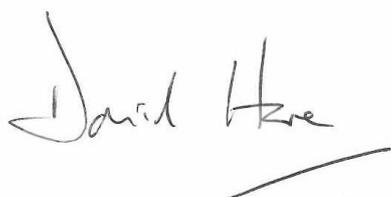


Supplementary Report of the Independent Expert on the Proposed Scheme to Transfer Long-Term Insurance Business from National Provident Life Limited to Phoenix Life Assurance Limited

Prepared by David Hare FIA

22 April 2015

A handwritten signature in black ink that reads "David Hare". The signature is written in a cursive style and is underlined with a single horizontal stroke.

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1. Introduction

Overview

- 1.1. When a scheme for the transfer of insurance business from one company to another is submitted to the High Court of Justice of England and Wales (the “Court”) for approval, it has to be accompanied by a report from an Independent Expert. This is a requirement of Section 109 of the Financial Services and Markets Act 2000 (“FSMA”) and the report must be made in a form approved by the Prudential Regulation Authority (“PRA”) having consulted the Financial Conduct Authority (“FCA”), the UK regulators (together, the “Regulators”).
- 1.2. I have been appointed as the Independent Expert to provide the required report on a proposed scheme for the transfer of the entire long-term insurance business of National Provident Life Limited (“NPLL”) to Phoenix Life Assurance Limited (“PLAL”). For this proposed scheme of transfer (the “Scheme”), I have been appointed jointly by NPLL and PLAL (together, the “Companies”). My appointment has been approved by the PRA. The costs associated with my work are being born by the shareholder fund of PLAL (“PLAL SHF”).
- 1.3. This report (my “Supplementary Report”) is supplementary to my report entitled “Report of the Independent Expert on the Proposed Scheme to Transfer Long-Term Insurance Business from National Provident Life Limited to Phoenix Life Assurance Limited” (my “Report”) dated 15 December 2014.
- 1.4. My Supplementary Report should be read in conjunction with my Report (together “my Reports”) and both should be considered in their entirety.
- 1.5. The Scheme will be submitted to the Court for sanction under Section 111 of the FSMA. If approved, it will become operative on 30 June 2015 (the “Transfer Date”). My Reports will be presented to the Court, which will consider the contents of these Reports in deciding whether to sanction the Scheme.
- 1.6. All definitions and abbreviations used in my Report apply equally to my Supplementary Report, unless stated otherwise. Readers of my Supplementary Report may wish to refer to the Glossary in my Report.

The Purpose and Scope of my Supplementary Report

- 1.7. The purpose of my Supplementary Report is to consider any developments since the issue of my Report which might materially affect policyholders of the Companies. This includes consideration of updated financial information, any concerns expressed by policyholders as a result of the Companies’ communications with them regarding the Scheme, and other matters as discussed later in this Supplementary Report. I explain whether these developments have affected the conclusions that I set out in my Report. In doing so, I consider the impact of the Scheme on the policyholders of NPLL that are transferring as a result of the Scheme and the existing policyholders of PLAL separately.
- 1.8. I am required to comment on the proposed Scheme only. My Reports are not concerned with possible alternatives to the Scheme.

- 1.9. To the best of my knowledge, I have taken account of all relevant facts at the date of this Supplementary Report in assessing the impact of the Scheme and in preparing my Reports.

Regulatory and Professional Guidance

- 1.10. My Reports have been prepared in accordance with guidance contained in Chapter 18 of the Supervision Manual of the Regulator's Handbook of Rules and Guidance ("SUP 18") for scheme reports relating to the transfer of long-term insurance business. See Appendix 2 of my Report for details of how these requirements have been met. I have also considered "*The Prudential Regulation Authority's approach to insurance business transfers*", published on 2 April 2015, and believe my Reports to be consistent with the PRA's approach and expectations set out in that document.
- 1.11. The Financial Reporting Council ("FRC") has issued standards which apply to certain types of actuarial work. I have prepared this Report, which is a component report under the relevant FRC definitions, with the intention that it, and my work underlying it, should meet the requirements of Technical Actuarial Standards TAS D, TAS M, TAS R (which cover, respectively, data, modelling, and reporting actuarial information), Insurance TAS and Transformations TAS. I believe that it, and my actuarial work underlying it, do so in all material respects. I have applied all of the principles outlined in the Transformations TAS in reaching the opinions stated in my Reports.

Independence

- 1.12. An important element of the UK requirements around transfers of business between insurance companies is that the report mentioned in paragraph 1.1 above is from an expert who is independent and therefore able to give an objective opinion on the impact of the transfer on the policyholders affected.
- 1.13. In paragraphs 1.6 to 1.8 of my Report, I confirmed that neither I, nor any of my immediate family, had any financial interest in the Companies and that I did not believe that any previous Deloitte engagements compromised my independence, created a conflict of interest, or compromised my ability to report on the proposed Scheme.
- 1.14. Since the finalisation of my Report and its presentation to the Court, there have been certain developments concerning my appointment to another independent role concerning the Phoenix Group that I believe it is important to draw to the attention of the Court in this public Supplementary Report. The appointment, which became effective on 27 March 2015, is in a personal capacity rather than through an engagement between Phoenix and Deloitte with me as a named supplier of services (as is the arrangement for the Independent Expert engagement under which I am providing this Supplementary Report).
- 1.15. The role concerned is to chair the Independent Governance Committee ("IGC") that Phoenix has set up in response to new FCA requirements, which came into force on 6 April 2015, concerning the oversight of workplace pensions business. This committee has been established to focus on the oversight of the workplace pensions business written by the Phoenix Group and the value for money that the relevant policyholders receive. While this role is remunerated by the Phoenix Group, the Chair is required to be independent of Phoenix and so able to provide effective challenge, along with the other members of the IGC, of management and the relevant boards. The role does not involve a contract of employment or acting in any executive capacity for any company in the Phoenix Group, nor does the remuneration involve any performance-related element.

- 1.16. The role of an IGC is to act solely in the interests of the policyholders within scope and assess the ongoing value for money being delivered to them by the workplace pension schemes of which they are members. Where the IGC has any concerns in relation to the value for money being delivered to policyholders within scope, they must raise this with the firm's governing body and, if not addressed satisfactorily, escalate as appropriate.
- 1.17. Thus, being the independent chair of an IGC brings different responsibilities to that of an Independent Expert. Both are concerned with the outcome for policyholders. However, the IE is concerned with their relative position before and after a proposed scheme of transfer, whereas the IGC is concerned with the absolute value for money being delivered to the holders of certain contract-based workplace pension schemes.
- 1.18. I disclosed the possibility of my taking on this IGC role to the PRA and FCA in February of this year and, before I accepted the position, agreed that I would include appropriate detail about this development in my Supplementary Report. Such disclosure is consistent with the Regulators' expectations of independent experts and also the requirements on actuaries set out in The Actuaries Code. It is also important, I believe, in helping policyholders feel assured that the Court is receiving the views of an expert who is aware of the importance of transparency in such matters and sensitive to aspects of perception as well as fact.
- 1.19. I note that the activities which I have undertaken to date as Chair of the Phoenix IGC, and will undertake prior to the Final Hearing of the Scheme, are limited, being primarily concerned with assisting Phoenix with decisions on the membership of the new committee, high level planning and attendance at the first meeting of the committee.
- 1.20. I can accordingly confirm that I believe that I remain suitably independent of the Companies to perform my Independent Expert duties to the Court.
- 1.21. I have confirmed my acceptance of the role of Chair of the Phoenix IGC to the PRA and the FCA and they have confirmed that they are content for me to continue as Independent Expert.
- 1.22. While the IE role is a personal responsibility, as mentioned above the engagement letter for the provision of these services is between Phoenix and Deloitte. On such important tasks, Deloitte operates an internal "peer review" quality assurance process and, for this IE engagement, the role is being performed by an experienced actuary who is also a partner in Deloitte, Roger Simler. Mr Simler is aware of my appointment as the independent chair of the Phoenix IGC and the importance of ensuring the potential conflict of interest is recognised and managed appropriately, both in terms of facts and perceptions.

Terms of Reference

- 1.23. The terms of reference for my Reports have been agreed with the Regulator and the Companies and are set out in full in Appendix 1 of my Report.
- 1.24. In reporting on the Scheme as the Independent Expert, I recognise that I owe a duty to the Court to assist on matters within my expertise. This duty overrides any obligation to the Companies from whom I have received instructions. I believe that I have complied, and confirm that I will continue to comply, with this duty. I also confirm that I am aware of the duties and requirements regarding experts set out in Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Protocol for Instruction of Experts to give evidence in Civil Claims.

- 1.25. Readers of my Supplementary Report may find it helpful to read some of the other documents relating to the Scheme, such as the reports and supplementary reports prepared by the Actuarial Function Holders of the Companies. I have considered these documents in coming to my opinions.

Reliances

- 1.26. In performing my review and preparing my Reports, I have relied on the accuracy and completeness of data and information provided to me, both written and oral, by the Companies. I have reviewed the information for consistency and reasonableness using my knowledge of the UK life assurance industry but have not otherwise verified it.
- 1.27. I have used the financial information as at 31 December 2013 in various places in my Report to consider the size and mix of the business in the Companies. The Companies' PRA returns for 2014 were only available shortly before the completion of this Supplementary Report. While I have used these figures in my analysis of the solvency position of the Companies, the closed book nature of the Companies means that their business size and mix are expected to be relatively stable from year to year. Consequently, I do not consider it necessary to refresh this analysis of the size and mix of the business in the Companies. My analysis of the solvency position of the Companies is based on the actual pre-Scheme position and estimated post-Scheme financial position as at 31 December 2014 produced by the Companies and summarised in Appendix 2. I have been in regular contact with the Companies and have taken account of significant known or expected changes since 31 December 2014.
- 1.28. The Report also comments on a second set of solvency calculations that the Regulators require long-term insurance companies to produce. Known as the "Pillar 2" or Individual Capital Adequacy Standard ("ICAS") calculations, these are not audited, but are submitted to the Regulators on request, who also expect to see evidence that the calculations are used in the risk management of the insurer concerned. I have considered the most recent Pillar 2 financial information available (including estimates of what the post-Scheme Pillar 2 positions would have been as at 31 December 2014) in forming my conclusions in relation to the Scheme.
- 1.29. I note that the economic position at the Transfer Date cannot be predicted with certainty. The absolute solvency level may therefore differ from that shown in the Supplementary Report, but I would not expect the impact of the Scheme at the Transfer Date to vary significantly from the estimates shown and it is this impact which is my primary consideration (alongside the Companies continuing to satisfy regulatory solvency requirements, as is currently the case).
- 1.30. Selected financial information, written information and data upon which I have relied for this Supplementary Report is noted in Appendix 1.
- 1.31. Other than as set out in the following sections, I am not aware of any events that have occurred since the date of my Report, nor has anything been drawn to my attention by the Companies, that will materially change the analysis and stated conclusions in my Supplementary Report. I have also considered updated management information provided by the Companies that show the estimated financial position as at 31 March 2015.

Limitations

- 1.32. My Supplementary Report is issued subject to the same limitations as my Report (as set out in paragraphs 1.23 to 1.28 of my Report) and may be provided to the same parties as my Report.

