



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

Prepared by David Murray FIA

17 October 2011

A handwritten signature in blue ink, appearing to be "David Murray".

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1. Introduction

Introduction

The Independent Expert

- 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 Part VII of the Financial Services and Markets Act 2000 ("FSMA") and the report must be made in a form approved by the Financial Services Authority ("FSA").
- 1.2. I have been appointed as the Independent Expert to provide the required report on a proposed scheme for the transfer of designated groups of long-term insurance business from National Provident Life Limited ("NPLL") and NPI Limited ("NPIL") to Phoenix Life Limited ("PLL"). For this proposed scheme of transfer (the "Scheme"), I have been appointed jointly by PLL, NPIL and NPLL ("the Companies") and my appointment has been approved by the FSA.
- 1.3. The Scheme will be submitted to the Court for sanction under Section 111 of Part VII of the FSMA. If approved, it is expected that the Scheme will become operative on 27 February 2012 (the "Transfer Date"), but will take effect as between the Companies, including for accounting purposes and for determining the level of policyholder benefits, from 1 January 2012 (the "Effective Date"). This report (my "Report") and any supplementary report (my "Supplementary Report" and, together with my Report, my "Reports") will be presented to the Court and it is likely that the Court will consider the contents of these Reports in deciding whether to sanction the Scheme.
- 1.4. I am a Fellow of the Institute of Actuaries, having qualified in 1989, and am a Partner in the Actuarial and Insurance Solutions practice of Deloitte MCS Limited ("Deloitte"). I am an "approved person" for the purposes of Section 59 of the FSMA, and currently act as a With-Profits Actuary and Actuarial Function Holder. I was the Independent Expert for the Part VII transfer of long-term insurance business from another company in the Phoenix Group, Phoenix & London Assurance Limited, to PLL, which was approved by the Court in February 2011 (the "2011 Scheme"). I also acted as the Independent Actuary in relation to a scheme of arrangement approved by the Court in 2010 in respect of certain policies in PLL, and approved by policyholders in a vote. The terms of those policies are not affected by the Scheme.
- 1.5. I have acted as Independent Expert in relation to Part VII transfers for other UK companies, and I have also acted as an Expert Witness and as the FSA-appointed expert in investigations of the management and solvency of with-profits funds. I have advised a range of UK insurers on Part VII transfer schemes and other restructuring projects.
- 1.6. I do not hold any insurance policies, investments, shareholdings or have any other financial interests in PLL or NPIL. I have two with-profits endowment policies with NPLL, but these policies will not transfer to PLL under the Scheme nor will the Scheme have any impact on the benefits payable under these policies, the premiums due, or any of their terms and conditions.
- 1.7. Through my previous employment with National Provident Institution ("NPI"), which ceased in 1999, I am a deferred member of the NPI staff pension scheme (now part of the Pearl Group scheme). None of the companies involved in the Scheme have a sponsoring obligation in respect of the NPI staff pension scheme, as this is provided elsewhere in the Phoenix Group, and the pension scheme will not be affected by the Scheme.
- 1.8. Deloitte is a large consulting firm and has advised the Phoenix Group on various other projects. In particular I note that:
 - In 2008 and 2009, Tim Sheldon (previously an Associate Partner of Deloitte) acted as the Independent Expert in relation to two Part VII schemes which involved the transfer of some

long-term insurance business to PLL and Royal London Mutual Insurance Limited. Mr Sheldon is no longer an employee of Deloitte. I played no part in that project;

- In 2009, around the time of Pearl Group Limited's acquisition by Liberty Acquisition Holdings (International) Company (which was subsequently renamed Phoenix Group Holdings in March 2010), Deloitte advised a consortium of banks in relation to the restructuring and renegotiation of some of the debt obligations of the Phoenix Group. I understand that the debt obligations under consideration had been issued at a holding company level and none of the companies involved in the proposed Scheme were directly affected by the renegotiation. Neither I nor any members of my engagement team were involved in providing this advice;
- Another Partner of Deloitte, David Hindley, is acting as the Independent Expert for a Part VII transfer of general insurance business out of another company in the Phoenix Group, Pearl Assurance Limited ("Pearl"). There is no overlap between the policies transferring under that scheme, and those transferring under the Scheme. That transfer, which is expected to complete in advance of the Transfer Date is not expected to have any effect on policies affected by the Scheme.

1.9. I do not believe that any of the above assignments or interests compromise my independence, create a conflict of interest, or compromise my ability to report on the proposed Scheme.

The Scope of my Report

- 1.10. This Report considers the consequences of the Scheme for the policyholders of PLL, NPLL and NPIL. I am concerned particularly to assess whether any group of policyholders might be materially adversely affected by the Scheme. I comment in paragraph 4.3 on how I have interpreted materiality.
- 1.11. To the best of my knowledge, I have taken account of all material facts in assessing the impact of the Scheme and in preparing my Report.
- 1.12. I am required to comment on the proposed Scheme and my Report is not concerned with possible alternatives to the Scheme.
- 1.13. If necessary, in order to reflect any updated financial information or circumstances nearer to the date of the hearing, I will provide a Supplementary Report to update my opinions in respect of the Scheme.

Regulatory and Professional Guidance

- 1.14. My Report has been prepared in accordance with guidance contained in Chapter 18 of the Supervision Manual of the FSA's Handbook of Rules and Guidance ("SUP 18") for scheme reports relating to the transfer of long-term insurance business. See Appendix 6 for details of how these requirements have been met.
- 1.15. The Board of Actuarial Standards has issued standards that apply, or will apply, to certain types of actuarial work. I have prepared this Report with the intention that it should meet the requirements of Technical Actuarial Standards ("TAS") R, TAS M, TAS I and TAS T. I believe that it does so.

Terms of Reference

- 1.16. The terms of reference for my Report have been agreed with the FSA and the Companies and are set out in full in Appendix 1. These terms of reference anticipated that I would prepare a report on an additional scheme involving other companies in the Phoenix Group for submission to the Court alongside this Report. However, no application will now be made to the Court in respect of that additional scheme until next year.
- 1.17. 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 am aware of the duties and requirements regarding experts set out in Part 35 of the Civil Procedure Rules.

- 1.18. My Report should be read in conjunction with the terms of the Scheme and with the reports prepared by the Actuarial Function Holders and With-Profits Actuaries of PLL, NPLL and NPIL.

Reliances

- 1.19. In performing my review and preparing this Report, 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. The financial information in this Report relating to policy numbers, premium levels and size of reserves is shown as at 31 December 2010. This has been independently audited in accordance with the financial reporting requirements of the FSA so I believe it is reasonable to rely on its accuracy. The Report also includes analysis of the solvency position of the Companies and figures are quoted on the "Pillar 1" basis reported to the FSA. The analysis uses 31 December 2010 information, which has also been audited, as its starting point. Allowance has been made for significant known or expected changes between then and 31 August 2011. I have discussed these adjustments with the Companies, and believe them to be reasonable.
- 1.20. The Report also comments on a second set of solvency calculations, known as the "Pillar 2" calculations. These are not audited, but are submitted to the FSA on request, and are produced using a thorough process including detailed checking. The 31 December 2010 Pillar 2 calculations were completed in August 2011, and have been submitted to the FSA for review. For ongoing solvency monitoring purposes during the year, the most-recent year-end results are "rolled forward" each month, and the starting point for the information I have seen is the 31 December 2010 position rolled forward to 31 August 2011. From this position the Companies have adjusted for significant known or expected changes prior to the Effective Date. As above, I have relied on the information provided to me, but have reviewed it and have discussed the adjustments with the Companies and believe them to be reasonable. I have considered the most recent Pillar 2 financial information in forming my conclusions in relation to the Scheme.
- 1.21. I recognise that economic conditions continually change. I have been in regular contact with the Companies and have been provided with more recent financial information up to 7 October 2011, which I have duly considered in finalising my conclusions.
- 1.22. I note that the economic position at the time of the Scheme cannot be predicted with certainty. The absolute solvency level may therefore differ from that shown in the Report, but I would not expect the impact of the Scheme 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). I will continue to keep the position under review, and will prepare further information in a Supplementary Report if appropriate.
- 1.23. Selected financial information, written information and data upon which I have relied is summarised in Appendix 12.

Limitations

- 1.24. The Report has been written in accordance with English law, and has been prepared solely for the use of the Companies and the Court, and solely for the purpose of assisting in determining whether the Scheme should be permitted. It should not be used for any other purpose. The Report may not be relied upon by any other party for any purpose whatsoever. Neither I nor Deloitte, its partners and staff owe or accept any duty to any other party and shall not be liable for any loss, damage or expense (including interest) of whatever nature which is caused by any other party's reliance on representations in the Reports.
- 1.25. The Report should be considered in its entirety, as parts taken in isolation may be misleading.

- 1.26. A copy of my Report may be provided to the following parties:
- The FSA, for the purposes of the performance of its statutory obligations under FSMA;
 - Other insurance regulators who have a legitimate interest in the Scheme and the local schemes in Guernsey and Jersey (the “Overseas Schemes”, see paragraphs 1.27 and 1.28 below);
 - Any other person who has (or asserts) a right to receive a copy of any of the Reports under the terms of the FSMA, or any Jersey, Guernsey, or other non-EEA resident policyholder who has or asserts a right to receive a copy of such relevant Reports under the terms of local legislation; and
 - The relevant courts and regulators in Jersey and Guernsey, solely in connection with the Scheme or the Overseas Schemes.
- 1.27. The Companies have been advised that in order to transfer insurance business carried on in or from within Jersey, and to transfer policies issued to residents of Guernsey, local schemes will also need to be effected in each of those territories, subject to the sanction of the Royal Court of Jersey or the Royal Court of Guernsey (the “Overseas Courts”) as appropriate. The terms of the transfers under the local schemes are based on (and are in all material respects the same as) the Scheme, and the local schemes are expected to take effect on the same date as the Scheme. The local schemes are conditional upon the sanction of the Scheme by the Court. In the event that the transfer under a local scheme is delayed, the policies intended to be transferred thereunder (if any) will be fully reinsured pursuant to the Scheme until the relevant local scheme transfer is effected.
- 1.28. In writing this Report, I have also considered the effect of the Overseas Schemes on policyholders. My Report and conclusions apply equally to business carried on, in or from within Jersey, or comprising policies issued to residents of Guernsey as they do to business comprising policies held by residents in the UK or any other territory, and this Report may therefore be used to satisfy the requirement for a report by an independent actuary on the terms of the local schemes in Jersey and Guernsey. I will, as necessary, provide additional reports or commentary in respect of Jersey and Guernsey to assist the Overseas Courts.
- 1.29. A copy of the Report may be published on the websites of the Companies and any other Phoenix Group Company and made available for inspection at the offices of the Companies’ solicitors. Otherwise, this Report (or any extract from it) should not be published without the prior written consent of Deloitte. A summary of the Report, approved by me, will be provided to the policyholders of the Companies with an interest in the Scheme. No other summary of this Report may be made without the prior written consent of Deloitte.
- 1.30. This Report has been prepared in accordance with agreed terms of reference and for a specific purpose. No liability will be accepted for the use of this Report for a purpose for which it was not intended or for the results of any misunderstandings by any user of this Report. No liability will be accepted under the terms of the Contracts (Rights of Third Parties) Act 1999.

2. Summary and Conclusions

Introduction

- 2.1. I have been appointed as the Independent Expert to provide a report to the High Court of Justice of England and Wales (the “Court”) on a proposed scheme (the “Scheme”) for the transfer of long-term insurance business from National Provident Life Limited (“NPLL”) and NPI Limited (“NPIL”) to Phoenix Life Limited (“PLL”).
- 2.2. As the Independent Expert, I have considered the effect which the proposed Scheme is expected to have on different groups of policyholders in NPIL, NPLL and PLL, and in particular whether or not there are likely to be any material adverse effects for policyholders. I have written this scheme report (my “Report”) setting out my views. Its purpose is to assist the Court in deciding whether or not to allow the Scheme to go ahead. I am independent of the companies involved in the Scheme, and my appointment has been approved by the FSA.
- 2.3. The Scheme is intended to be presented to the Court for sanction on 10 February 2012. If approved, it is expected to become operative on 27 February 2012 (the “Transfer Date”). However, the Scheme will have financial effect between the Companies as if it had taken place on 1 January 2012 (the “Effective Date”), including for accounting purposes and for determining the level of policyholder benefits.
- 2.4. This summary of my Report sets out my main considerations in respect of the different groups of policyholders affected by the Scheme, along with my views and conclusions.

Overview of the Scheme

- 2.5. If approved, the Scheme, together with corresponding local schemes in Jersey and Guernsey (the “Overseas Schemes”), will transfer designated groups of policies, assets and liabilities within NPLL and NPIL to PLL.
 - All policies, assets and liabilities of the NPIL long-term insurance fund will transfer to the non-profit fund of PLL, except as set out in paragraph 2.6 below;
 - A group of annuity policies in NPLL, which are reinsured to NPIL, will be transferred to the non-profit fund of PLL. The reinsurance of these policies will no longer be required following the implementation of the Scheme;
 - The assets and liabilities of the shareholder fund in NPIL will be transferred to the shareholder fund of PLL, with the exception of an amount that will be retained to cover the minimum capital resources requirement required under FSA rules. Following the de-authorisation of NPIL, these assets will be transferred to the PLL shareholder fund under the terms of the Scheme.
- 2.6. The NPI With-Profits Fund (“NPI WPF”) will be established as an additional with-profits sub-fund alongside the other existing sub-funds within the PLL long-term insurance fund to receive the unitised with-profits benefits attaching to policies transferring from NPIL. Accordingly, the assets held by NPIL in respect of these unitised with-profits benefits, and the liabilities associated with these assets, will be allocated to the NPI WPF.

Main Considerations

- 2.7. I have considered the likely impacts of the Scheme on the security of policyholder benefits, the reasonable benefit expectations of policyholders, service standards and governance arrangements.
- 2.8. I have considered the implications of the Scheme for the following groups of policyholders separately, as the impacts differ in each case:
- NPIL policyholders transferring to PLL (“Transferring NPIL Policyholders”);
 - NPLL policyholders transferring to PLL (“Transferring NPLL Policyholders”);
 - Existing policyholders in PLL (“Existing PLL Policyholders”); and
 - NPLL policyholders that remain in NPLL (“Non-Transferring NPLL Policyholders”).
- 2.9. The Transferring NPIL Policyholders and Transferring NPLL Policyholders together are referred to as the “Transferring Policyholders”, and their policies as “Transferring Policies”.

Security of Policyholder Benefits

Transferring Policyholders

- 2.10. Having regard to points (i) to (v) below, I am satisfied that the security of benefits for Transferring Policyholders is not likely to be materially adversely affected by the Scheme:
- (i) The level of financial strength in PLL, on the basis of financial information at 31 August 2011, is at least as strong as that in NPIL and NPLL.
 - (ii) The basis on which PLL manages its capital and risks, through the application of the PLL Capital Policy, which requires more capital to be held than the regulatory minimum and provides additional protection for policyholders, means that PLL is expected to be able to withstand a more severe level of stressed conditions than both NPIL and NPLL and still meet its regulatory capital requirements.
 - (iii) The nature of the risks to which PLL is exposed is unlikely to be sufficiently different from those in NPIL and NPLL such that the effect for Transferring Policyholders could be materially adverse. While there are some differences, including the exposure to a number of with-profits funds in PLL, I am satisfied that PLL has sufficient financial strength and maintains adequate capital margins in line with the PLL Capital Policy such that it can withstand a large range of adverse events (or combination of events) of a greater severity than would be expected to occur only once in every 200 years.
 - (iv) PLL is expected to be able to meet its regulatory capital requirements and maintain an additional capital margin in accordance with the PLL Capital Policy. This allows for current proposals which will impact its future corporate structure and composition of business, including new business plans and amendments to reinsurance arrangements.
 - (v) On the basis of my considerations, I am not aware of any proposals under Solvency II (the future regime that will govern UK life companies) that would result in any group of Transferring Policyholders being more adversely affected by Solvency II as a result of the Scheme having been implemented. I will revisit this in due course, if more details of Solvency II become known before the Transfer Date.

Existing PLL Policyholders

- 2.11. Having regard to points (i) to (v) below, I am satisfied that the security of benefits for Existing PLL Policyholders is not likely to be materially affected by the Scheme:
- (i) The level of financial strength in PLL, on the basis of financial information as at 31 August 2011, is at least as strong after the implementation of the Scheme as before.
 - (ii) The basis on which PLL proposes to manage its capital and risks in future is unaffected by the Scheme.
 - (iii) The capital needed to cover the additional risks associated with the Transferring Policies is covered by the surplus assets transferring from NPIL, and existing surplus assets in PLL.
 - (iv) The level of capital support for individual sub-funds in PLL is not expected to be materially diminished by the Scheme.
 - (v) On the basis of my considerations, I am not aware of any proposals under Solvency II that would result in any group of Existing PLL Policyholders being more adversely affected by Solvency II as a result of the Scheme having been implemented. I will revisit this in due course, if more details of Solvency II become known before the Transfer Date.

Non-Transferring NPLL Policyholders

- 2.12. The policies held by Non-Transferring NPLL Policyholders (“Non-Transferring NPLL Policies”) will remain in NPLL following the implementation of the Scheme. The impact on these policies of the Scheme is expected to be minimal, since the Transferring NPLL Policies are already fully reinsured to NPIL. Therefore, on a net of reinsurance basis, all assets, liabilities and business of the long-term insurance and shareholder funds of NPLL would be unaffected by the Scheme.
- 2.13. On the basis that NPLL is expected to be able to meet regulatory capital requirements and maintain additional capital margins in accordance with its capital policy following the implementation of the Scheme, I am satisfied that the Scheme is unlikely to have any impact on the benefit security of the Non-Transferring NPLL Policyholders.
- 2.14. I am also satisfied that the Scheme will not have any impact on the benefit expectations of Non-Transferring NPLL Policyholders.

Policyholder Benefit Expectations

- 2.15. I discuss separately the impact of the Scheme on the benefit expectations of the groups of policyholders identified below. Some Transferring NPIL Policyholders have policies with attaching unit-linked and unitised with-profits benefits or which contain the option to switch to or from unit-linked and unitised with-profits investments (“Hybrid Policies”). Hybrid Policies will fall into more than one group.
- Holders of Transferring Policies which are unit-linked policies (“Transferring Unit-Linked Policyholders”);
 - Holders of Transferring Policies with attaching with-profits benefits, or which are unitised with-profits policies (“Transferring With-Profits Policyholders”);
 - Holders of Transferring Policies which are non-profit policies (“Transferring Non-Profit Policyholders”);
 - Non-Transferring NPLL Policyholders; and
 - Existing PLL Policyholders.

Transferring Unit-Linked Policyholders

- 2.16. New unit-linked funds will be created in PLL corresponding to those currently in NPIL (such new funds being “Former NPIL Linked Funds”). The Former NPIL Linked Funds will receive the assets and associated liabilities of the corresponding unit-linked funds in NPIL at the Transfer Date and relevant transferring policies will be allocated the same number and value of units as were comprised in the corresponding unit-linked funds immediately prior to the Transfer Date. Premiums payable under the policies held by the Transferring Unit-Linked Policyholders (“Transferring Unit-Linked Policies”) will not change.
- 2.17. On the basis of the considerations set out in (i) to (vi) below, I am satisfied the Scheme is unlikely to have any material impact on benefit expectations of Transferring Unit-Linked Policyholders.
- (i) Policyholders’ immediate interests in the relevant funds will be preserved under the Scheme.
 - (ii) **Investment mandates.** The Former NPIL Linked Funds established in PLL will have the same underlying assets as the corresponding former unit-linked funds in NPIL. The investment strategies and permitted asset holdings of these unit-linked funds will be preserved.
 - (iii) **Charges.** Charges applicable to unit-linked policies will continue to be made in line with policy terms and conditions, which will be unchanged following implementation of the Scheme. A small number of policies with reviewable charges will transfer to PLL under the Scheme, for which there have been no reviews carried out in recent years and for which no established review methodology exists. In the event of a review, due to the small number of cases, it is likely that this business would be considered alongside other similar business in the Phoenix Group or alongside applicable data from the Continuous Mortality Investigation Bureau. This is unlikely to be influenced by the transfer of the business to PLL.
 - (iv) **Unit pricing.** The Former NPIL Linked Funds established in PLL will be priced on the same basis as the corresponding former unit-linked funds in NPIL.
 - (v) **Choice of funds.** Although the Scheme provides for the wind up, amalgamation and division of Former NPIL Linked Funds, the same range of funds available to Transferring Unit-Linked Policyholders prior to the Scheme will continue to be made available following the Scheme.
 - (vi) **Provisions of previous Court scheme.** As discussed in paragraphs 7.16 to 7.19, policyholders’ interests are not adversely affected by the Scheme preserving certain provisions set out in the NPIL 2006 Scheme (a previous scheme which transferred unit-linked business into NPIL in 2006).

Transferring With-Profits Policyholders

- 2.18. Prior to the Scheme, any unitised with-profits benefits attaching to policies held by Transferring With-Profits Policyholders (“Transferring With-Profits Policies”) are fully reinsured to the Pearl With-Profits Fund in Pearl. The Scheme will transfer the Transferring With-Profits Policies to the non-profit fund of PLL and the NPI WPF will be established to receive the unitised with-profits benefits attaching to Transferring With-Profits Policies. These benefits will, however, be fully reinsured from the NPI WPF to the Pearl With-Profits Fund in the same way as they are currently reinsured from the NPIL long-term insurance fund to the Pearl With-Profits Fund.
- 2.19. It is necessary to consider whether foreseeable circumstances might arise where the provisions of the Scheme could potentially act to the detriment of Transferring With-Profits Policyholders. On the basis of the considerations set out in (i) to (iv) below, I am satisfied that the Scheme is unlikely to have any material adverse impact on the benefit expectations of Transferring With-Profits Policyholders:
- (i) Key considerations relevant to Transferring With-Profits Policyholders will not change as a result of the Scheme, including the basis on which asset shares are determined, the current

level of asset shares and guaranteed benefits, surrender values, bonus rates, payout levels, investment strategy, charges, smoothing of payouts and the level of premiums payable.

