

Summary of the report of the Independent Expert

Background

I have been instructed by The Prudential Assurance Company Limited ("**PAC**")¹ and Rothesay Life Plc ("**Rothesay**") to report to the High Court of Justice of England and Wales (the "**Court**") on the terms of the proposed transfer of certain non-profit annuity insurance business of PAC ("**the transferring policies**") to Rothesay. The transfer will be effected by means of a scheme of transfer (the "**Scheme**") in accordance Part VII of the Financial Services and Markets Act 2000. Subject to Court approval, the date on which the transfer takes place ("**the transfer date**") is expected to be 26 June 2019.

On 14 March 2018, Rothesay entered into an agreement to acquire the transferring policies from PAC. While the formal transfer of the transferring policies to Rothesay requires the sanction of the Court, PAC and Rothesay agreed that PAC's economic interest in the material risks and rewards of the transferring policies should be transferred to Rothesay in the meantime². This was achieved by putting in place a reinsurance agreement between PAC and Rothesay ("**the Reinsurance Agreement**"). Under the Reinsurance Agreement, Rothesay must reimburse PAC for all benefit payments made to holders of the transferring policies³ unless and until the transferring policies are formally transferred to Rothesay under the Scheme, after which Rothesay will make the payments directly. There are a number of policies that are covered by the Reinsurance Agreement which are not transferring policies. These policies will instead remain reinsured to Rothesay after the transfer date.

I am a Fellow of the Institute and Faculty of Actuaries in the UK and a partner of Milliman LLP. I have fulfilled the role of Independent Expert for over 20 insurance business transfers that have been approved by the Court. I confirm that I do not have any direct or indirect interest in PAC, Rothesay or any other related firms that could compromise my independence.

My assessment of the effect of the transfer has been informed by the financial positions of PAC and Rothesay at 30 June 2018, the most recent date at which both sets of financial results are available at the time of writing.

This is a summary of my full report dated 21 January 2019. Please refer to my full report (which is available from the PAC and Rothesay websites) for the scope of my work and my conclusions, and the reliances, limitations and standards applying to my work. The full report and this summary do not provide financial or other advice to individual policyholders.

Before the final Court Hearing I will prepare a further report (the "**Supplementary Report**") to provide an update on my conclusions regarding the effect of the proposed transfer on the different groups of policyholders in light of any significant events arising after my full report has been finalised. The Supplementary Report will include information on the financial position of the companies at 31 December 2018.

The effect of the transfer on transferring policies of PAC

Benefit security

Transferring PAC policyholders will be transferred from a very large, long established company with a familiar brand name to a smaller, less well-known company founded only twelve years ago. However, the security of policyholders' benefits depends primarily on factors other than the size and age of the company, and in reviewing the transfer I have considered, among other things:

¹ PAC is a UK insurance company and is the primary European insurance entity of the Prudential plc group.

² With effect from 1 April 2018 for deferred annuities and 1 July 2018 for annuities in payment.

³ With the exception of differences in payments to policyholders that arise through differences between PAC's and Rothesay's commutation factors

Solvency cover: If the proposed transfer had taken place on 30 June 2018, the level of cover for regulatory solvency requirements⁴ would have been lower in Rothesay post-transfer than that in PAC pre-transfer. However, PAC's solvency cover decreased from 14 December 2018 due to the transfer of the legal ownership of PAC's Hong Kong subsidiaries to Prudential Corporation Asia, reversing the relative positions of the two companies.

Capital policies: PAC and Rothesay have capital policies aimed at maintaining solvency cover⁵ within an appropriate range. I have reviewed the capital policies of both companies and have concluded that they are of broadly comparable strength. At 30 June 2018 the solvency cover of each company exceeded the upper end of the target range set by its respective Board, and this would also have been the case after the transfer if it had taken place on that date. Each company is free to distribute to its shareholders any surplus capital which is not ring-fenced or expected to be needed by the business, and this means that additional security provided by solvency cover in excess of the target range may be temporary.

Risk exposures: Differences in the risks to which each fund is exposed may lead to differences in the variability of solvency cover as financial and other conditions change, and it is also necessary to take account of any such differences.

Based on my review of all the relevant factors, I am satisfied that the transfer will not have a material adverse impact on the security of benefits of the transferring policies.