- 1.33. A copy of my Reports may be published on the websites of the Companies and made available for inspection at the offices of the Companies' solicitors. In order to avoid any perception of a lack of appropriate transparency around the independence considerations set out above, the Companies will publish a copy of this Supplementary Report as soon as possible once it is finalised. Otherwise, my Reports (or any extract from them) should not be published without the prior written consent of Deloitte.
- 1.34. As I noted in my Report, the current regulatory solvency regime is expected to be replaced by a new regime known as "Solvency II" in January 2016. Many of the principles of how this will operate are known but, at the time I finalised my Report, there were some substantive issues yet to be finalised. This remains the case. As a consequence, it is not possible to be certain of the pre- or post-Scheme solvency positions of the Companies under the new regime from 2016. Nevertheless, despite this limitation, I believe there is enough information available for me to be able to assess whether or not the introduction of Solvency II should alter my conclusions in my Reports. I discuss this matter in Section 2 below.

2. Scheme Update, Financial Analysis and Additional Considerations

Introduction

- 2.1. In this Section, I comment on any changes to the Scheme since my Report, the most recent available financial analyses of the expected impact of the Scheme and any other changes that I am aware of that have been relevant in establishing my conclusions. My consideration of the financial analyses includes the most recent assessment of whether the Companies are expected to meet the various regulatory capital requirements and internal capital policies to which they are subject, both before and after the implementation of the Scheme.
- 2.2. As set out in paragraph 4.3 of my Report, I am concerned as Independent Expert with the issue of whether the Scheme could have a material adverse effect on any policyholders of the Companies. In particular, this assessment includes consideration of the expected impact of the Scheme on the benefit security and benefit expectations of policyholders. I have also considered whether the Scheme is likely to lead to a material reduction in the service standards for the policyholders affected. I comment on these issues in Section 3.
- 2.3. As described in Section 10 of my Report, information relating to the Scheme has been sent to relevant policyholders, providing them with the opportunity to comment, ask questions and object about any element of the Scheme or its potential impact. In Section 4, I comment on the views that have been expressed by policyholders and how I have considered these views in reaching my conclusions.

Scheme Update

- 2.4. Paragraph 1.4 of my Report explained that the Scheme was expected to become operative on 6 April 2015 (the expected Transfer Date), but take effect, insofar as it creates rights and obligations that exist only between the Companies, on 1 January 2015 (the “Effective Date”), including for accounting and financial reporting purposes. Since the date of my Report, the date of the Final Hearing has been delayed and it is no longer proposed that there will be a split between the Transfer Date and the Effective Date. The draft of the Scheme at the time of my Report included definitions of both terms and provisions that effected the split between the two dates. The concept of a separate Effective Date is no longer required and the Scheme has been amended to remove references to the Effective Date and to delete the provisions that effected the split.
- 2.5. As noted in paragraph 3.2 of my Report, I was satisfied that the difference in dates did not adversely affect policyholders. I am satisfied that the subsequent amalgamation of these dates is a simplification of the previous arrangements and does not affect my conclusions on the impact of the Scheme on policyholders.

2.6. The Scheme has also been amended to include provisions specifying the process that the Companies must follow in the event that they intend to delay the Transfer Date beyond the planned Transfer Date of 30 June 2015. In particular:

- an application for such a change is required to be approved by the Court;
- the Regulators must be notified in advance and will have the right to be heard at the Court hearing at which the application is considered;
- the application must be accompanied by a report from an Independent Expert stating that, in their opinion, the amendment will not materially adversely affect the reasonable expectations of the Transferring Policyholders or the Existing PLAL Policyholders; and
- the Companies must publish a notice of the making of such an order approving such an application on their websites within five days of the making of such an order.

My interpretation of “reasonable expectations” in this situation includes both policyholder expectations in relation to the level of benefits receivable and the security of those benefits. I have confirmed that this is consistent with the Companies’ interpretation of this term.

While I do not believe that any delay is likely, these amendments have the effect of introducing additional safeguards for policyholders in the event that there is a delay. I am satisfied that this change represents a modest strengthening of policyholder protections.

2.7. There have been no other changes to the Scheme, other than a small number of minor clarifications to the wording, which have no bearing on my conclusions.

Impact on PLAL 2012 Scheme

2.8. As a result of the Scheme, the NPLL Scheme will cease to have effect and will be replaced by the Scheme. I considered the implications of this within my Report, concluding that this did not represent a materially adverse effect on the Transferring Policyholders. However, the PLAL 2012 Scheme includes reference to the NPLL Scheme, by defining the maximum level of expenses chargeable to the SERP Fund with reference to the expenses chargeable to the NPLL LTF. I provided an overview of the business in the SERP Fund in Appendix 4 of my Report. The Companies have received legal advice that, as a consequence of the NPLL Scheme ceasing to have effect, and in the absence of any amendment of the PLAL 2012 Scheme, the interpretation of the references to the NPLL Scheme in the PLAL 2012 Scheme might be subject to doubt following the implementation of the Scheme. To help avoid such doubt, the Companies propose to amend the PLAL 2012 Scheme as follows:

- (a) the addition of the new defined terms "NPL WP Fund" and "PLAL 2014 Scheme" in the PLAL 2012 Scheme, to enable reference to be made to the new with-profits sub-fund which will be established by PLAL to receive the bulk of the NPLL business (the NPL WPF, as defined in my Report) and the relevant provisions of the Scheme;
- (b) amendments to paragraphs 3 and 4 of Schedule 3 to the PLAL 2012 Scheme (which sets out the costs, expenses and charges to the SERP Fund), to update the cross references in that schedule from:

- (i) references to Schedule 4 to the NPLL Scheme, which set out the expenses and charges to be borne by the NPLL LTF;
- to:
- (ii) references to Schedule 2 of the Scheme, which sets out the expenses and charges to the NPL WPF;
- (c) the deletion of the defined terms "National Provident Life Fund", "NPI" and "NPLL Scheme" to reflect the fact that these defined terms will no longer be required in the PLAL 2012 Scheme once the amendments at (a) and (b) above have been made.

While I have not sought to verify the Companies' legal advice, I can understand why such doubt could have arisen and am satisfied that the proposed amending of the PLAL 2012 Scheme is an appropriate way to help avoid such doubt.

- 2.9. It is a requirement of the PLAL 2012 Scheme that any proposed amendments of this nature are approved by the Court and accompanied by a certificate from an independent actuary stating that, in their opinion, the amendment will not adversely affect the reasonable expectations of the holders of policies of PLAL. The Companies have requested that I perform the role of the independent actuary in respect of this proposed amendment. In terms of my independence to provide this opinion, the reader is referred to paragraphs 1.12 to 1.22 in this Supplementary Report. While these paragraphs deal with my continuing independence to carry out the role of Independent Expert for the Scheme, I believe that similar considerations apply to the provision of this independent actuary opinion.
- 2.10. I can confirm that I have provided this certificate and have included a copy in Appendix 3, along with a summary of my rationale for reaching the required opinion.

NPLL Scheme - Paragraph 34 Requirements Update

- 2.11. In paragraphs 6.34 to 6.38 of my Report, I noted that paragraph 34 of the NPLL Scheme outlines certain conditions regarding an application for the transfer of the business in NPLL to PLAL (then Pearl Assurance plc), such as that which would be effected by the Scheme, and the co-operation of the Supervisory Board. It is the responsibility of the Supervisory Board to conclude whether the proviso is met (a conclusion that I noted the Supervisory Board had reached). However, I provided my opinion, as an actuary and based on my own interpretation of the wording of the proviso (an interpretation which I do not claim to be necessarily in line with how the proviso would be interpreted in law) that:
- the interests and reasonable expectations of the Transferring Policyholders will not be adversely affected by the Scheme; and
 - the protections afforded to the Transferring Policyholders whether pursuant to the NPLL Scheme or otherwise, will not, in aggregate, be reduced by the Scheme.

My assessment of this was based on the analysis, rationale and conclusions set out in my Report, and nothing in this Supplementary Report has changed my opinion on this matter.

Securitised Loan Update

2.12. As discussed in paragraphs 2.69 to 2.71 of my Report, NPLL is party to a Securitised Loan Agreement, which will be transferred to the new NPL WPF under the terms of the Scheme. Such a transfer is only permitted under the terms of the Securitised Loan Agreement if certain conditions are met or certain consents obtained. One exception to this restriction is if the transfer meets the definition of a "Permitted Transfer". This requires the transfer to be a transfer under which all or substantially all of NPLL's business will be transferred to a single legal entity (which assumes all of NPLL's obligations under the Securitised Loan Agreement) and in respect of which two further requirements are satisfied:

- (i) the provision of a legal opinion to the trustee of the bonds (the "Bond Trustee") issued by legal advisors approved by the Bond Trustee, confirming that the transferee's assumption of NPLL's obligations under the Securitised Loan Agreement will be legal, valid, binding and enforceable; and
- (ii) confirmation from the rating agents that the transfer will not result in a downwards revision of the credit rating of the bonds or the bonds being placed on credit watch.

At the time of writing my Report, these two further requirements had not been satisfied, although I was not aware of any reason why they could not be satisfied in due course. The Companies have provided me with a copy of the required legal opinion and of the draft required rating agent confirmations that have been issued to the Bond Trustee. These confirmations will only be finalised shortly before the Sanctions Hearing, as the ratings agents intend to review final versions of, among other items, this Supplementary Report.

I note that one of the ratings agents has expressed an intention to withdraw from the role following the provision of the confirmation for the purposes of the Final Hearing. While the timing of any withdrawal is still to be finalised, the Companies' preference is for the ratings agent to continue in the role until the Transfer Date, to ensure that there is no doubt about the validity of the confirmation at that point. I am not aware of any reason why the ratings agent would be unable to reissue its confirmation at that point, if required, so am satisfied that does not alter my conclusions on the Scheme. I do not consider that any future change to the identity of the rating agent after the Transfer Date to be relevant to my conclusions in respect of the Scheme. In addition, I do not believe that this intention of the ratings agent implies anything about the Scheme that would be relevant to my opinion as the Independent Expert.

Updated Financial Analysis

2.13. The financial analysis in my Report focused on company solvency under the two key reporting measures used to monitor the financial position of insurance companies in the UK. These are known as "Pillar 1" and "Pillar 2" and were explained in Section 5 of my Report. Pillar 2 data is private between firms and the PRA. I have seen and reviewed updated Pillar 2 numbers and comment on those, but do not quote the actual figures in my Reports.

2.14. The Pillar 1 financial information that I have quoted in this Supplementary Report has been based on the financial position of the Companies as at 31 December 2014, the final version of which has been subject to external audit. I believe it is reasonable to rely on their accuracy, subject to reasonableness checking as stated in paragraph 1.26.

- 2.15. The Pillar 2 ICAS calculations are not audited, but the PRA can request for them to be submitted for review, so it is necessary for them to be produced to a standard that is appropriate for external review. The Pillar 2 figures provided by the Companies are based on the position as at 31 December 2014.
- 2.16. These calculations are produced by the Companies and are used by them in practice as an input to decision making. A material error in these figures would be a significant matter, and so I believe it is reasonable to rely on their accuracy, subject to reasonableness checking as stated in paragraph 1.26.

