contemplated by the migration plan.
- 2.24 Rothesay's business model involves entering into large bulk annuity transactions, many of which involve Rothesay managing the transfer of large numbers of policies onto new administration systems, for example the transfer of large blocks of annuity business from Zurich Assurance Ltd and from Scottish Equitable plc in June 2017. Rothesay intends to administer the Transferring Policies in the same manner as its other policies, which will mean using one of its current specialist administration partners. These administration partners have experience in managing the transfer of large numbers of policies on to their systems whilst maintaining a suitably high standard of administration services for Rothesay's current policyholders.
- 2.25 Rothesay therefore has the necessary experience to minimise the likelihood of disruption when the migration takes place.
- 2.26 Considering this in conjunction with my conclusions in paragraphs 8.83 to 8.87 of my Main Report, which are still valid, I have no reason to believe that the implementation of the Scheme will have a material adverse impact on service standards experienced by holders of Transferring Policies.

## TAX

- 2.27 Confirmation and clearance that the transaction is not for an "unallowable purpose" for corporation tax purposes was granted by HM Revenue and Customs ("HMRC") to PAC on 11 March 2019 and Rothesay on 29 March 2019. Clearance that the "transfer of going concern" treatment will apply for VAT purposes was not provided by HMRC on the grounds that such clearance is only provided in cases where there is clear uncertainty surrounding the treatment of the transaction. PAC and Rothesay are both satisfied that this treatment will apply. There are no further tax clearances outstanding and so the impact of the proposed transfer on the taxes payable by Rothesay will be as expected.
- 2.28 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 have liaised with HMRC to establish the best approach to minimise any inconvenience for affected policyholders. HMRC has agreed to monitor the situation appropriately to ensure that, as far as practicable, transferring policyholders' tax codes are not affected by the proposed transfer.

## UNITED KINGDOM'S EXIT FROM THE EUROPEAN UNION ("**BREXIT**")

- 2.29 In a referendum held in the UK on 23 June 2016, a majority voted for the UK to leave the European Union. The subsequent triggering by the UK government of Article 50 of the Treaty on European Union in March 2017 meant that the UK's exit was scheduled to take place on 29 March 2019. However, this exit date has now been amended to be no later than 31 October 2019.
- 2.30 Given the uncertainty around Brexit and its potential impact on the volatility of financial markets, both PAC and Rothesay have tested the impact of a "no deal" Brexit scenario (i.e. the situation in which the UK leaves the EU without a comprehensive withdrawal agreement in place) and have put in place plans to minimise the likelihood that this would result in a breach of either company's risk tolerances.



- 2.31 PAC and Rothesay have both confirmed to me that they do not expect Brexit to affect their ability to continue to service and manage their policies, including Transferring Policies that are held by policyholders residing overseas. Additionally, if there were to be an unanticipated Brexit-related impact on this area, it would be likely to affect PAC and Rothesay equally and the outcome would not be affected by the proposed transfer.
- 2.32 Therefore I am satisfied that the outcome of the Brexit process will not change the conclusions set out in Section 13 of my Main Report.

## CONCLUSION

- 2.33 I am satisfied that none of the developments described above affects the conclusions set out in Section 13 of my Main Report, which are restated in Section 6 of this report, either individually or in aggregate.

### 3. The updated financial position of the companies at 31 December 2018

#### INTRODUCTION

- 3.1 This section describes the financial position of PAC and Rothesay as at 31 December 2018, the most recent date for which full financial results are available at the date of this report.
- 3.2 My assessment of the impact of the implementation of the Scheme as set out in my Main Report was based on financial information on a Solvency II basis as at 30 June 2018.
- 3.3 The financial positions of PAC and Rothesay under Pillar 1 of Solvency II as at 31 December 2018 have now been published, following a full external audit. I consider it reasonable to rely on the audited financial results of PAC and Rothesay in revisiting the conclusions of my Main Report.

#### PAC'S FINANCIAL CONDITION

##### *Balance sheet changes since 30 June 2018*

- 3.4 Since 30 June 2018, there have been a number of changes to PAC's business that have affected its balance sheet:
- PAC transferred its existing long-term insurance business in Poland, France, Malta, Ireland and Germany to Prudential International Assurance plc ("PIA") on 1 January 2019. The total policyholder liabilities transferred amounted to approximately £74 million at 31 December 2017<sup>10</sup>.
  - The legal ownership of Prudential plc's Hong Kong insurance subsidiaries, Prudential Hong Kong Limited ("PHKL") and Prudential General Insurance Hong Kong Limited ("PGHKL"), has been transferred from PAC to Prudential Corporation Asia Limited ("PCA"), another subsidiary of Prudential plc.

The transfer of the Hong Kong subsidiaries took place on 18 December 2018<sup>11</sup>, and was effected by a share purchase agreement between PAC and PCA. Prior to this transaction, PHKL contributed around £4 billion of surplus to PAC's Solvency II capital position.

While the effect of these transactions was not reflected in PAC's 30 June 2018 balance sheet, I considered the *pro forma* financial impact of the transactions as if they had occurred on that date in reaching the conclusions set out in Section 13 of my Main Report.

- 3.5 In addition to the events described in paragraph 3.4, changes in financial market conditions between 30 June 2018 and 31 December 2018 have affected the financial position of PAC. In particular:
- The shape of the risk-free interest rate curves, published by the European Insurance and Occupational Pensions Authority ("EIOPA"), changed between 30 June 2018 and 31 December 2018. The most relevant curve in this case is the United Kingdom risk-free curve which had small increases at terms of 4 years and shorter (principally as a result of the increase in the Bank of England base rate in August 2018) and small reductions at longer terms.
  - Credit spreads<sup>12</sup> on medium to long term investment grade corporate debt increased modestly between 30 June 2018 and 31 December 2018.
  - UK equity markets fell between 30 June 2018 and 31 December 2018, with the FTSE All-Share Index falling from 4,202 to 3,675.

<sup>10</sup> This figure of £74 million is stated before deducting the amount of the negative liabilities of PAC's Polish business, which were included in the transfer. A policy gives rise to a negative liability (i.e. it represents an asset to the insurer) when, on a best estimate basis, future premiums payable are expected to exceed future claims and expenses incurred in respect of the policy.

<sup>11</sup> In paragraph 5.26 and 5.33 of my Main Report I stated that the change of ownership of PAC's Hong Kong subsidiaries took place on 14 December 2018. It has since been brought to my attention that the actual date of the change of ownership was 18 December 2018. For the avoidance of doubt, the correction of this date has no impact on the financial information in my Main Report or my conclusions in relation to the Scheme.

<sup>12</sup> 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.

- 3.6 The Solvency II Pillar 1 balance sheet as at 31 December 2018 for PAC is shown in Table 3.1, with figures as at 30 June 2018 (as presented in Table 5.5 of my Main Report) for comparison. The movement in the second half of 2018 shown by the figures reflects the impact of the transfer of ownership of PHKL and PGHKL to PCA during that period, as described in paragraph 3.4. The movement does not reflect the transfer of business from PAC to PIA, also described in paragraph 3.4, because it did not take place until 1 January 2019. However, the financial impact on PAC of that transfer was very small, and I am satisfied that the financial analysis presented in this report would not be materially different if it included the effect of the PIA transfer.

**Table 3.1: PAC Solvency II Pillar 1 balance sheet**

PAC Solvency Balance sheet	31 December 2018			30 June 2018		
	£ million	Total PAC shareholder-backed business	Total PAC With-Profits Fund	Consolidated PAC	Total PAC shareholder-backed business	Total PAC With-Profits Fund
Solvency II Assets (net of other items)	60,740	125,257	176,823	72,544	127,025	212,834
Technical Provisions (including TMTP)	51,918	115,620	163,823	57,637	117,107	192,722
<b>Own Funds (A)</b>	<b>8,822</b>	<b>9,637</b>	<b>13,001</b>	<b>14,907</b>	<b>9,918</b>	<b>20,112</b>
SCR (B)	5,130	4,179	9,309	7,215	3,846	12,420
Surplus <sup>13</sup> (=A-B)	3,691	5,458	3,691	7,692	6,071	7,692
<b>SCR coverage ratio (A/B)</b>	<b>172%</b>	<b>231%</b>	<b>140%</b>	<b>207%</b>	<b>258%</b>	<b>162%</b>

- 3.7 Table 3.1 shows that the SCR coverage ratio of the PAC shareholder-backed business fell from 207% to 172% between 30 June 2018 and 31 December 2018. This is primarily as a result of the transfer of the legal ownership of PAC's Hong Kong subsidiaries to PCA on 18 December 2018.

*PAC's projected post-transfer financial position*

- 3.8 The financial information below shows the Solvency II Pillar 1 position of PAC's shareholder-backed business as at 31 December 2018 (from Table 3.1) as well as the *pro forma* post-transfer position if the Scheme had been implemented on 31 December 2018.