- (ii) **Profit sharing and distribution of surplus.** The Scheme states that all of the surplus arising in the NPI WPF will be available for distribution to eligible policyholders of the fund over time. The timing of this will be at the discretion of the PLL Board in consultation with the PLL With-Profits Committee and relevant With-Profits Actuary. In exercising their discretion in relation to the NPI WPF, in particular regarding the distribution of any surplus, the PLL Board, the PLL With-Profits Committee and the relevant With-Profits Actuary will be required to have regard to the “established practices” of NPIL prior to the implementation of the Scheme.
- (iii) **Insufficient capital in the NPI WPF.** I have discussed with PLL and understand that it would be extremely unlikely for the NPI WPF to experience a capital shortfall while the reinsurance arrangement with Pearl remains in place. This is because all claims and liabilities, including expenses, relating to the reinsured benefits are paid by Pearl (with the exception of a small provision in relation to the switching rights of some policies, the cost of which will be borne by the non-profit fund of PLL following the implementation of the Scheme). The management of PLL consider it unlikely that the cost of any adverse regulatory or taxation changes, or any other miscellaneous liabilities, would be attributed to the NPI WPF while the reinsurance arrangement is in place, since the fund has no net liabilities or assets.
- (iv) **Wind up of the NPI WPF.** If the aggregate value of the statutory liabilities (before reinsurance) of the NPI WPF falls below £50m, the Scheme would require PLL to wind up the NPI WPF and convert the relevant remaining unitised with-profits benefits to non-profit fixed benefits. This provision will not apply for so long as substantially all of the liabilities of the NPI WPF are wholly reinsured. In the event of a wind up, the assets and liabilities of the NPI WPF would be transferred to the non-profit fund of PLL. The basis on which any such conversion is effected and the allocation of any surplus assets between policies would be determined by the PLL Board, having obtained appropriate actuarial advice. Any such wind up and conversion of benefits would require prior written approval from the FSA to ensure that affected policyholders are treated fairly.

Transferring Non-Profit Policyholders

- 2.20. The premiums and benefits payable under policies held by Transferring Non-Profit Policyholders (“Transferring Non-Profit Policies”) are fixed. Upon transfer of these policies to PLL, there will be no change other than that the ultimate obligation to pay benefits (and any right to receive premiums, if relevant) will reside with PLL rather than NPIL or NPLL. The terms and conditions of the Transferring Non-Profit Policies will not be changed by the Scheme. I am satisfied that the Scheme will not have any impact on the benefit expectations of Transferring Non-Profit Policyholders.

Existing PLL Policyholders

- 2.21. On the basis of the considerations set out in (i) and (ii) below, I consider that the Scheme is unlikely to have any material impact on the benefit expectations of Existing PLL Policyholders:
- (i) The Transferring Policies will all transfer to the non-profit fund of PLL, so there will be no transfer of policies, assets or liabilities into or out of any of the existing with-profits funds of PLL under the Scheme. There will be no change to the level of assets and asset mix backing existing PLL with-profits policies, to the premiums or expected benefit levels, or to any of the other terms and conditions of any policy in PLL. I note further that there should be no change in the level of expenses charged to the policies, allowing for both direct expenses and the sharing of overheads, or to the level of tax charged to the with-profits funds in PLL as a result of the Scheme. Considerable discretion can be applied in managing with-profits funds, but the existing governance arrangements will continue in force after the Scheme, and I am satisfied that there should be no material change to the future management of the with-profits funds as a result of the Scheme.

- (ii) The level of premiums and benefit expectations of existing PLL unit-linked policies will be unchanged, as there should be no changes to the value of any policy, the premiums or charges under any policy, the range of investment funds available, the tax payable under any policy, or to any of the other terms and conditions of any unit-linked policy. Similarly, there should be no change for existing non-profit policies in PLL.

Service Standards

- 2.22. All outsourcing arrangements for the administration of the policies held by Existing PLL Policyholders ("Existing PLL Policies") will be unchanged by the Scheme. Existing agreements for the administration of the Transferring Policies will be transferred to PLL under the terms of the Scheme but will otherwise be unchanged. The existing agreement for the administration of Non-Transferring NPLL Policies will remain unchanged by the Scheme.
- 2.23. Existing arrangements for investment management services provided to PLL will be unchanged as a result of the Scheme. Investment management arrangements for the Transferring Policies will transfer to PLL under the terms of the Scheme but will otherwise be unchanged. The investment management arrangements for the Non-Transferring NPLL Policies will remain unchanged.
- 2.24. Accordingly, I consider that there should be no impact on the quality or cost of administration or investment management services for Existing PLL Policyholders, Transferring Policyholders or Non-Transferring NPLL Policyholders.

Governance

Governance of with-profits business

- 2.25. Following the implementation of the Scheme, the Transferring With-Profits Policies will become subject to the governance provisions set out in the 2009 scheme which transferred the businesses of Scottish Mutual Assurance Limited and Scottish Provident Limited to PLL (the "2009 Scheme"). The PLL Board and the PLL With-Profits and SPI WPF Supervisory Committee (the "PLL With-Profits Committee") will assume the respective duties and responsibilities of the NPIL Board and the NPIL With-Profits Committee in relation to the Transferring With-Profits Policies, including ultimate responsibility for setting bonus levels. A With-Profits Actuary will be appointed to the NPI WPF. In exercising its function in relation to any with-profits fund, the PLL With-Profits Committee's terms of reference include a duty to act at all times in the best interests of the with-profits policyholders allocated or reinsured to the relevant fund.
- 2.26. Arrangements for the governance of Existing PLL Policies will not be affected by the Scheme, other than to recognise the establishment of the NPI WPF.
- 2.27. I am satisfied that the Scheme should not impact the quality of with-profits governance arrangements in PLL. In relation to the Transferring With-Profits Policyholders, I am satisfied that those arrangements represent a level of governance quality which is at least as strong as the current arrangements in NPIL.

Governance of non-profit and unit-linked business

- 2.28. The 2009 Scheme includes a requirement for the PLL With-Profits Committee to consider all proposals relating to the exercise of discretion in respect of non-profit policies and PLL's approach to treating customers fairly. This duty is included in the committee's terms of reference and extends to unit-linked policies. Following the Scheme, the Transferring Non-Profit Policies and Transferring Unit-Linked Policies will be covered by this duty. For those policies with reviewable premiums and discretionary charges, this will continue to represent a strong level of governance.

Conclusions

- 2.29. I am satisfied that all groups of policyholders in PLL, NPIL and NPLL will experience no material change to their benefit expectations as a result of the proposed Scheme.

- 2.30. With regard to security of benefits, all groups of policyholders should benefit from solvency coverage that will be maintained at a level well in excess of that required by UK regulations, and I do not consider that the Scheme will materially disadvantage the security of benefits for any group of policyholders.
- 2.31. All of my conclusions take into account the effect of the Overseas Schemes, and apply equally to policyholders in Jersey and Guernsey as they do to policyholders in the UK.

3. Outline of the Scheme

Overview

- 3.1. The broad effect of the Scheme will be to transfer designated blocks of long-term insurance business and assets of NPIL and NPLL to PLL, without affecting the policy benefits or substantially changing how the policies are managed.
- 3.2. The Scheme will establish a new with-profits sub-fund in PLL but this is primarily for operational reasons, rather than to change how any of the policies are managed or the benefits that are due.
- 3.3. The NPIL 2006 Scheme (described in paragraph 3.24 below) will cease to apply following the Scheme. The Scheme will preserve a number of provisions of the NPIL 2006 Scheme relating to the maintenance of unit-linked funds, as described in paragraphs 3.23 to 3.27.
- 3.4. I include in the remainder of this section a more detailed outline of the Scheme, its purpose and its key features.

Purpose of the Scheme

- 3.5. The purpose of the Scheme is to transfer designated blocks of long-term insurance business and assets of NPIL and NPLL to PLL. It is intended to take place as part of the Phoenix Group's programme to improve capital efficiency. This is important in the context of new regulatory developments, in particular Solvency II, which seem likely to increase regulatory capital requirements across the insurance industry.
- 3.6. There are likely to be small expense savings arising from the implementation of the Scheme, as it will reduce the Phoenix Group's ongoing overhead costs. I understand that there will also be tax benefits associated with the Scheme.

Background on the Companies

- 3.7. The Companies are all wholly owned indirect subsidiaries of Phoenix Group Holdings, which is the ultimate parent company of the Phoenix Group. Details of the structure and business of the Phoenix Group, PLL, NPLL and NPIL can be found in Appendices 2 to 5.

Summary of the Scheme

Policies Transferring

- 3.8. The Scheme, together with the Overseas Schemes, will transfer the following policies in NPLL and NPIL (the "Transferring Policies") to PLL:
 - All policies in the NPIL long-term insurance fund will be transferred to the non-profit fund of PLL (the "PLL NPF");
 - A group of annuity policies in NPLL which are currently reinsured to NPIL (the "Transferring NPLL Policies") will be transferred to the PLL NPF.
- 3.9. NPIL policies transferring to PLL under the Scheme (the "Transferring NPIL Policies") comprise a range of non-profit policies and policies with attaching unit-linked and unitised with-profits benefits (including Hybrid Policies with the right to invest in both unit-linked and unitised with-profits benefits). Prior to the Scheme, the policies in NPIL with attaching unitised with-profits benefits have those benefits fully reinsured to Pearl. This reinsurance arrangement will remain in place following the Scheme, i.e. from PLL to Pearl.

- 3.10. All inwards reinsurance arrangements of long-term insurance business into NPIL will be transferred to PLL under the Scheme and any related obligations will be assumed by the PLL NPF.
- 3.11. The Scheme provides for Transferring Policies which cannot be transferred at the Transfer Date to be excluded from the Scheme (“Excluded Policies”). This could be as a result of an outstanding sanction from another court (for example, in Jersey or Guernsey), an outstanding certificate to permit the transfer (for example, in the case of policies written in an EEA country outside the UK), or for another reason. All Excluded Policies will be fully reinsured to PLL until such time as their transfer can subsequently be effected on terms set out in the Scheme.
- 3.12. The diagram below summarises the long-term insurance business to be transferred under the Scheme and the allocation of unitised with-profits benefits to the NPI WPF that will be established.

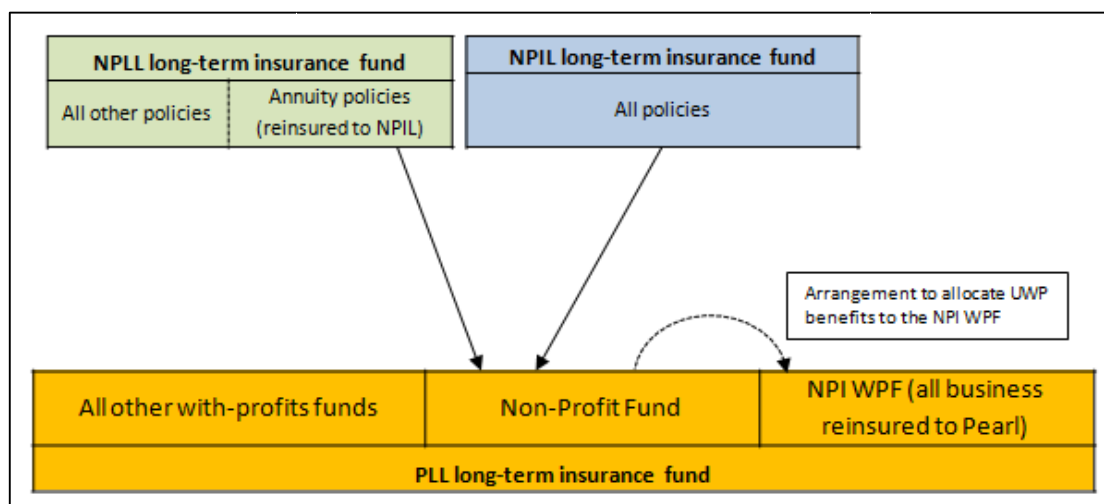


Figure 3.1: Policies transferring under the Scheme

Assets and Liabilities Transferring

- 3.13. The Scheme will transfer all assets and liabilities relating to the Transferring Policies to the PLL NPF, including all assets and liabilities relating to inwards reinsurance arrangements of long-term insurance business into NPIL, except as set out in paragraph 3.14 below.
- 3.14. The assets held by NPIL in respect of unitised with-profits benefits (together with the liabilities associated with these assets) will be allocated to the NPI WPF. In practice, these assets and liabilities predominantly amount to rights and obligations under the reinsurance agreement with Pearl described in paragraph 3.9 above.
- 3.15. The assets and liabilities of the shareholder fund of NPIL will be transferred to the shareholder fund of PLL, except for any assets required to meet NPIL’s ongoing capital resources requirement following the Scheme. Any assets held for this purpose, together with investment income and any associated tax liability, will be transferred to the shareholder fund of PLL following the de-authorisation of NPIL by the FSA under the terms of the Scheme.

Reinsurance Arrangements

- 3.16. Significant outwards reinsurance arrangements from NPIL which will carry over to PLL under the Scheme are described below. Appendix 11 gives a full list of these arrangements, and the cross-references here refer to the list in Appendix 11:
- The outwards reinsurance to Pearl of the annuity policies and personal pension guarantees attaching to policies previously sold by Pearl Assurance (Unit Linked Pensions) Limited (“PAULP”) (INT12);

- The outwards reinsurance to Pearl of pensions mis-selling liabilities arising from policies previously sold by PAULP (OTHER);
 - The outwards reinsurance to Pearl of all unitised with-profits benefits attaching to policies in NPIL (with the exception of a small provision in relation to the switching rights of some policies) (INT01, INT02, INT03 and INT04);
 - The outwards reinsurance to Pearl of temporary assurance rider benefits previously sold by Pearl Assurance (Unit Funds) Limited (“PAUF”) (INT11);
 - The outwards reinsurance to Opal Reassurance Limited (“Opal Re”) of a group of pension annuity policies written in NPIL, and other such policies reinsured into NPIL (INT17);
 - The outwards reinsurance to London Life Limited (“LL”) of certain non unit-linked benefits attaching to (former London Life Linked Assurances Limited (“LLLA”)) unit-linked policies in NPIL (INT16).
- 3.17. Significant inwards reinsurance arrangements into NPIL, which will carry over to PLL under the Scheme, are described below:
- The inwards reinsurance of all new policies and increments written in NPLL since 1 January 2000, with the exception of conventional with-profits business. The Transferring NPLL Policies are included in the scope of this arrangement (INT06 and INT09);
 - The inwards reinsurance on an investment-only basis of unit-linked holdings of policies written in NPLL prior to 1 January 2000 (INT07);
 - The inwards reinsurance from LL of unit-linked funds previously sold by LLLA on an investment-only basis (INT15);
 - The inwards reinsurance from Pearl of unit-linked funds previously sold by PAUF on an investment-only basis (INT10).
- 3.18. The reinsurance arrangements of NPIL set out in paragraphs 3.16 and 3.17 will carry over to PLL without any material changes. The aim is simply to ensure that equivalent arrangements are maintained in PLL. However I note that:
- The inwards reinsurance of Transferring NPLL Policies to NPIL will no longer be required as the Scheme will transfer the relevant policies to the PLL NPF. There is no change to the terms of those policies. The relevant treaty itself, under which new (vesting) annuities arising in NPLL are reinsured to NPIL, will be amended such that future vesting annuities will be reinsured to the non-profit fund of Pearl. This amendment does not constitute part of the Scheme;
 - The treaty under which new (vesting) annuities arising from long-term insurance business previously written in PAULP are reinsured to Pearl will be amended such that future vesting annuities will be written in the non-profit fund of PLL and will not be reinsured to Pearl. The outwards reinsurance to Pearl of personal pension guaranteed annuity options previously sold in PAULP will continue.
- 3.19. Other than removal of the arrangement for the reinsurance of annuity policies between NPLL and NPIL and the amendment such that new vesting annuities are written in the Pearl NPF, the existing reinsurance arrangements in NPLL will be unaffected by the Scheme.
- 3.20. Existing reinsurance arrangements in PLL will be unaffected by the Scheme.

Company and Fund Structure

- 3.21. The NPI WPF will be established as an additional with-profits sub-fund alongside the other existing sub-funds within the PLL long-term insurance fund and will be liable for the unitised with-profits

benefits attaching to Transferring With-Profits Policies. This is largely to simplify administration and governance of the respective benefits. There will be no economic effect since PLL will maintain outwards reinsurance of the benefits to Pearl on the same terms as those currently in place.

Management of the NPI WPF

- 3.22. The Scheme requires that the NPI WPF will be maintained in a similar manner to other with-profits funds in PLL and will be subject to the following provisions arising as a result of the 2009 Scheme:
- (i) **Profit sharing.** The Scheme states that all of the surplus arising in the NPI WPF will be available for distribution to eligible policyholders of the fund over time. The timing of this will be at the discretion of the PLL Board in consultation with the PLL With-Profits Committee and relevant With-Profits Actuary.
 - (ii) **Distributions of surplus.** In exercising their discretion in relation to the NPI WPF, in particular regarding the distribution of any surplus, the PLL Board, the PLL With-Profits Committee and the relevant With-Profits Actuary will be required to have regard to the “established practices” of NPIL prior to the implementation of the Scheme.
 - (iii) **Application of the PLL Capital Policy.** The provisions of the PLL Capital Policy will be extended to cover the NPI WPF. Accordingly, the NPI WPF will be required to have sufficient assets to satisfy regulatory minimum capital requirements plus 0.5% of its With-Profits Benefit Reserve (as defined in the 2009 Scheme), although the terms of the PLL Capital Policy will be modified in relation to the NPI WPF by removing the requirement to hold a minimum of £5m in assets over and above the regulatory minimum amount required to support its liabilities for so long as substantially all of the liabilities of the NPI WPF are wholly reinsured. In the event the fund is unable to satisfy its own regulatory capital requirements then the PLL With-Profits Committee can recommend that the PLL Board makes support available or otherwise take actions in the fund to restore the position.
 - (iv) **Wind up of the NPI WPF.** If the aggregate value of statutory liabilities of the NPI WPF (before reinsurance) falls below £50m, the Scheme would require PLL to wind up the NPI WPF and convert the relevant remaining unitised with-profits benefits to non-profit fixed benefits. This provision will not apply for so long as substantially all of the liabilities of the NPI WPF are wholly reinsured. As at 31 December 2010, £173m of unitised with-profits benefits were reinsured from NPIL to the Pearl With-Profits Fund. In the event of a wind up, the basis on which any such conversion is effected and the allocation of any surplus assets between policies would be determined by the PLL Board, having obtained appropriate actuarial advice. Any such wind up and conversion of benefits would require prior written approval from the FSA to ensure that affected policyholders are treated fairly.
 - (v) **Tax.** The NPI WPF will be charged tax as if it were a separate mutual life insurer. Whilst the reinsurance arrangement with Pearl remains in place, it is unlikely that any tax charge will be allocated to the NPI WPF.

Management of Unit-Linked Funds

- 3.23. New unit-linked funds will be created in PLL corresponding to those currently in NPIL (such new unit-linked funds being “Former NPIL Linked Funds”). The Former NPIL Linked Funds will receive the assets of the corresponding unit-linked funds in NPIL at the Transfer Date and relevant Transferring Policies will be allocated the same number and value of units as were comprised in the corresponding unit-linked funds immediately prior to the Transfer Date.
- 3.24. In 2006, a scheme was sanctioned which transferred the long-term insurance businesses of PAUF, PAULP and LLLA to NPIL (the “NPIL 2006 Scheme”). The NPIL 2006 Scheme will be disappplied from the Transfer Date. In order to preserve the provisions granted to NPIL under the NPIL 2006 Scheme (i.e. so there is no material change for policyholders), the Scheme will allow PLL to carry out any combination of the following actions:

- (i) Merger of Former NPIL Linked Funds or any part thereof with any other unit-linked funds in PLL.
- (ii) Wind up of Former NPIL Linked Funds (subject to meeting the requirements in paragraph 3.25 below).
- (iii) Division of any Former NPIL Linked Fund into one or more unit-linked funds.
- (iv) Amendments to the name or designation of any Former NPIL Linked Fund.
- (v) Modification of the investment objectives of any Former NPIL Linked Fund.

Any such action by the PLL Board would need to be on terms which the PLL Board considered equitable as between the affected policyholders and would be subject to the advice of the Actuarial Function Holder of PLL. In the event that any such proposed action would be precluded by the terms of the relevant policies, PLL would be required to obtain permission from the Court and notify affected policyholders of its intention to do so.

- 3.25. The Scheme will allow PLL to wind up Former NPIL Linked Funds where the value of assets falls below a specified threshold (being £5m, increasing annually based on the Retail Prices Index from 31 December 2006) or such other amount below which the PLL Board, on the advice of the Actuarial Function Holder, considers the maintenance of the relevant unit-linked fund to be no longer administratively feasible. NPIL was previously permitted to wind up unit-linked funds covered by the NPIL 2006 Scheme, however there were no wind up thresholds or guidelines specified around the circumstances where it was appropriate to do so. Following the Transfer Date, should a Former NPIL Linked Fund be wound up, each affected policyholder would be allocated units of an equal value in a substitute unit-linked fund which, in the opinion of the PLL Board, having regard to the advice of the Actuarial Function Holder, provided reasonably equivalent investment exposure to the Former NPIL Linked Fund being wound up.
- 3.26. The Scheme will preserve the provisions of the NPIL 2006 Scheme which permitted unit-linked policies transferred under that scheme to switch only between unit-linked funds transferred under that scheme, and unit-linked policies written in NPIL prior to 1 October 2006 to switch only between unit-linked funds maintained by NPIL prior to 1 October 2006. Equivalent limitations in investment choice will continue to apply to Transferring Policies with attaching unit-linked benefits in PLL.
- 3.27. Any policyholder affected by the application of any actions outlined in paragraphs 3.24 or 3.25 above will be entitled to switch to one or more other eligible unit-linked funds to which their policy is linked, even if such a switch was not permitted under their policy terms, without incurring a switching charge, provided the switch is effected within 12 months of the relevant change occurring.
- 3.28. The NPIL 2006 Scheme included a requirement that any amendments to it must be accompanied by a certificate from an Independent Expert to the effect that in his opinion the proposed amendment will not materially adversely affect the security of any relevant policyholder. In my role as Independent Expert for the Scheme I have also been asked to provide an opinion on the amendments to the NPIL 2006 Scheme and this is provided in Appendix 13 of this Report.

Costs of the Scheme

- 3.29. The costs incurred in connection with the preparation and implementation of the Scheme will be borne by the PLL shareholder fund. None of the costs will be borne by the long-term insurance funds of the Companies.

4. The Role of the Independent Expert

Overview

- 4.1. The Independent Expert is asked to prepare a scheme report in a form approved by the FSA and in accordance with the guidance contained in SUP 18. The purpose of this scheme report is to assist the Court in deciding whether to sanction the Scheme.
- 4.2. As Independent Expert, I need to consider the effect that the Scheme may have on the various classes of policyholders in the Companies which are affected by the Scheme. In doing so, I consider separately:
 - Transferring Policyholders, which in the case of the Scheme are the holders of designated policies in NPIL and NPLL;
 - Policyholders of NPLL whose contracts will not be transferring under the Scheme; and
 - Policyholders of the transferee company, which is PLL.
- 4.3. For any group of policyholders, there may be some changes for the better and some for the worse. If there are some changes for the worse this does not necessarily mean that the Scheme is unfair or unreasonable, as they might be outweighed by other benefits, or they might be extremely small. The test I have applied is whether the position of any group is, in the round, “materially adversely affected” – this phrase is used in the context of considering policyholder security in SUP 18.2 of the FSA Handbook. The word “material” is not defined, 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.
- 4.4. In considering the effect of the Scheme on any group of policyholders, I have reviewed in particular the likely impact on:
 - The security of policyholders’ benefits;
 - Policyholders’ benefit expectations, particularly for policies where benefits are significantly dependent on the exercise of discretion, any tax effects and any options available under a policy;
 - For unit-linked policies, the approach to unit pricing and any changes to the investment fund mandates or choice of funds; and
 - Service levels.
- 4.5. The effect of the Scheme on policyholders will depend on the type of policy held. For non-profit policies which provide guaranteed benefits in return for fixed premiums, security of future benefits is of paramount importance. I therefore need to consider whether the Scheme is likely to materially adversely affect the security of benefits for these policies. For policies which include discretionary benefits, such as with-profits policies, I need to consider the implications of the Scheme for reasonable benefit expectations as well as the security of benefits.
- 4.6. Some policies have other discretionary elements, such as the level of charges on unit-linked policies or policies with reviewable premiums. For these policies, I need to consider whether, as a result of the Scheme, adequate protections are in place in relation to the future exercise of discretion for charges and premium reviews.