Capital Policies of the Companies

- 2.17. In paragraphs 5.24 to 5.32 of my Report, I discussed the capital policies that are currently used by the Companies to define the level of capital targeted in excess of the level required by the regulations. I considered the impact on the benefit security of the Transferring Policyholders of the differences in the Companies' capital policies in paragraphs 6.22 to 6.28 of my Report, concluding that the differences did not lead to a materially adverse impact on the benefit security of these policyholders.
- 2.18. As noted in paragraphs 5.33 to 5.36 of my Report, it is intended that the parameter used to calculate the contribution of the PLAL WPFs in the Pillar 1 test of the PLAL Capital Policy will be changed following the Scheme. Although this represents a change to the mechanics of how this element of the PLAL Capital Policy is calculated, it does not change the strength of the PLAL Capital Policy. In particular, it aims to ensure that the Scheme itself does not change the overall level of capital held in respect of PLAL, where there is no corresponding change in Pillar 1 capital requirements. In order to achieve this aim, the parameter applicable to the PLAL WPFs to the Pillar 1 test under the PLAL Capital Policy would have reduced from 175% to 110%, had the Scheme taken effect at 31 December 2014. This is consistent with the change set out in paragraph 5.34 of my Report.
- 2.19. In March 2015, the PLAL Board approved a proposal that the parameter will be changed immediately following the Scheme. While the final parameter will not be known until that point, I am satisfied that the proposed approach will not result in a reduction in the level of capital targeted under the Pillar 1 test at the Transfer Date and is intended to preserve the strength of the PLAL Capital Policy.
- 2.20. Other than as outlined above, there have been no changes to the capital policies since the time of my Report, including in relation to the governance arrangement around future changes to these policies. I am satisfied that the proposed change to the parameter used does not alter my conclusions in relation to the effect of the Scheme on policyholder benefit security.

Estimated Pillar 1 Solvency Position

- 2.21. Using information provided to me by the Companies, I have reviewed the solvency position of both of the Companies as at 31 December 2014.
- 2.22. The Pillar 1 coverage ratios of the Companies before and after the implementation of the Scheme (had it been implemented on 31 December 2014) are set out in Tables 2.1 and 2.2 below, together with the equivalent information from my Report. The figures show the level of coverage of the Pillar 1 regulatory requirement.

- 2.23. The figures in Table 2.1 are based on the total position of each company including the assets in the with-profits funds. Some of these with-profits funds had free assets at 31 December 2014, which would only be available to support the capital requirements of the Transferring Policies in the extreme event of insolvency (and even then, as detailed in paragraph 5.63 of my Report, there is uncertainty about whether these assets would be available for the benefit of the policies outwith the relevant with-profits fund). Consequently, I have also considered the figures in Table 2.2, which exclude the capital resources and capital requirements for those with-profits funds with surplus assets.
- 2.24. The NPLL post-Scheme solvency position can be ignored for the purposes of assessing policyholder benefit security as no policies are expected to be retained and the only assets remaining in NPLL will be those necessary to satisfy the remaining regulatory capital requirements prior to de-authorisation. The Companies have confirmed to me that they do not expect there to be any Excluded Policies.

Table 2.1: Expected Pillar 1 solvency position pre- and post-Scheme

| £m | Position as at 31 December 2014 | | | Estimates in my Report as at 31 October 2014 | | |
|---|---------------------------------|-------------|--|--|-------------|------------------------------|
| | Pre-Scheme | | Merged companies estimated post-Scheme | Pre-Scheme | | Merged companies post-Scheme |
| | PLAL | NPLL | | PLAL | NPLL | |
| Capital Resources | 2,118 | 203 | 2,147 | 1,950 | 207 | 1,978 |
| Capital Resources Requirement (including any WPICC) | 1,683 | 124 | 1,685 | 1,525 | 120 | 1,527 |
| Surplus ⁽¹⁾ | 434 | 79 | 462 | 425 | 86 | 452 |
| Solvency ratio⁽²⁾ | 126% | 164% | 127% | 128% | 172% | 130% |

Source: Financial analysis provided by Phoenix

Notes:

- (1) Pre-Scheme PLAL figures include the value of NPLL as a subsidiary in the capital resources and the capital requirements of NPLL as a subsidiary
- (2) Surplus figures are calculated as available capital less the CRR (including any WPICC) and the solvency ratio is calculated as the ratio of the available capital to the CRR (including any WPICC)

Table 2.2: Expected Pillar 1 solvency position pre- and post-Scheme, excluding with-profits funds in surplus

| £m | Position as at 31 December 2014 | | | Estimates in my Report as at 31 October 2014 | | |
|-------------------------------------|---------------------------------|-------------|--|--|-------------|------------------------------|
| | Pre-Scheme | | Merged companies estimated post-Scheme | Pre-Scheme | | Merged companies post-Scheme |
| | PLAL | NPLL | | PLAL | NPLL | |
| Capital Resources | 501 | 203 | 530 | 461 | 207 | 489 |
| Capital Resources Requirement | 266 | 124 | 268 | 247 | 120 | 248 |
| Surplus ⁽¹⁾ | 234 | 79 | 262 | 214 | 86 | 241 |
| Solvency ratio⁽²⁾ | 188% | 164% | 198% | 187% | 172% | 197% |

Source: Financial analysis provided by Phoenix

Notes:

- (1) Pre-Scheme PLAL figures include the value of NPLL as a subsidiary in the capital resources and the capital requirements of NPLL as a subsidiary
- (2) Surplus figures are calculated as available capital less the CRR and the solvency ratio is calculated as the ratio of the available capital to the CRR

- 2.25. Table 2.1 shows that between 31 October 2014 and 31 December 2014 there was a fall in the pre-Scheme solvency position of NPLL. The change in the pre-Scheme position is largely reflective of an increase in Pillar 1 required capital due to a reduction in yields on fixed interest securities over the period.
- 2.26. The estimated post-Scheme solvency position of PLAL as at 31 December 2014 is slightly lower than the estimate of 130% as at 31 October 2014 given in my Report. This reflects the changes in the economic environment over the period – particularly the reduction in yields – and other changes to the stated position that were not fully captured in the 31 October 2014 results (which were based on management information, compared to a full, audited set of results at 31 December 2014).
- 2.27. I am satisfied that these changes do not invalidate my analysis of the financial impact of the Scheme, as set out in my Report. Importantly, as at 31 December 2014, the Companies had sufficient assets to meet their respective Pillar 1 capital requirements and the associated internal capital policies both before and after the implementation of the Scheme, had it been implemented on that date.
- 2.28. Consistent with the analysis provided in my Report based on the financial position at 31 October 2014, the updated impact estimates in Tables 2.1 and 2.2 above confirm that the Scheme is still expected to have a slightly positive impact on the financial position of PLAL on a Pillar 1 basis. This primarily reflects an increase in the value of admissible loans under the Pillar 1 rules. This is also consistent with the impact shown in Table 2.2. Consequently, based on the estimated financial position as at 31 December 2014, the Scheme will have no material adverse impact on PLAL's Pillar 1 Solvency position. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 30 June 2015).

- 2.29. Similarly, the updated impact estimates in Tables 2.1 and 2.2 above confirm the position set out in my Report that, had the Scheme taken effect on 31 December 2014, there would have been a decrease in the solvency position of NPLL pre-Scheme compared to the combined company following the Scheme (reduction of 164% to 127%). This decrease is smaller than that stated in my Report, which was based on the position as at 31 October 2014. As discussed in paragraph 6.20 of my Report, I attach limited significance to the reduction in this ratio in relation to my assessment of the impact of the Scheme on the benefit security of the Transferring Policyholders, provided that PLAL is able to meet its capital target under the PLAL Capital Policy following the Scheme. This is because capital held above the PLAL Capital Policy (and above the NPLL Capital Policy pre-Scheme) can be relatively easily removed from the Companies. It is relevant to note that, if the capital held above the level targeted by the respective capital policies was removed the reduction in the Pillar 1 coverage ratio would be significantly less. While the Pillar 1 coverage ratio in PLAL following the Scheme may well be lower than the NPLL pre-Scheme coverage ratio (as would have been the case had the Scheme taken effect on 31 December 2014), PLAL will remain strongly capitalised and with surplus in excess of capital policy requirements. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 30 June 2015).
- 2.30. Further details of the Pillar 1 solvency positions of the Companies at 31 December 2014 are given in Appendix 2.
- 2.31. The economic positions of the Companies at the time of the implementation of the Scheme cannot be predicted with certainty, and the absolute solvency position is likely to have changed from the figures in Table 2.1. However, this should not alter the expected impact of the Scheme, which is my principal concern as Independent Expert (alongside the Companies continuing to satisfy regulatory solvency requirements, as is the case at the date of this Supplementary Report).
- 2.32. I have reviewed updated management information that sets out the Pillar 1 solvency position of the Companies as well as analysis on the sensitivity of the Companies' solvency position as at 31 December 2014 to moderate market stresses. These demonstrate that the Companies were expected to remain able to meet their Pillar 1 capital requirements shortly before I finalised this Supplementary Report. In addition, the sensitivity analysis provides evidence that this is likely to remain the case under the stress scenarios analysed. As a result, I have no reason to change my conclusions in relation to the financial impact of the Scheme. I will continue to monitor information of this nature until the Final Hearing and will comment at the Final Hearing if there have been any changes significant enough to materially adversely impact the ability of either company to meet its capital requirements.

Estimated Pillar 2 Solvency Position

- 2.33. I have reviewed the Companies' latest Pillar 2 solvency positions that take into account the ICA approved by the Board on 14 April 2015 (based on the position at 31 December 2014) as well as the capital injection from PLAL to NPLL that was authorised at the same Board meeting and completed shortly afterwards. These figures show that PLAL had sufficient surplus assets to meet its Pillar 2 capital requirements and the targets under the PLAL Capital Policy and would have had after the implementation of the Scheme. NPLL was able to meet its Pillar 2 capital requirements, but would have been unable to meet the target under its capital policy without the injection discussed above. The expected changes in Pillar 2 coverage due to the Scheme remain in line with the comments in Section 5 of my Report, and are not significant. Pillar 2 analysis shows that, based on the position described above, the coverage ratio in PLAL post-Scheme would have been higher than the

equivalent ratio in NPLL pre-Scheme, and the absolute surplus held above Pillar 2 capital requirements would have been much greater in PLAL post-Scheme than in NPLL pre-Scheme.

- 2.34. The Pillar 2 position set out in my Report was based on the Companies' estimates of the position as at 31 October 2014, rather than a full recalculation of the accurate position at that date. The equivalent estimate as at 31 December 2014 was subject to a significant revision to fully reflect the accurate Pillar 2 calculation, casting a degree of doubt on the accuracy of the absolute Pillar 2 position described in my Report. However, as set out in my Report, I am principally interested in understanding the impact of the Scheme on the financial position of the Companies, the validity of which is not, of itself, significantly impacted by the accuracy of the underlying absolute position. As a result of this and the fact that the analysis on Pillar 2 in this Supplementary Report is based on the approved "actual" Pillar 2 position, I am satisfied that my conclusions remain valid.
- 2.35. I have reviewed updated management information that sets out the Pillar 2 solvency positions of the Companies as well as analysis on the sensitivity of the Companies' solvency position as at 31 December 2014 to moderate market stresses. These demonstrate that the Companies were expected to remain able to meet their regulatory capital requirements shortly before I finalised this Supplementary Report. In addition, the sensitivity analysis provides evidence that this is likely to remain the case under the stress scenarios analysed. As a result, I have no reason to change my conclusions in relation to the financial impact of the Scheme. I will continue to monitor information of this nature until the Final Hearing and will comment at the Final Hearing if there have been any changes significant enough to materially adversely impact the ability of either company to meet its capital policy.

Significant changes since 31 December 2014

- 2.36. The solvency position of the Companies will depend on the external economic environment and I have addressed this possibility by considering management information and sensitivities as set out above. However, the solvency position can also be affected by one-off events like the payment of dividends. The Companies have confirmed that they are not aware of any significant examples of such events and, in particular, have confirmed that they do not expect a dividend to be payable at or around the Transfer Date. The ability to pay a dividend would depend on the continued ability to meet the PLAL Capital Policy.