Reasonable expectations of transferring policyholders

The transferring policies are all non-profit annuities⁶ and therefore, in my view, policyholders' reasonable expectations in respect of their policies are principally that:

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

No changes are proposed to the terms and conditions of the transferring policies, and so the contractual benefits will be unchanged by the Scheme.

Holders of some of the transferring policies are able to elect to commute some or all of the contractual benefits of their policy in certain limited circumstances⁷; that is, the policyholder or contingent beneficiary may choose to forgo some or all of their annuity income in return for a lump sum payment. The amount of lump sum received is, in almost all cases, at the discretion of the insurer (subject to the overriding requirement to treat customers fairly), and is determined by a commutation factor⁸ that depends on the insurer's estimate of the life expectancy of the customer, as well as prevailing market conditions (in particular the level of long-term interest rates). PAC is in the process of implementing a change to its commutation factors which will, by and large, result in the factors reducing. I have received analysis from PAC and Rothesay showing that, while PAC's commutation factors (after the planned change) may be higher or lower than those of Rothesay depending on the features of the policy, the two sets of

⁴ The UK insurance regulations specify minimum levels of capital that an insurer must hold based upon the risks that the insurer has written.

⁵ The capital that an insurer holds expressed as a percentage of the minimum level permitted by regulations.

⁶ All transferring policies are in-payment annuities with the exception of a very small number of deferred annuity policies

⁷ For in-payment annuities, these circumstances comprise:

- a situation in which a pension sharing order has been issued; or
- a situation where the benefits of a contingent beneficiary are small enough to qualify for trivial commutation following the death of the main policyholder.

⁸ A commutation factor is the lump sum received by the policyholder for each £1 p.a. of pension income forgone. For example, a commutation factor of 20 means that the policyholder would receive a £20 lump sum for each £1 p.a. of pension forgone.

factors will not differ materially. I have provided more details on this aspect in my full report and I will provide an update in my Supplementary Report.

Since October 2018, the administration and servicing of all of PAC's annuity business (including the transferring policies) has been carried out by Tata Consultancy Services ("TCS") and Diligenta, its UK subsidiary. Subject to putting in place a suitable transitional services agreement, PAC will continue to provide administration and servicing (undertaken by TCS on its behalf) to Rothesay for 12 to 24 months after the transfer date, which means that no changes to administration or service standards are expected as a result of the transfer during this period. While this 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. After the expiry of the transitional services agreement, Rothesay would choose either to put in place a direct relationship with TCS/Diligenta or the administration would migrate to a service provider of Rothesay's choice. 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 the service standards to be reasonable. I have no reason to believe that the future outsourcing arrangements for the transferring policies organised by Rothesay will result in materially different service standards from those applicable to Rothesay's existing non-profit annuities. I will comment on the outcome of the discussions surrounding the Transitional Services Agreement in my Supplementary Report. However, assuming that a suitable Transitional Services Agreement is put in place, I am satisfied that the implementation of the Scheme will not result in a material adverse impact on service standards applicable to the Transferring Policies.

Following the transfer, the transferring policies will be managed by Rothesay and subject to the governance of the Rothesay Board of Directors. As noted above, Rothesay currently manages large volumes of non-profit annuity business, and is therefore experienced in the management and governance of such business.

After the transfer date it will be necessary to use Rothesay's Pay As You Earn ("PAYE") reference for transferring policies. For some holders of transferring policies, this may trigger a change in their PAYE tax code, either at or directly after the transfer date. Rothesay and PAC are liaising with HMRC to establish the best approach to minimise any inconvenience for affected policyholders. I will comment further on this aspect in my Supplementary Report.

In October 2016, the Financial Conduct Authority (the "FCA") announced the findings of its Thematic Review of Annuity Sales Practices ("TRASP") which assessed whether firms had provided new annuity customers with sufficient information about the availability of enhanced annuities⁹ at the point of sale. As a result of TRASP a number of firms, including PAC, were asked by the FCA to review all non-advised annuity sales¹⁰ since July 2008 and provide compensation where appropriate. PAC is currently conducting this review.