- 4.7. In my role as the Independent Expert I am not required to consider the possible effects on new policyholders entering into contracts after the Transfer Date, and I do not do so in this Report.
- 4.8. Except where I have commented on the forthcoming Solvency II regime, all of my considerations are made in the context of the current UK regulatory regime for life insurance companies.
- 4.9. I have considered the Scheme only in the form in which it is to be presented to the Court. I am not required to, and do not, consider any possible alternative schemes or arrangements.

5. Solvency and Capital Support

Introduction

- 5.1. In this section, I explain the capital requirements that the Companies must satisfy and set out some key information on how the Scheme is expected to affect the solvency position of the Companies.
- 5.2. As Independent Expert, I am required to consider the effect of the Scheme on the security of benefits of Existing PLL Policyholders, Transferring Policyholders and Non-Transferring NPLL Policyholders. This analysis depends heavily on the level of capital support available to the different entities and the impact of the Scheme on the ability of PLL to satisfy its solvency requirements in the future, both of which I discuss in this section of the Report. My conclusions in respect of the different groups of policyholders in turn are set out in sections 6 to 8.

Current Supervisory Regime

- 5.3. The FSA is responsible, amongst other things, for the supervision of UK authorised insurance companies. The main aim of the FSA's supervisory regime is to ensure that, as far as possible, insurance companies remain solvent and will be able to meet policy claims and fulfil the benefit expectations of their policyholders. Since life insurance business can be very long term, with some contracts lasting for 30 years or more, it is necessary to set solvency standards and monitor insurance companies against those standards. No supervisory regime can ensure that every company will remain solvent in all possible circumstances, but a good one will ensure that the chance of an insurance company becoming insolvent is remote. Furthermore, a good regime acts as an early warning system, permitting remedial action to be taken if a company starts getting into financial difficulty.
- 5.4. The current regulatory capital requirements for a UK life insurer are based on satisfying at all times two minimum standards, referred to as Pillar 1 and Pillar 2. Companies are required to ensure that they have adequate capital to meet these requirements at all times during the year, and are not permitted to pay dividends if such payment would cause these requirements to be breached.
- 5.5. The Pillar 1 calculations are split into two parts, known as "peaks". Under Peak 1 of Pillar 1, admissible assets are taken at market value and reserves are set up to cover a fund's liabilities. These liabilities exclude non-guaranteed discretionary payments and are valued using assumptions that include prudent margins. Additional solvency capital, expressed as a percentage of reserves and of sums at risk, is required in addition to the base reserves. This calculation is commonly referred to as the "regulatory peak".
- 5.6. Companies such as PLL and NPLL which have a with-profits fund in excess of £500m are also required by UK regulations to report under Pillar 1 on a realistic, market consistent, basis. In this second calculation, assets are again taken at market value, while liabilities include allowance for any non-guaranteed benefits that are expected to be paid. The liabilities are valued using best estimate assumptions. A Risk Capital Margin ("RCM") is held in addition to the realistic liabilities, reflecting the additional capital that would be needed in moderately adverse scenarios specified in FSA rules. These calculations are referred to as the "realistic peak", or Peak 2 of Pillar 1. If the excess assets after the RCM are less than the excess assets under the regulatory peak, then an addition, called the With-Profits Insurance Capital Component ("WPICC"), is made to the regulatory peak capital requirements equal to the difference. This ensures that the more onerous requirement of the two peaks is met under Pillar 1.
- 5.7. Pillar 2 requires that each UK insurance company undertakes its own Individual Capital Assessment ("ICA"). The ICA is based on an analysis of the various risks affecting the company (including market, credit, insurance, operational and liquidity risk), the results of various stress and scenario tests, and an overall assessment of the amount and type of capital required to meet those risks. Companies can set their own risk tolerance which must be based on a confidence level at least as high as the FSA's minimum standard of a 99.5% solvency confidence level over one year. The FSA may issue Individual Capital Guidance ("ICG") if it feels that the ICA is insufficient to meet

the minimum 99.5% confidence level. This may occur, for example, if the FSA is not satisfied with the severity of the stress scenarios used by the company, or if it is not satisfied that the company has fully taken into account all of its risks. This effectively means that a company with sufficient capital to meet the higher of its ICA and ICA plus ICG capital add-on should (at least) be able to withstand an event or combination of events of a severity expected to occur only once every two hundred years and still be able to meet its best estimate liabilities.

- 5.8. Companies are required to publish their Pillar 1 calculations each year and these are externally audited. Pillar 2 figures are not published or audited and are commercially sensitive; however, the Companies have made their Pillar 2 figures available to me in my role as Independent Expert for the Scheme. I have reviewed the Companies' estimated Pillar 1 and Pillar 2 figures pre and post-scheme to assess the impact on security of policyholders' benefits. Although the Pillar 2 calculations are not shown in my Report, I have included a qualitative summary of the relevant findings emerging from these figures.
- 5.9. As explained in paragraph 1.20, the calculations use year-end 2010 figures as a base and are "rolled forward" from that point to allow for significant events that have occurred since, or that are expected to occur prior to the Effective Date. My main concern here is to consider the impact of the Scheme on the Pillar 2 solvency position. Differences in the base position do not necessarily affect that to a material extent, although there could be some minor consequential impacts, especially if there are any changes in assumptions or methodology. I will review the updated Pillar 2 calculations and assumptions for reasonableness, and will comment on any material changes in a Supplementary Report to the Court as necessary.
- 5.10. Companies will usually choose to hold a level of capital in excess of the capital requirements determined under the above Pillar 1 and Pillar 2 assessments, if only because they will want to ensure that they can continue to meet their solvency requirements in adverse conditions, or in order to satisfy rating agency requirements or their own internal capital standards. The level of capital that a company wishes to hold is often set out in an internal capital policy. The internal capital policies of PLL, NPLL and NPIL are explained later in this section.

Solvency II

- 5.11. The regulatory capital regime for insurers is due to be superseded by a new European Directive, referred to as Solvency II, which is expected to come into force on 1 January 2013 (although it seems likely that aspects of its implementation will be delayed until 2014). The Framework Directive for Solvency II has been issued by the European Parliament and Council of the European Union. Implementing measures, which will govern the basis on which regulatory capital adequacy is assessed, are now being drafted but the precise rules and transitional arrangements from the current regime are unlikely to be known until 2012.
- 5.12. During autumn 2010 the insurance industry was invited to participate in an exercise referred to as the fifth Quantitative Impact Study ("QIS5"), which sought to estimate the possible impact of various proposed capital adequacy measures under Solvency II. Until further guidance is issued by the European Insurance and Occupational Pensions Authority, or until the rules and transitional arrangements are finalised, the QIS5 measures will continue to represent the industry's best benchmark for assessing the potential impact of Solvency II on capital adequacy. The Phoenix Group elected to participate in the QIS5 exercise and I have seen its summary outputs.
- 5.13. While the precise impact of Solvency II on the Companies is uncertain, the new Directive will impact their business whether or not the Scheme proceeds. Having enquired of the Companies, I am not aware of any proposals under Solvency II that would result in the effect of the Scheme for any group of policyholders on the (currently expected) Solvency II basis being materially different from the effect of the Scheme under the current FSA regulatory system. I will revisit this in due course, if more details of Solvency II become known before the Transfer Date.

The Existing PLL Capital Policy and Support Arrangements

- 5.14. The 2009 Scheme provided for PLL to adopt a particular internal capital policy (the “PLL Capital Policy”). Adherence to the PLL Capital Policy results in PLL holding more capital than the regulatory minimum amounts required by the FSA under Pillar 1 and Pillar 2, providing additional policyholder security. The aim of the PLL Capital Policy is to enable PLL to continue to meet the regulatory minimum capital requirements in internally specified stressed economic and operating conditions.
- 5.15. The application of the PLL Capital Policy comprises four tests, three of which are expressed in terms of various percentages applied to the components of the Pillar 1 and Pillar 2 minimum capital requirements. Under the PLL Capital Policy, PLL will hold an amount of capital not less than that dictated by the most onerous of the four tests. If the available capital is less than that amount and the deficit is not expected to be removed within four months through the normal release of capital from the run-off of the business, corrective action will be considered. If there is a deficit that is considered to be immaterial relative to the PLL Capital Policy and would be expected to be recovered within the four month period, then no action is taken other than that no capital can be released, for example, through the payment of dividends.
- 5.16. The percentages above minimum capital requirements required by the PLL Capital Policy are regularly reviewed against the internally specified stress scenarios as conditions change in order that the PLL Capital Policy continues to meet its underlying objective. As a result, the percentages may change from time to time without changing the strength of the policy, which is based on the scenarios tested.
- 5.17. As at September 2010, the most recent date at which the parameters of the PLL Capital Policy were determined, the tests were:

(i) Test 1: (Based on the FSA’s Pillar 1 test)

The required capital is the sum of:

- In respect of each with-profits fund, the proportion of the Capital Resources Requirement (“CRR”) attributable to that fund, plus an amount equal to the greater of (i) the value of any positive free assets and (ii) 150% of the proportion of the Long-Term Insurance Capital Requirement (“LTICR”) attributable to that fund less its WPICC; and
- In respect of the PLL NPF, 125% of its CRR, plus 125% of the CRR of NPIL and Scottish Mutual Investment Limited (the regulated subsidiaries of PLL), less 100% of the sum of any positive free assets for each with-profits fund, a negative overall result being permitted for the PLL NPF.

(ii) Test 2: (Based on the FSA’s Pillar 2 test, excluding any ICG add-on)

The required capital is sum of:

- In respect of each with-profits fund, 138% of its ICA, subject to a minimum of the ICA plus 1% of the With-Profits Benefit Reserve (“WPBR”); and
- In respect of the PLL NPF, 138% of its ICA.

(iii) Test 3: (Based on the FSA’s Pillar 2 test including any ICG add-on)

The required capital is sum of:

- In respect of each with-profits fund, 110% of its ICA plus 110% of any additional capital which the FSA indicates via ICG add-on should be held; and
- In respect of the PLL NPF, 110% of its ICA plus 110% of any additional capital which the FSA indicates via ICG add-on should be held.

(iv) Test 4: (Liquidity test)

The objective of this test is to ensure that the PLL NPF and PLL shareholder fund jointly have:

- Sufficient admissible assets to meet the Pillar 1 liabilities of these funds;
- Sufficient liquid assets to meet any immediate demands from the with-profits funds for support in accordance with the PLL Capital Policy (actual capital injections to meet either regulatory or realistic liabilities). Liquid assets in this context means assets capable of being transferred from the PLL NPF or PLL shareholder fund to the with-profits fund and so will not include, for example, the value of future transfers from the with-profits funds;
- Plus an additional amount to be determined by the PLL Board at least once per annum, see part (vi) below.

(v) When calculating whether the total capital available in PLL satisfies Tests 1, 2 and 3, any excess capital in a with-profits fund over the calculated minimum capital for that fund will not be taken into account.

(vi) The “additional amount” referred to in Test 4 above will be derived by considering the ability of the PLL NPF and the PLL shareholder fund to meet the same test (excluding the additional amount) in the same range of stresses as is used to derive the Pillar 1 capital policy parameters. The additional amount is currently £100m.

5.18. The PLL Board may amend the PLL Capital Policy if the FSA’s rules governing the calculation of the Pillar 1 or Pillar 2 capital requirements, the LTICR, the WPICC or the ICA or any other component in the calculation of the PLL Capital Policy change materially, subject to the amended policy continuing to be such as to ensure that PLL can meet its Pillar 1 and Pillar 2 capital requirements in internally specified stress scenarios.

5.19. In addition, members of the Phoenix Group and PLL have agreed with the FSA that until 31 December 2016, PLL will obtain the FSA’s prior written approval to any change to the first three tests above that would reduce the amount of capital required to be held by PLL.

5.20. The Phoenix Group has also agreed with the FSA for the same period, unless otherwise agreed by the FSA, to maintain an additional amount of £100m liquid assets within the group to support PLL, its subsidiaries and Phoenix Group Management Services Limited (“PGMS”), although that capital is not specifically earmarked for PLL. No account or reliance is placed on this potential additional capital in setting the parameters of the PLL Capital Policy, or when assessing whether the PLL Capital Policy is satisfied.

5.21. In addition to the provisions outlined in paragraphs 5.14 to 5.17, if the value of the assets of any with-profits fund falls below the regulatory minimum amount required to support its liabilities plus 0.5% of the WPBR (or £5m if greater), support will be provided to that fund, as described in Appendix 10.

The Existing NPIL Capital Policy and Support Arrangements

5.22. NPIL also maintains an internal capital policy (the “NPIL Capital Policy”) which requires more capital to be available in NPIL than is required by the FSA under Pillar 1 and Pillar 2, providing additional policyholder security.

5.23. The policy involves two tests and NPIL must hold at least the amount of capital indicated by the most onerous of these tests:

(i) Test 1: (Based on the FSA's Pillar 1 test)

The required capital is the capital needed to cover the Pillar 1 capital requirements plus £11 million.

(ii) Test 2: (Based on the FSA's Pillar 2 test, including any ICG add-on)

The required capital is the capital needed to cover the Pillar 2 capital requirements, including any additional capital which the FSA indicates via ICG add-on should be held, plus £18 million.

- 5.24. Members of the Phoenix Group and NPIL have agreed with the FSA that until 31 December 2016, NPIL will obtain the FSA's prior written approval to any change to its capital policy which it proposes to make that would have the effect of reducing the amount of capital required to be held.
- 5.25. In addition, the £100m in liquid assets discussed in paragraph 5.20 above is available to support NPIL, together with PLL, its other subsidiaries and PGMS, although that capital is not specifically earmarked for NPIL. No account or reliance is placed on this potential additional capital in setting the parameters of the NPIL Capital Policy or when assessing whether it is satisfied.

The Existing NPLL Capital Policy and Support Arrangements

- 5.26. NPLL maintains an internal capital policy (the "NPLL Capital Policy") which requires more capital to be available in NPLL than is required by the FSA under Pillar 1 and Pillar 2, providing additional policyholder security.
- 5.27. The policy involves two tests and NPLL must hold at least the amount of capital indicated by the most onerous of these tests:

(i) Test 1: (Based on the FSA's Pillar 1 test)

The required capital is the capital needed to cover the Pillar 1 capital requirements plus £44 million.

(ii) Test 2: (Based on the FSA's Pillar 2 test, including any ICG add-on)

The required capital is the capital needed to cover the Pillar 2 capital requirements, including any additional capital which the FSA indicates via ICG add-on should be held, plus £52 million.

- 5.28. Members of the Phoenix Group and NPLL have agreed with the FSA that until 31 December 2016, NPLL will obtain the FSA's prior written approval to any change to its capital policy which it proposes to make that would have the effect of reducing the amount of capital required to be held.
- 5.29. Members of the Phoenix Group have also agreed with the FSA for the same period and unless otherwise agreed by the FSA to maintain an additional amount of £50m liquid assets within the group to support Pearl, LL and NPLL, although that capital is not specifically earmarked for NPLL. No account or reliance is placed on this potential additional capital in setting the parameters of the NPLL Capital Policy or when assessing whether it is satisfied.

Future Operation of the PLL Capital Policy and Support Arrangements

- 5.30. The PLL Capital Policy will remain in force following the Scheme and its terms and conditions will be unchanged.
- 5.31. As described in paragraph 5.19, the FSA would be required to formally approve any future changes to the PLL Capital Policy and this would include any changes resulting from Solvency II, to the extent that these pre-dated 31 December 2016.

Future Operation of the NPIL Capital Policy and Support Arrangements

- 5.32. The Scheme will result in the long-term insurance business transferred from NPIL becoming subject to the capital support arrangements set out in the PLL Capital Policy rather than the existing NPIL Capital Policy. Following implementation of the Scheme, the NPI WPF will receive support as required from the PLL NPF or PLL shareholder fund and the long-term insurance business transferred to the PLL NPF will receive support from the PLL shareholder fund if required.
- 5.33. Following the implementation of the Scheme and the Overseas Schemes, the NPIL Capital Policy will be rendered redundant as there will be no long-term insurance business remaining in NPIL.

Future Operation of the NPLL Capital Policy and Support Arrangements

- 5.34. The Scheme will result in the long-term insurance business transferred from NPLL becoming subject to the capital support arrangements set out in the PLL Capital Policy rather than the existing NPLL Capital Policy. Following implementation of the Scheme, the long-term insurance business transferred from NPLL to the PLL NPF will receive support from the PLL shareholder fund if required.
- 5.35. The NPLL Capital Policy will continue to apply in respect of Non-Transferring NPLL Policyholders.

Estimated Impact of the Scheme on Solvency / Capital Support

- 5.36. The estimated impact of the Scheme on the Pillar 1 and Pillar 2 solvency positions of PLL, NPLL and NPIL has been determined with reference to conditions at 31 August 2011. The Pillar 1 and Pillar 2 solvency positions at this date have been estimated by rolling forward the solvency position at 31 December 2010 to allow for the changes in underlying economic conditions over the period to 31 August 2011. The figures have been adjusted to allow for significant known or expected changes prior to the implementation of the Scheme.
- 5.37. The process used to adjust the 31 December 2010 position involves approximations and would likely produce different results than those obtained from a full valuation process carried out at 31 August 2011. I also recognise that the economic position at the time of the Scheme cannot be predicted with certainty, so the absolute solvency level may differ from that shown in the Report. However, as I described in paragraph 5.9, my considerations mainly concern the impact of the Scheme on the financial position of the Companies, and differences in the base position do not necessarily affect that to a material extent. I am satisfied that the degree of potential mis-estimation is sufficiently small in proportion to the overall capital established by the regulatory capital requirements and PLL Capital Policy that it is not significant for the purposes of determining whether the Scheme would have any material adverse impact on the overall security of any group of policyholders affected by the Scheme.
- 5.38. I consider the use of capital ratios, such as the ratio of Pillar 1 capital resources to Pillar 1 CRR, to be a useful indicator of the immediate impact of the Scheme on the level of surplus capital within the Companies. However, whilst the impact on the solvency position at the time of the implementation of the Scheme is important, I would be concerned if other actions subsequently taken meant that a fund could be weakened, for example through the payment of dividends to shareholders. The ongoing protection afforded to policyholders is mainly governed through the application of the PLL Capital Policy. It is important to consider the strength of protection this provides, and I place considerable emphasis on the strength of the PLL Capital Policy in my assessment of the impact Scheme on the security of policyholder benefits. Accordingly, I consider this further in the context of the security of policyholder benefits in sections 6, 7 and 8.

Estimated Impact of the Scheme on Solvency of PLL

Estimated Effect on the Pillar 1 Solvency Position of PLL

- 5.39. The estimated impact of the Scheme on the Pillar 1 solvency position of PLL has been determined with reference to conditions at 31 August 2011. The pre-Scheme Pillar 1 solvency position at this date has been estimated by rolling forward the solvency position at 31 December 2010, and it allows for a dividend payment of £60m that is expected to be paid from PLL prior to the Effective Date.
- 5.40. The estimated overall consolidated solvency position pre and post-scheme is shown in Table 5.1 below, with a more detailed breakdown by fund in Tables A7.1 and A7.2 of Appendix 7.

Table 5.1 – Estimated PLL Pillar 1 Solvency Position (31 August 2011)		
£m	Pro-forma pre-scheme	Pro-forma post-scheme
Capital Resources ⁽¹⁾	4,379	4,375
Long-Term Insurance Capital Requirement (“LTICR”)	1,108	1,137
With-Profits Insurance Capital Component (“WPICC”)	2,340	2,340
Capital Resources Requirement (“CRR”) of regulated subsidiary	69	13
Capital Resources Requirement ⁽²⁾	3,516	3,490
Surplus Assets in excess of CRR ⁽³⁾	862	885
Cover for CRR ⁽⁴⁾	125%	125%
Cover for CRR, excluding WPICC from calculation ⁽⁵⁾	173%	177%

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to FSA rules on capital tiering.
- (2) LTICR plus WPICC plus CRR of regulated subsidiary.
- (3) Capital Resources less CRR.
- (4) Capital Resources divided by CRR.
- (5) Capital Resources less WPICC, divided by (CRR less WPICC).
- 5.41. Table 5.1 demonstrates that the impact of the Scheme on the Pillar 1 solvency position of PLL is expected to be small. This is primarily due to NPIL being a subsidiary of PLL pre-scheme, with the result that the pre-scheme position includes the consolidated value of NPIL’s capital resources and capital requirements. Additionally the long-term insurance business transferring from NPLL is currently fully reinsured to NPIL and so is also reflected already in the consolidated PLL Pillar 1 position.
- 5.42. The Pillar 1 solvency position is expected to improve slightly due to the Scheme. This improvement arises from the removal of the restrictions on the credit that can be taken for reinsurance in the LTICR calculation within NPIL. The Pillar 1 capital resources of PLL reduce slightly as a result of the Scheme as the costs incurred in connection with the preparation and implementation of the scheme (estimated as £4m) are borne by the PLL shareholder fund.

However, the reduction in the capital resources of PLL is less than the reduction in the CRR of PLL, meaning the solvency position is marginally improved.

Estimated Effect on the Pillar 2 Solvency Position of PLL

- 5.43. Prior to the Scheme, the Pillar 2 solvency basis is expected to be less onerous than the Pillar 1 basis for PLL. Similarly to the Pillar 1 solvency position, the impact of the Scheme is expected to be small because NPIL is a subsidiary of PLL and the long-term insurance business transferring from NPLL is fully reinsured to NPIL. Pillar 2 capital resources increase slightly and this positive impact is partially offset by the costs incurred in connection with the Scheme, with a positive impact overall. After the Scheme, the Pillar 2 solvency basis is still expected to be less onerous than Pillar 1 for the combined business in PLL. PLL is expected to be able to meet its Pillar 2 capital requirements following the Scheme and still have an additional margin in accordance with the PLL Capital Policy.

Estimated Effect on the Capital Policy and Support Arrangements of PLL

- 5.44. The PLL Capital Policy applies to PLL both before and after the Scheme is implemented. PLL is expected to be able to meet each of the tests under the PLL Capital Policy before and after the implementation of the Scheme, with the most onerous test being Test 2 in each case.
- 5.45. Post-scheme, the PLL Capital Policy will be extended to include the NPI WPF on the same basis as other with-profits funds in PLL, except that, to reflect the fact that all of the liabilities of the NPI WPF will be fully reinsured following the Transfer Date, the usual requirement to hold a minimum of £5m in assets over and above the regulatory minimum amount required to support its liabilities (see paragraph 5.21) will be disapplied for so long as substantially all of the liabilities of the NPI WPF are wholly reinsured.