Changes to capital support mechanisms

- 2.37. Paragraphs 5.42 to 5.46 of my Report describe the expected changes to the capital support mechanisms relating to the Transferring Policyholders. There have been no changes to these proposals. The Companies have provided me with copies of the proposed capital support arrangements for the PLAL SHF and the PLAL NPF, which allow for the current internal capital support arrangements within PLAL to be extended to the newly created NPL WPF after the Scheme has taken effect. In addition, the agreements establishing these arrangements set the initial amount of support equal to the amount of the Shareholder Equalisation Fund and Earmarked Portfolio, consistent with the proposed simplifications set out in paragraph 3.50 of my Report. The proposed arrangements were approved by the Board in April 2015.
- 2.38. Table 2.3 shows the value of the various capital support mechanisms at 31 December 2014.

Table 2.3: Size of capital support mechanisms as at 31 December 2014

| Support Arrangement (£m) | Values as at 31 December 2014 | Values in my Report as at 30 June 2014 |
|-------------------------------|-------------------------------|--|
| Capital Funds | 181 | 162 |
| Asset Share Charge Fund | 590 | 437 |
| Shareholder Equalisation Fund | 81 | 72 |
| Earmarked Portfolio | 92 | 99 |

Solvency II

- 2.39. The current regulatory solvency regime is expected to be replaced by a new regime known as Solvency II in January 2016. I addressed this area in some detail in paragraphs 5.53 to 5.61 of my Report and noted that I would keep the Companies' preparations for Solvency II under review and comment on any changes in my Supplementary Report.
- 2.40. While Solvency II will impact the Companies irrespective of the Scheme, I noted in my Report that I would be concerned if a proposed scheme meant that a group of policyholders moved into a company that would be adversely affected by Solvency II to the extent that the benefit security of its policyholders was materially reduced. Thus, as well as operational readiness for Solvency II, I believe it is relevant to my consideration of the Scheme to review the impact on the Companies' solvency coverage of the move to the new regime in 2016. I have received updated information on the solvency positions of the Companies under Solvency II and so I am able to comment on it and how it has influenced my consideration of the Scheme.

Operational readiness for Solvency II

- 2.41. As both Companies are members of the Phoenix Group, their preparations for Solvency II are covered by the same programme of work. I have discussed the preparations for Solvency II with the Companies and have no reason to believe that the Companies are poorly prepared to implement the various requirements of the new regime. In addition, I have confirmed my expectation that there is no interdependence between the Scheme and the Companies' readiness for Solvency II, except that, if anything, the Scheme is expected to have a modest positive impact on the programme by simplifying the group structure.
- 2.42. Thus, I am satisfied that the operational readiness of the Companies for Solvency II does not alter my conclusions on the effect of the Scheme on policyholders, as set out in my Reports.

Financial position under Solvency II

- 2.43. While many of the underlying regulations and the principles of how the Solvency II regime will operate are known, there remain some areas of uncertainty in relation to how these regulations will be interpreted in practice and certain approvals that the Companies are required to obtain. These are uncertainties that impact the life insurance industry as a whole and are unlikely to be resolved for any individual company for several months. As a consequence, it is not possible to be certain of the pre- and post-Scheme solvency positions of the Companies under Solvency II. However, I believe there is enough information available to assess whether or not this uncertainty should influence the

conclusions that I have made in my role as the Independent Expert in relation to the impact of the Scheme on policyholders.

- 2.44. The Solvency II estimates provided to me by the Companies and discussed in paragraph 5.57 of my Report showed PLAL to have a lower solvency ratio (taken as a ratio of the available capital resources to the Solvency Capital Requirement (“SCR”)) than NPLL as at 31 December 2013.
- 2.45. The Companies have provided me with an estimate of their solvency positions under Solvency II, as at 31 December 2014. Although the pre- and post-Scheme solvency positions of the Companies under Solvency II are uncertain, these figures suggest that PLAL would have been in a stronger position to meet its SCR than NPLL, had Solvency II been implemented at that date. For both of the Companies, the position was heavily dependent on the use of optional transitional measures, the use of which is subject to approval from the PRA. When the anticipated transitional arrangements are excluded, PLAL was still expected to have a stronger position at that date on a Solvency II basis than NPLL (pre-Scheme). While the position at 31 December 2014 is of use in providing an indication of the respective solvency positions of the Companies under Solvency II, it is important to note that these positions are unlikely to be fully representative of the actual solvency position when Solvency II is implemented. In particular, the Companies have highlighted additional actions that could be (and, in some cases, are planned to be) taken by management to improve the solvency position under Solvency II, prior to its implementation on 1 January 2016. Given the uncertainty around the actual solvency position when Solvency II comes into effect, I place limited reliance on these comparisons, but I consider that they provide some evidence that PLAL is better placed to meet its capital requirements under Solvency II than NPLL.
- 2.46. Additionally, as discussed in Section 5.50 of my Report, the PLAL 2012 Scheme outlines that PLAL will set new capital policy tests before Solvency II is implemented, with the objective that PLAL can meet its Solvency II Pillar 1 capital requirements in internally stressed scenarios. The adoption of the new tests and their parameters will be subject to the Regulators’ non-objection. The Companies have confirmed that the intention of the revisions to the tests under Solvency II will not be to reduce the amount of capital targeted in excess of the regulatory capital requirements, but rather to re-cast the tests in light of the revised regulatory solvency regime. As a result, the PLAL Capital Policy will provide ongoing protection to all policyholders affected by the Scheme after Solvency II is implemented.
- 2.47. Thus, for the reasons set out above, I am satisfied that any changes to the financial position of the Companies as a result of the move to Solvency II do not alter my conclusions on the effect of the Scheme on policyholders, as set out in my Reports.

Overall conclusion on Solvency II

- 2.48. In conclusion, therefore, I am satisfied that the introduction of Solvency II from 1 January 2016 does not impact my conclusions that the Scheme will not result in any materially adverse effect on the policyholders of the Companies.

Tax Considerations

- 2.49. In Section 9 of my Report I discussed the tax considerations arising from the Scheme, and noted that the Companies were in the process of obtaining clearance from HMRC in respect of Section 132 of

the Finance Act 2012 and anti-avoidance provisions. This clearance has subsequently been granted.

- 2.50. For the reasons stated in my Report I remain of the opinion that there should not be any tax considerations arising from the Scheme that will affect any group of policyholders.

3. Expected Impact of the Scheme on Different Groups of Policyholders

Overview

3.1. As Independent Expert I have particular concern for the impact of the Scheme on the security of policyholder benefits and on policyholders' benefit expectations, as well as the impact of the Scheme on the ongoing governance, administration and investment management arrangements. In this section I comment on these areas, setting out my considerations for each group of policyholders affected by the Scheme separately where appropriate.

Benefit expectations and security of Transferring Policyholders

Benefit expectations of Transferring Policyholders

3.2. In Section 6 of my Report, I considered the impact of the Scheme on the benefit expectations of the Transferring Policyholders. I considered separately the holders of with-profits policies, holders of unit-linked policies and holders of non-profit policies, and I do so again below for ease of reference.

With-profits policies

3.3. In paragraphs 6.7 to 6.10 of my Report, I set out the rationale for my conclusion in respect of the impact of the Scheme on the benefit expectations of the Transferring Policyholders that hold with-profits policies. I set out a summary of this rationale below, together with updates where appropriate:

- There will be no change to the asset share, bonus rates and surrender value calculations, which will continue to use the current methodology. The current process for allocating investment returns to asset shares will continue to apply.
- As a result of the changes to the capital support arrangements (as outlined in Section 5 of my Report), the shareholder is giving up the right to receive the support charges on the Capital Funds and any of these funds which are not used to meet the cost of guarantees or policyholder reasonable expectations. While a surplus is not expected to arise, this change to shareholder entitlements results in a small positive impact on the benefit expectations of these policyholders, in the event that such a surplus were to arise.
- Although the Supervisory Board will no longer exist, its responsibility to have regard solely to the interests and reasonable expectations of NPLL policyholders when carrying out its duties, together with its power to manage investment and bonus policy in relation to the current NPLL LTF, will be passed on to the PLAL WPC as part of their duties in respect of NPL WPF. The management of the NPL WPF by the PLAL Board will be subject to oversight by the PLAL WPC. This brings the management of the NPL WPF into line with the management of the other PLAL WPFs. Appendix 11 of my Report discussed the changes to governance in further detail.

Expected Impact of the Scheme on Different Groups of Policyholders

- The Scheme will result in all of the annuities in payment and assets corresponding to the realistic reserve for this business being transferred to the PLAL NPF. Consequently, any profits or losses arising on this business that would previously have arisen in the NPLL LTF will accrue to the PLAL NPF as a result of the Scheme. However, the majority of this business is already largely reinsured to the PLAL NPF (either fully reinsured, on original terms, for annuities written since 31 March 2012, or reinsured other than in relation to the administration expenses for certain pension annuities written before 1 January 2000), and so any profits or losses on this reinsured business would already be expected to largely arise in the PLAL NPF. The remaining business had a realistic reserve of approximately £13m at 31 December 2014, a small reduction from the realistic reserve of £13.6m as at 31 December 2013 shown in my Report. I am satisfied that any future profits or losses on these policies would not materially affect benefit expectations of the holders of with-profits Transferring Policies. I am also satisfied that it is appropriate to base the amount of assets to be transferred on the realistic reserve for these policies, as such a reserve is based on NPLL's best estimate of future experience. This view is consistent with the opinion expressed by the WPA in his report on the Scheme. The Companies have informed me that the assets transferred will be government bonds, selected with reference to the expected term of the liabilities. I am satisfied that this choice of assets will not materially adversely affect the holders of with-profits Transferring Policies.
- The Scheme will allow the PLAL Board to reallocate non-profit policies within the NPL WPF to the PLAL NPF. If it wishes to go ahead, the Scheme requires the PLAL Board to seek appropriate actuarial advice and to ensure that the terms of such a reallocation are fair and equitable. I also note that any such proposal would be subject to TCF and other regulatory requirements.

The Companies have confirmed to me that there are no current plans to reallocate any existing non-profit business using this provision, but that new annuities at vesting will be set up in the PLAL NPF, rather than reassured to it, utilising where necessary the powers under this clause. These powers provide the PLAL Board with the means to prevent the non-profit business of the NPL WPF becoming of a disproportionately large size as the fund runs off. Preventing this situation provides a benefit to with-profits policyholders by eliminating the need to hold additional capital within the NPL WPF in respect of the risks associated with these non-profit policies.

Given the protections in place, I am satisfied that the inclusion of this provision does not materially adversely affect the benefit expectations of the with-profits Transferring Policyholders.

- Consistent with the terms of the PLAL 2012 Scheme, the Scheme will provide that PLAL must convert with-profits policies in the NPL WPF into non-profit policies with a scale of guaranteed increases in benefits when the statutory with-profits liabilities (before reinsurance) of the NPL WPF fall below £50m, and close the fund. Any such wind-up and conversion of benefits would require prior written approval from the Regulators, would be based on appropriate actuarial advice and would include the full distribution of any surplus in the fund, to help protect the interests of policyholders.

Given the protections in place and the requirement to distribute any surplus to policyholders at the point of conversion, I am satisfied that the inclusion of this provision does not materially adversely affect the benefit expectations of the with-profits Transferring Policyholders.