Depending on the outcome of the TRASP review, PAC may need to make lump sum compensation payments and/or augment the level of annuity payments for certain policies, including some of the transferring policies. The planned processes for reviewing and, where appropriate, providing TRASP compensation after the transfer have been designed with the aim that a transferring policyholder's experience would be the same as that of a non-transferring policyholder of PAC. Therefore, transferring policyholders should not experience a delay in receiving any compensation due as a result of the implementation of the Scheme, nor will the amount of compensation they receive be affected.

Conclusions for transferring policies

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

- The security of benefits under the transferring policies;
- The reasonable expectations of the transferring policyholders; or

⁹ An annuity sold to an individual in poorer than average health, which pays out a higher annuity amount to reflect their lower life expectancy relative to a healthy individual.

¹⁰ When a customer does not receive financial advice when purchasing an annuity, it is called a 'non-advised annuity sale'.

- The service standards and governance applicable to the transferring policies.

The effect of the transfer on non-transferring policies of PAC

Benefit security

If the proposed transfer had taken place on 30 June 2018, there would have been an improvement to PAC's financial strength as a result of the transfer. However, this improvement would be relatively small as PAC has already transferred the risks and rewards associated with the transferring policies to Rothesay through the Reinsurance Agreement, and so has already realised most of the financial benefits of the transfer.

The proposed transfer will not lead to any material change in the risk appetite¹¹ or capital policy in accordance with which PAC is managed, and PAC's ability to comply with its capital policy will not be materially affected by the transfer.

Reasonable expectations of non-transferring PAC policyholders

No changes will be made to the terms and conditions of non-transferring policies in PAC as a result of the transfer. Furthermore, there will be no change to the operation of PAC and the governance of non-transferring PAC policies will continue to be the responsibility of the PAC Board of Directors and, in the case of with-profits policyholders (none of which will transfer to Rothesay), the role of the PAC With-Profits Committee will be unchanged.

The non-transferring policies in PAC will continue to be administered under the same arrangements and will therefore not experience any change to service standards as a result of the transfer.

The Scheme will have no effect on the benefits payable under policies remaining in PAC.

Conclusions for non-transferring policies

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

- The security of benefits under non-transferring policies in PAC;
- The reasonable benefit expectations of non-transferring policyholders of PAC; or
- The service standards and governance applicable to non-transferring policies of PAC.

The effect of the transfer on Rothesay policies

Benefit security

Based on the financial information I have received as at 30 June 2018, there will be no material change to the financial strength of Rothesay as a result of the transfer as PAC has already transferred the risks and rewards associated with the transferring policies to Rothesay through the Reinsurance Agreement.

Rothesay's existing business consists solely of annuities in payment and deferred annuities, and while the Reinsurance Agreement significantly increased the volume of business in Rothesay, it did not materially change the nature of the risks to which its policies are exposed (principally longevity risk¹² and credit risk¹³). As the risks on the transferring policies have already been passed to Rothesay through the Reinsurance Agreement, the transfer itself will not add to these risks.

¹¹ Risk appetite is the amount and type of risk that an organisation is willing to take in order to meet its strategic objectives.

¹² Longevity risk is the risk of an adverse financial impact arising from annuity policyholders living longer than expected.

¹³ Credit risk is the risk of losses arising from a loan made to a third party. A loss may arise from failure of the counterparty to make payments when due. A loss may also arise because the market considers the likelihood of the counterparty defaulting has increased, and so the value at which the loan may be traded falls.

The proposed transfer will not lead to any material change in the risk appetite or capital policy in accordance with which Rothesay is managed, and Rothesay's ability to comply with its capital policy will not be materially affected by the transfer.

Reasonable expectations of existing Rothesay policyholders

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

The transfer will not lead to any changes to the servicing and administration arrangements for existing Rothesay policies, and no change is expected to service standards for these policies as a result of the Scheme.

The governance of the existing policies will continue to be the responsibility of the Rothesay Board of Directors.

Conclusions for existing Rothesay policies

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

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

Overall Conclusions

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

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

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

The Independent Expert's full report is available online at pru.co.uk/annuitytransfer. It shows in much more detail how the Independent Expert has reached his conclusions. You can also request a copy by post, by calling PAC's helpline on 0800 640 9164 or +44 203 755 9194 if calling from outside the UK, or by writing to PAC at Rothesay Life Transfer, Prudential, PO Box 3122, Lancing BN15 8GB.