Estimated Impact of the Scheme on Solvency of NPLL

Estimated Effect on the Pillar 1 Solvency Position of NPLL

- 5.46. The estimated impact of the Scheme on the Pillar 1 solvency position of NPLL has been determined with reference to conditions at 31 August 2011. The pre-Scheme Pillar 1 solvency position at this date has been estimated by rolling forward the solvency position at 31 December 2010.
- 5.47. The estimated overall solvency position pre and post-scheme is shown in Table 5.2 below, with a more detailed breakdown by fund in Tables A8.1 and A8.2 of Appendix 8.

Table 5.2 – Estimated NPLL Pillar 1 Solvency Position (31 August 2011)		
£m	Pro-forma pre-scheme	Pro-forma post-scheme
Capital Resources ⁽¹⁾	432	432
Long-Term Insurance Capital Requirement (“LTICR”)	164	131
With-Profits Insurance Capital Component (“WPICC”)	52	52
Capital Resources Requirement (“CRR”) ⁽²⁾	216	183
Surplus Assets in excess of CRR ⁽³⁾	217	250
Cover for CRR ⁽⁴⁾	200%	236%
Cover for CRR, excluding WPICC from calculation ⁽⁵⁾	232%	290%

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to FSA rules on capital tiering.
- (2) LTICR plus WPICC.
- (3) Capital Resources less CRR.
- (4) Capital Resources divided by CRR.
- (5) Capital Resources less WPICC, divided by (CRR less WPICC).
- 5.48. The Pillar 1 solvency position of NPLL is expected to improve by £33m as a result of the Scheme. The improvement is due to a reduction in LTICR (and hence the CRR) due to the less onerous application of the limit on credit for reinsurance in NPLL. The underlying position, ignoring any regulatory constraints, is not expected to change.

Estimated Effect on the Pillar 2 Solvency Position of NPLL

- 5.49. Prior to the Scheme, the Pillar 2 basis is more onerous than Pillar 1 for NPLL.
- 5.50. Following the Scheme:
- (i) Pillar 2 is expected to remain the most onerous basis - the implementation of the Scheme is expected to have no impact on either Pillar 2 capital resources or capital requirements of NPLL. This is because the Transferring NPLL Policies are already fully reinsured to NPIL prior to the implementation of the Scheme, so the economic effect is unchanged.

- (ii) NPLL is expected to be able to continue to meet its Pillar 2 capital requirements.

Estimated Effect on the Capital Policy and Support Arrangements of NPLL

- 5.51. As noted in paragraph 5.34, the Scheme will result in the long-term insurance business transferred from NPLL to the PLL NPF becoming subject to the PLL Capital Policy and its related capital support arrangements. Based on the solvency position of NPLL at 31 August 2011, if the PLL Capital Policy was applied to NPLL's pre-scheme position, it would allow NPLL to hold a slightly lower capital buffer in excess of regulatory capital requirements than the NPLL Capital Policy, representing a difference of broadly £17m. This difference arises due to a proportionately high level of ICG add-on that has previously been allocated to NPLL – I understand that some of the reasons for that ICG add-on have been addressed by NPLL in preparing the updated ICA, and accordingly the Phoenix Group expects its ICG add-on to be substantially reduced as part of the next FSA review. No credit has been taken for this in the numbers quoted above, and while the ICG add-on is ultimately the FSA's responsibility, where the reasons for adding it have been addressed I would typically expect the requirement to be reduced or removed. Further, due to the substantially different forms of the PLL Capital Policy and the NPLL Capital Policy, comparing them requires consideration of a broader range of factors – I discuss this further in paragraph 6.5 onwards in relation to the security of policyholder benefits. Taking all of this together, I do not believe that the PLL Capital Policy is weaker than the NPLL Capital Policy as at 31 August 2011.

Estimated Impact of the Scheme on Solvency of NPIL

Estimated Effect on the Pillar 1 Solvency Position of NPIL

- 5.52. The estimated impact of the Scheme on the Pillar 1 solvency position of NPIL has been determined with reference to conditions at 31 August 2011. The pre-Scheme Pillar 1 solvency position at this date has been estimated by rolling forward the solvency position at 31 December 2010.
- 5.53. The estimated overall solvency position pre and post-scheme is shown in Table 5.3 below, with a more detailed breakdown by fund in Table A9.1 of Appendix 9.

Table 5.3 – Estimated NPIL Pillar 1 Solvency Position (31 August 2011)		
£m	Pro-forma pre-scheme	Pro-forma post-scheme
Capital Resources ⁽¹⁾	174	
Long-Term Insurance Capital Requirement (“LTICR”)	55	
Resilience Capital Requirement (“RCR”)	3	
With-Profits Insurance Capital Component (“WPICC”)	0	N/A – no policies, assets or liabilities remaining
Capital Resources Requirement (“CRR”) ⁽²⁾	58	following de-authorisation.
Surplus Assets in excess of CRR ⁽³⁾	116	
Cover for CRR ⁽⁴⁾	300%	
Cover for CRR, excluding WPICC from calculation ⁽⁵⁾	300%	

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to FSA rules on capital tiering.
- (2) LTICR plus WPICC plus RCR.
- (3) Capital Resources less CRR.
- (4) Capital Resources divided by CRR.
- (5) Capital Resources less WPICC, divided by (CRR less WPICC).
- 5.54. No policies or liabilities will be left in NPIL following the implementation of the Scheme and the Overseas Schemes, since their terms provide that all of the long-term insurance business in NPIL will be transferred to PLL, and it is not anticipated that there will be any Excluded Policies. Any Excluded Policies that do arise will be fully reinsured to the PLL NPF, as described in paragraph 3.11.
- 5.55. Under the terms of the Scheme, £4m of assets will be retained in NPIL following the implementation of the Scheme to cover the Base Capital Resources Requirement (“BCRR”) that is required under FSA rules. Following the de-authorisation of NPIL, these assets will be transferred to the PLL shareholder fund under the terms of the Scheme.

Estimated Effect on the Pillar 2 Solvency Position of NPIL

- 5.56. Prior to the Scheme, the Pillar 2 solvency basis is more onerous than Pillar 1 for NPIL. After the Scheme, the Pillar 1 solvency basis is expected to be more onerous than Pillar 2 due to the requirement to hold the BCRR, which is not needed under Pillar 2.

Estimated Effect on the Capital Policy and Support Arrangements of NPIL

- 5.57. As noted in paragraph 5.32, the Scheme will result in the long-term insurance business that transferred from NPIL to PLL becoming subject to the capital support arrangements set out in the PLL Capital Policy (with the exception of its application to the NPI WPF, which is modified as described in paragraph 3.22 (iii)). Based on the solvency position of NPIL at 31 August 2011, if the PLL Capital Policy was applied to NPIL's pre-scheme position, it would require NPIL to hold a higher capital buffer in excess of regulatory capital requirements than the NPIL Capital Policy. The value of NPIL's capital resources and capital requirements are consolidated into the financial position of PLL prior to the implementation of the Scheme, so PLL already implicitly recognises its obligation to support business in NPIL.

Estimated Impact of the Scheme on the Group Capital Adequacy Position

- 5.58. The Phoenix Group is required to maintain overall capital at a level sufficient to meet the FSA's Group Capital Resources Requirement (the "GCR"). The GCR is based on the Pillar 1 solvency position; for the Phoenix Group it is measured at the level of Phoenix Life Holdings Limited and takes into account all UK regulated entities.
- 5.59. Implementation of the Scheme is expected to lead to an increase in surplus of approximately £26m under the FSA's Group Capital Adequacy Test.

Reviewing benefit security for policyholders

- 5.60. In later sections I refer to the above analysis in considering the effect of the Scheme on benefit security for different groups of policyholders.
- 5.61. In assessing the impact of the Scheme on the security of benefits of each group of policyholders I have considered the following factors:
- The underpinning level of capital protection afforded to each group of policyholders through the PLL Capital Policy;
 - The changes in the capital available to support each group of policyholders, by reference to the various measures of capital required. In particular, I have considered the ratio of available capital to required capital before and after implementation of the Scheme. Generally, the higher this ratio is, the greater the level of security for policyholders at a particular point in time, though this can be obscured where there are hidden areas of prudence in assumptions. However, considered alongside a capital management strategy or capital policy, such ratios are a helpful guide to the inherent strength of a fund, particularly where one can observe the change in the ratio, calculated using consistent methods and assumptions, as is the case here;
 - Substantive changes in the nature or size of the risks to which each group of policyholders is exposed.

Consideration of most recently available financial information

- 5.62. The analysis provided in this section has been developed on the basis of financial information as at 31 August 2011. As discussed in paragraph 1.21, I have been provided with more recent

estimates of the financial positions of the Companies up to 7 October 2011. On the basis of that information, the Companies remain sufficiently capitalised to meet the requirements of their respective capital policies. However, as a result of financial conditions over September 2011, I note that the PLL Board elected to provide additional financial support to NPIL in order to ensure that it was able to continue to meet the requirements of the NPIL Capital Policy. I will continue to keep the position under review, and will prepare further information in a Supplementary Report if appropriate.

6. Policyholders of National Provident Life Limited

Overview

6.1. As described in section 3, the broad effect of the Scheme will be to transfer designated blocks of business and assets of NPIL and NPLL to PLL, without affecting the policy benefits or substantially changing how the policies are managed.

Scope of Transferring Policies

6.2. The Transferring NPLL Policies to be transferred from NPLL to PLL under the Scheme comprise non-profit annuity policies, and are summarised below:

Table 6.1 - NPLL Policies				
31 December 2010 (figures rounded)	Number Of Policies	Gross Mathematical Reserves (£m)	Net Mathematical Reserves (£m)	Planned destination
<i>Transferring NPLL Policies</i>				
Annuities (non profit)	58,000	970	0	PLL Non-Profit Fund
<i>Non-Transferring NPLL Policies</i>				
Annuities (non-profit)	48,412	817	114	Policies remain in NPLL
Life conventional with-profits	3,133	32	32	Policies remain in NPLL
Pensions conventional with-profits	8,760	419	419	Policies remain in NPLL
Miscellaneous	8,288	116	116	Policies remain in NPLL
Life unitised with-profits	11,928	213	196	Policies remain in NPLL
Pensions unitised with-profits	121,990	2,001	2,015	Policies remain in NPLL
Deposit administration	1,433	31	31	Policies remain in NPLL
Unit-linked life	6,239	85	1	Policies remain in NPLL
Unit-linked pensions	140,288	1,802	38	Policies remain in NPLL
Total	408,471	6,486	2,962	

6.3. In the remainder of this section I consider in more detail the effect of the Scheme on the benefit security and benefit expectations of Transferring NPLL Policyholders and Non-Transferring NPLL Policyholders.

Transferring NPLL Policyholders

Benefit Security for Transferring NPLL Policyholders

- 6.4. Key considerations applicable to the security of benefits for Transferring NPLL Policyholders are the level of surplus assets, capital and risks in NPLL relative to those in PLL and the way in which surplus assets and capital are managed relative to each company's risks. On the basis of the financial information that has been made available to me:
- (i) Immediately prior to implementation of the Scheme, NPLL is expected to have a higher proportionate Pillar 1 capital coverage than PLL immediately following implementation of the Scheme, representing a reduction from 200% to 125%. This is based on the pro-forma estimates at 31 August 2011 shown in Tables 5.1 and 5.2 respectively. However PLL is expected to have a significantly higher absolute level of surplus assets than NPLL (£885m compared to £217m).
 - (ii) The expected reduction in proportionate Pillar 1 capital coverage as a result of the Scheme does not necessarily indicate a weakening of the level of policyholder benefit security. First, a large part of existing surplus could be paid away from the fund, for example, as a dividend (the capacity to do this is constrained by capital policies, which both require minimum levels of coverage of Pillar 1 capital requirements). Second, in practice, the most onerous capital test for NPLL is currently the Pillar 2 test (i.e. Test 2), and post-scheme PLL is expected to provide a greater level of proportionate capital coverage on this basis and higher absolute surplus assets.
- 6.5. Other factors, such as the basis on which capital is managed, also need to be considered. In particular, PLL and NPLL adhere to capital policies which represent the key constraint to future capital management by limiting the extent to which surplus assets can be released to shareholders. As discussed in section 5, the PLL Capital Policy is able to adapt and accommodate new or developing risks within PLL as circumstances change. I attach a high degree of importance to the strength of the PLL Capital Policy in my assessment of the Scheme. Some further commentary on the capital policies of NPLL and PLL is included in paragraphs 6.6 to 6.8 below.

Ongoing Capital Management

- 6.6. As part of PLL, Transferring NPLL Policyholders will be part of a much larger company carrying a higher absolute level of overall risk and a higher absolute level of surplus assets. It is the ongoing relationship of these two components, and how they are managed, that is key to policyholder benefit security. This relationship is captured in the capital policies of the respective companies, which set minimum target levels of capital.
- 6.7. NPLL and PLL have capital management policies as described in section 5. Both companies' policies operate in a similar manner by providing a margin of surplus assets in excess of minimum regulatory capital requirements. Such capital policies are valuable as they limit the extent to which excess surplus assets can be released from the companies and act as an early warning system for remedial action before a company fails to satisfy its regulatory capital requirements.
- 6.8. Generally, as the margin required above minimum regulatory capital requirements increases, so does the security provided by the capital policy. However, this is not the only relevant factor. A good capital policy will have due regard to the main risks of a company and will seek to ensure that sufficient capital is available to support these. An advantage of the PLL Capital Policy is its ability to adapt and accommodate new or developing risks within PLL as circumstances change, since the parameters of the policy are derived from internally specified stress scenarios and are recalibrated against these scenarios from time to time. Further, the PLL Capital Policy is set out in the 2009 Scheme and its overall methodology cannot be changed without approval from the Court (although aspects of the policy may be adjusted to reflect changes in the regulatory framework from time to time). This provides additional protection to the Transferring NPLL Policyholders.

Other Considerations

- 6.9. I have considered the potential differences in the nature and mix of risks in PLL and NPLL, and my thoughts are set out below:

- (i) **Disproportionate risks.** As part of the PLL NPF, the Transferring NPLL Policies will be part of a much larger company with exposure to a greater number of with-profits funds. However, as I describe in (iii) below, these risks are managed in a manner that should not expose the whole company, and hence the Transferring NPLL Policies, to a material risk of failure. I note the following points:
- NPLL is dependent on shareholder support and has been adversely impacted by the presence of costly guarantees within its long-term insurance fund. Currently, the benefit security of Transferring NPLL Policies is directly exposed to these guarantees within NPLL's single long-term insurance fund to the extent that if they became increasingly valuable the capital resources of the fund could fall. Following the implementation of the Scheme, the Transferring NPLL Policies will be only indirectly exposed to risks associated with with-profits guarantees in the other with-profits sub-funds of PLL;
 - The PLL NPF contains a large volume of annuity policies compared to NPLL, and hence carries a proportionately high level of annuitant longevity risk in comparison to NPLL. However, the level of risk associated with annuitant longevity in PLL is reflected in its capital policy, which requires capital to be held against those risks on an ongoing basis;
 - PLL does not appear to be subject to any other foreseeable risks or developments which would represent a significant change from the risk profile of NPLL.
- (ii) **New business.** There is no new long-term insurance business written in PLL except for increments on existing policies and annuities in respect of pension policies approaching retirement. I have considered management's projected levels of increments and new annuities and, relative to the size of existing business and having regard to the level of surplus capital in PLL, I consider that the incremental risks associated with new business are highly unlikely to adversely impact the security of benefits of Transferring NPLL Policyholders.
- (iii) **Competition for capital.** NPLL contains only a single long-term insurance fund, which is reliant on capital in the NPLL shareholder fund (including a large amount of shareholder capital injected directly into the long-term insurance fund over the past 10 years) to satisfy its solo regulatory capital requirements. PLL contains a number of with-profits funds which, in extremis, could become reliant on capital support from the PLL NPF or PLL shareholder fund reducing the level of additional capital that would be available to support Transferring NPLL Policyholders. This risk is managed through the PLL Capital Policy, which aims to ensure that sufficient capital is provided against these risks. In addition, with the exception of two with-profits funds that have received a limited amount of contingent support (as described in Appendix 10), each of the with-profits funds in PLL is managed with the intention of not placing reliance on shareholder support. This is a requirement of the 2009 Scheme and provides comfort that the risks arising from each with-profits fund will continue to be managed in a manner that should not expose the whole company, and hence the Transferring NPLL Policies, to a material risk of failure.
- (iv) **Extreme circumstances.** There is an even more remote risk that in very extreme circumstances the inter-fund boundaries between the funds in PLL might break down. This would occur in the event that there were no surplus assets available in the non-profit and shareholder funds in PLL, regulatory intervention by the FSA had been ineffective and PLL became insolvent on a Companies Act basis. Such an event appears highly unlikely given the management strategy of the with-profits funds in PLL, the level of protection provided by the current regulatory capital regime and the level of additional protection from the PLL Capital Policy. These are designed to ensure that an extreme adverse event in excess of a 1 in 200 year level loss can be sustained.
- (v) **Liquidity risks.** According to the Pillar 2 solvency information determined with reference to conditions at 31 August 2011, there is not a material risk that any sub-funds of PLL or NPLL have insufficient liquid assets to meet expected claim payments as they fall due. In addition, as described in paragraph 5.17, the PLL Capital Policy contains a liquidity test that ensures that sufficient liquid assets are available in the PLL NPF and PLL shareholder fund in the internally specified stress scenarios that underpin the derivation of Test 1 of the PLL Capital

Policy. The liquidity test will apply in respect of Transferring NPLL Policyholders following the implementation of the Scheme.

Conclusion on Benefit Security for Transferring NPLL Policyholders

- 6.10. Taking the points in paragraphs 6.4 to 6.9 together, I am satisfied that the benefit security of Transferring NPLL Policyholders is unlikely to be materially adversely affected by the Scheme. In concluding this I place considerable weight on the Transferring NPLL Policyholders benefitting from the strength of the PLL Capital Policy in the future. This policy should ensure that those policyholders enjoy a level of benefit security that is considerably higher than required by regulation.

Benefit Expectations for Transferring NPLL Policyholders

- 6.11. The Transferring NPLL Policies comprise only non-profit annuity policies. The benefits payable under these policies are either fixed, or escalate at a fixed rate or in line with inflation. Upon transfer of these policies to PLL, there will be no change to the benefits other than that the ultimate obligation to pay benefits will reside with PLL rather than NPLL. The premiums payable and the terms and conditions of the Transferring NPLL Policies are also unchanged by the Scheme.
- 6.12. I am satisfied that the benefit expectations of Transferring NPLL Policyholders are not affected by the Scheme.

Non-Transferring NPLL Policyholders

Benefit Security for Non-Transferring NPLL Policyholders

- 6.13. In relation to Non-Transferring NPLL Policyholders, I note that the impact of the Scheme would be minimal since the Transferring NPLL Policyholders are already fully reinsured to NPIL prior to the Scheme, with the result that the resultant risks, cash flows and profits or losses already emerge in NPIL rather than NPLL. No capital resources are transferred away from NPLL, and a potential source of risk from the Transferring NPLL Policies is removed from the NPLL long-term insurance fund. To the extent that there is a change, the financial impact of the Scheme on NPLL is expected to be beneficial as explained in paragraph 5.48, but this is more a function of a regulatory constraint falling away than any significant change in the underlying financial position.
- 6.14. Accordingly, I am satisfied that the Scheme would be unlikely to have any effect on the benefit security of the Non-Transferring NPLL Policyholders.

Benefit Expectations for Non-Transferring NPLL Policyholders

- 6.15. The Non-Transferring NPLL Policies include with-profits, unit-linked and non-profit policies and the consideration of the factors pertinent to the benefit expectations of policyholders in each category of business are substantially different. Holders of Hybrid Policies with both unit-linked and with-profits investment elements could be affected by changes relating to either with-profits or unit-linked business and so both sections below are relevant to these policyholders.

Holders of with-profits policies

- 6.16. Key considerations relevant to Non-Transferring NPLL Policies which are with-profits policies will not change as a result of the Scheme, including the basis on which asset shares are determined, the current level of asset shares and guaranteed benefits, surrender values, bonus rates, payout levels, investment strategy, charges, smoothing of payouts and the level of premiums payable. Expenses charged to with-profits policyholders can also include an element of overheads, but I note that there should be no change in the level of expenses charged to the policies, allowing for both direct expenses and the sharing of overheads. There is no loss of profits from the Transferring NPLL Policies, as these policies are already fully reinsured to NPIL.

Holders of non-profit policies

- 6.17. There will be no changes to the premiums due or benefits payable on Non-Transferring NPLL Policies that are non-profit policies, or the terms and conditions of those policies, as a result of the Scheme.

Holders of unit-linked policies

- 6.18. The benefits, premiums payable, and terms and conditions of Non-Transferring NPLL Policies that are unit-linked policies will not be changed by the Scheme. The existing unit-linked funds in NPLL will continue to operate with the same investment mandates, level of charges and unit pricing bases.

Conclusion on Benefit Expectations for Non-Transferring NPLL Policyholders

- 6.19. Accordingly, I am satisfied that the Scheme would be unlikely to have any effect on the benefit expectations of the Non-Transferring NPLL Policyholders.

7. Policyholders of NPI Limited

Overview

- 7.1. As described in section 3, the broad effect of the Scheme will be to transfer all the business of NPIL to PLL, without affecting the policy benefits or substantially changing how the policies are managed.
- 7.2. The Scheme will establish a new with-profits sub-fund in PLL, the NPI WPF, to receive the unitised with-profits benefits attaching to Transferring NPIL Policies. This is primarily for operational reasons (as discussed in paragraph 3.21 above) and the benefits will remain reinsured to the Pearl With-Profits Fund on equivalent terms to the existing arrangement in NPIL. Accordingly, in most respects there is no change for holders of Transferring NPIL Policies with attaching unitised with-profits benefits.
- 7.3. The NPIL 2006 Scheme will be disapplied from the Transfer Date. The Scheme will preserve the provisions of that scheme relating to maintenance of unit-linked funds, and will introduce a new wind up provision (described in paragraph 3.25), which is consistent with that applying to existing unit-linked funds in PLL. In my view this is a small change for holders of Transferring NPIL Policies with attaching unit-linked benefits.