**Table 3.2 PAC shareholder-backed business pre-transfer and *pro forma* post-transfer regulatory solvency position**

PAC pre- and post-Scheme solvency position as at 31 December 2018			
£ million	PAC shareholder-backed business, pre-Scheme	PAC shareholder-backed business, post-Scheme	Difference
Solvency II Assets (net of other items)	60,740	49,537	(11,203)
Technical Provisions (including TMTP)	51,918	40,716	(11,203)
<b>Own Funds (A)</b>	<b>8,822</b>	<b>8,822</b>	-
SCR (B)	5,130	5,030	(100)
Surplus (=A-B)	3,691	3,791	100
<b>SCR coverage ratio (A/B)</b>	<b>172%</b>	<b>175%</b>	<b>3%</b>

<sup>13</sup> In my Main Report, I used the term 'Excess Capital' rather than 'Surplus' when presenting these figures. The terms are interchangeable in this context but I have used Surplus in this report for consistency with the financial information presented with the other Court documents.

- 3.9 Table 3.2 shows that, on a Solvency II Pillar 1 basis, if the Scheme had been implemented on 31 December 2018, the SCR coverage ratio of PAC's shareholder-backed business would have increased from 172% to 175%. PAC's consolidated SCR coverage ratio would have been 141% had the Scheme been implemented on 31 December 2018, compared to 140% pre-Scheme.
- 3.10 The impact of the Scheme on the financial position of PAC's shareholder-owned business at 31 December 2018 (a change in the SCR coverage ratio of +3%) is similar to that shown in Tables 9.1 (+5%) and 9.2 (+5%) of my Main Report at 30 June 2018<sup>14</sup>, i.e. the Scheme would have resulted in a modest improvement in the SCR coverage ratio calculated for this business.
- 3.11 The impact of the Scheme on PAC's consolidated SCR coverage ratio at 31 December 2018 (+1%) is also similar to that quoted in paragraphs 9.9 (+2%) and 9.14 (+3%) of my Main Report at 30 June 2018<sup>15</sup>; the Scheme would have resulted in a modest improvement in PAC's consolidated SCR coverage ratio.

## ROTHESAY'S FINANCIAL CONDITION

### *Balance sheet changes since 30 June 2018*

- 3.12 Rothesay received approval from the PRA to use its partial internal model ("**PIM**") to produce its reported Solvency II results from 31 December 2018. The PIM is used to determine the counterparty default risk and credit risk components of Rothesay's SCR and risk margin, and resulted in a reduction in Rothesay's SCR relative to that required under the Standard Formula. All of the other components of Rothesay's SCR and risk margin are calculated using the Solvency II Standard Formula.
- 3.13 Other changes that affected Rothesay's balance sheet between 30 June 2018 and 31 December 2018 were:
- A recalculation of Rothesay's Transitional Measure on Technical Provisions ("**TMT**P") to reflect the impact of the PIM approval.
  - Following approval of its PIM, Rothesay put in place a securitisation<sup>16</sup> of its investments in equity release mortgages in order to create assets that were eligible for inclusion in Rothesay's matching adjustment portfolio (see paragraphs 4.18 and 4.19 of my Main Report). In isolation, this change resulted in a reduction in Rothesay's technical provisions due to an increase in the size of the matching adjustment.
  - The financial impact of new business issued by Rothesay between 30 June 2018 and 31 December 2018.
  - Some of the changes in financial markets described in paragraph 3.5.
- 3.14 Table 3.3 below shows the financial position at Rothesay at 31 December 2018 compared to Rothesay's financial position at 30 June 2018 that was shown in Table 10.1 of my Main Report. Rothesay's financial position at 31 December 2018 reflects the use of its approved PIM, whereas its 30 June 2018 financial position was determined using the Solvency II Standard Formula for all components of its SCR.

<sup>14</sup> Tables 9.1 and 9.2 of my Main Report show the *pro forma* impact of the Scheme on the PAC shareholder-owned business at 30 June 2018 respectively before and after allowing for the transfer of PAC's Hong Kong business to PCA.

<sup>15</sup> Paragraphs 9.9 and 9.14 of my Main Report state the *pro forma* impact of the Scheme on PAC's consolidated balance sheet at 30 June 2018 respectively before and after allowing for the transfer of PAC's Hong Kong business to PCA.

<sup>16</sup> Securitisation refers to the creation of financial instruments, the cash flows from which are supported by a pool of underlying assets (in this case, a portfolio of equity release mortgages). Some of the financial instruments created will meet the eligibility requirements for the matching adjustment and can therefore be used to back liabilities subject to the matching adjustment.

**Table 3.3 – Rothesay regulatory solvency position at 31 December 2018 and 30 June 2018**

Rothesay solvency balance sheet	31 December 2018	30 June 2018
<b>£ million</b>		
Solvency II Assets (net of other items)	36,089	36,315
Technical Provisions (including TMTP)	32,195	32,157
<b>Own Funds (A)</b>	<b>3,895</b>	<b>4,158</b>
SCR (B)	2,163	2,351
Surplus (=A-B)	1,731	1,807
<b>SCR coverage ratio (A/B)</b>	<b>180%</b>	<b>177%</b>

- 3.15 Table 3.3 shows that Rothesay's financial position has strengthened slightly between 30 June 2018 and 31 December 2018, with its SCR coverage ratio increasing from 177% to 180%.
- 3.16 The financial information below shows the Solvency II Pillar 1 position of Rothesay as at 31 December 2018 (from Table 3.3) as well as the *pro forma* post-transfer position if the Scheme had been implemented on 31 December 2018.

**Table 3.4 - Rothesay pre-transfer and *pro forma* post-transfer regulatory solvency position at 31 December 2018**

Rothesay pre- and post-Scheme solvency position as at 31 December 2018			
£ million	Rothesay, pre-Scheme	Rothesay, post-Scheme	Difference
Solvency II Assets (net of other items)	36,089	36,089	-
Technical Provisions (including TMTP)	32,195	32,195	-
<b>Own Funds (A)</b>	<b>3,895</b>	<b>3,895</b>	-
SCR (B)	2,163	2,163	-
Surplus (=A-B)	1,731	1,731	-
<b>SCR coverage ratio (A/B)</b>	<b>180%</b>	<b>180%</b>	-

- 3.17 As was the case for the equivalent table in my Main Report at 30 June 2018 (Table 10.1), Table 3.4 shows that the Scheme would not have resulted in a change to Rothesay's financial position had it been implemented at 31 December 2018. This is because the Transferring Business is a subset of the business covered by the Laker Reinsurance Agreement, which has already transferred the risks and rewards of the business covered by that Agreement to Rothesay.

## CONCLUSION

- 3.18 The financial information in this section shows that the impact of the implementation of the Scheme on the financial positions of PAC and Rothesay at 31 December 2018 is similar to that shown in my Main Report in Tables 9.2 and 10.1 at 30 June 2018. In addition it shows that the relative financial positions of PAC before the transfer (140%) and Rothesay after the transfer (180%) remain similar to those shown in my Main Report in Table 8.2 (150% PAC, 177% Rothesay), i.e. Rothesay has a somewhat stronger financial position than PAC, measured by SCR coverage ratio<sup>17</sup>, after allowing for the transfer of ownership of PHKL and PGHKL from PAC to PCA.
- 3.19 I am satisfied that, based on the financial information as at 31 December 2018, the conclusions in relation to the financial resources available to support the benefits of policyholders of PAC and Rothesay set out in Section 13 of my Main Report (and reproduced in Section 6 of this report) remain valid.

<sup>17</sup> The consolidated SCR ratio in the case of PAC.

## 4 Correspondence and questions received from policyholders

- 4.1 PAC has received a number of comments on the Scheme from policyholders and representatives of policyholder schemes (e.g. trustees or employers)<sup>18</sup> via email, letter and telephone. Rothesay has also received comments from its policyholders and PAC's policyholders on the Scheme. Comments have also been received by PAC's solicitors and forwarded to PAC. I have been provided with summaries of all submissions that have been classed by PAC and Rothesay as objections to the Scheme on or prior to 15 May 2019, and have reviewed the full submissions and the responses provided by PAC or Rothesay for a sample of these cases (chosen by me). I understand that copies of all objections and associated responses will be provided to the Court, the PRA and the FCA.
- 4.2 I have been copied into a letter to PAC from a PAC policyholder objecting to the Scheme. As this letter was addressed to PAC, I have not responded directly to the policyholder, but I have addressed the substance of the policyholder's objection in this section. I have also received email correspondence from a PAC policyholder outlining some concerns in relation to the Scheme and I have responded directly to this policyholder. I have provided the PRA and FCA with a copy of this correspondence and I will also provide the Court with a copy.