Expected Impact of the Scheme on Different Groups of Policyholders

- While the term “appropriate actuarial advice” is not clearly defined, I have discussed this with the Companies and they have confirmed my expectation that “appropriate” is likely to include independent, external actuarial review (similar to that provided by the Independent Expert in relation to the Scheme) where a particular issue is material or considered likely to be contentious.
- The Scheme allows for the future merger of the NPL WPF with another with-profits fund in PLAL when the with-profits liabilities of the NPL WPF fall below £750m, subject to future increases related to inflation. In this occurrence the Scheme also provides protection for existing policyholders by ensuring that there is a review from an independent actuary to ensure that the merger would not adversely affect their expectations. The terms of the merger would also be subject to the prior approval of the Regulators. This replaces a similar clause in the NPLL Scheme, whereby the fund could cease to be maintained as a separate fund once the with-profits assets of the fund fell below £500m, adjusted for inflation since 31 December 1999 – equivalent to £750m as at 31 December 2013.
- The NPLL Scheme contains restrictions on the type of expenses and the level of per policy and investment expenses that can be charged to the NPLL LTF. However, the relevant provisions are not easy to apply in practice now that the initial 10 year term has expired (as it requires the level of expenses to be benchmarked against rates that could be achieved externally). The Scheme sets out a pragmatic solution, detailed in paragraphs 6.8 to 6.10 of my Report. The Scheme also includes provisions allowing the expenses charged to be reviewed should it be appropriate to do so (including if the PLAL WPC requests a review), with any future changes subject to approval by the PLAL WPC. The Scheme also includes clear statements that its provisions take effect subject to applicable law and regulation: in practice, this means that, if the expenses incurred in running the NPL WPF were less than set out in the Scheme, then PLAL would be required to charge the lower amount.

I am satisfied that the rationale set out in my Report continues to hold. In particular, the Scheme is expected to have a similar impact on the level of capital available for future discretionary distribution as at 31 December 2014 as it would have had as at 31 October 2014 and there have been no changes to the Scheme since my Report.

Unit-linked policies

3.4. I noted in paragraphs 6.11 to 6.14 of my Report that the Scheme will not have a material effect on the benefit expectations of the Transferring Policyholders that hold unit-linked policies:

- The Scheme will allow PLAL to carry out the following actions on its unit-linked funds, unless prohibited from doing so by the terms and conditions of the affected policies, or unless the PLAL Board, having obtained the advice of the PLAL Actuarial Function Holder, considers it impractical or inappropriate with regards to the interests of the affected policyholders to carry out these actions. Policyholders would be entitled to a free switch to another linked fund to which their policy is linked and which the PLAL Board considers offers reasonably equivalent investment exposure in the event of any of these situations occurring:
 - (i) merger of any unit-linked funds within PLAL;
 - (ii) division of any unit-linked funds within PLAL; or

- (iii) modification of investment objectives of any unit-linked fund within PLAL to permit investment in reasonably similar assets or to provide reasonably similar investment exposure.
- The Scheme will allow PLAL, under the power of the PLAL 2012 Scheme, to wind up any unit-linked fund in PLAL if the value of assets falls below £5.9m (increased annually based on the Retail Prices Index from 31 December 2011) or, regardless of size, if the PLAL Board receive advice from the Actuarial Function Holder that the maintenance of the fund is no longer administratively feasible. In such an event, each affected policyholder would be allocated units of an equal value in an alternative fund which the PLAL Board, having obtained appropriate advice from the Actuarial Function Holder, considers provides reasonably equivalent investment exposure to the unit-linked fund being wound up. In the event of such an action, the Board must comply with TCF requirements with respect to the level of charges, and thus any change in the level of charges must be deemed to be fair to policyholders. In addition, during the 12 months after the fund is wound up, any affected policyholders will be entitled to a free switch, even where such a switch is not permitted under the policy terms, into one or more funds to which their policy is linked.
- In the event that the PLAL Board, having obtained advice from the Actuarial Function Holder, considers that any group of policyholders have been disadvantaged financially by any action outlined in paragraphs 6.11 - 6.12 of my Report, it must, under the terms of the PLAL 2012 Scheme, consider whether appropriate compensation should be contributed to the relevant policyholders.
- I noted in my Report that I was satisfied that none of these rights represent a materially adverse impact on policyholder benefit expectations, and that there are appropriate safeguards in place to protect the interests of these policyholders.

These reasons continue to hold.

Non-profit policies

3.5. I noted in paragraph 6.15 of my Report that the Scheme will not have any impact on the benefit expectations of the Transferring Policyholders that hold non-profit policies:

- annuities in payment will transfer to the PLAL NPF. The Scheme does not change the benefits payable under these policies; and
- there will be no change to the terms and conditions of any other non-profit Transferring Policies.

This rationale continues to hold.

Conclusion on benefit expectations for Transferring Policyholders

3.6. I concluded in paragraph 6.16 of my Report that I was satisfied that the Scheme, of itself, does not materially adversely affect the benefit expectations of any group of the Transferring Policyholders. For the reasons stated above, my conclusion still stands.

Benefit Security for Transferring Policyholders

3.7. In Section 6 of my Report I also commented on the benefit security of the Transferring Policyholders. The level of surplus assets available to meet the capital requirements of the business is an important consideration in an assessment of policyholder security. My assessment of the impact of the Scheme on the benefit security of the Transferring Policyholders was primarily based on the relative strengths of the capital policies which specify the level of excess assets over the regulatory requirements targeted by each company. Although the capital policies differed (and, at the time of writing, continue to differ) between the Companies, I concluded that I was satisfied that there was no materially adverse impact on policyholder benefit security for the Transferring Policyholders for the following reasons. I set out a summary of this rationale below together with any updates since my Report was finalised.

- They will be protected by the PLAL Capital Policy which provides ongoing security well in excess of regulatory requirements. In March 2015 the PLAL Board approved a proposal to recalculate the parameter used to calculate the contribution of the PLAL WPFs to the Pillar 1 test under the PLAL Capital Policy immediately after the Transfer Date. This change in parameter is intended to ensure that the Scheme does not change the overall level of capital held in respect of PLAL, without a corresponding change in CRR. The level of protection it affords to the policies will not change as a result of the Scheme, nor will the governance processes in place to scrutinise future changes to it.
- While the Pillar 1 coverage ratio in PLAL following the Scheme may well be lower than the NPLL pre-Scheme coverage ratio (as would have been the case had the Scheme taken effect on 31 December 2014), PLAL will remain strongly capitalised and with surplus in excess of capital policy requirements. Pillar 2 analysis shows that, based on the position as at 31 December 2014, the coverage ratio in PLAL post-Scheme would have been higher than the equivalent ratio in NPLL pre-Scheme, and the absolute surplus held above Pillar 2 capital requirements much greater in PLAL post-Scheme than in NPLL pre-Scheme. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 30 June 2015).
- There are no significant changes to the level of contagion risk faced by the Transferring Policyholders and the likelihood of a contagion risk occurring remains remote.
- The Scheme will significantly simplify the capital support arrangements for the NPLL with-profits business without any reduction in the level of support available.

3.8. These reasons continue to hold and, importantly, the level of ongoing protection provided by the PLAL Capital Policy is unchanged by the Scheme, and continues to require solvency to be maintained at a higher level than regulatory requirements.

3.9. I concluded in paragraph 6.32 of my Report that I was satisfied that the Scheme will not have a material adverse effect on the benefit security of the Transferring Policyholders. For the reasons set out above, my conclusion still stands.

Benefit expectations and security of Existing PLAL Policyholders

Benefit expectations of Existing PLAL Policyholders

3.10. In Section 7 of my Report, I considered the impact of the Scheme on the benefit expectations of the Existing PLAL Policyholders. I considered separately the holders of with-profits policies, holders of unit-linked policies and holders of non-profit policies, and I do so again below for ease of reference.

With-profits policies

3.11. In Section 7 of my Report, I set out the rationale for my conclusion in respect of the benefit expectations of the Existing PLAL Policyholders that hold with-profits policies. This is repeated below, and takes account of the refreshed analysis of the impact of the Scheme on policyholder benefit security for these policies:

- there will be no change to the basis on which asset shares are determined, the current level of asset shares and guaranteed benefits, the expected level of emerging profits or how they are shared, expected bonus rates and payout levels, or the smoothing of payouts;
- the PLAL WPFs contain non-profit business, and profits or losses from that business remain in the relevant fund. All of the non-profit business will remain within the respective funds, and there will be no change to the basis on which profits are shared;
- some unitised with-profits Transferring Policies are already reinsured into the Pearl WPF and this will continue to be the case after the Scheme (albeit through an inter-fund agreement, rather than reinsurance). Consequently, the exposure of with-profits Existing PLAL Policyholders to the risks associated with these policies will not change as a result of the Scheme;
- with-profits policyholders have a contingent interest in any surplus assets in their particular fund, and, while they remain in the fund, will receive a share of any such assets that are distributed in the future. The level of surplus assets in each existing PLAL WPF is unchanged, and so the value of this contingent interest is unaffected in each case;
- there will be no changes to the investment policy or asset mix of any fund as a result of the Scheme;
- the Scheme will not change the PPFM principles for this business, nor does it impact the way in which this business is expected to be managed or the powers that PLAL has under previous schemes (for example in relation to the merger and closure of with-profits funds under certain circumstances);
- the governance arrangements and the existing policyholder protections will be maintained and, indeed, strengthened as described in paragraphs 7.7 – 7.10 of my Report; and
- the level of discretionary benefits payable under with-profits policies (for example, the level of bonus declared) often relate to the financial position of the fund in which they are held. Consequently, the benefit expectations of with-profits policyholders are related to the benefit security of these policies. I consider the impact of the Scheme on policyholder benefit security

Expected Impact of the Scheme on Different Groups of Policyholders

in paragraphs 3.15 to 3.17 and conclude that the Scheme does not materially adversely impact on policyholder benefit security for the with-profits policyholders in PLAL.

These reasons continue to hold.

Unit-linked policies

3.12. In paragraph 7.11 of my Report, I set out the rationale for my conclusion that the Scheme will not have a material effect on the benefit expectations of the Existing PLAL Policyholders that hold unit-linked policies:

- the unit-linked policies in PLAL will remain invested in the same unit-linked funds as previously, with the same number and value of units, and with the same range of fund choice available to them;
- the value of each policy's unit holdings will be unchanged, and the pricing principles used for each unit-linked and unitised with-profits fund will be unchanged by the Scheme. The level of fund charges will also not be changed by the Scheme; and
- there will be no change to the unit pricing principles, investment mandates, charges or taxation of any unit-linked fund;

This rationale continues to hold.

Non-profit policies

3.13. I noted in paragraph 7.12 of my Report that I was satisfied that the Scheme will not have any impact on the benefit expectations of the Existing PLAL Policyholders that hold non-profit policies:

- the benefits payable under existing non-profit policies in PLAL are fixed, or escalate with respect to inflation or at a fixed rate. The Scheme will have no impact on the benefits or premiums payable under any non-profit policy. The terms and conditions of the existing non-profit policies in PLAL will not be changed by the Scheme; and
- the Scheme will not affect the current premium levels or charges of any non-profit policies with reviewable premiums or charges. Future reviews will continue in accordance with existing practice and subject to TCF.

This continues to hold.

Conclusion on benefit expectations for Existing PLAL Policyholders

3.14. I concluded in paragraph 7.13 of my Report that I was satisfied the Scheme is unlikely to have any effect on the benefit expectations of the Existing PLAL Policyholders with non-profit policies, any material effect on the benefit expectations of the Existing PLAL Policyholders with unit-linked policies and any materially adverse effect on the benefit expectations of the Existing PLAL Policyholders with with-profits policies. For the reasons stated above, these conclusions still stand.