Scope of Transferring Policies

- 7.4. The Transferring NPIL Policies to be transferred from NPIL to the PLL NPF under the Scheme comprise immediate annuities in payment, life and pensions policies with attaching unitised with-profits benefits, and life and pensions policies with attaching unit-linked benefits. There are a number of Hybrid Policies with both unit-linked and unitised with-profits investment elements. No policies will remain in NPIL following the Scheme and the Overseas Schemes. This is summarised below:

Table 7.1 - NPIL Policies				
31 December 2010 (figures rounded)	Number of Policies	Gross Mathematical Reserves (£m) ⁽¹⁾	Net Mathematical Reserves (£m)	Planned Destination
Transferring NPIL Policies				
Annuities	19,251	768	81	PLL Non-Profit Fund
Life UWP (Single Premium)	4,173	107	2	PLL Non-Profit Fund ⁽²⁾
Pensions UWP	5,323	68	0	PLL Non-Profit Fund ⁽²⁾
Unit-Linked Life	25,113	310	310	PLL Non-Profit Fund
Unit-Linked Pensions	91,386	889	839	PLL Non-Profit Fund
Miscellaneous	84	1	1	PLL Non-Profit Fund
Total	145,330	2,143	1,233	

Notes:

- (1) This excludes long-term insurance business which has been reinsured into NPIL. See Appendix 5 for details of the total mathematical reserves in NPIL including inwards reinsurance.
- (2) These unitised with-profits benefits will remain reinsured to the Pearl With-Profits Fund from the NPI WPF, as described in paragraph 3.21.

Transferring NPIL Policyholders

Benefit Security for Transferring NPIL Policyholders

- 7.5. Key considerations applicable to the security of benefits for Transferring NPIL Policyholders are the level of surplus assets and capital in NPIL relative to those in PLL and the way in which surplus assets and capital are managed relative to each company's risks. On the basis of the financial information that has been made available to me:
- (i) Immediately prior to implementation of the Scheme, NPIL is expected to have a higher proportionate Pillar 1 capital coverage than PLL immediately following implementation of the Scheme, representing a reduction from 300% to 125%. This is based on the pro-forma positions at 31 August 2011, as shown in Tables 5.1 and 5.3 respectively. However PLL is expected to have a significantly higher absolute level of surplus assets than NPIL (£885m compared to £116m).
 - (ii) The expected reduction in proportionate Pillar 1 capital coverage as a result of the Scheme does not necessarily indicate a weakening of the level of policyholder benefit security. First, a large part of existing surplus could be paid away from the fund, for example, as a dividend (the capacity to do this is constrained by the PLL Capital Policy, which requires a minimum level of coverage of Pillar 1 capital requirements). Second, in practice, the most onerous capital test for NPIL is currently the Pillar 2 test, and post-scheme PLL is expected to provide a greater level of proportionate capital coverage on this basis and a higher level of surplus assets.
- 7.6. Other factors, such as the basis on which capital is managed, also need to be considered. In particular, PLL and NPIL adhere to capital policies which represent the key constraint to future capital management by limiting the extent to which surplus assets can be released to shareholders. As discussed in section 5, if the PLL Capital Policy were applied to NPIL it would require NPIL to hold more capital in excess of regulatory capital requirements than the NPIL Capital Policy, and is able to adapt and accommodate new or developing risks within PLL as circumstances change. I attach a high level of importance to the strength of the PLL Capital Policy in my assessment of the Scheme. Some further commentary on the capital policies of NPIL and PLL is included in paragraphs 7.7 to 7.10 below.

Ongoing Capital Management

- 7.7. As part of PLL, Transferring NPIL Policyholders will be part of a much larger company carrying a higher absolute level of overall risk and a higher absolute level of surplus assets. It is the ongoing relationship of these two components, and how they are managed, that is key to policyholder benefit security. This relationship is captured in the capital policies of the respective companies, which set minimum target levels of capital.
- 7.8. NPIL and PLL have capital management policies as described in section 5. Both companies' policies operate in a similar manner by providing a margin of surplus assets in excess of minimum regulatory capital requirements. Such capital policies are valuable as they limit the extent to which excess surplus assets can be released from the companies and act as an early warning system for remedial action before a company fails to satisfy its regulatory capital requirements.
- 7.9. Generally, as the margin required above minimum regulatory capital requirements increases, so does the security provided by the capital policy. However, this is not the only relevant factor. A good capital policy will have due regard to the main risks of a company and seek to ensure that sufficient capital is available to support these. An advantage of the PLL Capital Policy is its ability to adapt and accommodate new or developing risks within PLL as circumstances change, since the parameters of the policy are derived from internally specified stress scenarios and are recalibrated against these scenarios from time to time. Further, the PLL Capital Policy is set out in the 2009 Scheme and its overall methodology cannot be changed without approval from the Court (although aspects of the policy may be adjusted to reflect changes in the regulatory framework from time to time). This provides additional protection to the Transferring NPIL Policyholders.

- 7.10. It is necessary to consider whether the position of Transferring NPIL Policyholders is weakened as a result of NPIL's long-term insurance business transferring into its parent company. Absent the Scheme, NPIL is ring-fenced from risks in PLL because it is a subsidiary with its own capital. Further, it is likely that NPIL would receive support from PLL if it experiences financial difficulty, but only to the extent that PLL has sufficient resources to continue to satisfy its own capital requirements. While the current situation has its advantages for Transferring NPIL Policyholders, I consider that these are outweighed by the advantages of being part of PLL, which are:
- Following the implementation of the Scheme, the Transferring NPIL Policyholders will be covered by the PLL Capital Policy, and more capital will be held in respect of these policies in absolute terms than was the case prior to the Scheme. In addition, the capital resources in the non-profit fund and shareholder fund of PLL become available to provide support to these policies should it be required;
 - The similarity of the risk profiles in NPIL and PLL (see paragraph 7.11 (i) below) means that an event which adversely affects PLL would be likely to adversely affect NPIL as well. It is therefore highly unlikely that an event of sufficient magnitude to render PLL insolvent would leave NPIL in a position of financial strength, due to the relative strength and responsiveness of the PLL Capital Policy;
 - I understand the provision of capital support from PLL to NPIL is not a legal obligation, and PLL would only be able to provide such support if it is able to continue to satisfy its own capital requirements. As such, although Transferring NPIL Policyholders can be said to have lost the protection that comes with being part of a standalone legal entity, they will have the added protection of the capital held by PLL in respect of NPIL being directly available to support the entire combined business of PLL, including payments to former NPIL policyholders, following the transfer. By residing in a sub-fund of PLL rather than a subsidiary company, the Transferring NPIL Policies will be supported directly by the capital resources of PLL on an equal footing with the other sub-funds of PLL.

Other considerations

- 7.11. I have considered the potential differences in nature and mix of risks in PLL and NPIL, and my views are set out below:
- (i) **Disproportionate risks.** As part of the PLL NPF, the Transferring NPIL Policies will be part of a much larger company with exposure to a greater number of with-profits funds. However, as I describe in (iii) below, these risks are managed in a manner that should not expose the whole company, and hence the Transferring NPIL Policies, to a material risk of failure. I note the following points:
- The PLL NPF contains a large volume of annuity policies compared to NPIL, and hence carries a proportionately high level of annuitant longevity risk in comparison to NPIL. However, the level of risk associated with annuitant longevity in PLL is reflected in its capital policy, which requires capital to be held against those risks on an ongoing basis. The transfer to PLL does not result in a concentrated exposure to longevity risk for Transferring NPIL Policyholders, as they are exposed to these risks already in NPIL;
 - Other than the exposure to a greater number of with-profits funds, as discussed above, PLL does not appear to be subject to any foreseeable risks or developments which would represent a significant change from the risk profile of NPIL.
- (ii) **New business.** There is no new long-term insurance business written in PLL except for increments on existing policies and annuities in respect of pension policies approaching retirement. Prior to the implementation of the Scheme, NPIL reinsures the vesting annuity policies of NPLL, and so the mix of new business in PLL is not dissimilar to NPIL. I have considered management's projected levels of increments and new annuities and, relative to the size of existing business and having regard to the level of surplus capital in PLL, I consider that the incremental risks associated with new business are highly unlikely to adversely impact the security of benefits of Transferring NPIL Policyholders.

- (iii) **Competition for capital.** NPIL contains only a single long-term insurance fund, which is reliant on capital in the NPIL shareholder fund to satisfy its solo regulatory capital requirements. PLL contains a number of with-profits funds which, in extremis, could become reliant on capital support from the PLL NPF or PLL shareholder fund, reducing the level of additional capital that would be available to support Transferring NPIL Policyholders. This risk is managed through the PLL Capital Policy, which aims to ensure that sufficient capital is provided against these risks. In addition, with the exception of two with-profits funds that have received a limited amount of contingent support (as described in Appendix 10), each of the with-profits funds in PLL is managed with the intention of not placing reliance on shareholder support. This is a requirement of the 2009 Scheme and provides comfort that the risks arising from each with-profits fund will continue to be managed in a manner that should not expose the whole company, and hence the Transferring NPIL Policies, to a material risk of failure.
- (iv) **Extreme circumstances.** There is an even more remote risk that in very extreme circumstances the inter-fund boundaries between the funds in PLL, including the NPI WPF, might break down. This would occur in the event that there were no surplus assets available in the non-profit and shareholder funds in PLL, regulatory intervention by the FSA had been ineffective and PLL became insolvent on a Companies Act basis. Such an event appears extremely unlikely given the management strategy of the with-profits funds in PLL, the level of protection provided by the current regulatory capital regime and the level of additional protection from the PLL Capital Policy. These are designed to ensure that an extreme adverse event in excess of a 1 in 200 year level loss can be sustained.
- (v) **Liquidity risks.** According to the Pillar 2 solvency information determined with reference to conditions at 31 August 2011, there is not a material risk that any sub-funds of PLL or NPIL have insufficient liquid assets to meet expected claim payments as they fall due. In addition, as described in paragraph 5.17, the PLL Capital Policy contains a liquidity test that ensures that sufficient liquid assets are available in the PLL NPF and PLL shareholder fund in the internally specified stress scenarios that underpin the derivation of Test 1 of the PLL Capital Policy. The liquidity test will apply in respect of Transferring NPIL Policyholders following the implementation of the Scheme.

Conclusion on Benefit Security for Transferring NPIL Policyholders

- 7.12. Taking the points in paragraphs 7.5 to 7.11 together, I am satisfied that the benefit security of Transferring NPIL Policyholders is unlikely to be materially adversely affected by the Scheme. In concluding this I place considerable weight on the Transferring NPIL Policyholders benefitting from the strength of the PLL Capital Policy in the future. This policy should ensure that those policyholders enjoy a level of benefit security that is considerably higher than required by regulation.

Benefit Expectations for Transferring NPIL Policyholders

- 7.13. The Transferring NPIL Policies include policies with attaching unitised with-profits benefits, unit-linked policies and non-profit policies, and the consideration of the factors pertinent to the benefit expectations of policyholders in each category of business are substantially different. Holders of Hybrid Policies with both unit-linked and with-profits investment elements could be affected by changes relating to either with-profits or unit-linked business and so both sections below are relevant to these policyholders. These policies will remain as Hybrid Policies following the implementation of the Scheme, and their rights to switch between unit-linked and unitised with-profits investments will not be changed.

Transferring Unit-Linked Policyholders

- 7.14. New unit-linked funds will be created in PLL, corresponding to those currently in NPIL. These Former NPIL Linked Funds will receive the assets of the corresponding unit-linked funds in NPIL at the Transfer Date and will be allocated the same number and value of units as were comprised in the corresponding unit-linked funds immediately prior to the Transfer Date. Premiums payable under the Transferring Unit-Linked Policies will not change.
- 7.15. I note the following:

- (i) **Investment mandates.** The Former NPIL Linked Funds will have the same underlying assets as the corresponding former unit-linked funds in NPIL. The investment strategies and permitted asset holdings of these unit-linked funds will be preserved.
 - (ii) **Charges.** Charges applicable to unit-linked policies will continue to be made in line with policy terms and conditions, which will be unchanged in this respect by the implementation of the Scheme. A small number of policies with reviewable charges will transfer to PLL under the Scheme, for which there have been no reviews carried out in recent years and for which no established methodology exists. In the event of a review, due to the small number of cases, it is likely that this business would be considered alongside other similar business in the Phoenix Group by reference to industry data. I have no reason to believe this will change due to the transfer of the business to PLL.
 - (iii) **Unit pricing.** The Former NPIL Linked Funds will be priced on the same basis as the corresponding unit-linked funds in NPIL.
 - (iv) **Choice of funds.** The range of unit-linked funds available to unit-linked policyholders prior to the Scheme will continue to be made available following the Scheme.
- 7.16. As discussed in paragraph 3.24, the Scheme will grant PLL equivalent powers to those currently available to NPIL to merge or divide Former NPIL Linked Funds or to amend the name or modify the investment objectives of the Former NPIL Linked Funds.
- 7.17. NPIL was previously permitted to wind up unit-linked funds covered by the NPIL 2006 Scheme, however there were no wind up thresholds or guidelines specified around the circumstances where it was appropriate to do so. Following the Transfer Date, PLL will be required to wind up Former NPIL Linked Funds where the value of assets falls below a specified threshold (see paragraph 3.25). Should a Former NPIL Linked Fund be wound up, each affected policyholder would be allocated units of an equal value in a substitute unit-linked fund which, in the opinion of the PLL Board, having regard to the advice of the Actuarial Function Holder, provides reasonably equivalent investment exposure to the Former NPIL Linked Fund being wound up.
- 7.18. Any policyholder affected by the application of any actions outlined in paragraphs 7.16 or 7.17 above would be entitled to switch to one or more other eligible unit-linked funds to which their policy is linked, even if such a switch was not permitted under their policy terms, without incurring a switching charge, provided the switch is effected within 12 months of the relevant change occurring. I believe this is an appropriate safeguard for affected policyholders.
- 7.19. The Scheme will preserve the provisions of the NPIL 2006 Scheme which permitted unit-linked policies transferred under that scheme to switch only between unit-linked funds transferred under that scheme, and unit-linked policies written in NPIL prior to 1 October 2006 to switch only between unit-linked funds maintained by NPIL prior to 1 October 2006. Equivalent limitations in investment choice will continue to apply to Transferring Unit-Linked Policies in PLL. Based on discussions with management, it is my understanding that should PLL exercise its right to wind up any Former NPIL Linked Fund, the substituted funds will subsequently be made available to all policyholders who previously had a right to invest in (or switch to) the Former NPIL Linked Fund being wound up.
- 7.20. Having regard to paragraphs 7.14 to 7.19 above, I am satisfied that the benefit expectations of unit-linked policyholders transferring from NPIL to PLL are not materially affected by the Scheme.

Transferring With-Profits Policyholders

- 7.21. Prior to the Scheme, any unitised with-profits benefits attaching to Transferring NPIL Policies are fully reinsured to the Pearl With-Profits Fund. As described in section 3, the Scheme will transfer these policies to the PLL NPF, and the assets held by NPIL in respect of these unitised with-profits benefits and the associated liabilities will be allocated to the NPI WPF.
- 7.22. The PLL Board and the PLL With-Profits Committee will assume the respective duties and responsibilities of the NPIL Board and the NPIL With-Profits Committee in relation to the transferring unitised with-profits benefits, including ultimate responsibility for setting bonus levels. However, PLL will maintain the reinsurance arrangement with Pearl in relation to the unitised with-

profits benefits and the terms of this arrangement will not be changed by the Scheme. PLL will also be required to manage the NPI WPF having regard to the established practices of NPIL.

- 7.23. Key considerations relevant to these benefits will not change as a result of the Scheme, including the basis on which asset shares are determined, the current level of asset shares and guaranteed benefits, surrender values, bonus rates, payout levels, investment strategy, charges, smoothing of payouts and the level of premiums payable.
- 7.24. It is also necessary to consider whether foreseeable circumstances might arise where the provisions of the Scheme could potentially act to the detriment of Transferring NPIL Policyholders whose policies have attaching unitised with-profits benefits, and the governance arrangements in place to deal with this. I discuss below potential scenarios and comment on the implications:
- (i) **Profit sharing and distribution of surplus.** The Scheme states that all of the surplus arising in the NPI WPF will be available for distribution to eligible policyholders of the fund over time. The timing of this will be at the discretion of the PLL Board in consultation with the PLL With-Profits Committee and relevant With-Profits Actuary. In exercising their discretion in relation to the NPI WPF, in particular regarding the distribution of any surplus, the PLL Board, the PLL With-Profits Committee and the relevant With-Profits Actuary will be required to have regard to the “established practices” of NPIL prior to the implementation of the Scheme.
 - (ii) **Insufficient capital in the NPI WPF.** I have discussed with PLL and understand that it would be extremely unlikely for the NPI WPF to experience a capital shortfall while the reinsurance arrangement with Pearl remains in place. This is because all claims and liabilities, including expenses, relating to the reinsured benefits are paid by Pearl (with the exception of a small provision in relation to the switching rights of some policies, the cost of which will be borne by the PLL NPF following the implementation of the Scheme). The management of PLL consider it unlikely, as do I, that the cost of any adverse regulatory or taxation changes, or any other miscellaneous liabilities, would be attributed to the NPI WPF while the reinsurance arrangement is in place, since the fund has no net liabilities or assets.
 - (iii) **Recapture of the NPI WPF reinsurance arrangement.** The reinsurance arrangement between NPIL and Pearl does not provide for recapture other than through mutual agreement between the parties. This will be unaffected by the Scheme, except that any subsequent recapture would need to be mutually agreed between PLL and Pearl. In reaching its decision, the PLL Board would need to have regard to the advice of the PLL With-Profits Committee which, in discharging its functions in relation to each with-profits fund, has a duty to act at all times in the best interests of the relevant policyholders. Therefore, while it is possible for the reinsurance arrangement to be recaptured in future, it should only occur if both the PLL Board and the PLL With-Profits Committee consider this to be in the best interests of the affected policyholders.
 - (iv) **Wind up of the NPI WPF.** If the aggregate value of the statutory liabilities (before reinsurance) of the NPI WPF falls below £50m, the Scheme requires PLL to wind up the NPI WPF and convert the relevant remaining unitised with-profits benefits to non-profit fixed benefits. This provision will not apply for so long as substantially all of the liabilities of the NPI WPF are wholly reinsured. In the event of a wind up, the assets and liabilities of the NPI WPF would be transferred to the PLL NPF. This is not unusual, and should facilitate a fairer distribution of surplus between the last remaining policies. The basis on which any such conversion is effected and the allocation of any surplus assets between policies would be determined by the PLL Board, having obtained appropriate actuarial advice. Any such wind up and conversion of benefits would require prior written approval from the FSA to ensure that affected policyholders are treated fairly.
- 7.25. Having regard to paragraphs 7.21 to 7.24 above, I am satisfied that the benefit expectations of Transferring With-Profits Policyholders of NPIL are not materially affected by the Scheme.

Transferring Non-Profit Policyholders

- 7.26. The premiums due and benefits payable under non-profit policies are fixed. Upon transfer of these policies to PLL, there will be no change other than that the ultimate obligation to pay benefits (and any right to receive premiums, if relevant) will reside with PLL rather than NPIL. The terms and conditions of the Transferring Non-Profit Policies in NPIL will not be changed by the Scheme.
- 7.27. The internal treaty which reinsures new (vesting) annuities arising from policies previously written in PAULP to the non-profit fund of Pearl will be amended such that future annuities will be written in the PLL NPF. Management have confirmed that future annuity rates that will be offered to vesting annuities arising from policies previously written in PAULP will be unaffected by the Scheme. This is because the Phoenix Group prices vesting annuities according to the system on which policy administration is carried out, rather than the company in which the business is located, and management anticipates that the administration of policies previously written in PAULP will be unaffected by the Scheme.
- 7.28. Some of the policies previously written in PAULP contain a Guaranteed Annuity Option (“GAO”), guaranteeing policyholders a higher annuity rate at retirement than prevailing market rates. This is a valuable option which will remain in place. The reinsurance of these GAO liabilities to the Pearl With-Profits Fund will also continue following the implementation of the Scheme, albeit that the annuity policies arising from such obligations will be written into the PLL NPF. I have discussed this matter with the management of the affected companies to confirm that this will not adversely impact the with-profits fund of Pearl, due to different costs associated with writing annuity business into the PLL NPF:
- (i) Management have confirmed that the cost of establishing annuity reserves in the PLL NPF, to the extent that these cannot be met from policy proceeds as a result of the GAO, will be unaffected by the Scheme.
 - (ii) Notwithstanding the above, I understand that the Phoenix Group is considering a project to align its approach to annuity pricing across the various group companies. Such a project could potentially have an impact on the costs borne by the Pearl With-Profits Fund in relation to the GAO liabilities. However, this is independent of the Scheme.
- 7.29. Having regard to paragraphs 7.26 to 7.28 above, I am satisfied that the benefit expectations of non-profit policyholders transferring from NPIL to PLL will not be materially affected by the Scheme.

Conclusion on Benefit Expectations for Transferring NPIL Policyholders

- 7.30. In summary, I am satisfied that the Scheme will not have a material effect on the benefit expectations of Transferring NPIL Policyholders.

8. Policyholders of Phoenix Life Limited

Overview

- 8.1. As discussed in section 3, the broad effect of the Scheme will be to transfer designated blocks of business and assets of NPIL and NPLL to PLL. The Existing PLL Policies will remain in place, and will not see any direct changes. However, I have considered whether the transfer could have any indirect effects on Existing PLL Policyholders.
- 8.2. The Scheme will establish a new with-profits sub-fund in PLL, the NPI WPF, to receive transferring unitised with-profits benefits of NPIL. This is primarily for operational reasons (as discussed in paragraph 3.21 above) and the benefits will remain fully reinsured to the Pearl With-Profits Fund on equivalent terms to the existing arrangement in NPIL.

Scope of Transferring Policies

- 8.3. There is no long-term insurance business transferred out of PLL as a result of the Scheme. The Transferring NPIL Policies and Transferring NPLL Policies will transfer to the PLL NPF under the Scheme. Tables 6.1 and 7.1 include further details of the Transferring NPLL Policies and Transferring NPIL Policies respectively.
- 8.4. In the remainder of this section I consider in more detail the effect of the Scheme on the benefit security and benefit expectations of Existing PLL Policyholders.

Existing PLL Policyholders

Benefit Security for Existing PLL Policyholders

- 8.5. Key considerations applicable to the security of benefits for Existing PLL Policyholders are the level of surplus assets in the long-term insurance fund and shareholder fund of PLL and the way in which those assets are managed relative to the company's risks. In considering the benefit security of Existing PLL Policyholders, I note that NPIL is already a wholly owned subsidiary of the PLL shareholder fund and that the Transferring NPLL Policies are fully reinsured to NPIL. On the basis of the financial information that has been made available to me:
 - (i) The Scheme is expected to result in a small increase in the proportionate Pillar 1 capital coverage from 124.5% to 125.3% for Existing PLL Policyholders, due to a reduction in the Pillar 1 CRR. (Refer to Table 5.1 in section 5). Absolute surplus is expected to increase from £862m to £885m based on 31 August 2011 financials.
 - (ii) Similarly to the Pillar 1 solvency position, the impact of the Scheme on a Pillar 2 basis is expected to be small because NPIL is already consolidated into PLL prior to the implementation of the Scheme for this purpose. The Pillar 2 position of PLL is expected to improve slightly as a result of the Scheme. The Pillar 2 capital resources of PLL are expected to increase slightly due to tax benefits realised and this positive impact would be partially offset by the costs incurred in connection with the Scheme.
 - (iii) Relative to the PLL Capital Policy, the Scheme is expected to result in a slight improvement in the level of excess assets. The most onerous capital policy test is expected to remain the Pillar 2 test (i.e. Test 2).