### OBJECTIONS

- 4.3 As at 15 May 2019, PAC had received 983 objections to the Scheme. All of the objections received were from transferring policyholders. I have reviewed summaries of all of the objections PAC received and I have also reviewed samples (chosen by me) of the correspondence between PAC and the transferring policyholders; based on this sample, I consider that the responses by PAC appropriately address the questions or issues raised. I am also satisfied that the criteria used to determine whether a submission should be classified as an objection are reasonable.
- 4.4 As at 15 May 2019, Rothesay had received 31 objections to the Scheme. However, 21 of the 31 objections were from PAC policyholders deemed directed at PAC and therefore were acknowledged by Rothesay and forwarded to PAC. The remaining 10 objections were all from existing policyholders of Rothesay. I have reviewed the correspondence between Rothesay and its existing policyholders, and I consider that the responses by Rothesay appropriately address the questions or issues raised. I am also satisfied that the criteria used to determine whether a submission should be classified as an objection are reasonable.
- 4.5 The main arguments and issues put forward in the objections are listed below. Some of the individual objections received covered more than one issue, and for clarity I have dealt with each distinct issue separately, where appropriate. I have set out my comments on these matters in the following paragraphs.

#### *Those arising from an apparent misunderstanding of the transfer and its effects*

- Policyholders suspicious about the motivation for the proposed transfer (see paragraph 4.6)
- Policyholders who object because they are concerned that their benefit payments might change as a result of the proposed transfer (see paragraphs 4.7 to 4.8).
- Policyholders who object because they live in Scotland which has a different legal system and are concerned how this will affect their pension (see paragraph 4.9).
- Policyholders who are concerned that they will no longer be in scope of PAC's Thematic Review of Annuity Sales Practices Past Business review ("TRASP PBR") (see paragraph 4.10).
- Policyholders who are concerned about their eligibility for compensation should Rothesay default or become insolvent (see paragraph 4.11).
- Policyholders who believe that caveating conclusions with "material" suggests that Rothesay could choose not to pay policyholders' guaranteed benefits in full and that the 'opinion' of the independent expert does not provide legally binding reassurances (see paragraphs 4.12 to 4.15).

<sup>18</sup> For clarity I will refer to both policyholders and representatives of policyholder schemes as 'policyholders' in this section.

- Policyholders who believe the Independent Expert's final conclusions were withheld from them (see paragraphs 4.16 to 4.19).
- Policyholders who believe that the costs associated with the proposed transfer are being paid for by policyholders (see paragraphs 4.20 to 4.21).
- Policyholders who are concerned that the annual charges on their policy may increase under Rothesay's management (see paragraph 4.22).
- Policyholders who are concerned that they will have less control over their investments as a result of the proposed transfer (see paragraph 4.23).

#### *Those relating to the process*

- Policyholders who believe that "no material adverse effect" is not sufficient reassurance and that the proposed transfer should not have any adverse effect on policyholders (see paragraphs 4.24 to 4.25).
- Policyholders who are concerned that there is only one Independent Expert (see paragraph 4.26).
- Policyholders who do not want their pension to be moved without their authority and wish to have the right to opt out or vote (see paragraphs 4.27 to 4.28).
- Policyholders who object because they were not made aware that their policy could transfer to another organisation when it was purchased (see paragraph 4.29).
- Policyholders who believe that PAC is breaching its contracts with policyholders by transferring them to another organisation (see paragraph 4.30).
- Policyholders who believe they should have been informed earlier of the proposed transfer and who feel that they have not been given sufficient notice of the proposed transfer (see paragraphs 4.31 to 4.32).
- Policyholders who believe PAC should be required to guarantee annuity payments in the event that Rothesay defaults or becomes insolvent (see paragraphs 4.33 to 4.36).
- Policyholders who believe it is unfair that PAC is able to transfer their policies to another company but policyholders are not themselves able to do so (see paragraphs 4.37 to 4.39).
- Policyholders concerned about the independence of the Independent Expert (see paragraphs 4.40 to 4.42).

#### *Those relating to the reasonableness of the proposals*

- Policyholders who are concerned about the ongoing service standards that will apply to their policy following the transfer (see paragraphs 4.43 to 4.50).
- Policyholders who are concerned that their policy is moving to a company from which they would not have chosen to buy a policy (see paragraphs 4.51 to 4.52).
- Policyholders who are concerned with the security of benefits for the Transferring Business that will be provided by Rothesay, when compared to PAC (see paragraphs 4.53 to 4.55).
- Policyholders who are concerned that Rothesay does not have the necessary expertise to manage their policies (see paragraphs 4.56 to 4.57).
- Policyholders who are concerned that Rothesay's business is not as diversified as the business of PAC and/or the wider Prudential Group (see paragraphs 4.58 to 4.61).
- Policyholders who, as a result of the proposed transfer, will have one or more annuity policies with both PAC and Rothesay and are concerned that dealing with multiple companies will be inconvenient for them and their families (see paragraphs 4.62 to 4.64).
- Policyholders who do not wish to be transferred to Rothesay due to already having a policy with Rothesay and who wish to maintain their policies with different companies in case one of the companies should become insolvent (see paragraphs 4.65 to 4.66).

- Policyholders who want their policy to remain with PAC due to their positive experiences of being a PAC policyholder (see paragraph 4.67).
- Policyholders who want their policy to remain with PAC because they chose specifically to take out a policy with PAC based on its reputation (see paragraphs 4.68 to 4.70).
- Policyholders who do not want their policies to be transferred due to previous experiences of Rothesay's administration of existing policies (see paragraphs 4.71 to 4.75).
- Policyholders who want to be able to surrender their annuities or transfer them to another insurance company because they do not want to transfer to Rothesay (see paragraphs 4.76 to 4.77).
- Policyholders who do not want to be transferred due to negative experiences of previous transfers (see paragraph 4.78).
- Policyholders who object that the proposed transfer does not benefit policyholders (see paragraph 4.79).
- Policyholders who object because their tax codes might change as a result of the proposed transfer (see paragraph 4.80).
- Policyholders who are concerned that Rothesay is part of an international organisation and/or has international shareholders (see paragraphs 4.81 to 4.82).
- Policyholders who do not feel there has been sufficient justification regarding the selection of Transferring Policies (see paragraphs 4.83 to 4.85).
- Policyholders who are concerned that Rothesay may transfer their policies to another insurance company in the future (see paragraph 4.86).
- Policyholders who are concerned that Rothesay may change their policy terms and conditions in the future (see paragraph 4.87).
- Policyholders who are concerned about Rothesay's financial results (see paragraphs 4.88 to 4.91).
- Policyholders who do not wish their personal details to be shared with Rothesay (see paragraphs 4.92 to 4.93).
- Policyholders who do not wish the administration/servicing of their policy to be outsourced (see paragraphs 4.94 to 4.95).
- Policyholders who reside in other member states of the European Union and are concerned about the impact of UK leaving the European Union (see paragraph 4.96).
- Policyholders who believe they should have been consulted before the companies had agreed to the proposed transfer (see paragraphs 4.97 to 4.98).
- Policyholders who are concerned that the proposed transfer will weaken Rothesay's financial strength in the long-term (see paragraphs 4.99 to 4.101).
- Policyholders who are concerned that the proposed transfer will increase their exposure to risks associated with fossil fuel activities (see paragraphs 4.102 to 4.106).

The other objections either relate to events that are unconnected to the Scheme, or are based on misunderstandings of the consequences of the Scheme for individual policyholders.

## ASSESSMENT OF OBJECTIONS

### *Policyholders suspicious about the motivation for the proposed transfer (37 objections)*

- 4.6 The motivation stated by the companies for the transfer is that, 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, it was 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 (to which the PRA did not object). The Scheme is the process



by which PAC will cease to be the insurer in relation to the Transferring Business and, as such, the means by which the remaining solvency capital requirement that relates to the Transferring Business will be released. This type of transaction is not uncommon within the UK insurance industry.

*Policyholders who object because they are concerned that their benefit payments might change as a result of the proposed transfer (14 objections)*

4.7 As stated in paragraph 8.64 of my Main Report, there will be no 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. For the avoidance of doubt, this includes any policies whose benefit payments increase in line with an inflation index or otherwise.

4.8 In addition, as described in paragraphs 2.4 to 2.21 of this report, I do not consider that transferring policyholders' discretionary benefits (i.e. benefits upon commutation, surrender or transfer) will be materially adversely affected by the Scheme.

*Policyholders who object because they live in Scotland which has a different legal system and are concerned how this will affect their pension (1 objection)*

4.9 The analysis and conclusions presented in my Main Report, and in this report, apply to all policies of PAC and Rothesay, irrespective of where the holders of these policies reside. A Part VII transfer is legally effective in all territories in the United Kingdom and this therefore includes Scotland.

*Policyholders who are concerned that they will no longer be in scope for the PAC TRASP PBR (2 objections)*

4.10 As stated in paragraph 8.79 of my Main Report, 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. Therefore, all policyholders who are currently in scope of PAC's TRASP PBR will remain so after the proposed transfer.