Benefit security for Existing PLAL Policyholders

3.15. In Section 7 of my Report I commented on the benefit security of the Existing PLAL Policyholders. I concluded that I was satisfied that the Scheme had no adverse impact on the benefit security of the Existing PLAL Policyholders for the following reasons. (The original analysis made use of Scheme impact estimates as at 31 October 2014. In what follows, I have referred to the later figures that are now available, estimating the impact of the Scheme had it been implemented as at 31 December 2014.)

- These policies do not move, and will continue to have recourse to surplus in the fund in which they are held, the PLAL NPF and the PLAL SHF.
- They will continue to be protected by the PLAL Capital Policy which provides ongoing security in excess of regulatory requirements. The level of protection it affords to the policies will not change as a result of the Scheme, nor will the governance processes in place to scrutinise future changes to it.
- There is no material change in the risks to which the policyholders are exposed.
- Had the Scheme taken effect on 31 December 2014, there would have been very little change to the Pillar 1 or Pillar 2 solvency coverage ratios. On both measures the analysis as at 31 December 2014 indicates that PLAL would have demonstrated coverage well in excess of minimum requirements following the implementation of the Scheme. I do not expect the impact of the Scheme to be materially different at the planned Transfer Date (being 30 June 2015).
- The surplus position in the existing PLAL WPFs remains unchanged by the Scheme and they will continue to have the same level of capital support from the PLAL NPF and the PLAL SHF.
- The risk of contagion risk occurring does not change significantly and remains remote.

3.16. These reasons remain valid. As described in paragraphs 2.18 and 2.19 of this Supplementary Report, in March 2015, the PLAL Board approved a proposal to change the parameter used to calculate the contribution of the PLAL WPFs to the Pillar 1 test under the PLAL Capital Policy immediately after the Transfer Date to ensure that the Scheme does not change the overall level of capital held in respect of PLAL, without a corresponding change in CRR. This does not represent a change in the level of protection afforded by the PLAL Capital Policy, and PLAL is expected to be able to meet its capital target under the PLAL Capital Policy immediately following the Scheme.

3.17. I concluded in paragraph 7.25 of my Report that I was satisfied that the Scheme is not expected to have a materially adverse effect on the benefit security of the Existing PLAL Policyholders. For the reasons stated above, my conclusion still stands.

Service Standards and Administration

3.18. As I noted in paragraphs 8.11 to 8.13 of my Report, the Scheme is not expected to lead to any changes in the administration arrangements of any group of policies. In particular, I noted that, immediately after the implementation of the Scheme, all policies, including those which transfer, will continue to be administered on the same underlying systems as now, by staff from the same company as is currently the case. Following the implementation of the Scheme, communications to the Transferring Policyholders will originate from PLAL rather than NPLL, and the 'Phoenix Life' branding will be introduced to the Transferring Policyholders. I also noted that, reflecting certain requirements of the NPLL Scheme, the Scheme will introduce a specific requirement that service standards and the level of skill and diligence applied in investment management for the NPL WPF

Expected Impact of the Scheme on Different Groups of Policyholders

should be appropriate having regard to the standards applied to the equivalent business in PLAL. Similarly, immediately after the implementation of the Scheme, the investment management of the funds will continue to be performed by the same fund managers, using the same processes as are currently in place, with the funds having the same investment mandates and objectives as now.

- 3.19. This allowed me to conclude that I was satisfied that there will be no materially negative impact on the quality of service standards for these policies as a result of the Scheme. As these reasons continue to hold, I am satisfied that my conclusion remains valid.

4. Policyholder Communications, Objections and Scheme-Related Queries

Overview

- 4.1 As set out in Section 10 of my Report, the Companies have undertaken an exercise to communicate with policyholders in accordance with the proposals put to the Court at the Directions Hearing.
- 4.2 The Companies have provided me with regular updates of the communications received from policyholders in relation to the Scheme. This has included a breakdown of the types of communications received, details of any objections and queries received and copies of the responses sent to objecting policyholders. I have relied upon the Companies' categorisation of the communication and the accuracy of the information provided to me.
- 4.3 As at 10 April 2015, NPLL had sent information packs to 199,596 Transferring Policyholders and had received 3,477 queries. The significant majority (3,436) of these queries were either not directly related to the Scheme or were requests for general information about the Scheme. The remaining communications were either queries referred by the call-centre for additional consideration and requiring a written response (25) or potential objections to the Scheme (16). I have reviewed the detail of each of the objections and summaries of the referred queries, as well as the responses provided by the Companies. I set out below how I have considered these in reaching my conclusions on the Scheme.
- 4.4 PLAL was granted dispensation from the Court from the requirement to notify the Existing PLAL Policyholders about the Scheme, since they are not transferring, there will be no change to the terms and conditions of their policies and the Scheme does not have a material impact on the financial position of PLAL. Instead, notices advertising the Scheme, applicable to all groups of policyholders, were published in various places, including the Phoenix Life website, seven national newspapers in the UK and the official gazettes. To date, no referred queries or objections have been received from Existing PLAL Policyholders in relation to the Scheme.

NPLL policyholder queries and objections

- 4.5 I have reviewed all of the currently-identified objections to the Scheme and summaries of the referred queries raised by policyholders and received by the Companies up to 10 April 2015. I have considered each of the 16 objections and 25 referred queries received to see if they raise issues in relation to the Scheme that might constitute a material adverse effect for policyholders. I have summarised the objections (and any referred queries where these raised a distinct point) below, along with my view on the extent to which each point raised might impact my assessment of the Scheme as the Independent Expert.
- 4.6 Six objecting policyholders expressed a desire not to transfer, with three wishing to either cash-in or transfer their policies to another company without any penalties being applied. One of these policyholders also expressed concern that PLAL could take over NPLL without consideration of the

Transferring Policyholders. In addition, eight of the referred queries included questions about whether the policyholders were able to choose not to transfer or transfer elsewhere (without exit charges) or expressed general dissatisfaction about transferring to PLAL. For the reasons set out below, I am satisfied that none of these objections or referred queries raise any issues that change my conclusions in relation to the Scheme.

- The Part VII process does not require the consent of individual policyholders and it does not give them a right to opt out. However, the Part VII process includes various protections to help ensure that policyholders are not materially disadvantaged by the Scheme – including my role as Independent Expert and the right for policyholders to raise objections to the Court if they believe that the Scheme will adversely affect them.
- Other than as set out in my Reports, the Scheme does not alter the terms and conditions of any Transferring Policy. In particular, it does not change the exit charges (if any) that are applied if the policy is terminated or transferred to a third party provider.
- It is possible that the publicity surrounding the reforms to the pensions and annuity market in the UK, announced on 19 March 2014 as part of the Budget 2014, has highlighted the possibility of withdrawing retirement benefits early (with less adverse tax treatment) to the policyholders making these objections and queries. This is not a Scheme-related change and any impact it has on the Companies or policyholders of NPLL or PLAL (including the Transferring Policyholders) will occur regardless of whether or not the Scheme proceeds. In particular, any additional flexibility required by the legislation will be available to Transferring Policyholders after the Scheme is implemented.

4.7 Three Transferring Policyholders raised objections to their policies being subject to greater risk following the transfer. In addition, two of the referred queries included references to changes in the risks to which their policies will be exposed if the Scheme is implemented.

- I considered the change in the risks to which Transferring Policyholders are exposed in my discussion on “contagion risk” in paragraph 6.31 of my Report. While the Scheme will lead to the Transferring Policyholders being exposed to the risks within PLAL, I noted that benefits would only be theoretically at risk of being reduced in the extreme event of the insolvency of PLAL. I consider this event to be of very low likelihood as a result of the capital held to meet the regulatory capital requirements and the additional capital targeted under the PLAL Capital Policy, as set out in Section 5 of my Report, and also certain protections afforded by the PLAL 2012 Scheme. In my Report, I concluded that I was satisfied that the change in contagion risk does not represent a materially adverse effect on benefit security for the Transferring Policyholders. I am satisfied that the rationale and my conclusion remain valid.
- One of the three objecting Transferring Policyholders highlighted that they were objecting to their policy potentially being exposed to risks in relation to policies held by policyholders in Guernsey or Jersey. While they were not specific about which entity was giving rise to the concern, to the extent that the potential contagion risk was in respect of Existing PLAL Policies, this matter is considered in the previous bullet point. To the extent that the potential exposure is from policies currently in NPLL, then I note that this exposure is not related to the Scheme as it is a fact of their current situation. Thus, I do not consider that this objection raises new issues that could change my conclusion on the impact of the Scheme on the benefit security for the Transferring Policyholders.

4.8 Eight Transferring Policyholders raised objections on the basis that they were concerned about the way that the expenses charged to the NPL WPF will be increased in the future under the terms of the Scheme. This issue was also highlighted as part of seven of the referred queries.

- As I note in paragraphs 6.8 to 6.10 of my Report, the Scheme will result in certain per policy expenses that are charged to the overall NPL WPF increasing each year in line with RPI + 1%. It is important to note that this rate of increase is consistent with the current approach to charging these expenses to the fund, and so the Scheme does not change the expected level of costs charged to the fund in the future. I also consider it helpful to note that, while the Scheme allows for increases to the per policy expenses charged to the fund, any impact this might have on the overall amount charged to the fund will be offset by the reduction in the number of policies in the fund as it runs off. I do not consider it unreasonable that a closed fund would expect per policy expenses to increase at a level above inflation, as certain fixed costs are spread over a decreasing number of policies.
- While I understand that policyholders may be concerned that the automatic nature of the increase could lead to inappropriate levels of costs being charged to the fund, I note that the Scheme includes provisions allowing this rate of increase to be reviewed should it be appropriate to do so (including if the PLAL WPC requests a review), with any future changes subject to approval by the PLAL WPC. The Scheme also includes clear statements that its provisions take effect subject to applicable law and regulation: in practice, this means that, if the expenses incurred in running the NPL WPF were less than set out in the Scheme, then PLAL would be required to charge the lower amount. As a result, should the increases become unreflective of the actual costs associated with administering the fund in future, I would expect the level of expenses charged to be reviewed and note that the Scheme provides the means for this to be achieved.
- I also note that there is not necessarily a direct relationship between the expenses charged to the fund and the charges taken from policyholders. For example, for unitised with-profits policies, the expense charges are taken as a percentage of each policy's fund and these will not be affected by the above changes. In addition, as the NPL WPF will be, in part, dependent on shareholder support to meet PRE, changes to the expenses charged to the fund are likely to, primarily, impact the level of shareholder support required rather than the benefits payable to policyholders.
- I considered the impact on policyholder benefit expectations as a result of the Scheme in paragraphs 6.8 to 6.10 of my Report, concluding that the Scheme will have no materially adverse impact on the benefit security for Transferring Policyholders. I am satisfied that the rationale set out in my Report and the associated conclusions remain valid.

4.9 Two objections and four referred queries were received from policyholders who stated that they did not understand some of the terminology used in my Report (particularly the word "material") or the implications for them of the mailing. One policyholder expressed concerns that the communications should have used fewer specialist terms.

- I appreciate that there can be difficulty in communicating the technical details of such a transfer to policyholders. In each case where this was an issue, the policyholder was contacted to help ensure that they understood the details of the Scheme and the implications for them. I believe these responses to be appropriate and I have not considered this point further.

- I defined my interpretation of the word “material” in paragraph 4.3 of my Report. This stated that:

“The word “material” is not uniquely defined, and so where there are adverse changes I have attempted to give some context as to their size or likelihood of occurring. If a potential effect is very unlikely to happen and does not have a large impact, or if it is likely to happen but has a very small impact, I do not consider it material.”