Ongoing Capital Management

- 8.6. The PLL Capital Policy will continue to operate following the Scheme and its scope will be extended to cover the Transferring Policies. The NPI WPF will become subject to the PLL Capital Policy as existing PLL with-profits funds are, subject to the amendment described in paragraph

3.22(iii). However, the application of the PLL Capital Policy in respect of Existing PLL Policyholders will not be changed by the Scheme.

Other considerations

8.7. As NPIL is a subsidiary of the shareholder fund of PLL and the Transferring NPLL Policies are fully reinsured to NPIL, the risks associated with the Transferring Policies are already borne by PLL and analysis demonstrates that there is minimal impact on its solvency position as a result of the Scheme. Consequently, there is no material change to the risks faced by Existing PLL Policyholders, and the Scheme does not represent a material change to the position of Existing PLL Policyholders.

Conclusion on Benefit Security for Existing PLL Policyholders

8.8. Overall, I am satisfied that the benefit security of Existing PLL Policyholders will not be materially affected by the Scheme.

Benefit Expectations for Existing PLL Policyholders

8.9. The Existing PLL Policies include with-profits, unit-linked and non-profit policies and the consideration of the factors pertinent to the benefit expectations of policyholders in each category of business are substantially different. Holders of Hybrid Policies with both unit-linked and with-profits investment elements could be affected by changes relating to either with-profits or unit-linked business and so both sections below are relevant to these policyholders.

Holders of with-profits policies

8.10. The Scheme will not amend or alter the operation of the 2009 Scheme or 2011 Scheme, which included a number of principles relating to the management of with-profits business in PLL. No new provisions relating to the management of existing with-profits business will be included in the Scheme, although the NPI WPF will be created to accommodate the unitised with-profits benefits transferring from NPIL. The new NPI WPF will be treated as if it had been part of the 2009 Scheme and be subject to a number of the same provisions.

8.11. Key considerations relevant to existing with-profits policies in PLL will not change as a result of the Scheme, including the basis on which asset shares are determined, the current level of asset shares and guaranteed benefits, surrender values, bonus rates, payout levels, investment strategy, charges, smoothing of payouts and the level of premiums payable. Expenses charged to with-profits policyholders can also include an element of overheads, but I note that there should be no change in the level of expenses charged to the policies, allowing for both direct expenses and the sharing of overheads.

Holders of non-profit policies

8.12. There will be no changes to the premiums due or benefits payable under existing non-profit policies in PLL, or the terms and conditions of those policies, as a result of the Scheme.

Holders of unit-linked policies

8.13. The benefits, premiums payable, and terms and conditions of existing PLL unit-linked policies will not be changed by the Scheme. The existing unit-linked funds in PLL will continue to operate with the same investment mandates, level of charges and unit pricing bases.

8.14. The Scheme provides for new unit-linked funds corresponding to those in NPIL to be created in PLL. These Former NPIL Linked Funds will accommodate the transferring NPIL unit-linked business. However, the creation of these funds is not expected to have any impact on the operation and performance of existing unit-linked funds in PLL.

Conclusion on Benefit Expectations for Existing PLL Policyholders

- 8.15. I am satisfied that the Scheme will not have any material effect on the benefit expectations of Existing PLL Policyholders.

9. Ongoing Governance, Administration and Investment Management

Introduction

- 9.1. In this section, I consider the effect of the Scheme on the ongoing governance, administration and investment management of the Existing PLL Policies, Transferring Policies and Non-Transferring NPLL Policies.

Governance of with-profits business

- 9.2. The arrangements for the governance of with-profits business in PLL will continue in the form set up under the 2009 Scheme and the 2011 Scheme. Specific responsibilities and duties will continue to be carried out by the relevant With-Profits Actuaries and the PLL With-Profits Committee. The PLL With-Profits Committee's duties will be extended to cover the NPI WPF and a With-Profits Actuary will be appointed to that fund. The PLL Board is obliged to keep the appointed With-Profits Actuary informed of its plans for that fund, and must request and pay due regard to his advice about the likely effect of material changes in the firm's business plans, practices or other circumstances on the fair treatment of the relevant with-profits policyholders.
- 9.3. The PLL With-Profits Committee is required to provide independent judgement on how any competing or conflicting rights and interests of policyholders have been addressed. When considering any particular with-profits fund, the PLL With-Profits Committee must act in the best interests of the with-profits policies written in or reinsured to that fund, taking into account the capital resources of that fund and any support that the PLL Board has agreed to make available from the PLL NPF or the PLL shareholder fund.
- 9.4. Prior to the Scheme, the unitised with-profits element of the with-profits business in NPIL is fully reinsured to Pearl. The responsibility for bonus declarations rests with the NPIL Board and responsibility will transfer to the PLL Board following the implementation of the Scheme. Should the PLL Board subsequently consider amending or recapturing the reinsurance arrangement with Pearl, it would need to have regard to the advice of the relevant With-Profits Actuary and the PLL With-Profits Committee. Additionally, the Pearl Board would be required to approve any change.
- 9.5. In assessing the impact of the Scheme, I am required to consider whether potential conflicts of interest between the incumbent with-profits funds of PLL and the incoming NPI WPF could materially adversely affect policyholders. There is little scope for such conflict because the unitised with-profits benefit element of Transferring NPIL Policies will be managed within its own fund and the existing PLL with-profits funds will continue to operate as separate funds. The 2009 Scheme provides comfort that the risks arising from each with-profits fund will continue to be managed in a manner that should not expose the whole company to a material risk of failure, while also mitigating the risk of potential conflicts between with-profits funds.
- 9.6. It is possible to envisage circumstances where the PLL With-Profits Committee might need to take into account different considerations in respect of the NPI WPF than in respect of one or more existing with-profits funds of PLL. It would follow from this that the PLL With-Profits Committee might, as a result, exercise its discretion in respect of each fund in a different way, or reach a different decision according to the particular circumstances and history of each fund. This does not necessarily mean that there would be a conflict between the roles being carried out for different funds, provided that the PLL With-Profits Committee considered each role and the factors relevant to each, when exercising its discretion. Indeed, this is already the case for PLL, which has many constituent funds.

- 9.7. The 2009 Scheme sets a number of requirements that would need to be satisfied for the terms of reference for the PLL With-Profits Committee to be changed, including consultation with the PLL With-Profits Committee itself and it not raising any objections to the changes. The PLL Actuarial Function Holder and With-Profits Actuaries of the affected funds would also need to be satisfied that the proposed changes did not adversely affect the reasonable expectations of the respective with-profits policyholders. These protections remain in place and should mitigate the risk of adverse changes to the governance framework in future.
- 9.8. The Scheme will have no impact on the governance arrangements in respect of Non-Transferring NPLL Policies that are with-profits policies.
- 9.9. I am satisfied that the Scheme is unlikely to adversely impact the quality of with-profits governance arrangements in PLL. In relation to the holders of Transferring NPIL Policies with attaching unitised with-profits benefits, I am satisfied that those arrangements provide a level of governance quality which is at least as strong as the current arrangements in NPIL. In relation to Non-Transferring NPLL Policies I am satisfied the quality of the existing governance arrangements in relation to with-profits policies will not be impacted by the Scheme.

Governance of non-profit and unit-linked business

- 9.10. PLL management has informed me that changes will continue to be made to discretionary policy features for non-profit policies in line with previous practice in PLL, NPLL and NPIL.
- 9.11. The 2009 Scheme includes a requirement for the PLL With-Profits Committee to consider all proposals relating to the exercise of discretion in respect of non-profit policies and the company's approach to treating customers fairly. This duty is included in the PLL With-Profit Committee's terms of reference and extends to unit-linked policies. For those policies with reviewable premiums and discretionary charges, this will continue to provide protection against adverse treatment.
- 9.12. In relation to the Transferring Non-Profit Policyholders and Transferring Unit-Linked Policyholders, I am satisfied that the arrangements in PLL represent a level of governance quality which is at least as strong as the current arrangements in NPIL and NPLL respectively. In relation to existing PLL non-profit and unit-linked policyholders I am satisfied that the level of governance quality is not affected by the Scheme.

Service Levels and Administration

- 9.13. Administration of the policies in NPLL and NPIL is provided by Pearl Group Services Limited ("PGS") under a management services contract. Under the Scheme, the contract will transfer to PLL in respect of Transferring Policies, and the relevant terms and conditions and charges will remain unchanged. The Transferring Policies and Non-Transferring NPLL Policies will continue to be administered on the same underlying systems by the same staff.
- 9.14. PGS has outsourced its customer service function and much of its information and technology function to Diligenta Limited, a subsidiary of Tata Consulting Services. There will be no change to these arrangements as a result of the Scheme.
- 9.15. PGMS provides administration services to PLL. This arrangement will not change as a result of the Scheme and policies will continue to be administered on the same systems by the same staff.
- 9.16. For the reasons above there should be no change to the costs of administration. Expenses charged to with-profits policyholders can also include an element of overheads. These should also be unchanged, as Transferring With-Profits Policyholders will be allocated to a separate with-profits sub-fund and will continue to be administered by the same provider, while Existing PLL Policies and Non-Transferring NPLL Policies with attaching with-profits benefits will also continue to be administered on the same basis as previously.

- 9.17. Accordingly, I consider that there should be no adverse impact on the quality or cost of administration services for Existing PLL Policyholders, Transferring Policyholders or Non-Transferring NPLL Policyholders as a consequence of the Scheme.

Investment Management

- 9.18. Ignis Asset Management (“Ignis”), a subsidiary of the Phoenix Group, currently provides investment management services to PLL. The terms and conditions of the arrangement, and the level of charges, will not change as a result of the Scheme.
- 9.19. NPIL and NPLL have investment management arrangements with Henderson Global Investors (“HGI”) for investment management, record keeping and unit pricing services for unit-linked funds. The unit pricing service is provided by BNP Paribas through an outsourcing arrangement with HGI. These arrangements will transfer unchanged to PLL in relation to Transferring Policies following the Scheme, and the arrangements in relation to Non-Transferring NPLL Policies will be unchanged.
- 9.20. NPIL also has an investment management arrangement with Ignis for assets backing immediate annuities and reinsurance collateral arrangements. This arrangement will be transferred to PLL unchanged.
- 9.21. The unitised with-profits benefits in NPIL are fully reinsured to the Pearl With-Profits Fund and investment management services are arranged by Pearl. The business will continue to be reinsured to Pearl following the Scheme and investment management services will continue to be arranged by Pearl.
- 9.22. The investment mandates and the principles governing the setting of investment strategies, unit pricing, and charges to unit-linked funds will be unchanged as a result of the Scheme.
- 9.23. Accordingly, I consider that there should be no impact on the quality or cost of investment management services for Existing PLL policyholders, Transferring Policyholders and Non-Transferring NPLL Policyholders as a consequence of the Scheme.

10. Tax Considerations

Overview

- 10.1. In this section, I consider the effect of the Scheme on the tax economically borne by groups of policyholders, and whether policyholders might be materially adversely affected by additional tax charges as a result of the Scheme.

Impact on Fund Level Tax Charges

- 10.2. In accordance with the provisions of the 2009 Scheme and the 2011 Scheme, each of the existing with-profits sub-funds in PLL is taxed on the basis that it is either a standalone mutual or a standalone proprietary company. There will be no change to this approach as a result of the Scheme. Further, as the Scheme will not impact any of the assets and liabilities of any existing with-profits fund of PLL, there will be no impact on the level of tax charged to any of the with-profits funds.
- 10.3. The newly established NPI WPF will be charged for tax in PLL on the basis that it is a standalone mutual company, as provided for under the Scheme. The long-term insurance business of the fund is likely to remain fully reinsured to the Pearl With-Profits Fund for the foreseeable future and it is highly unlikely that any income will be attributed to that fund. Since there are not expected to be any investment returns within the fund subject to company level “I minus E” tax, it is likely that no tax charge will be applied to the NPI WPF while the reinsurance arrangement with Pearl remains in place.

Impact on Policy Tax Charges – Unit-Linked

- 10.4. The Scheme is not expected to have any impact on tax charges to unit-linked policies:
- (i) A substantial amount of unit-linked business will transfer from NPIL to PLL under the Scheme. NPIL currently determines and attributes tax between unit-linked business on the basis of tax status, whether Basic Life and General Annuity Business (“BLAGAB”) or Gross Roll-up Business (“GRB”). As each of the unit-linked funds of NPIL will be replicated in PLL, there is not expected to be any change in the level of tax charges to holders of Transferring Unit-Linked Policies.
 - (ii) No unit-linked business will transfer from NPLL under the Scheme.
 - (iii) The existing unit-linked business and funds of PLL will be unaffected by the Scheme.

Impact on Policy Tax Charges – With-Profits

- 10.5. The Scheme is not expected to have any impact on tax charges to with-profits policies:
- (i) The Scheme will have no impact on tax charged to any of the with-profits funds of PLL.
 - (ii) The reinsurance of unitised with-profits investment elements of Hybrid Policies from NPIL to Pearl will remain in place, albeit between the NPI WPF and the Pearl With-Profits Fund. Accordingly, the asset shares of relevant policies will continue to be taxed in accordance with the existing practice of Pearl, and this will be unaffected by the Scheme.

Impact on Company Level Tax

- 10.6. In relation to NPLL, the Scheme is not expected to impact the level of company tax since the Transferring NPLL Policies are currently fully reinsured to NPIL and the net of reinsurance assets and liabilities of NPLL will be unaffected.
- 10.7. In relation to NPIL and PLL, the Scheme is expected to result in tax synergies as a result of unutilised tax deductible losses in NPIL, the use of which will be accelerated as a result of the

transfer of business under the Scheme. There is expected to be a minor impact on mean fund tax apportionment in PLL since the majority of business transferring from NPIL is unit-linked and therefore subject to separate tax under the “I minus E” regime. Any tax synergies that emerge are likely to be fully attributed to the PLL NPF and PLL shareholder fund.

Policy Tax Status

- 10.8. The Phoenix Group is seeking confirmation and clearances from HMRC that the Scheme will not adversely impact the favourable tax status of any relevant policies, including Qualifying Policies and those benefiting from treatment as GRB business. The Phoenix Group is currently in the process of identifying those cases where recertification will be required and expects that such certification will be granted. If necessary, I will consider the outcome of these clearances as part of my Supplementary Report on the Scheme.

Stamp Duty and VAT

- 10.9. As NPIL, PLL and NPLL are all under common ownership, the Phoenix Group expects that there should be no UK stamp duty or related tax costs associated with the Scheme, and that any overseas stamp duty costs incurred are likely to be small. If any such costs were incurred, these would be borne by the PLL shareholder fund.
- 10.10. As NPIL, PLL and NPLL are all members of the same VAT group, the Phoenix Group expects that there should be no VAT costs associated with the Scheme. Again, if any such costs were incurred, these would be borne by the PLL shareholder fund.

Tax Regime

- 10.11. The Phoenix Group considers that the anti-avoidance legislation relating specifically to transfers of business will not be of relevance to the Scheme. I have discussed the rationale for this with Phoenix, and consider that it is a reasonable view to take.
- 10.12. I understand that the Phoenix Group is seeking clearance from HMRC that the more general targeted anti-avoidance rules will not apply to the Scheme. I have seen the draft external tax advice prepared for PLL focussing on aspects of the Scheme that affect policyholders. I understand that no material tax disadvantages have been identified arising from the timing of the Scheme. I am not aware of any reason why HMRC would not provide clearance under section 444AED of the Income and Corporation Tax Act 1988 in respect of the Targeted Anti-Avoidance Rules (“TAARs”) that apply to insurance business transfer schemes, subject to HMRC seeing the final Scheme and Phoenix carrying out the transfer in accordance with the information submitted to HMRC as part of the clearance. To the extent that any additional tax arises as a result of the TAARs this would be tax on shareholder profits so would not be borne by policyholder funds. On the basis of the circumstances and my discussions with Phoenix, it seems highly unlikely that HMRC would not provide clearance in relation to the application of TAARs, although I understand that Phoenix is awaiting final confirmation from HMRC in this regard. I will consider this further if necessary in my Supplementary Report if such clearance is not obtained.
- 10.13. Clearance will also be sought that under Section 748 CTA 2010 the transfer does not constitute a transaction in securities to which “Cancellation of corporation tax advantages from certain transactions in securities” applies. No issues are expected to arise in this context.
- 10.14. HMRC is currently reviewing the basis for the taxation of life insurers in recognition of the wider changes that the forthcoming Solvency II regime will bring. These changes will occur whether or not the Scheme is approved. I am not aware of any reason why approval of the Scheme should make any future tax changes more onerous for any group of policyholders.
- (i) In relation to the with-profits funds of PLL, the 2009 Scheme provides that if there is a material change to the basis of taxation of UK life assurance companies then the PLL Board may change the basis of the tax charges to the with-profits funds, subject both to prior notification of the FSA and having obtained appropriate advice in order to ensure that the intention of that scheme regarding the attribution of tax to the various funds is maintained. The NPI WPF will also become subject to these provisions under the Scheme.

- (ii) In relation to unit-linked policies affected by the Scheme, the Phoenix Group considers that the impact of proposed tax regime changes is unlikely to have a significant impact on tax charges borne by the relevant policyholders. Considering the nature of the current draft proposals, I concur with this view.
 - (iii) As the majority of transferring business under the Scheme is unit-linked in nature, the Phoenix Group considers that the potential of the Scheme to adversely impact tax charges to policyholders under the new tax regime is small.
- 10.15. On the basis of the above, I am satisfied that there do not appear to be any tax considerations arising from the Scheme that would materially adversely affect the benefit expectations or benefit security of any group of policyholders in PLL, NPLL or NPIL.

11. Policyholder Communications

Overview

- 11.1. Transferring Policyholders whose mailing details are available will be sent copies of a letter, scheme guide and question and answer booklet explaining the Scheme and its implications. NPIL, NPLL and PLL policyholders will also be able to access the full scheme document, this Report and reports from the Actuarial Function Holders and With-Profits Actuaries of NPIL, NPLL and PLL on each company's website, as well as the scheme guide, question and answer booklet and the updated PPFM and Customer Friendly PPFM. The full terms of the Overseas Schemes will also be available on the website. Alternatively, policyholders will be able to call a helpline with any enquiries about the Scheme. Copies of all these documents will also be available to view at the offices of the Companies' solicitors.
- 11.2. The Companies do not plan to send similar information on the Scheme to either Existing PLL Policyholders or Non-Transferring NPLL Policyholders, but information will be available to these policyholders on the websites of the Companies and notices will be published in six national newspapers. Information, including tailored guides to the Scheme for Existing PLL Policyholders and Non-Transferring NPLL Policyholders, will be available to these policyholders on request to the Companies.
- 11.3. PLL believes that sending this information to all Existing PLL Policyholders would be disproportionate for the following reasons:
- No policies within PLL will be transferred and there will be no change to the terms and conditions of the Existing PLL Policies or to how these policies or the existing PLL sub-funds are run;
 - The security of PLL policyholders is supported by the PLL Capital Policy, which will continue in force after the Scheme is implemented;
 - The total number of Transferring Policies is a small proportion of the total number of Existing PLL Policies (around 5%);
 - The unitised with-profits benefits attaching to Transferring NPIL Policies will be managed in a separate with-profits sub fund;
 - PLL's Actuarial Function Holder and With-Profits Actuaries do not believe any Existing PLL Policyholder will be adversely affected by the Scheme;
 - The costs of the Scheme will not be met by the PLL NPF or any of the PLL with-profits funds;
 - The creation of a new with-profits sub-fund within PLL does not represent a new type of risk to Existing PLL Policyholders and the potential consequences of the existence of different with-profits sub-funds in PLL is currently explained in the PLL PPFM; and
 - Including Existing PLL Policyholders in the mailing would cost approximately £3.7m.
- 11.4. Given that no policies within PLL will be transferred by the Scheme, and that there will be no change to the terms and conditions of the Existing PLL Policies, and my opinions in section 8, I am satisfied that the proposal not to mail details of the Scheme to Existing PLL Policyholders is fair and reasonable.
- 11.5. NPLL believes that sending this information to all Non-Transferring NPLL Policyholders would be disproportionate given that the Scheme will not have any material impact on these policyholders. In particular:
- There will be no change to the terms and conditions of any Non-Transferring NPLL Policy;

- There will be no change to the governance arrangements applicable to Non-Transferring NPLL Policies;
 - All of the long-term insurance business that will transfer from NPLL to PLL is already fully reinsured to NPIL and NPLL receives no share of any profits or other benefit from this business;
 - The Scheme will not result in any changes to the current operation or financial management of the long-term insurance fund of NPLL; and
 - All costs of the Scheme will be met from the PLL shareholder fund and not from the long-term insurance fund of NPLL.
- 11.6. Given that there will be no change to the terms and conditions of the Non-Transferring NPLL Policies and my conclusions in section 6, I am satisfied that the proposal not to mail details to Non-Transferring Policyholders is fair and reasonable.
- 11.7. I am also satisfied that the approach to communicating with Transferring Policyholders is reasonable.
- 11.8. NPIL, NPLL and PLL policyholders who feel they will be adversely affected by the Scheme may put their objections to the Court either in writing, by attending the hearing or by asking a representative to raise their objection. In deciding whether to sanction the Scheme, the Court will consider any objections. I will also consider them in coming to my view on the appropriateness of the Scheme and will report as appropriate in my Supplementary Report.

Appendix 1: Independent Expert Terms of Reference

Scope of the work of the Independent Expert in relation to the proposed schemes (the “Schemes”)

The Independent Expert’s reports (the “Reports”) are to consider the terms of the Schemes generally and the effect which the Schemes will have on the holders of long term policies of London Life (“LL”), National Provident Life Limited (“NPLL”), NPI Limited (“NPIL”), Pearl Assurance Limited (“Pearl”) and Phoenix Life Limited (“PLL”), (together, the “Companies”). Note, the terms of reference were agreed assuming the Independent Expert would report on two schemes. Only this Scheme is currently being pursued, though the second scheme may be considered in 2012.

In preparing the Reports, the Independent Expert must have regard to the duty that he owes to assist the High Court on those matters within his expertise. This duty overrides any obligations to the Companies. The Reports apply equally to business written by the Companies in Jersey and Guernsey as it does to business written in the UK, and may therefore be used to satisfy the requirement for a report by an independent actuary on the terms of the local schemes in those jurisdictions (to the extent that any such local schemes are required).

In particular the Reports should consider the following specific matters:

- The matters listed in SUP 18.2.33G, 18.2.36G and 18.2.39G.
- The impact of the Schemes on the security of the different groups of policyholders involved in the Schemes.
- The impact of the Schemes on the benefit expectations of the different groups of policyholders involved in the Schemes.
- A review of, and opinion on the fairness of, any mechanisms implemented in relation to the transferring policies at the same time as the Schemes, to provide financial support to the Companies.
- A review of, and opinion on the adequacy of, the communications made to policyholders concerning the Schemes.
- A review of, and opinion on the fairness of, any intra-fund arrangements which will be adopted pursuant to the Schemes to replace reinsurance arrangements currently in place between the Companies.
- The impact of the Schemes on the level of service provided to the different groups of policyholders involved in the Schemes.
- The adequacy of any safeguards in the Schemes to protect the ongoing interests of different groups of policyholders.
- Any other matters drawn to the attention of the Independent Expert by the Financial Services Authority or required by the Financial Services Authority to be addressed within the Reports.