*Policyholders who are concerned about their eligibility for compensation should Rothesay default or become insolvent (16 objections)*

4.11 As stated in paragraph 12.39 of my Main Report, implementation of the Scheme will not adversely affect eligibility for compensation from the Financial Services Compensation Scheme ("FSCS") for any transferring or non-transferring PAC policyholders or for the existing Rothesay policyholders. Therefore should Rothesay default or become insolvent, the transferring policyholders will have the same entitlement to compensation from the FSCS as they would have if the Scheme were not to be implemented and PAC were to default or become insolvent. Where the transferring policyholders are eligible for FSCS protection the transfer will not affect any policyholder's eligibility.

*Policyholders who believe that caveating conclusions with "material" suggests that Rothesay could choose not to pay policyholders' guaranteed benefits in full and that the opinion of the Independent Expert does not provide legally binding reassurances (2 objections)*

4.12 As stated in paragraph 3.12 to 3.15 of my Main Report, 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. Therefore 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. It is not the role of an independent expert to provide legally binding reassurances. The Court has the power to sanction the transfer. If the Scheme is sanctioned by the Court and implemented then Rothesay will be legally bound to meet the liabilities that are transferred to it.

4.13 As stated in paragraph 8.64 of my Main Report, there will be no changes to the terms and conditions of the Transferring Policies and so the contractual benefits as set out in these terms and conditions will be unaffected by the Scheme. Rothesay will be obliged to pay these benefits in full. I have considered the financial position of Rothesay and consider it to be of comparable financial strength to PAC. I therefore concluded in paragraph 8.61 of my Main Report that, based on financial information as at 30 June 2018, the implementation of 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.

4.14 I have provided an update to this conclusion in Section 3 of this report to reflect the updated position at 31 December 2018. I have concluded in paragraph 3.19 that the conclusion on the security of benefits that was presented in my Main Report

remains valid; in particular, the implementation of 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.

- 4.15 In addition, in the unlikely event that Rothesay were to become insolvent, any shortfall would be made good by the FSCS for policyholders eligible for FSCS protection<sup>19</sup>.

*Policyholders who believe the Independent Expert's final conclusions were withheld from them (1 objection)*

- 4.16 A policyholder has objected because they were unable to find my Supplementary Report on Rothesay's website and were therefore concerned that Rothesay was withholding it because the Independent Expert's conclusions regarding the Scheme had changed upon reviewing the 31 December 2018 financial information. In addition, upon hearing that the Supplementary Report would not be published until closer to the Final Hearing (also known as the Sanction Hearing), they were concerned that they would have insufficient time to assess the Independent Expert's final conclusions.
- 4.17 At the time of the objection, this Supplementary Report was not available on Rothesay's website because it had not been published. This report will be available on both PAC's and Rothesay's websites before the Final Hearing, which is scheduled to take place on 10 June 2019.
- 4.18 The purpose of the supplementary report is to provide an update to the Independent Expert's assessment of the impact of the scheme that reflects any developments since the publication of the main report. In order to ensure that the supplementary report contains the most up-to-date information possible, it is typical to publish it approximately 2 weeks before the final hearing.
- 4.19 There is no requirement in FSMA or in delegated legislation that the supplementary report is published in advance of the Final Hearing, however, the FCA has stated in "FG18/4: The FCA's approach to the review of Part VII insurance business transfers", that it expects, as a matter of good practice, that policyholders be given a minimum of two weeks to review the Supplementary Report, unless the Supplementary Report contains substantive new material or changes to anything previously communicated, in which case policyholders should be given longer to review the report. I do not consider that this report contains substantive new material or changes and therefore I am satisfied that publishing it two weeks in advance of the Final Hearing is sufficient.

*Policyholders who believe that the costs associated with the proposed transfer are being paid for by policyholders (1 objection)*

- 4.20 As stated in paragraphs 12.24 and 12.25 of my Main Report, 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.
- 4.21 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.

*Policyholders who are concerned that the annual charges on their policy may increase under Rothesay's management (1 objection)*

- 4.22 All of the Transferring Policies are annuities providing a guaranteed regular income for life, or deferred annuities which will provide a guaranteed regular income for life in the future. There are no charges levied on the Transferring Policies, and this will remain the case after the proposed transfer.

*Policyholders who are concerned that they will have less control over their investments as a result of the proposed transfer (1 objection)*

- 4.23 A policyholder was concerned that the proposed transfer would lead them to have less control over their investments. The benefits under an annuity are defined in the terms and conditions of the policies and are either fixed or linked to an inflation index. In particular the benefits are not dependent on the investment performance of any pool of assets, and this will remain the case after the proposed transfer.

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<sup>19</sup> Eligibility for FSCS protection is not affected by the transfer

*Policyholders who believe that “no material adverse effect” is not sufficient reassurance and believe that the proposed transfer should not present any adverse effect on policyholders (6 objections)*

4.24 As stated in paragraph 3.12 to 3.15 of my Main Report, 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.

4.25 In order to acknowledge this residual 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. This framework for setting my conclusion has been accepted by the Court in considering numerous previous schemes.

*Policyholders who are concerned that there is only one Independent Expert (1 objection)*

4.26 The process being followed is that required to lawfully undertake a transfer of insurance business between companies. Under FSMA, the application to the Court for a transfer of insurance business should be accompanied by a report on the terms of the Scheme by an Independent Expert. In particular, the legislation does not contemplate the appointment of more than one Independent Expert. However, my analysis has been subject to peer review by another actuary with extensive experience of transfer schemes.

*Policyholders who do not want their pension to be moved without their authority and wish to have the right to opt out or vote (52 objections)*

4.27 Under FSMA, the Court will determine whether the proposals are fair to policyholders and other interested parties and so may be put into effect. The Court will take into consideration my views as the Independent Expert and the views of the financial services regulators (the PRA and the FCA), who have reviewed this transfer in detail. Taking into consideration these views, the Court will determine whether the Scheme is, as a whole, fair to policyholders of PAC (both transferring and non-transferring) and Rothesay.

4.28 The Scheme does not permit policyholders to opt out of, or vote on, the proposed transfer and this is in line with normal practice for such transfer schemes. One of the main aims of the Scheme is to transfer policies that have already been reinsured to Rothesay, and thereby simplify administration and remove counterparty risk. Allowing policyholders to opt out of the proposed transfer would frustrate this aim.

*Policyholders who object because they were not made aware that their policy could transfer to another organisation when it was purchased (4 objections)*

4.29 There is no requirement for insurance companies to inform policyholders that their policies could be transferred to another organisation. The process being followed is that required to lawfully undertake a transfer of insurance business between companies, and the Court will determine whether the proposals are fair to policyholders and other interested parties and so may be put into effect.

*Policyholders who believe that PAC is breaching its contracts with policyholders by transferring them to another organisation (53 objections)*

4.30 Under FSMA, companies are able to undertake a transfer of insurance business subject to Court approval. The Court will determine whether the proposals are fair to policyholders and other interested parties, taking due account of policyholder objections.

*Policyholders who believe they should have been informed earlier of the proposed transfer and who feel that they have not been given sufficient notice of the proposed transfer (9 objections)*

4.31 The process being followed is that required to lawfully undertake a transfer of insurance business between companies. As part of this process, the Court must grant the companies permission to publicise the Scheme and notify policyholders. The Court granted permission to publicise the Scheme and notify policyholders at the Directions Hearing on 31 January 2019.

4.32 Regulatory guidance on the transfer of long-term insurance business suggests that it would not be adequate for there to be a period of less than six weeks between sending notices to policyholders and the date of the final court hearing<sup>20</sup>. In this case, all of the PAC policyholder packs were sent on or before 25 March 2019 and all of the Rothesay policyholder letters

<sup>20</sup> FCA handbook, SUP 18.2.46G

were sent on or before the 22 February 2019<sup>21</sup>. The Final Hearing is scheduled for 10 June 2019 and so the notice period will be in excess of the six week minimum in all cases. Relevant policyholders have been notified within a timeframe that is, in my experience, typical for such processes, and I consider the notification period to be reasonable. I am satisfied that policyholders were given sufficient notice of the proposed transfer. I am also satisfied with the adequacy of the information provided to such policyholders.

*Policyholders who believe PAC should be required to guarantee annuity payments in the event that Rothesay defaults or becomes insolvent (5 objections)*

- 4.33 The process being followed is that required to lawfully undertake a transfer of insurance business between companies. Under FSMA, there is no requirement that the transferor should be obliged to provide financial compensation or security to the transferring policies once they are transferred, unless specifically provided for in the transfer scheme. In this Scheme, there is a category of excluded liabilities for which PAC will continue to be responsible, the most significant of which is in respect of PAC's TRASP PBR. Following the transfer, PAC will still be obliged to meet (either directly or via Rothesay) the cost of TRASP Lump Sums and TRASP Incremental Liabilities, as described in paragraph 7.23 of my Main Report, that arise from PAC's TRASP PBR.
- 4.34 In addition, based on a comparison of the financial resilience of Rothesay and PAC, I am satisfied that transferring policyholders do not require additional guarantees after the transfer to maintain the security of benefits that they currently enjoy as PAC policyholders. I concluded in paragraph 8.61 of my Main Report that, based on the position at 30 June 2018, the implementation of 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.
- 4.35 I have provided an update to this conclusion in Section 3 of this report to reflect the updated position at 31 December 2018. I have stated in paragraph 3.19 that the conclusion on the security of benefits that was presented in my Main Report remains valid; in particular, the implementation of 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.
- 4.36 In addition, in the unlikely event that Rothesay became insolvent, any shortfall would be made good by the FSCS for all policyholders eligible for FSCS protection.