While I appreciate that policyholders may have a preference for absolute statements and conclusions, the nature of actuarial analysis is such that there will always be a degree of uncertainty in any conclusions reached. The use of “material” within my conclusions and the definition used reflects this uncertainty.

4.10 One Transferring Policyholder has raised a large number of questions in relation to the Scheme, the supporting documentation provided by the Companies and my Report. I have reviewed these objections and comment on the various themes raised below.

- The policyholder’s primary objection related to the change in the level of “contagion” risk faced by Transferring Policyholders as a result of the Scheme. In particular, the policyholder highlighted the possibility that, following the Scheme, the NPL WPF will be required to provide support to one or more of the other with-profits funds within PLAL and queried whether such an event had occurred in the past. As I noted in paragraph 6.31 of my Report, it is important to realise that contagion risk is only relevant in the highly unlikely event of the insolvency of PLAL. The capital held under the PLAL Capital Policy provides protection against such an event and the extent of this protection will not change as a result of the Scheme. Support could only be provided from the NPL WPF to another with-profits fund in PLAL if there were no excess assets within the PLAL NPF and PLAL SHF and, even then, the terms of such support are required by the Scheme to be no less favourable than commercial terms. As a result of these factors, I am satisfied that the change in the level of contagion risk faced by the Transferring Policyholders does not represent a materially adverse effect on their benefit security. No contagion risk events have occurred within PLAL.
- The policyholder also queried why the Scheme was being proposed by the Companies and whether there are any benefits to policyholders as a result. I set out a more detailed description of the purpose of the Scheme in paragraph 3.3 of my Report, but the main purpose is to simplify the group structure within the Phoenix Group. While there is no requirement for such schemes to provide a benefit to policyholders, I note that the Scheme does result in a potential for benefit from the fact that no financing charges will be payable on the loan from the PLAL SHF that replaces the SEF and the Earmarked Portfolio. It is also important to note that all costs of the Scheme are being borne by the PLAL SHF and, as I concluded in my Report, I am satisfied that the Scheme does not have a materially adverse effect on any of the groups of policyholders considered.
- The policyholder queried the use of the word “material”. I have considered this point in paragraph 4.9 above.
- The policyholder also queried the potential changes to governance as a result of the Scheme. I discussed these in Section 8 and Appendix 11 of my Report, concluding that I am satisfied that the changes do not represent a material adverse effect on the Transferring Policyholders. In

particular, I noted that the key elements of discretion will become the responsibility of the PLAL WPC, which is required to have regard solely to the interests of the policyholders in the NPL WPF when carrying out its duties in respect of that fund. Where the management of the NPL WPF is the responsibility of the Board, this will be subject to oversight from the PLAL WPC. I am satisfied that the conclusions in my Report remain valid.

- The policyholder noted that there were a number of areas in my Report where I highlighted the fact that I would provide additional analysis in advance of the Sanctions Hearing. I believe that this Supplementary Report addresses all relevant developments since the finalisation of my Report. Should I become aware of any additional points, which I consider could impact my conclusions, I will bring these to the attention of the Court. I understand that the Companies intend to send a copy of this Supplementary Report directly to the policyholder.
- The policyholder also raises a complaint about his policy. I understand that this is being considered through the normal complaints process and I do not consider it further.

4.11 One policyholder submitted detailed technical queries regarding various aspects of the Scheme. I have reviewed the correspondence between the policyholder and the Companies and considered the points raised in drafting this Supplementary Report. I am satisfied that no substantive issues have been raised that are not addressed by my Reports.

4.12 The remaining referred queries were from policyholders seeking clarification about how the Scheme would affect their policies, in particular, seeking clarification around whether certain features (such as guarantees or the right to participate in profits) would be changed by the Scheme. I have reviewed the written responses in respect of these queries and I am satisfied that the responses provided were appropriate to the query raised. I note that the responses included a section inviting future correspondence in the event that the policyholders did not believe that their query had been appropriately addressed.

PLAL policyholder queries and objections

4.13 No Existing PLAL Policyholders raised specific objections or concerns about the Scheme.

5. Overall Conclusions

Scheme Changes

- 5.1. I note that there have been some minor amendments to the Scheme and also to the PLAL 2012 Scheme since the date of my Report. I have considered these and am satisfied that they do not affect the conclusions of my Report.

Additional considerations

- 5.2. I have considered the progress made on Solvency II, and developments in relation to the satisfaction of the requirements of the Securitised Loan Agreement in Section 2. Nothing that has occurred since my Report has changed my conclusions in relation to the impact of these factors on my analysis of the Scheme.

Security of Policyholder Benefits

- 5.3. In Sections 5, 6 and 7 of my Report I considered various aspects of the proposed transfer that might have an impact on the security of benefits for policyholders affected by the Scheme. In carrying out my review for this Supplementary Report, nothing has come to my attention to change my opinion on any of these aspects. I continue to gain comfort from the operation of the capital policies that will govern the management of the funds following the implementation of the Scheme. The level of protection that they provide is unchanged from the time of my Report and continues to provide policyholders with additional security above that required by current UK regulations.
- 5.4. I have reviewed updated information as at 31 December 2014 on the solvency position of the Companies. I am satisfied following this analysis that, if the Scheme had been implemented on 31 December 2014, there would have been sufficient capital resources to satisfy the requirements of the PLAL Capital Policy. Transferring Policyholders and Existing PLAL Policyholders would each continue to benefit from the availability of a capital margin to absorb adverse experience (e.g. in equity and bond markets). It remains the case (based on analysis as at 31 December 2014) that the Scheme will have a slightly positive impact on the financial position of PLAL, but that the post-Scheme Pillar 1 solvency ratio of PLAL will be less than the pre-Scheme Pillar 1 solvency ratio of NPLL. As discussed in paragraph 6.20 of my Report and paragraph 2.29 of this Supplementary Report, I attach limited significance to this change in the Pillar 1 solvency ratio in my consideration of the impact of the Scheme on the benefit security of Transferring Policyholders. I am also satisfied that (based on the analysis as at 31 December 2014) the Companies will be able to meet their Pillar 2 capital requirements and the post-Scheme Pillar 2 solvency ratio of PLAL will be higher than the pre-Scheme Pillar 2 solvency ratio of NPLL.
- 5.5. The Companies have processes in place to track their solvency position and I am in regular dialogue to understand developments. I have asked the Companies to notify me if there is a significant change to the position I have set out in my Supplementary Report. If that occurs before the Sanctions Hearing, I will bring it to the Court's attention.
- 5.6. I have considered the impact of the Scheme on the benefit security of each of the different groups of policyholders. In my Report, I concluded that I was satisfied that the Scheme will not have a materially adverse effect on the benefit security of any group of policyholders. I remain of this view.

Policyholder Benefit Expectations

- 5.7. In my Report I concluded that I was satisfied that the Scheme will not materially adversely affect the benefit expectations of any group of policyholders. I remain of this view.

Policyholder Communications, Objections and Scheme-Related Queries

- 5.8. In Section 10 of my Report I considered the approach to policyholder communications for different groups of policyholders, both Transferring Policyholders and Existing PLAL Policyholders, in the Companies. Having checked for any concerns or objections raised by policyholders or up to 2 April 2015, nothing has come to my attention that affects the conclusions in my Report.

Other Conclusions and Considerations

- 5.9. My Report also considered other factors and their possible impact on the Companies' policyholders, including governance arrangements, tax, service standards and investment management. I am not aware of any changes from the arrangements that I described in my Report. I remain satisfied that the conclusions in my Report still stand. In particular, I continue to believe that for all groups of policyholders there will not be any material adverse impact on the ongoing governance arrangements, no adverse impact on the quality or cost of service standards and no impact on the quality or cost of investment management services as a result of the Scheme.
- 5.10. As set out in paragraph 2.11 of this Supplementary Report, on the basis of the analysis, rationale and conclusions set out in my Reports, it remains my opinion as an actuary and based on my own interpretation of the wording of the proviso in paragraph 34 of the NPLL Scheme (an interpretation which I do not claim to be necessarily in line with how the proviso would be interpreted in law) that:
- the interests and reasonable expectations of the Transferring Policyholders will not be adversely affected by the Scheme; and
 - the protections afforded to the Transferring Policyholders whether pursuant to the NPLL Scheme or otherwise, will not, in aggregate, be reduced by the Scheme.



David Hare FIA

Independent Expert

22 April 2015

Appendix 1: Data and Reliances

The following section lists the items of information that I have received, reviewed and relied upon in relation to the preparation of this Supplementary Report. This includes various emails and documents received from the management of the Companies and publicly available information.

| Scheme documents and Witness Statements | Date of document* | Company relating to |
|--|--------------------------|----------------------------|
| Scheme document | April 2015 | Both |
| Order for adjournment of the Scheme | March 2015 | Both |
| Second witness statement of Andrew Moss | March 2015 | Both |
| Mailing witness statement of Karen Chidgey | March 2015 | Both |
| AFH supplementary reports on the Scheme | | |
| AFH Supplementary Report, including WPA opinion | April 2015 | PLAL |
| AFH Supplementary Report, including WPA opinion | April 2015 | NPLL |
| Amendment of the PLAL 2012 Scheme | | |
| Witness statement of Andrew Moss regarding amendment of the PLAL 2012 Scheme | March 2015 | Both |
| PLAL 2012 Scheme with proposed amendments | March 2015 | Both |
| Application notice of amendment of the PLAL 2012 Scheme | March 2015 | Both |
| Tax | | |
| Tax clearances | 23/02/2015 | Both |
| Scheme-related financials | | |
| Pillar 1 and 2 financial impact of the Scheme | 31/12/2014 | Both |
| Solvency Management Information | 31/03/2015 | Both |
| Investigation of the variance of the actual and the MI (used in my Report) versions YE14 financial positions | 20/03/2015 | Both |
| Sensitivity analysis as at Q4 2014 | 31/12/2014 | Both |
| PLAL Capital Policy post-Scheme | 13/03/2015 | Both |
| Correspondence around the PLAL Capital Policy refresh | 19/03/2015 | Both |
| Restated PLAL NPF Capital Support (to the NPL WPF) | 29/01/2015 | Both |

Appendix 1: Data and Reliances

| | | |
|--|----------------------------|------|
| Restated PLAL SHF Capital Support (to the NPL WPF) | 29/01/2015 | Both |
| Draft letter from Phoenix Group Holdings to PLAL around restated capital support | 29/01/2015 | Both |
| Solvency II | | |
| Solvency II position as at 31 December 2014 | 31/12/2014 | Both |
| Solvency II Transitionals update | 9/04/2015 | Both |
| YE14 Phoenix Annual operating plan | 3/03/2015 | Both |
| Correspondence regarding Solvency II readiness of the Companies | 19/03/2015 | Both |
| Policyholder communications | | |
| Responses from policyholders to the communications sent out by both Companies and oral update | December 2014 – April 2015 | Both |
| Phoenix policyholder response MI | 10/04/2015 | Both |
| Other | | |
| Confirmation letter from Moody's regarding Securitisation Loan | 30/01/2015 | NPLL |
| Confirmation letter from S&P's regarding Securitisation Loan | 16/01/2015 | NPLL |
| Legal opinion from Hogan Lovells International LLP regarding the Securitisation Loan (draft version) | 19/01/2015 | NPLL |

*This date refers to the date of the document or the date that the figures relate to, if relevant (for example, the valuation date for documents relating to the financial position)

Appendix 2: Summary Pillar 1 Financial Information for the Companies

Introduction

This Appendix provides a fund-level breakdown of the estimated Pillar 1 financial impact of the Scheme, had it been implemented as at 31 December 2014, as summarised in Section 2 of this Supplementary Report.