The review and Reports will address generally the way in which the Companies have conducted their long term business but taking into account the particular circumstances of each class of business to be transferred. It will consider inter alia the following aspects of each Company:

- The Memorandum and the Articles of Association, at least insofar as these affect the rights, expectations and interests of policyholders.
- Where potential concerns arise, consideration of the terms of policies issued by each Company or otherwise held by policyholders of each Company.
- Where potential concerns arise, materials sent or otherwise made available to policyholders, including promotional or marketing materials (including those documents issued under the Financial Services

and Markets Act 2000 and previous regulatory regimes), which would influence the reasonable expectations of policyholders.

- The existing and proposed internal working arrangements relating to the financial management of the long term business funds of each Company, including the operational and administrative arrangements which will apply to the policies to be transferred under the terms of the Schemes.
- The terms and conditions expected to be imposed by the Schemes to be presented to the Court and the terms and conditions of any other schemes or arrangements in overseas jurisdictions which may be required to transfer certain of the policies, including the views expressed by the governing body or management of each Company.
- The terms of any previous schemes of transfer that created particular rights or protections for a class of policyholders within one or more of the Companies.

The above list is not intended to be exclusive of any other aspects which may be identified during the completion of the project and which are considered to be relevant.

The Independent Expert shall not be directly involved in the formulation of the proposed transfer although he will be expected to give guidance during the evolution of the detailed proposals on those issues which are of concern to him, or which he considers unsatisfactory.

Appendix 2: Background to the Phoenix Group

Introduction

Phoenix Group Holdings (“PGH”) is the ultimate parent company of the group of authorised life assurance companies collectively known as the Phoenix Group. PGH owns the UK’s largest closed life funds business with approximately 6 million policies in force and around £67.5 billion worth of assets as at 31 December 2010. PGH is listed on the London Stock Exchange.

History

In 2005, Pearl Group Limited (“PGL”) was set up to acquire and manage closed life insurance funds. In that year, it acquired the life business of Henderson Holding Group plc (“HHG”), comprising Pearl Assurance Limited (“Pearl”), National Provident Life Limited (“NPLL”), London Life Limited (“LL”), NPI Limited (“NPIL”) and HHG Services Limited (which provided administration services to all four life companies).

On 1 May 2008, PGL acquired Resolution plc (“Resolution”), which has subsequently been renamed Pearl Group Holdings (No.1) Limited.

Resolution had been formed in September 2005 from the merger of Resolution Life Group Limited and Britannic Group plc. Resolution Life Group Limited had previously acquired the United Kingdom life insurance business of the Royal and Sun Alliance Group and Swiss Life (UK) plc. The Britannic Group acquired the life insurance operations of Allianz Cornhill in December 2004 and the Century Group in April 2005.

In September 2006, Resolution Life Limited, a subsidiary of Resolution, acquired the life insurance companies of Abbey National plc, including Scottish Mutual Assurance Limited (“Scottish Mutual”), Scottish Provident Limited and Phoenix Life Assurance Limited.

In 2008, following the acquisition of Resolution, PGL sold Phoenix Life Assurance Limited and the protection and health care business of Scottish Mutual and Scottish Provident Limited to Royal London Group.

In 2009, Liberty Acquisition Holdings (International) Company (“Liberty”) acquired PGL and became the ultimate holding company. Liberty was incorporated in 2008 as a non-operating Special Purpose Acquisition Company to acquire one or more operating businesses with principal activities outside of North America. Following the acquisition of PGL, Liberty changed its legal name to Pearl Group and moved its principal place of business to Jersey.

In 2009, the life and pensions business of Scottish Mutual and Scottish Provident Limited was rebranded as Phoenix Life Limited (“PLL”).

In 2009, Pearl Group achieved Secondary Listing on the London Stock Exchange.

On 15 March 2010, Pearl Group changed its name to Phoenix Group Holdings, and subsequently moved its primary listing to the London Stock Exchange.

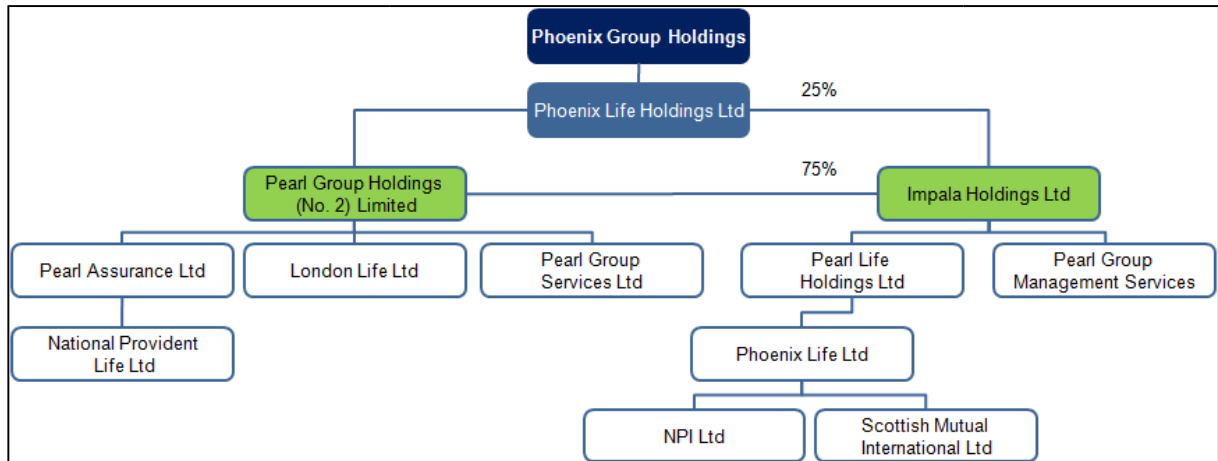
Current structure

PGH has two core areas of business: life assurance (Phoenix Life Holdings Limited) and asset management (Ignis Asset Management).

PGH's life assurance business comprises six operating regulated life companies, including well-known brands such as PLL, Pearl, Scottish Mutual, LL and NPI.

Ignis Asset Management Limited is PGH's asset management business, providing services to the Phoenix Group's life companies as well as to third-party clients, including retail and institutional investors.

The following diagram shows the simplified structure of the Phoenix Group:



Note: Phoenix Life Holdings Limited has a 25% participation in Impala Holdings Limited ("Impala"), and fully owns PGH2. PGH2 has a 75% participation in Impala. Therefore, Phoenix Life Holdings Limited owns all of Impala - 25% through its direct participation in Impala, and 75% indirectly via its ownership of PGH2.

Appendix 3: Background to Phoenix Life Limited

Introduction

Phoenix Life Limited (“PLL”) traces its history back to Lloyds Life Assurance Limited, which was founded in 1971 and was purchased by the Royal Insurance Group in 1985. It was subsequently renamed Royal Heritage Life Assurance Limited (“RHL”) in 1986.

Following the merger of the Royal Insurance Group with the Sun Alliance and London Insurance Group in 1996, the business of Royal Life (Unit Linked Assurances) Limited, Royal Life (Unit Linked Pension Funds) Limited, Sun Alliance Linked Insurance Limited, Sun Alliance Pensions Limited and Property Growth Assurance Company Limited was transferred into RHL in 1998. At the same time, RHL was renamed Royal & Sun Alliance Linked Insurances Limited (“RSALI”). RSALI was closed to new business in 2002.

In September 2004, Resolution Life Group Limited bought the UK Life funds of the Royal & Sun Alliance Group, including RSALI.

Resolution Life Group Limited subsequently bought the business of Swiss Life (UK) plc. Pursuant to a scheme approved by the Court in November 2005, the life businesses of Bradford Insurance Company Limited Assurance Limited and Swiss Life (UK) plc were transferred into RSALI, which was at the same time renamed PLL.

Since then, PLL has been involved in three further schemes:

The Phoenix 2006 Scheme

As the result of a scheme approved by the Court in December 2006 (the “2006 Scheme”), the life businesses of Alba Life Limited, Britannic Assurance plc, Britannic Retirement Solutions Limited, Britannic Unit Linked Assurance Limited, Century Life plc and Phoenix Life & Pensions Limited were transferred into PLL.

The Phoenix 2009 Scheme

As a result of a further scheme approved by the Court on 30 January 2009 (the “2009 Scheme”), the life businesses of Scottish Mutual Assurance Limited (excluding the Self Assurance protection portfolio and Pegasus business) and Scottish Provident Limited (excluding the Self Assurance protection portfolio) were transferred to PLL on 6 February 2009, but with effect from 31 December 2008.

The Phoenix 2011 Scheme

On 11 February 2011, the Court approved the transfer of all the Phoenix & London Assurance Limited policies to PLL (the “2011 Scheme”). The policies were transferred on 21 February 2011, but with effect from 1 January 2011.

The Corporate Structure

Further to the schemes described above, the structure of the long-term insurance fund of PLL has been changed so as to comprise ten sub-funds:

- Non-Profit Fund (“PLL NPF”) – from which all of the surplus is payable to shareholders;

- 100% With-Profits Fund (“100% WPF”) – which is a with-profits fund from which all surplus is payable to policyholders;
- SAL With-Profits Fund (“SAL WPF”).
- Scottish Mutual With-Profits Fund (“SM WPF”);
- SPI With-Profits Fund (“SPI WPF”);
- 90% With-Profits Fund (“90% WPF”);
- Alba With-Profits Fund (“Alba WPF”);
- Britannic Industrial Branch Fund (“Britannic IB Fund”);
- Britannic With-Profits Fund (“Britannic WPF”); and
- Phoenix With-Profits Fund (“Phoenix WPF”).

The last eight funds are each with-profits funds from which at least 90% of the surplus is payable to with-profits policyholders, with the balance being distributable to shareholders.

There is also a shareholder fund in PLL.

The following diagram shows the PLL fund structure following the 2011 Scheme, together with the approximate number of policies and regulatory reserves, as at 31 December 2010:

	PLL									
	Shareholder Fund									
	NPF	100% WPF	SAL WPF	SM WPF	SPI WPF	90% WPF	Alba WPF	Britannic IB Fund	Britannic WPF	Phoenix WPF
Number of policies (k)	1,840	1.4	450	71	190	430	150	590	355	400
Mathematical reserves (£m)	9,408	31	4,984	2,404	2,254	120	1,657	334	3,414	4,190

Nature of Business of PLL

PLL has a range of non-profit, unit-linked and with-profits business in its long-term insurance fund, as described below.

Phoenix Non-Profit Fund

The range of non-profit policies in the PLL NPF mainly falls into the following categories:

- Unit-linked regular and single premium pension policies;
- Immediate and deferred annuities; and
- Term assurance, critical illness and income protection policies written on both guaranteed and reviewable premium bases.

100% With-Profits Fund

The 100% WPF consists of the with-profits policies transferred to PLL from the Phoenix Assurance participation fund, the Swiss Life With-Profits Fund and the Bradford Life long-term insurance fund. The with-profits policies are mainly traditional endowments and whole life policies. In addition, the investment element of certain unitised with-profits policies is reinsured into the fund from the SAL WPF.

SAL With-Profits Fund

The SAL WPF consists of conventional with-profits policies, unitised with-profits policies, non-profit policies, unit-linked policies and some immediate and deferred non-profit annuities. This business was transferred to PLL under the 2011 Scheme.

Scottish Mutual With-Profits Fund

The SM WPF consists of conventional and unitised with-profits policies sold by Scottish Mutual. It comprises conventional with-profits policies and unitised with-profits policies and benefits under policies which are written in the PLL NPF and reinsured to the SM WPF. This business was transferred to PLL as part of the 2009 Scheme.

SPI With-Profits Fund

The SPI WPF consists of conventional with-profits policies, unitised with-profits policies, a small volume of non-profit business and with-profits benefits under policies written in the PLL NPF. The business was transferred to PLL as part of the 2009 Scheme.

90% With-Profits Fund

The 90% WPF consists of the conventional with-profits policies transferred to PLL from the Swiss Life Ordinary Branch Fund (including former with-profits policies which became non-profit policies on becoming paid-up) and Britannic Unit Linked Assurance Limited (being policies originally issued by Allianz Cornhill) together with the with-profits policies of the Swiss Life Industrial Branch Fund. The with-profits policies are mainly traditional endowments and whole life policies. In addition, the investment element of certain unitised with-profits policies is reinsured into the fund from the PLL NPF (in respect of former Swiss Life business).

Alba With-Profits Fund

The Alba WPF mainly consists of traditional with-profits life and corporate pension business. There is also some unitised with-profits business as well as non-profit deferred and immediate annuities.

The fund mainly consists of United Kingdom business but there is also some overseas business, mainly former branch business of the Life Association of Scotland written in the Republic of Ireland.

Britannic Industrial Branch Fund

The Britannic IB Fund contains the former Industrial Branch business of Britannic Assurance plc, which comprises:

- Industrial assurance business – the distinguishing feature of this is that home service agents traditionally collected premiums in cash. This business was sold before 1 December 2001 under the Industrial Assurances Act 1923;
- Home service business – this is business sold since 1 December 2001 where premiums were initially received in cash by collectors more frequently than once every two months. This business is similar to the industrial assurance business above, except that it was not sold under the Industrial Assurances Act 1923.

Policies in this fund may be with-profits or non-profit, and are typically for small amounts. The main types of business are endowment assurances and whole of life assurances.

Britannic With-Profits Fund

The Britannic WPF comprises mainly:

- Traditional with-profits endowment assurances;
- Unitised with-profits business;
- Traditional with-profits business that formed part of the With-Profits Fund of Century Life plc prior to the 2006 Scheme; and
- Unit-linked business, the unit liability of which is wholly reinsured to the PLL NPF.

Phoenix With-Profits Fund

The Phoenix WPF comprises the with-profits contracts originally written by Phoenix Life and Pensions Limited. These mainly fall into the following categories:

- Traditional endowments and whole life policies;
- Traditional pension policies, most of which have guaranteed annuity options;
- Single premium unitised with-profits whole life bonds; and
- Unitised with-profits pension policies, some of which are reinsured in from the SAL WPF.

There is also a range of non-profit contracts in the Phoenix WPF, the majority of which fall into the following categories:

- Endowment or whole life policies;
- Term assurance policies on a guaranteed premium basis;
- Critical illness policies on a guaranteed premium basis;
- Immediate and deferred annuities; and
- Unit-linked regular and single premium pension policies, the liability for which (apart from any unitised with-profits element) is reinsured to the PLL NPF.

Appendix 4: Background to National Provident Life Limited

Introduction

National Provident Institution (“NPI”) was established in 1835 as a mutual life insurance company.

In 2000, NPLL was established to take over the existing business of NPI, subsequent to the demutualisation and acquisition of NPI by AMP Limited. This transfer was achieved by a scheme of transfer (the “NPLL Scheme”) effected under Schedule 2C of the UK Insurance Companies Act 1982 and approved by the High Court of Justice in England and Wales on 5 October 1997 and subsequently amended on 5 February 2010. All the existing business of NPI was transferred to the newly formed NPLL and NPLL was immediately closed to new business, except for increments to existing policies and new vesting pension annuities.

In December 2003, NPLL, together with NPIL, Pearl and LL, became part of a group of companies headed by HHG. HHG was created by the demerger of the UK businesses in the AMP Limited group from the Australian businesses of the group.

In December 2004, the HHG board accepted an offer of over £1 billion for Pearl, NPIL and LL and, on 13 April 2005, the three companies became subsidiaries of the newly formed PGL.

In 2010, NPLL transferred certain Self Employed Retirement Plans (“SERP” policies) to Pearl under the terms of a scheme approved by the Court on 9 February 2010 (the “Pearl SERP Scheme”).

NPLL is a wholly owned subsidiary of Pearl.

Corporate Structure

NPLL has a shareholder fund and one long-term insurance fund, which includes both with-profits and non-profit business. It holds the assets backing the Capital Funds, the Asset Share Charge Fund, the Shareholder Equalisation Fund and the Earmarked Portfolio in separate sub-funds of its long-term insurance fund (see section on Capital Support below for a description of these sub-funds).

Existing Schemes

The NPLL Scheme governed the demutualisation of NPI and the subsequent operation of NPLL.

As a consequence of the NPLL Scheme, all of NPI’s long-term insurance business was transferred into NPLL. The terms are such that the NPLL long-term insurance fund continues to operate as if it were a mutual company and eligible policyholders are entitled to 100% of the profits and losses on long-term insurance business written prior to demutualisation. Incremental business written since January 2000 (except for conventional with-profits business) is reinsured to NPIL and the shareholder is entitled to any profits and losses arising on such business (with the exception of unitised with-profits business).

Capital support

Under the NPLL Scheme, AMP Limited provided £800m of capital support (the “Life Capital Account”) to NPLL. The Life Capital Account was originally held within a separate account in the shareholder fund of NPLL, but could be drawn down into the NPLL long-term insurance fund subject to certain conditions. This drawdown was achieved by way of a transfer to the NPLL Transfer Capital Fund or by means of a contingent loan to the NPLL Loan Capital Fund. The NPLL Transfer Capital Fund and NPLL Loan Capital Fund (together, the “Capital Funds”) are separate accounts within the NPLL long-term insurance fund.

Amounts in the Capital Funds are not repayable to the extent that it is necessary to meet guarantee costs when the estate of NPLL is exhausted. Subject to this, payouts are set as far as possible excluding assets in the Capital Funds. At 31 December 2010 the nominal balance was £158m, and the shareholder value was £37m. Currently no repayments of capital or accumulated investment returns are being made.

The shareholder has also provided further support in the form of the Earmarked Portfolio (£159m at 31 December 2010). The Earmarked Portfolio provides security for policyholders in that it is available to meet guarantee costs if the estate, the Asset Share Charge Fund and the Capital Funds are all exhausted. Other than for this purpose, it is not taken into account in determining payouts.

As a result of the Pearl SERP Scheme, SERP policies in NPLL were transferred to Pearl and the part of NPLL's assets representing this transferred business (including a proportion of the Capital Funds) was also transferred to Pearl. As part of the Pearl SERP Scheme and an associated amendment to the NPLL Scheme, a Shareholder Equalisation Fund (£58m at 31 December 2010) was established in NPLL with assets from the estate. This was established to help offset the loss in value for NPLL's shareholder from the transfer and is to be paid to the shareholder on an agreed schedule subject to such payments not endangering the regulatory solvency position. It may be used to meet guarantee costs when other sources to meet those costs (except the Earmarked Portfolio) are exhausted.

Guarantee charges

In each year since 2007, a 2% charge has been taken from asset shares because the estate was expected to be required to meet guarantee costs and other costs which are chargeable to it, and since it was also likely that the Capital Funds would be required to meet guarantee costs. These charges are to help meet guarantee costs and are held in a sub-fund of the NPLL long-term insurance fund designated the Asset Share Charge Fund.

Therefore, guarantee costs are currently met from the estate in the first instance. Once this is exhausted, they will be met in turn from the Capital Funds, the Asset Share Charge Fund, the Shareholder Equalisation Fund and the Earmarked Portfolio.

Governance

As part of the NPLL Scheme, the NPLL Supervisory Board was set up to be responsible for, amongst other things, the investment and bonus policy of NPLL, and to protect policyholders' interests. It is a requirement that the majority of the NPLL Supervisory Board, including the chairman, have to be independent of the shareholder of NPLL.

The NPLL Supervisory Board also acts as a separate with-profits committee and provides independent verification that the processes followed are consistent with the PPFM, and that decisions taken by the NPLL Board have followed due process and are consistent with the PPFM.

Nature of Business of NPLL

NPLL has a range of non-profit and with-profits business, as summarised in the table below (as at 31 December 2010):

Product Type	Number of policies	Gross Mathematical Reserves (£m)	Reinsured Mathematical reserves (£m)	Net Mathematical reserves (£m)
Annuities (non-profit)	106,412	1,787	1,673	114
Life conventional with-profits	3,133	32	-	32
Pensions conventional with-profits	8,760	419	-	419
Miscellaneous	8,288	116	-	116
Life unitised with-profits	11,928	213	17	196
Pensions unitised with-profits	121,990	2,001	(13)	2,015
Deposit administration	1,433	31	-	31
Unit-linked life	6,239	85	84	1
Unit-linked pensions	140,288	1,802	1,763	38
Total	408,471	6,486	3,524	2,962

Significant Reinsurance Arrangements

Reinsurance Ceded

Pensions annuities written prior to 1 January 2000 (£694m of reserves) and Portfolio Bond policies written between 1 July 1999 and 31 December 1999 (£17m of reserves) are reinsured to Pearl.

Unit-linked funds on policies written prior to 1 January 2000 (£1,565m of reserves) are reinsured to NPIL on an investment-only basis.

All new policies and increments written in NPLL since 1 January 2000, except for conventional with-profits policies, are fully reinsured to NPIL (£1,249m of reserves).

Reinsurance Accepted

NPLL has not accepted any inward reinsurance.

Other Financing Arrangements

£260m of debt capital was raised in 1998 with Mutual Securitisation plc. The capital was secured against surplus emerging from a specific fixed block of unit-linked, unitised with-profits and capital account business. The interest and principal repayments are made from the surplus emerging from this block of business. The Transferring NPLL Policies do not form part of this securitised block.

The repayments follow a fixed payment schedule. As at 31 December 2010, the nominal amount is £147 million.

£65m of lower tier 2 subordinated debt was issued in June 2006 to Pearl. The debt is a liability of the NPLL shareholder fund but the proceeds of the issue were transferred to the NPLL long-term insurance fund as part of the Earmarked Portfolio.

Outsourcing Arrangements

NPLL has an outsourcing arrangement with PGS, which provides administrative and IT services. In turn, PGS has outsourced the customer services and much of the IT function to Diligenta Limited, a subsidiary of Tata Consulting Services.

NPLL has an investment management arrangement with HGI for investment management, record keeping and unit pricing services for the unit-linked funds. The unit pricing service is provided by BNP Paribas through an outsourcing arrangement with HGI.

The amounts that may be charged to the NPLL long-term insurance fund for administration and investment management costs are prescribed by the NPLL Scheme.

Appendix 5: Background to NPI Limited

Introduction

NPIL was established to write new business under the NPI brand subsequent to the demutualisation of NPI on 1 January 2000. The existing business of NPI was transferred to NPLL at the same time, as described in Appendix 4.

In June 2003, NPIL closed to new business although it continues to accept increments to existing business and reinsurance of new and incremental business from NPLL.

In December 2003, NPIL, together with NPLL, Pearl and LL, became part of a group of companies headed by HHG. HHG was created by the demerger of the UK businesses in the AMP Limited group from the Australian businesses of the group.

In December 2004, the HHG board accepted an offer of over £1 billion for Pearl, NPIL and LL and, on 13 April 2005, the three companies became subsidiaries of the newly formed PGL.

With effect from 31 March 2010 NPIL became a wholly owned subsidiary of PLL.