*Policyholders who believe it is unfair that PAC is able to transfer their policies to another company but policyholders are not themselves able to do so (11 objections)*

- 4.37 The process being followed is that required to lawfully undertake a transfer of insurance business between companies. Under FSMA, companies are able to undertake a transfer of insurance business subject to Court approval. The Court will determine whether the proposals are fair to policyholders and other interested parties.
- 4.38 There is no equivalent legal mechanism for individual policyholders to transfer their policies if this is not explicitly permitted by their policies' terms and conditions. In particular, the transfer of in-payment annuities is not permitted (although in certain limited circumstances holders of in-payment annuities are permitted to commute their annuities for a lump sum). There will be no changes to the Transferring Policies' terms and conditions as a result of the Scheme and the Scheme does not introduce any additional options under policies that will transfer to Rothesay allowing policyholders to transfer or cash in those policies. However contingent beneficiaries of personal pension policies will gain the option to commute their benefits if these benefits fall below the trivial commutation threshold, as described in paragraph 2.12.
- 4.39 Holders of the small number of transferring deferred annuities will continue to have the ability to commute some or all of their benefits in the same circumstances as is currently the case.

*Policyholders concerned about the independence of the Independent Expert (4 objections)*

- 4.40 Several policyholders are concerned the statement from the Independent Expert was insufficient because the Independent Expert might not be independent, having been selected by PAC and/or paid by PAC.
- 4.41 As noted in paragraph 1.3 of the Main Report and paragraph 1.4 of this report, my appointment as Independent Expert was approved by the PRA, after consultation with the FCA, and having given due consideration to my independence and

<sup>21</sup> Except in the case where PAC or Rothesay succeeds in tracing a "goneaway" policyholder later in the process, in which case these policyholders will receive their policyholder packs / letters later

qualifications. The PRA and FCA have a robust approach to approving independent experts and have issued guidance on this subject<sup>22</sup>.

- 4.42 In addition, it is standard practice that the Independent Expert's fees are covered by the transferor and/or transferee, and there is no realistic alternative to that arrangement. For this transfer, my fees will be met equally by PAC and Rothesay from shareholder resources. This was disclosed in paragraph 1.18 of my Main Report.

*Policyholders who are concerned about the ongoing service standards that will apply to their policy following the proposed transfer (12 objections)*

- 4.43 There have been objections from both transferring PAC policyholders and existing Rothesay policyholders who are concerned that the proposed transfer may affect the service standards they experience.
- 4.44 As stated in paragraph 13.1 of my Main Report, I am satisfied that the implementation of the Scheme will not have a material impact on the service standards applicable to PAC and Rothesay policies, including the Transferring Policies.
- 4.45 Since 1 October 2018, the majority of administration services for the Transferring Business have been outsourced to TCS/Diligenta. Under the Transitional Services Agreement, PAC will continue to provide administration services (the majority of which are 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.
- 4.46 As stated in paragraph 2.22 of this report I have reviewed the terms of the draft Transitional Services Agreement and concluded that 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.
- 4.47 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.
- 4.48 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.
- 4.49 I have been informed that Rothesay's decision regarding the future administration of the Transferring Policies 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 Rothesay's Senior Management Committee. If approved by these committees, the recommendation will then be considered by Rothesay's Customer and Conduct Committee, which will focus on the potential for any customer detriment from the proposals, and then it will be submitted to Rothesay's Board of Directors for approval. Once the chosen administration arrangement is in place it will be overseen by Rothesay's Third Party Oversight Committee, with any significant issues escalated through the Senior Management Committee.
- 4.50 I am therefore satisfied that, when making this decision, Rothesay will consider any impact on both Transferring Policies and existing policies of Rothesay. While the proposed transfer will substantially increase the total number of policies under Rothesay's administration, I do not expect this to have a material adverse impact on service standards for existing Rothesay policies; in particular, I understand that Rothesay will ensure that the administration resources that will be needed once the policies become direct policies of Rothesay (rather than policies of PAC whose benefits are reinsured to Rothesay) will be scaled up appropriately to reflect the impact of the transfer on the number of policies administered by Rothesay.

*Policyholders who are concerned that their policy is moving to a company from which they would not have chosen to buy a policy (351 objections)*

- 4.51 Many of the objectors have expressed concern that Rothesay is a less-well known company than PAC and that it was founded only twelve years ago.
- 4.52 However, the security of policyholders' benefits depends primarily on factors other than the level of prominence and age of the company. In particular, Rothesay is an authorised insurance company, regulated by the PRA and FCA, and has capital resources in excess of its minimum regulatory capital requirements and will continue to do so after the transfer. As noted

<sup>22</sup> Paragraphs 3.2 and 3.6 of FG18/4: The FCA's approach to the review of Part VII insurance business transfers, May 2018

in Section 8 of my Main Report, I am satisfied that the proposed transfer will not have a material adverse effect on the security or reasonable expectations of transferring PAC policyholders or on the service standards or governance applicable to their policies.

*Policyholders who are concerned with the security of benefits for the Transferring Business that will be provided by Rothesay, when compared to PAC (159 objections)*

4.53 I concluded in paragraph 8.61 of my Main Report that, based on the position at 30 June 2018, the implementation of 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.

4.54 I have provided an update to this conclusion in Section 3 of this report to reflect the updated position at 31 December 2018. I have concluded in paragraph 3.19 that the conclusion on the security of benefits that was presented in my Main Report remains valid; in particular, the implementation of 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.

4.55 One transferring PAC policyholder has specifically expressed concern about the security of their policy benefits because Rothesay's records at Companies House show there are a number of outstanding charges<sup>23</sup> registered against Rothesay. It is not uncommon for a company to have charges registered at Companies House, in particular when an insurance company (the cedant) reinsures its business to another insurer (the reinsurer) it is common practice for the cedant to take a charge against the reinsurer in case the reinsurer fails to meet its obligations under the reinsurance arrangement. The majority of the charges against Rothesay are in relation to reinsurance agreements between Rothesay and other companies (including PAC in relation to the Laker Reinsurance Agreement). The outstanding charges against Rothesay do not alter my conclusion that the implementation of 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. It should be noted that PAC's records at Companies House also show a number of outstanding charges against PAC.

*Policyholders who are concerned that Rothesay does not have the necessary expertise to manage their policies (20 objections)*

4.56 As stated in paragraphs 8.85 and 8.89 of my Main Report, Rothesay currently manages approximately 380,000 non-profit annuities 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.

4.57 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.

*Policyholders who are concerned that Rothesay's business is not as diversified as that of PAC and/or the wider Prudential Group (1 objection)*

4.58 Some policyholders were concerned that Rothesay's business is not as diversified as the business of PAC and/or Prudential plc, both geographically and in terms of the types of product that the business comprises.

4.59 Rothesay's business comprises non-profit pension business originating in the UK whereas PAC's business comprises a wider range of products including both non-profit and with-profits policies. However, under Solvency II regulations, to which both PAC and Rothesay are subject, insurers' capital requirements are based on the risks that they face and the extent to which those risks are diversified. Therefore, all else being equal, a company that is not highly diversified will be required to hold more capital than a company that is highly diversified. This increased level of required capital means that the level of diversification of a company's business should not materially affect the security of its policyholders' benefits.

4.60 I have reviewed Rothesay's capital policy and I am satisfied that it is appropriate given the risks which Rothesay faces. In addition Rothesay targets a solvency capital ratios that are significantly in excess of the regulatory minimum.

<sup>23</sup>A charge is the legal security that is provided against a present or future obligation.

4.61 Additionally, Prudential plc intends to demerge into two separate groups, neither of which will be as geographically diversified as Prudential plc currently is.

*Policyholders who, as a result of the proposed transfer, will have one or more annuity policies with Prudential and one or more annuity policies with Rothesay and therefore, are concerned that dealing with multiple companies will be inconvenient for them and their families (101 objections)*

4.62 While it is understandable that policyholders with more than one PAC annuity policy will wish to minimise the complexity of their financial affairs, I do not consider that having annuities with two providers will result in material inconvenience to policyholders. In particular, no action is required by policyholders in relation to the transfer, and policyholders' benefit payments will continue to be paid automatically after the transfer on the days on which they are due.