Pre-Scheme Pillar 1 solvency position

Table A2.1 – PLAL pre-Scheme solvency position as at 31 December 2014

| £m | PWP | SERP | LL WP | Non Annuity | Annuity | Opal | SHF | Total |
|---|--------------|------------|------------|----------------|------------|-----------|------------|--------------|
| Capital Resources ⁽¹⁾ | 1,617 | 5 | 5 | 10 | 25 | -5 | 461 | 2,118 |
| LTICR | 228 | 51 | 27 | 12 | 52 | 0 | 0 | 370 |
| CRR Regulated Subsidiary | 0 | 0 | 0 | 0 | 0 | 0 | 124 | 124 |
| WPICC | 1,189 | 0 | 0 | | | 0 | 0 | 1,189 |
| Capital Requirement ⁽²⁾ | 1,417 | 51 | 27 | 12 | 52 | 0 | 124 | 1,683 |
| Surplus assets in excess of Capital Requirement ⁽³⁾ | 200 | -46 | -22 | -2 | -27 | -5 | 337 | 434 |
| Cover for Capital Requirement ⁽⁴⁾ | | | | | | | | 126% |

Table A2.2 – NPLL pre-Scheme solvency position as at 31 December 2014

| £m | LTF | SHF | Total |
|---|------------|------------|-------------|
| Capital Resources ⁽¹⁾ | 37 | 166 | 203 |
| LTICR | 124 | 0 | 124 |
| CRR Regulated Subsidiary | 0 | 0 | 0 |
| WPICC | 0 | | 0 |
| Capital Requirement ⁽²⁾ | 124 | 0 | 124 |
| Surplus assets in excess of Capital Requirement ⁽³⁾ | -87 | 166 | 79 |
| Cover for Capital Requirement ⁽⁴⁾ | | | 164% |

Estimated Post-Scheme Pillar 1 solvency position**Table A2.3 – PLAL post-Scheme solvency position, estimated values at 31 December 2014**

| £m | PWP | SERP | LL WP | NPL WP | Non Annuity | Annuity | Opal | SHF | Total |
|---|--------------|------------|------------|------------|----------------|------------|-----------|------------|--------------|
| Capital Resources ⁽¹⁾ | 1,617 | 5 | 5 | 37 | 10 | 25 | -5 | 453 | 2,147 |
| LTICR | 228 | 51 | 27 | 123 | 12 | 52 | 0 | 0 | 493 |
| CRR Regulated Subsidiary | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 3 | 3 |
| WPICC | 1,189 | 0 | 0 | 0 | | | 0 | 0 | 1,189 |
| Capital Requirement ⁽²⁾ | 1,417 | 51 | 27 | 123 | 12 | 52 | 0 | 3 | 1,685 |
| Surplus assets in excess of Capital Requirement ⁽³⁾ | 200 | -46 | -22 | -86 | -2 | -27 | -5 | 450 | 462 |
| Cover for Capital Requirement ⁽⁴⁾ | | | | | | | | | 127% |

Table A2.4 – NPLL post-Scheme solvency position, estimated values at 31 December 2014

| £m | LTF | SHF | Total |
|---|----------|----------|-------------|
| Capital Resources ⁽¹⁾ | 0 | 4 | 4 |
| LTICR | 0 | 3 | 3 |
| CRR Regulated Subsidiary | 0 | 0 | 0 |
| WPICC | 0 | 0 | 0 |
| Capital Requirement ⁽²⁾ | 0 | 3 | 3 |
| Surplus assets in excess of Capital Requirement ⁽³⁾ | 0 | 2 | 2 |
| Cover for Capital Requirement ⁽⁴⁾ | | | 160% |

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to the Regulator's rules on capital tiers.
- (2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component plus CRR of regulated subsidiary.
- (3) Capital Resources less Capital Requirements.
- (4) Capital Resources divided by Capital Requirement.

Appendix 3: Certification of the Amended PLAL 2012 Scheme

Background

- 1.1 Alongside the Scheme, I understand that PLAL and London Life Ltd (“LL”) intend to make an application to the Court for its consent to amend the PLAL 2012 Scheme at the same time as the Final Hearing in respect of the Scheme (which is expected to take place on 29 April 2015).
- 1.2 The rationale behind this decision is that, as a result of the Scheme, the NPLL Scheme will cease to have effect and will be replaced by the Scheme. I considered the implications of this within my Report, concluding that this did not represent a materially adverse effect on the Transferring Policyholders. However, the PLAL 2012 Scheme includes reference to the NPLL Scheme, by defining the maximum level of expenses chargeable to the SERP Fund with reference to the expenses chargeable to the NPLL LTF. I provided an overview of the business in the SERP Fund in Appendix 4 of my Report. The Companies have received legal advice that, as a consequence of the NPLL Scheme ceasing to have effect, and in the absence of any amendment of the PLAL 2012 Scheme, the interpretation of the references to the NPLL Scheme in the PLAL 2012 Scheme might be subject to doubt following the implementation of the Scheme. While I have not sought to verify the Companies’ legal advice, I can understand why such doubt could have arisen and am satisfied that proposed amending of the PLAL 2012 Scheme is an appropriate way to help avoid such doubt.
- 1.3 It is a requirement of the PLAL 2012 Scheme that any proposed amendments of this nature are approved by the Court and accompanied by a certificate from an independent actuary stating that, in their opinion, the amendment “*will not adversely affect the reasonable expectations of [the holders of policies of PLAL]*”. The Companies have requested that I perform the role of the independent actuary in respect of this proposed amendment.

Scope of the proposed amendments

- 1.4 The provisions of the PLAL 2012 Scheme which LL and PLAL seek the Court's consent to amend are the following paragraphs of Schedule 3 to the PLAL 2012 Scheme:

"3. Amounts in respect of investment management fees to be allocated to the SERP Fund shall at any time be the lower of:

- (a) a monthly fixed charge equivalent to an annual rate equal to 0.1125 per cent. of the average value of the property of the SERP Fund; and*
- (b) the equivalent charge incurred by the National Provident Life Fund for similar services pursuant to paragraph 5 of Schedule 4 of the NPLL Scheme.*

"4. The total increase (in percentage terms) applying to the SERP Fund Charges [defined as maintenance and termination expenses excluding investment management fees] after 31 December 2009... shall not at any time be more than the total increase (in percentage terms) in the same

period which applies to charges for similar services incurred by the National Provident Life Fund pursuant to Schedule 4 of the NPLL Scheme."

- 1.5 The changes which PLAL and LL propose to make to these provisions are shown in an amended version of the PLAL 2012 Scheme (the "Amended PLAL 2012 Scheme"), but in summary are:
- (a) the addition of the new defined terms "NPL WP Fund" and "PLAL 2014 Scheme" in the PLAL 2012 Scheme, to enable reference to be made to the new with-profits sub-fund which will be established by PLAL to receive the bulk of the NPLL business (the NPL WPF, as defined in my Report) and the relevant provisions of the Scheme;
 - (b) amendments to paragraphs 3 and 4 of Schedule 3 to the PLAL 2012 Scheme (which sets out the costs, expenses and charges to the SERP Fund), to update the cross references in that schedule from:
 - (i) references to Schedule 4 to the NPLL Scheme, which set out the expenses and charges to be borne by the NPLL LTF;to:
 - (ii) references to Schedule 2 of the Scheme, which sets out the expenses and charges to the NPL WPF;
 - (c) the deletion of the defined terms "National Provident Life Fund", "NPI" and "NPLL Scheme" to reflect the fact that these defined terms will no longer be required in the PLAL 2012 Scheme once the amendments at (a) and (b) above have been made.

Consideration of proposed amendments

- 1.6 Since the NPLL Scheme will cease to have effect upon implementation of the Scheme, and the business in the National Provident Life Fund will all be transferred to the NPL WPF under the terms of the Scheme, I am satisfied that it is reasonable to update the references to the National Provident Life Fund and the NPLL Scheme in paragraphs 3 and 4 of Schedule 3 to the PLAL 2012 Scheme to ensure that the interpretation of these provisions remains clear. This leaves the question of whether the particular changes which PLAL and LL propose to make are appropriate.
- 1.7 In summary, the effect of the existing provisions in Schedule 3 to the PLAL 2012 Scheme is that the amounts charged to the SERP Fund in PLAL in respect of administration and investment management services should not be greater than, or should not be increased by more than, the amounts charged to the National Provident Life Fund in NPLL for the same services under the terms of the NPLL Scheme.
- 1.8 The effect of the proposed amendments will be that the amounts charged to the SERP Fund in PLAL in respect of administration and investment management services should not be greater than, or should not be increased by more than, the amounts charged to the NPL WPF in PLAL for the same services under the terms of the Scheme.
- 1.9 The amendments will therefore require that the former NPLL with-profits policyholders in the SERP Fund are not subject to a level of charges which is greater than (or increased by more than) the amounts charged to the with-profits fund in which other former NPLL with-profits policyholders are allocated (i.e. the NPL WPF).

1.10 At the same time, although the restrictions which will apply to the allocation of charges for administration and investment management services to the new NPL WPF in PLAL will be different under the terms of the Scheme from those which apply to the National Provident Life Fund in NPLL under the terms of the NPLL Scheme, I am satisfied that these changes will not have an adverse effect on the policyholders in the SERP Fund. As noted in paragraphs 3.40 of my Report, the terms of the NPLL Scheme relating to the charges which can be made to the National Provident Life Fund for administration and investment management services (which are set out in Schedule 4 to the NPLL Scheme) provide that such charges should at no time exceed the charges for similar services made by third party companies or significantly exceed the costs which NPLL would incur in carrying out such services itself. As I commented in my Report, such "an assessment is difficult to make accurately and, in practice, this requirement in respect of administration expenses has been met by continuing the previous rate of increase (RPI + 1%)". As a consequence, NPLL and PLAL propose that, under the terms of the Scheme, this requirement will be removed and replaced with new protections in relation to the NPL WPF, as follows:

- (a) for administration expenses to be set at their current level and then increased in line with inflation plus 1%, subject to future modification at any time following implementation of the Scheme on such basis as the PLAL With-Profits Committee may approve; and
- (b) for investment management expenses to be charged on a basis agreed by the PLAL With-Profits Committee.

The Scheme also makes clear that these provisions take effect subject to applicable law and regulation from time to time: in practice this means that, if the expenses incurred in operating the NPL WPF were less than those set out in the Scheme, then PLAL would be required to charge the lower amount to the NPL WPF.

1.11 As I confirmed in paragraph 6.10 of my Report, I am satisfied that these proposed changes are reasonable and will not lead to a materially adverse impact on benefit expectations for policyholders in the new NPL WPF. I am equally satisfied that the proposed changes are reasonable in relation to the policyholders in the SERP Fund and will not lead to a materially adverse impact on the benefit expectations of these SERP policyholders.

Opinion

1.12 On the basis of the foregoing analysis, I certify that in my opinion the proposed amendments to the PLAL 2012 Scheme set out in the Amended PLAL 2012 Scheme will not adversely affect the reasonable expectations of the holders of policies of PLAL immediately prior to the PLAL 2012 Scheme Transfer Date or adversely affect the reasonable expectations of the holders of Transferred Policies or Excluded Policies (as such terms are defined in the PLAL 2012 Scheme).

1.13 In terms of my independence to provide this opinion, the reader is referred to paragraphs 1.12 to 1.22 in this Supplementary Report. While these paragraphs deal with my continuing independence to carry out the role of Independent Expert for the Scheme, I believe that similar considerations apply to the provision of this independent actuary opinion.

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