4.63 Additionally, as described in paragraph 2.19, PAC and Rothesay have received assurances from HMRC that everything possible will be done to avoid incorrect PAYE tax codes being applied to Transferring Policies following the transfer. In particular, HMRC is aware of those transferring policyholders who have other annuities with PAC that are not transferring, and has taken account of that in its work on PAYE tax codes.

4.64 Additionally, I have concluded in my Main Report, and in this report, that the transfer will not have a material adverse impact on the service standards applicable to the Transferring Policies.

*Policyholders who do not wish to be transferred to Rothesay due to having a policy already with Rothesay and wish to keep their policies with different companies in case one of the companies should become insolvent (6 objections)*

4.65 While it is likely that holding policies issued by different companies will result in some diversification of risk, the Solvency II regulations, to which both PAC and Rothesay are subject, require insurers to hold sufficient capital such that over one year there is a 99.5% probability of remaining able to pay policyholders' future benefits. Furthermore, both PAC and Rothesay target solvency capital ratios that are significantly in excess of the regulatory minimum, which further reduces the likelihood of insolvency. Accordingly, I am satisfied that policyholders' security of benefits will not be materially adversely affected by the proposed transfer.

4.66 In addition, if Rothesay or PAC were to become insolvent, policyholders would receive compensation from the FSCS to the extent that they are eligible for FSCS protection; the amount of compensation received would not be constrained by the number of policies held.

*Policyholders who want their policy to remain with PAC due to their positive experiences of being a PAC policyholder (253 objections)*

4.67 As stated in paragraph 8.92 of my Main Report, I am satisfied that the implementation of the Scheme will not have a material adverse impact on the security of benefits under the Transferring Policies, the reasonable expectations of the transferring PAC policyholders and the service standards and governance applicable to the Transferring Policies. Therefore, I have no reason to believe that the transferring policyholders will have a materially different experience as Rothesay policyholders than they have had thus far as PAC policyholders.

*Policyholders who want their policy to remain with PAC because they chose specifically to take out a policy with PAC based on its reputation (174 objections)*

4.68 Many of the policyholders who objected to the proposed transfer did so on the grounds that they had specifically chosen PAC as their annuity provider based on its reputation as a reliable, long-standing and well established company.

4.69 The security of policyholders' benefits depends primarily on factors other than the level of prominence and age of the company. In particular, Rothesay is an authorised insurance company, regulated by the PRA and FCA, and has capital resources in excess of its minimum regulatory capital requirements and will continue to do so after the transfer.

4.70 As stated in paragraph 8.92 of my Main Report, I am satisfied that the implementation of the Scheme will not have a material adverse impact 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. Therefore, I have no reason to believe that the transferring policyholders will have a materially different experience as Rothesay policyholders than they would have done if they remained as PAC policyholders. While I fully understand why many PAC policyholders draw comfort from the company's reputation, in reviewing the security of policyholders' benefits I have necessarily considered more tangible factors such as solvency cover, risk exposure and capital management policies.

*Policyholders who do not want to be transferred due to previous experiences of Rothesay's administration of existing policies (6 objections)*

- 4.71 Some policyholders have objected to the transfer due to perceived poor service standards that they have experienced in relation to the administration of their existing Rothesay policies or of Rothesay policies held by a close relative.
- 4.72 As described in paragraph 2.22 of this report 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. As stated in paragraph 2.22 of this report, these services will be provided by PAC under the Transitional Services Agreement which states that the service standards provide by PAC in this period must be at least the same standard as the services provided by PAC in the twelve months prior to the Transfer Date. Therefore, during the term of the Transitional Services Agreement, I see 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.
- 4.73 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.
- 4.74 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.
- 4.75 It would be very unusual for there to be no isolated instances of customer dissatisfaction for holders of Rothesay policies (or for holders of PAC policies); in my experience all insurance companies experience such lapses from time to time. However, as stated in paragraph 2.26 of this report, I am satisfied that the implementation of the Scheme will not have a material adverse impact on the service standards and governance applicable to the Transferring Policies.

*Policyholders who want to be able to surrender their annuities or transfer them to another insurance company because they do not want to transfer to Rothesay (40 objections)*

- 4.76 The surrender or transfer of in-payment annuities is only permitted in the limited circumstances described in paragraph 2.12. Holders of the small number of transferring deferred annuities will continue to have the ability to commute some or all of their benefits in a wider range of circumstances than for in-payment annuities.
- 4.77 In certain EEA states, not including the UK, the local laws allow policyholders (who were residents of the state at the time their policy was effected) to cancel their policy in the event that the policy is transferred (or due to be transferred) from one insurer to another. PAC and Rothesay have complied with local insurance regulator requests to inform transferring policyholders residing in the applicable EEA states of their cancellation rights (see paragraph 5.2).

*Policyholders who do not want to be transferred due to negative experiences of previous transfers (21 objections)*

- 4.78 As stated in paragraph 8.92 of my Main Report, I am satisfied that the implementation of the Scheme will not have a material adverse impact on the security of benefits under the Transferring Policies, the reasonable expectations of the transferring PAC policyholders and the service standards and governance applicable to the Transferring Policies. Therefore, I do not believe that policyholders will be materially adversely affected by the proposed transfer.

*Policyholders who object that the proposed transfer does not benefit the policyholders (47 objections)*

- 4.79 There have been objections from both transferring PAC policyholders and existing Rothesay policyholder who object that that the proposed transfer does not benefit them. There is no requirement under FSMA that the transfer generates benefits for policyholders.

*Policyholders who object because their tax codes might change as a result of the proposed transfer (4 objections)*

- 4.80 As stated in paragraph 2.28 of this report, PAC and Rothesay have consulted with HMRC to establish the best approach to minimise any inconvenience for affected policyholders. HMRC has agreed to monitor the situation appropriately to ensure as far as possible that transferring policyholders' tax codes are not affected by the proposed transfer.



*Policyholders who are concerned that Rothesay is part of an international organisation and/or has international shareholders (5 objections)*

4.81 As stated in paragraph 6.2 of my Main Report, 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<sup>24</sup>; and
- Management, Employees and Elian Employee Benefit Trustee Limited.

4.82 While a majority of shareholders by value are domiciled overseas, Rothesay, a UK company incorporated under the Companies Act 2006, is subject to the same UK laws and regulations as PAC. The transferring policyholders will therefore benefit from the same rights and protections as they enjoy currently. Rothesay HoldCo, Rothesay's direct parent, is also incorporated in the UK.

*Policyholders who do not believe there has been sufficient justification regarding the selection of Transferring Policies (21 objections)*

4.83 As described in paragraphs 7.30 and 7.31 of my Main Report, the Transferring Business was selected in order to achieve a target level of capital release to support the proposed demerger of M&G Prudential. Various practical constraints were taken into account in the original selection process, including the need to avoid separating policies covered by a single reinsurance arrangement.

4.84 In order to finalise the selection of transferring policyholders under the Scheme, a number of modifications have been made to the original selection, 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 of my Main Report, have been made to ensure that the Transferring Business can legally and effectively be transferred by means of the Part VII transfer.

4.85 There is no single selection approach that can be considered fairer to policyholders than any other, and so choosing the Transferring Policies on the basis of commercial, practical and legal considerations is in my view reasonable.

*Policyholders who are concerned that Rothesay may transfer them to another insurance company in the future (2 objections)*

4.86 Rothesay currently does not intend to transfer the Transferring Policies to another company. However, under FSMA, companies are able to undertake a transfer of insurance business subject to Court approval. If Rothesay were to choose to do this, the same legal process that has governed this proposed transfer would need to be adhered to. Therefore a court, taking into account the views of an independent expert and the views of the relevant financial services regulators, would need determine that the proposals were fair to policyholders and other interested parties before the transfer could take effect.

*Policyholders who are concerned that Rothesay may change their terms and conditions in the future (2 objections)*

4.87 The terms and conditions of the Transferring Policies are not changing as a result of the proposed transfer. Neither PAC nor Rothesay has the right to alter the terms and conditions of the Transferring Policies without either obtaining the explicit consent of individual policyholders or following an extensive legal process requiring, among other things, consultation with affected policyholders.

*Policyholders who are concerned about Rothesay's financial results (1 objection)*

4.88 Some policyholders have objected on the grounds that Rothesay's interim accounts for 2018 show that Rothesay incurred a pre-tax loss for the first half of 2018 of £253 million and that its full 2018 accounts show a significant decrease in pre-tax profit from £330 million in 2017 to £114 million in 2018.

4.89 The reduction in profit in 2018 arose as a result of new business strain<sup>25</sup> associated with the purchase of the Transferring Business from PAC (resulting in the Laker Reinsurance Agreement) and Rothesay's decision to reduce investment risk in

<sup>24</sup> Massachusetts Mutual Life Insurance Company is a US company established in 1851. MassMutual's and its subsidiaries' financial assets were valued at \$702 billion as at 31 December 2018.

<sup>25</sup> Upon entering into a new transaction such as the purchase of the Transferring Business, the premium received would typically be lower than the insurance contract liabilities the insurer is required to establish, which results in an accounting loss sometimes referred to as "new business strain".

relation to this transaction, in particular de-risking the underlying assets and adopting a cautious strategy when reinvesting the premium it received as a result of the transaction with PAC. This new business strain was anticipated by Rothesay when assessing the transaction.

4.90 It is normal for large transactions such as this to have a negative impact on the profits of a company at the point at which they are entered into, and profits would be expected to emerge over time to compensate the company for the “day 1” losses it has incurred. Rothesay entered into this transaction in full knowledge of this and knowing that its financial strength<sup>26</sup> was more than sufficient to withstand the impact of the transaction without threatening its solvency position. Therefore the reduction in profit arose primarily as a result of a conscious decision by Rothesay to enter into a large transaction, and not as a result of unexpected losses arising from other sources.

4.91 I have considered Rothesay’s financial position in paragraphs 3.12 to 3.17 and I have concluded that the Scheme will not have a material impact on the financial resources available to support the benefits of policyholders of PAC and Rothesay.

*Policyholders who do not wish their personal details to be shared with Rothesay (2 objections)*

4.92 PAC’s Data Protection Notices<sup>27</sup> allow PAC to share policyholder details where necessary with its ‘Business Partners’. This includes service providers and reinsurers. Therefore, under the Laker Reinsurance Agreement, PAC would have shared some transferring policyholder data with Rothesay. PAC received legal advice at the time of that the Laker Reinsurance Agreement was entered into that confirmed that PAC was able to share policyholder details related to the Laker Reinsured Business with Rothesay.

4.93 Moreover, in transferring the Transferring Business from PAC to Rothesay, it is necessary to transfer the relevant transferring policyholders’ details. The Scheme states that on the Transfer Date, Rothesay will become the data controller for all personal data comprised in the Transferring Business for which PAC is currently the data controller<sup>28</sup>. Therefore, if the Court were to sanction this transfer, it will also sanction the transfer of policyholders’ details in relation to the Transferring Policies.

*Policyholders who do not wish the administration/servicing of their policy to be outsourced (1 objection)*

4.94 Some policyholders have objected to the administration and/or servicing of policies being outsourced to third parties. As described in paragraph 5.52 of my Main Report, on 12 June 2018 PAC announced that its strategic partnership with TCS/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 majority of its policy administration services for the Transferring Policies to TCS/Diligenta, and therefore the transfer will have no impact on the extent of outsourcing applicable to the Transferring Policies.

4.95 More generally, it is not unusual for UK insurance companies to outsource the administration of aspects of their policies, including servicing, to third parties. However, the existence or otherwise of outsourced administration arrangements does not change the fact that the insurer is responsible for meeting its obligations, and in particular for monitoring outsourcing arrangements and ensuring it is able to pay the benefits guaranteed under the policy when due.

*Policyholders who reside in other member states of the EU and are concerned about the impact of Brexit (1 objection)*

4.96 As discussed in paragraph 2.31 of this report, PAC and Rothesay have stated that they do not expect Brexit to affect their ability to meet their obligations in relation to policies of policyholders living overseas. If there were to be a change this would impact both policyholders PAC and Rothesay equally.

*Policyholders who believe they should have been consulted before the companies had agreed to the proposed transfer (1 objection)*

4.97 A policyholder has objected on the grounds that policyholders should have been consulted before the proposed transfer was agreed upon by PAC and Rothesay.

4.98 Neither PAC nor Rothesay has any obligation to seek policyholders’ views or advance permission when agreeing upon a transaction of this nature. The process being followed is that required to lawfully undertake a transfer of insurance business between companies in the UK, and the Court will determine whether the proposals are fair to policyholders and other

<sup>26</sup> As shown in Table 3.3, Rothesay’s solvency coverage ratio at 31 December 2018 was 180%.

<sup>27</sup> A copy of PAC’s Data Protection notices can be found [here](https://www.pru.co.uk/pdf/GENM893901.pdf) (https://www.pru.co.uk/pdf/GENM893901.pdf) for direct and advised policyholders and [here](https://www.pru.co.uk/pdf/GENM877302.pdf) (https://www.pru.co.uk/pdf/GENM877302.pdf) for bulk annuity policies with trustees).

<sup>28</sup> For any personal data which PAC requires in relation to the TRASP PBR, PAC and Rothesay will both be separate data controllers.

interested parties and so may be put into effect. As part of this process, the Court directs the companies to publicise the Scheme and notify policyholders, at which point the terms of the proposed transfer will, of necessity, have already been agreed upon by both companies, but subject to the approval of the Court.

*Policyholders who are concerned that the proposed transfer will weaken Rothesay's financial strength in the long-term (2 objections)*

- 4.99 Two existing Rothesay policyholders have registered objections on the grounds that the proposed transfer would pose a threat to the long-term security of their policy. My assessment of the proposed transfer has included consideration of its potential impact in the long term. I concluded in paragraph 13.1 of my Main Report that the implementation of the Scheme will not have a material adverse effect on the security of the benefits of PAC and Rothesay policyholders, including the transferring policyholders.
- 4.100 I have provided an update to this conclusion in Section 3 of this report. I have concluded in paragraph 3.19 that the conclusion on the security of benefits that was presented in my Main Report remains valid.
- 4.101 In reaching this conclusion, I have taken into account that the liabilities of the transferring business have already been assumed by Rothesay under the Laker Reinsurance Agreement; the proposed transfer will not change those liabilities, nor the assets available to support them. Moreover, I have allowed for the fact that Rothesay manages its risk exposures carefully and targets a solvency capital ratio that is significantly in excess of the regulatory minimum, both of which will help to counteract the effect of any potential adverse future experience. In my view there is no reason to believe that implementation of the Scheme will be detrimental to Rothesay's long term financial strength.

*Policyholders who are concerned that the proposed transfer will increase their exposure to risks associated with fossil fuel activities (1 objection)*

- 4.102 A transferring PAC policyholder has objected on the basis that they are concerned that Rothesay's investment strategy could result in them being more exposed to the risks associated with fossil fuel activities such as fracking<sup>29</sup>.
- 4.103 Rothesay's insurance liabilities are backed by a diversified portfolio of investments including corporate bonds, sovereign debt, secured residential lending, infrastructure and commercial real estate loans. Rothesay has informed me that its corporate bond holdings result in some exposure to fossil fuel activities (including fracking), but that this exposure is very small in the context of its overall investments. In addition, Rothesay does not have any equity investments in companies associated with fossil fuel activities; all of Rothesay's financial investments with any exposure to such activities are debt instruments which are more secure than equity holdings, all else being equal.
- 4.104 As part of Rothesay's Risk Management Framework, all risks, including climate change, are considered when making investment decisions and Rothesay monitors the risks associated with its investment strategy on an ongoing basis. Rothesay's Risk Management Framework is described in more detail in paragraphs 6.29 to 6.36 of my Main Report.
- 4.105 Additionally, Rothesay is regulated by the PRA which has identified the financial risks associated with climate change as an area of focus in its 2019/2020 business plan<sup>30</sup>, and Rothesay will comply with any new requirements that the PRA introduces in this area.
- 4.106 I am satisfied that the implementation of the Scheme will not materially expose Transferring Policies to the risks associated with fossil fuel activities and that the implementation of the Scheme will not have a material adverse effect on the security of benefits of the transferring policyholders.

**MY REVIEW OF OBJECTIONS RECEIVED**

- 4.107 PAC sent me a brief description of every objection it has received, and I selected a sample of objections for which PAC provided the case file which contained full details of the objection and PAC's response.

<sup>29</sup>Fracking or 'hydraulic fracking' is a process of extracting oil or gas by injecting subterranean rock with liquid at high pressures.

<sup>30</sup> The PRA's 2019/2020 business plan is available here: <https://www.bankofengland.co.uk/prudential-regulation/publication/2019/pru-business-plan-2019-20>

- 4.108 Rothesay sent me the case file for all of the objections that were received from Rothesay policyholders<sup>31</sup> and, owing to the small number of such objections, I reviewed each of these. The case files contained the full details of the objections and Rothesay's responses to them.
- 4.109 On the basis of this review, I am satisfied that both companies' responses to this sample of objections were appropriate in tone, language and content, and in particular adequately addressed the substance of the policyholders' objections. I therefore do not have any concerns around the way in which objections to the proposed transfer have been handled by PAC or Rothesay.

## CONCLUSION

- 4.110 While many of the concerns raised by policyholders are understandable, I do not consider that any of the policyholder enquiries received that have been categorised as objections raise any concerns that cause me to change my conclusions in relation to the proposed transfer, and I am therefore satisfied that the conclusions in Section 13 of my Main Report (and reproduced in Section 6 of this report) remain valid.
- 4.111 In all cases policyholders have the right to raise their objections at the Final Hearing for the Scheme, which is scheduled to take place on 10 June 2019.

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<sup>31</sup> As noted in paragraph 4.4, 21 objections that Rothesay received were deemed to be directed at PAC and therefore forwarded to PAC. I have treated these as objections received by PAC.

## 5 Other considerations arising from the scheme

### THE POLICYHOLDER COMMUNICATION PROCESS

5.1 I understand that PAC and Rothesay published notices (in English) of the proposed Scheme in a form approved by the PRA:

- once in each of the London Gazette, the Edinburgh Gazette, the Belfast Gazette, Irish Gazette; and
- once in each of the following national newspapers in the UK:
  - The Times;
  - The Financial Times;
  - The Daily Telegraph;
  - The Sun;
  - The Daily Mail; and
  - The Daily Mirror.

In addition notices were also published in the online editions of The Times, The Daily Telegraph, The Daily Mirror and The Daily Mail.

5.2 The PRA has provided notification of the proposed Scheme to the insurance regulators in all EEA states. Following this, at the request of the local insurance regulator, PAC supplied a copy of the notice of transfer translated into French for publication in 'Memorial, Journal Officiel du Luxembourg'. In addition, at the request of the respective local regulators, Rothesay will send letters to all transferring policyholders residing in the Croatia, Czech Republic, Finland, Hungary, Norway, Poland and Romania to inform them, where appropriate, of their cancellation rights<sup>32</sup> under the laws of each country and, where applicable, Rothesay will publish a notice of transfer in the requisite journal or national newspaper of each country. As at 15 May 2019, no objections have been raised by regulators.

5.3 PAC sent the PAC policyholder pack to all transferring policyholders for whom it has a valid address. As noted in Section 12 of my Main Report, PAC sought a waiver from the requirement to directly contact:

- Certain groups of transferring policyholders:
  - "Goneaways";
  - Policyholders who have appointed an attorney in respect of their transferring policy (in these cases the attorney would be notified instead of the policyholder);
  - Beneficiaries under group schemes unless PAC has an existing arrangement in place with a trustee to directly contact that trustee's beneficiaries;
  - Contingent annuitants;
  - Policyholders where there is a record of the appointment of a trustee-in-bankruptcy, receiver or administrative receiver (in these cases the trustee-in-bankruptcy, receiver or administrative receiver would be notified instead of the policyholder);
  - Policyholders with the benefit of pension sharing orders where the records do not show the existence of a Pension Sharing Order;
  - Deceased policyholders;
  - Accidental omissions; and
- All non-transferring policyholders.

<sup>32</sup> In some EEA states, not including the UK, the local laws allow policyholders (who were residents of the state at the time their policy was effected) to cancel their policy in the event that the policy is transferred (or due to be transferred) from one insurer to another.

This waiver was granted by the Court at the Directions Hearing on 31 January 2019.

- 5.4 PAC also sought a waiver in respect of the requirement that the proposed transfer is advertised in every EEA state which is the member state of the commitment and to instead advertise the proposed transfer in the EEA states where there are more than 100 transferring policyholders. This waiver was granted by the Court at the Directions Hearing on 31 January 2019 and the legal notice was translated into the local language, where appropriate, and published in two national newspapers in each of the applicable EEA states. These were Cyprus, France, Germany, Greece, Italy, Portugal, the Republic of Ireland and Spain.
- 5.5 As at 15 May 2019, PAC has received 831 returned policyholder packs where the policyholder no longer lives at the address on record. For each of these policyholders, PAC will initiate a tracing procedure using a third party tracing agency. Where practicable, a policyholder pack will be sent to the individuals who have been successfully traced.
- 5.6 Rothesay sent the Rothesay policyholder letter to all its policyholders for which it has a valid address. As noted in Section 12 of my Main Report, Rothesay sought a waiver from the requirement to directly contact certain groups of policyholders:
- “Goneaways”;
  - Policyholders where there is a record of a current legal assignee of the transferring policyholders (in these cases the assignee would be notified instead of the policyholder);
  - Beneficiaries;
  - Scheme Beneficiaries of buy-ins unless Rothesay has an existing arrangement in place with a trustee to directly contact that trustee’s beneficiaries;
  - Contingent annuitants;
  - Policyholders with the benefit of pension sharing orders where the records do not show the existence of a Pension Sharing Order;
  - Policyholders who have appointed a power of attorney (in these cases the power of attorney would be notified instead of the policyholder);
  - Joint policyholders if both policyholders have the same address;
  - Policyholders where there is a record of the appointment of a trustee-in-bankruptcy, receiver or administrative receiver (in these cases the trustee-in-bankruptcy, receiver or administrative receiver would be notified instead of the policyholder);
  - Deceased policyholders; and
  - Accidental omissions.

This waiver was granted by the Court at the Directions Hearing on 31 January 2019.

- 5.7 As at 9 May 2019, Rothesay had received 1,577 returned policyholder letters where the policyholder was no longer living at the address on record. For each of these policyholders, Rothesay has used third party tracing services to attempt to obtain the current address, and sent a policyholder letter to the individuals who were successfully traced.
- 5.8 Policyholders and other interested parties have been, and are currently, able to obtain information on the Scheme from the PAC and Rothesay websites. The available documents include the full Scheme document, my Main Report, a summary of the terms of the Scheme and a summary of my Main Report, and examples of the PAC policyholder packs and Rothesay policyholder letters.

## THE SCHEME

- 5.9 Since I prepared my Main Report I have been provided with a revised version of the Scheme which incorporates some minor changes or corrections to the version that I reviewed previously<sup>33</sup>. These minor amendments do not affect my assessment of the consequences of the Scheme.
- 5.10 With the exception of minor or technical amendments, future amendments to the Scheme will require a process that has many similarities to the process involved in a Part VII transfer in relation to policyholder protection. Therefore, although it is not possible to be certain of the likely effects of any future Scheme amendments, I am satisfied that any such amendment will be subject to a robust governance process and be duly scrutinised at the time and, depending on the circumstances at the time, will typically only proceed when it is concluded that any such amendment will not have a material adverse effect on the benefit security or the reasonable expectations of affected policyholders.

## CORPORATE TRANSACTIONS SINCE MY LAST REPORT

- 5.11 On 1 April 2019, it was announced that, subject to regulatory approval, Rothesay had entered in to an agreement with Monument Re to sell a portfolio of Irish annuities worth approximately €140 million. The purpose of this transaction is to ensure that the annuities can continue to be serviced after Brexit, regardless of the terms on which the UK leaves the European Union<sup>34</sup>. The Part VII process that will be required to transfer the affected policies is expected to be completed in 2020. None of the Transferring Policies of PAC is to be transferred to Monument Re.
- 5.12 The impact of this transfer is expected to have a minimal impact on Rothesay's financial position. In addition, a UK court process, taking into account the views of an independent expert and the views of the PRA and the FCA, will determine whether the proposals are fair to policyholders and other interested parties before the transfer can take effect.

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<sup>33</sup> In preparing my Main Report I reviewed the final version of the Scheme submitted to the Court for the Directions Hearing in addition to the draft versions listed in Appendix 3 of my Main Report.

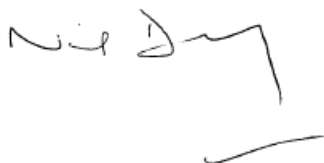
<sup>34</sup> The transfer of some of PAC's business to PIA, referred to in paragraph 3.4 above, was undertaken for the same reason.

## 6 Conclusions

6.1 I have considered relevant developments brought to my attention by PAC and Rothesay since the completion of my Main Report. I have not changed my conclusions regarding the likely effects of the Scheme.

6.2 Accordingly I remain 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.
- I am satisfied that the Scheme is equitable to all classes and generations of PAC and Rothesay policyholders.



Nick Dumbreck

17 May 2019

Fellow of the Institute and Faculty of Actuaries



## Appendix 1: Key documents 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:

- Agreed Form of the Schemes to be submitted to the Final Hearing of the Court, the Royal Court of Guernsey and the Royal Court of Jersey
- PAC's Chief Actuary's supplementary report on the Scheme (including pre and *pro forma* post-Scheme solvency position for PAC at 31 December 2018)
- PAC's With-Profits Actuary's supplementary report on the Scheme
- Rothesay's Chief Actuary's supplementary report on the Scheme (including pre-Scheme and *pro forma* post-Scheme solvency position for Rothesay at 31 December 2018)
- Draft Transitional Services Agreement
- Commutation factor analysis
- Policyholder objections (call summaries, call transcripts, emails and letters)
- PAC responses to a sample of policyholder objections
- Rothesay responses to all of its policyholder objections

**Note:** In Appendix 3 of my Main Report I referred to having considered drafts of reports by the Chief Actuaries of PAC and Rothesay and the With-Profits Actuary of PAC. I have since received final copies of those reports, and can confirm that there were no material changes from the corresponding drafts.