Corporate Structure

NPIL has a shareholder fund and a long-term insurance fund. The long-term insurance fund includes both unitised with-profits and non-profit long-term insurance business. The unitised with-profits benefits attaching to policies in NPIL are fully reinsured to Pearl on original terms.

For administrative purposes, the fund is divided into four separate sub-funds (one for NPI branded business, and one each for the business transferred in from PAUF, PAULP and LLLA).

Existing Schemes

In 2006, the long-term insurance business of PAUF, PAULP and LLLA was transferred to NPIL. This transfer was achieved by the scheme of transfer (the "NPIL 2006 Scheme"), effected under Schedule 2C of the UK Insurance Companies Act 1982 and approved by the High Court of Justice in England and Wales on 8 June 2006. The NPIL 2006 Scheme contained a number of provisions relating to the governance of the unit-linked funds.

Nature of Business

The business in the long-term insurance fund of NPIL, as at 31 December 2010, is summarised in the table below:

Product Type	Number of policies	Gross Mathematical reserves (£m)	Reinsured Mathematical Reserves (£m)	Net Mathematical Reserves (£m)
Annuities	19,251	1,162	617	545
Life UWP (Single Premium)	4,173	107	105	2
Pensions UWP	5,323	68	68	-
Unit-Linked Life	29,494	414	0	414
Unit-Linked Pensions	91,386	2,633	50	2,583
Miscellaneous	84	8	-	8
Total	149,711	4,392	840	3,552

Significant Reinsurance Arrangements

Reinsurance Ceded

There is one reinsurance arrangement with Opal Re where £547m of the mathematical reserves on non-profit annuities in payment are ceded.

NPIL has also ceded reinsurance to various other companies in the Phoenix Group. Specifically:

- The life and pensions unitised with-profits policies (£173m of reinsured reserves) is fully reinsured to Pearl.
- Personal pensions unit-linked liabilities (£20m of reserves) and annuities in payment (£99m of reserves) in NPIL are reinsured to Pearl.

Reinsurance Accepted

Almost all of NPLL's existing unit-linked business was reinsured on an investment-only basis into NPIL in January 2000. Since January 2000, increments on NPLL unitised with-profits and unit-linked business have been reinsured on an original terms basis into NPIL.

New pension annuities vesting in NPLL have been wholly reinsured into NPIL since 1 January 2000.

The PAUF sub-fund has accepted reinsurance of £8 million of unit-linked liabilities from Pearl.

Unit-linked funds (£13m of liabilities) are reinsured to the LLLA sub-fund of NPIL on an investment-only basis from LL.

Outsourcing Arrangements

NPIL has an outsourcing arrangement with PGS which provides administrative and IT services. In turn, PGS has outsourced the customer services and much of the IT function to Diligenta Limited, a subsidiary of Tata Consulting Services.

NPIL has an investment management arrangement with HGI for investment management, record keeping and unit pricing services for the unit-linked funds. The unit pricing service is provided by BNP Paribas through an outsourcing arrangement with HGI.

The assets backing retained immediate annuities and the assets backing the Opal Re collateral account are managed by Ignis Asset Management.

Appendix 6: SUP 18 Cross-reference

Chapter 18 of the Supervision Manual of the FSA's Handbook of Rules and Guidance ("SUP 18") sets out the FSA's requirements relating to the transfer of long-term insurance business. In particular, SUP 18.2 sets out the requirements of a scheme report in relation to the transfer of insurance business within the UK. The table below details where each of those requirements has been met within this Report.

SUP 18.2 item number and details	Section and paragraph reference in this Report
SUP 18.2.33G	
(1) who appointed the independent expert and who is bearing the costs of that appointment;	1.2, 3.29
(2) confirmation that the independent expert has been approved or nominated by the FSA;	1.2
(3) a statement of independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role;	1.4 – 1.5
(4) whether the independent expert has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest;	1.6 – 1.9
(5) the scope of the Report;	1.10 – 1.13
(6) the purpose of the scheme;	3.5 – 3.6
(7) a summary of the terms of the scheme in so far as they are relevant to the Report;	3.8 – 3.29
(8) what documents, reports and other material information the independent expert has considered in preparing his Report and whether any information that he requested has not been provided;	1.19 – 1.23, Appendix 12
(9) the extent to which the independent expert has relied on:	
(a) information provided by others; and	1.19 – 1.23, Appendix 12
(b) the judgment of others;	1.19 – 1.23, Appendix 12
(10) the people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable;	1.19 – 1.23, Appendix 12
(11) his opinion on the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee;	Sections 2, 5, 6, 7, 8 and 9
(12) what matters (if any) that the independent expert has not taken into account or evaluated in the Report that might, in his opinion, be relevant to policyholders' consideration of the scheme; and	1.12, 4.7, 4.9
(13) for each opinion that the independent expert expresses in the Report, an outline of his reasons.	Throughout the Report

SUP 18.2 item number and details	Section and paragraph reference in this Report
SUP 18.2.35G	
(1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme; and	3.16 – 3.20
(2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred.	3.11
SUP 18.2.36G	
The independent expert's opinion of the likely effects of the scheme on policyholders should:	
(1) include a comparison of the likely effects if it is or is not implemented;	Throughout the Report
(2) state whether he considered alternative arrangements and, if so, what;	1.12, 4.9
(3) where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders; and	Sections 5, 6, 7, 8 and 9
<p>(4) include his views on:</p> <p>(a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;</p> <p>(b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:</p> <p>(i) the security of policyholders' contractual rights;</p> <p>(ii) levels of service provided to policyholders; or</p> <p>(iii) for long-term insurance business, the reasonable expectations of policyholders; and</p> <p>(c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations.</p>	<p>Sections 5, 6, 7 and 8.</p> <p>Section 9, (6.9 and 7.11 for new business).</p> <p>Section 10, 3.29</p>
SUP 18.2.38G	Not applicable for the Scheme
SUP 18.2.39G	Where appropriate, sections 5, 6, 7 and 8.

Appendix 7: Summary Pillar 1 Financial Information for PLL

Table A7.1: PLL pre-scheme Estimated Pillar 1 solvency position (31 August 2011 figures)

£m	Alba WP Fund	Britannic IB Fund	Britannic WP Fund	Phoenix WP Fund	90% WP Fund	100% WP Fund	SM WP Fund	SPI WP Fund	SAL WP Fund	Non-Profit Fund	Shareholder Fund	Total ⁽⁷⁾
Capital Resources ⁽¹⁾	52	116	1,049	783	56	77	288	671	372	149	764	4,379
LTICR	69	12	134	181	4	1	92	89	208	314	3	1,108
WPICC	-	93	767	486	49	76	181	531	156	-		2,340
CRR of regulated subsidiary											69 ⁽⁶⁾	69
CRR ⁽²⁾	69	105	902	668	54	77	273	619	364	314	72	3,516
Surplus Assets in excess of CRR ⁽³⁾	(17)	12	148	115	2	-	15	52	8	(165)	692	862
Cover for CRR ⁽⁴⁾												125%
Cover for CRR (excluding WPICC) ⁽⁵⁾												173%

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to FSA rules on capital tiering.
- (2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component plus CRR of regulated subsidiary.
- (3) Capital Resources less Capital Resources Requirement.
- (4) Capital Resources divided by Capital Resources Requirement.
- (5) Capital Resources less WPICC, divided by (CRR less WPICC)
- (6) NPIL and Scottish Mutual International Limited ("SMI") are subsidiaries of PLL, and the capital resources and capital requirements of these entities are consolidated into the figures of PLL.
- (7) The figures allow for a dividend of £60m which is expected to be paid from the shareholder fund before the Effective Date.

Table A7.2: Estimated PLL post-scheme Pillar 1 solvency position (31 August 2011 figures)

£m	Alba WP Fund	Britannic IB Fund	Britannic WP Fund	Phoenix WP Fund	90% WP Fund	100% WP Fund	SM WP Fund	SPI WP Fund	SAL WP Fund	Non-Profit Fund	Shareholder Fund	Total ⁽⁷⁾
Capital Resources ⁽¹⁾	52	116	1,049	783	56	77	288	671	372	165	744	4,375
LTICR	68	12	134	181	4	1	92	89	208	344	3	1,137
WPICC	-	93	767	486	49	76	181	531	156	-		2,340
CRR of regulated subsidiary											13 ⁽⁶⁾	13
Capital Resources Requirement ⁽²⁾	68	105	902	668	54	77	273	619	364	344	16	3,490
Surplus Assets in excess of CRR ⁽³⁾	(16)	12	148	115	2	-	15	52	8	(179)	728	885
Cover for CRR ⁽⁴⁾												125%
Cover for CRR (excluding WPICC) ⁽⁵⁾												177%

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to FSA rules on capital tiering.
- (2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component plus CRR of regulated subsidiary.
- (3) Capital Resources less Capital Resources Requirement.
- (4) Capital Resources divided by Capital Resources Requirement.
- (5) Capital Resources less WPICC, divided by (CRR less WPICC).
- (6) Includes the residual value of NPIL and the value of SMI.
- (7) The figures allow for a dividend of £60m which is expected to be paid from the shareholder fund before the Effective Date.

Appendix 8: Summary Pillar 1 Financial Information for NPLL

Table A8.1: Estimated NPLL pre-scheme Pillar 1 solvency position (31 August 2011 figures)

£m	Long-term insurance fund	Shareholder Fund	Total
Capital Resources ⁽¹⁾	156	276	432
LTICR	164		164
WPICC	52		52
CRR ⁽²⁾	216		216
Surplus Assets in excess of CRR ⁽³⁾	(60)	276	217
Cover for CRR ⁽⁴⁾			200%
Cover for CRR (excluding WPICC) ⁽⁵⁾			232%

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to FSA rules on capital tiering.
- (2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component.
- (3) Capital Resources less Capital Resources Requirement.
- (4) Capital Resources divided by Capital Resources Requirement.
- (5) Capital Resources less WPICC, divided by (CRR less WPICC).

Table A8.2: Estimated NPLL post-scheme Pillar 1 solvency position (31 August 2011 figures)

£m	Long-term insurance fund	Shareholder Fund	Total
Capital Resources ⁽¹⁾	156	276	432
LTICR	131		131
WPICC	52		52
CRR ⁽²⁾	183		183
Surplus Assets in excess of CRR ⁽³⁾	(27)	276	250
Cover for CRR ⁽⁴⁾			236%
Cover for CRR (excluding WPICC) ⁽⁵⁾			290%

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to FSA rules on capital tiering.
- (2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component.
- (3) Capital Resources less Capital Resources Requirement.
- (4) Capital Resources divided by Capital Resources Requirement.
- (5) Capital Resources less WPICC, divided by (CRR less WPICC).

Appendix 9: Summary Pillar 1 Financial Information for NPIL

Table A9.1: Estimated NPIL pre-scheme Pillar 1 solvency position (31 August 2011 figures)

£m	Long-term insurance fund	Shareholder Fund	Total
Capital Resources ⁽¹⁾	16	158	174
LTICR	55		55
WPICC			
RCR	3		3
CRR ⁽²⁾	58		58
Surplus Assets in excess of CRR ⁽³⁾	(42)	158	116
Cover for CRR ⁽⁴⁾			300%

Notes:

- (1) Admissible assets less Pillar 1 liabilities (both calculated under Regulatory Peak), subject to FSA rules on capital tiering.
- (2) Long-Term Insurance Capital Requirement plus With-Profits Insurance Capital Component plus Resilience Capital Requirement.
- (3) Capital Resources less Capital Resources Requirement.
- (4) Capital Resources divided by Capital Resources Requirement.

Appendix 10: Capital Support Under the PLL Capital Policy

For the calculation referred to in paragraph 5.21, the amount required to support a with-profits fund's liabilities is the greater of the regulatory liabilities (calculated under the regulatory peak of Pillar 1 described in paragraph 5.5) and the realistic liabilities (calculated under the realistic peak of Pillar 1 described in paragraph 5.6 but excluding the distribution of the realistic surplus as a liability).

In the case of a with-profits fund in PLL having insufficient assets to meet its regulatory liabilities, the PLL Board would typically be able to implement management actions to help address the deficit before providing support. However, in some cases the ability to do so may be restricted by provisions of previous court schemes. For example, the management of the SAL WPF (see Appendix 3) must adhere to "established practice" under specific guidelines set out in the 2011 Scheme. Some of the existing with-profits funds have management actions expressed in the PLL PPFM. As at 31 August 2011, the with-profits funds within PLL requiring support under this arrangement were the Alba WPF and the SAL WPF. These with-profits funds were supported by loans from the PLL NPF with outstanding values of £99m and £174m respectively at that date.

The support would be provided by way of a loan from the PLL NPF to the extent that the PLL NPF has available surplus to make such a loan, which in practice requires that the PLL NPF can meet its own CRR under Pillar 1 after providing such support. If the amount available from the PLL NPF is insufficient, a loan would be made from the PLL shareholder fund; this would also be subject to the requirement that there would be sufficient assets in either the PLL NPF or PLL shareholder fund to be able to meet the PLL NPF's CRR after providing such support. The terms and conditions associated with such loans are set out in the PLL Internal Capital Support Arrangement agreements. Interest on any loan is calculated at a rate per annum equal to LIBOR.

In the event that insufficient capital support was available from the PLL NPF or PLL shareholder fund, the PLL Board would need to consider which, if any, of the other with-profits funds should provide support to the fund in deficit. The 2009 Scheme requires any such support to be, in the opinion of the relevant With-Profits Actuary, on terms no less favourable to the policyholders of the fund providing the support than commercial terms, and such that it will not detrimentally affect the reasonable expectations of with-profits policyholders of that fund. On the basis of the financial position as at 31 August 2011, on a Pillar 1 basis it would be necessary to burn-through over £530m of surplus assets in the PLL shareholder fund and PLL NPF without taking any remedial action before such support was required. Further information on fund level surplus assets is included in Appendix 7, Table A7.1.

Appendix 11: Description of Reinsurance Arrangements

There are currently 13 arrangements involving NPIL, plus a further quasi-reinsurance arrangement. Details of all these reinsurance arrangements are given below:

Reinsurance arrangements with NPIL as the cedant (8 arrangements)

INT01 – Portfolio Bonds from NPIL to Pearl With-Profits Fund

- This treaty, along with INT02 to INT04, covers unitised with-profits business reinsured from NPIL to the Pearl With-Profits Fund.

INT02 – Portfolio Bond II from NPIL to Pearl With-Profits Fund

- This treaty covers the second series of Portfolio Bonds.

INT03 – Investment Bond (unitised with-profits) from NPIL to Pearl With-Profits Fund

- This treaty covers Investment Bond business from 2 October 2000.

INT04 – Unitised with-profits benefits from NPIL to Pearl With-Profits Fund

- This covers unitised with-profits business written by NPIL other than that covered by INT01 – INT03 above.

INT11 - Additional temporary assurance benefits from NPIL (originally PAUF) to Pearl

- This treaty is in respect of a small rider benefit for temporary additional death benefits.

INT12 – Annuities and GAO from NPIL (originally PAULP) to Pearl (NPF and WPF)

- This treaty covers ex-PAULP business and in particular Retirement Plans and Retirement Bonds. Some of these policies include a GAO and the cost of the GAO is reinsured to the Pearl With-Profits Fund. When a policy reaches vesting, the annuity is reinsured to the Pearl Non-Profit Fund.
- Alongside the Scheme, but not as part of it, this treaty is to be amended such that new vesting annuities will not be reinsured to Pearl. For the avoidance of doubt, in-force annuities and GAO liabilities will continue to be reinsured.

INT16 – Certain non-unit linked liabilities from NPIL (originally LLLA) to LL

- This is a small treaty covering mortality risks on unit-linked business originally written by LLLA. The sum at risk on this treaty is currently zero.

INT17 – Certain pension annuities from NPIL to Opal Reassurance

- Claims under NPIL pension annuities in force at 31 December 2006 (including those that had been reinsured from NPLL under INT09 by that date) are reinsured to Opal Reassurance.

OTHER – Pension mis-selling Liability from NPIL (originally PAULP) to Pearl

- Pearl has undertaken to meet half the mis-selling liability in respect of ex-PAULP policies. This is an indemnity rather than a formal reinsurance, but is reported as a reinsurance in the FSA Returns.

Reinsurance arrangements with NPIL as the reinsurer (5 arrangements)

INT06 – Incremental unitised with-profits and unit-linked business from 1/1/2000 from NPLL to NPIL

- This treaty covers new increments in NPLL after the demutualisation.

INT07 – Unit Linked Liabilities from NPLL to NPIL

- This treaty covers the unit liability of all unit-linked policies in NPLL other than a very small block of pre-1982 Life policies.

INT09 – Immediate Annuities (post demutualisation) from NPLL to NPIL

- Although shown separately, in practice, this forms part of the same treaty as INT06 rather than being documented as a separate treaty.
- All in-force annuities reinsured under this treaty will be transferred to PLL as part of the Scheme.

INT10 – unit-linked business from Pearl to NPIL (originally PAUF)

- This is in respect of the unit-linked element of Hybrid Policies written by Pearl.

INT15 – unit-linked business from LL to NPIL (originally LLLA)

- This is in respect of the unit-linked element of Hybrid Policies written by LL and of “reinvestment bonds” (matured LL conventional policies left “on deposit” in a unit linked environment).

Appendix 12: Data and Reliances

The following sections list the items of information that I have received, reviewed and relied upon in relation to the preparation of this Report:

	Date
General	
Subject to paragraphs 1.19 to 1.23, I have relied upon information provided by National Provident Life Limited (“NPLL”), NPI Limited (“NPIL”) and Phoenix Life Limited (“PLL”, and, together with NPLL and NPIL, the “Companies”). This includes various emails and documents received from management of the Companies as well as the respective With-Profits Actuaries and Actuarial Function Holders of the Companies. Key documents which I have considered and relied upon are listed below:	
Scheme documents	
Scheme document	October 2011
PPFM	
Principles and Practices of Financial Management (PPFM) – NPLL	March 2010
Principles and Practices of Financial Management (PPFM) – NPIL	January 2007
Principles and Practices of Financial Management (PPFM) – PLL	February 2011
FSA Returns	
NPLL FSA returns for year ending 2010	31 December 2010
NPIL FSA returns for year ending 2010	31 December 2010
PLL FSA returns for year ending 2010	31 December 2010
Actuarial Function Holder and With-Profits Actuary reports on the Scheme	
Report by the PLL Actuarial Function Holder on the impact of the proposed transfer on its policyholders	October 2011
Report by the PLL With-Profits Actuary on the impact of the proposed transfer on its policyholders	October 2011
Report by the NPIL Actuarial Function Holder on the impact of the proposed transfer on its policyholders	October 2011
Report by the NPIL With-Profits Actuary on the impact of the proposed transfer on its policyholders	October 2011
Report by the NPLL Actuarial Function Holder on the impact of the proposed transfer on its policyholders	October 2011
Report by the NPLL With-Profits Actuary on the impact of the proposed transfer on its policyholders	October 2011
ICA reports	
ICA board papers for 2010	August 2011
Solvency II financials	
The Companies’ QIS5 submitted results	29 November 2010
Scheme-related financials	

	Date
Financial positions pre and post-Scheme (FM11 Solvency PLL NPIL NPLL before and after as at 31 Aug 11 pasted values v2.xlsx)	13 September 2011
FSA correspondence	
Letter from FSA approving David Murray's appointment as Independent Expert for the Scheme	10 June 2011
Correspondence between the FSA and the Companies containing questions and answers concerning the Scheme	July - September 2011
Previous Part VII transfers	
2009 Scheme document	11 February 2011
NPIL 2006 Scheme document	8 June 2006
Other	
Capital policy review for NPLL, NPIL and PLL	9 November 2010
Capital support arrangements for the PLL NPF and PLL shareholder fund	February 2011
Summary of reinsurance arrangements affected by the Scheme	September 2011
Solvency Update for The Phoenix Group Insurance Companies ("FSA Solvency Update Oct_07 broken links.doc")	7 October 2011
Customer communications	
Policyholder communications pack	October 2011

Appendix 13: NPIL 2006 Scheme Certificate

Opinion under Clause 21.2 of the NPIL 2006 Scheme

- Clause 21.2 of the NPIL 2006 Scheme provides that any application to the Court to amend its terms must be accompanied by a certificate from the Independent Expert (or another person approved by the FSA for such purpose) to the effect that in his opinion the proposed amendment will not materially adversely affect the benefit security of any relevant Policyholder. "Policyholder" as defined in the NPIL 2006 Scheme has the meaning set out in FSMA 2000 (meaning of "Policy" and "Policyholder") Order 2001 (SI 2001 / 2361) and as such, in the context of the Scheme, applies to all Transferring NPIL Policyholders.
- I have been asked to provide the certificate required by clause 21.2 of the NPIL 2006 Scheme, as the Scheme replaces the NPIL 2006 Scheme in its entirety. For the purposes of clause 21.2, I have interpreted the replacement of the NPIL 2006 Scheme by the Scheme as an amendment of the NPIL 2006 Scheme.
- As such, for the reasons set out in section 7 of this Report, I am satisfied that the security of benefits of the Transferring NPIL Policyholders will not be materially adversely affected by the Scheme. In particular, I am satisfied that the level of financial strength in PLL is at least as strong as that in NPIL.
- The NPIL 2006 Scheme was concerned with the transfer of unit-linked business only, and therefore contains limited provisions relevant to the ongoing management of NPIL's business. However, except as noted below, the Scheme preserves the restrictions on the range of unit-linked funds between which NPIL policyholders are entitled to switch and the powers of the NPIL Board to amalgamate unit-linked funds or change the investment objectives of unit-linked funds provided for under the NPIL 2006 Scheme. The one exception relates to the wind up of unit-linked funds, since the Scheme provides that PLL will be entitled to wind up Former NPIL Linked Funds where the value of assets in a fund falls below £5m (increased in line with RPI since 31 December 2006). However, I consider that this amendment to the operation of NPIL's current business will have no adverse impact on the security of Transferring NPIL Policyholders, which I consider in paragraphs 7.14 to 7.20.

Appendix 14: Glossary

Actuarial Function Holder is the actuary responsible for performing the actuarial function of a long-term insurer, which includes advising the directors of the insurer on the risks the firm runs, the capital required to support those risks and the monitoring required as well as the valuation of its long-term liabilities.

BCRR is the Base Capital Resources Requirement stipulated in the FSA Handbook.

Capital Resources is the excess of Pillar 1 admissible assets over Pillar 1 regulatory liabilities under the regulatory capital framework specified in the FSA Handbook.

Capital Resources Requirement (“CRR”) is a component of the regulatory capital framework specified in the FSA Handbook, specifically in relation to the Pillar 1 capital measure for life insurance companies. Companies must maintain Capital Resources in excess of the CRR.

Companies means PLL, NPIL and NPLL.

Court is the High Court of Justice in England and Wales.

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Effective Date is 1 January 2012 or any later date that is agreed, being the date on which the Scheme is to be treated as having taken effect between NPLL, NPIL and PLL (including for accounting purposes).

Existing PLL Policyholders are the policyholders in the PLL long-term insurance fund prior to the Transfer Date.

FSA is the Financial Services Authority, which is the independent, non-governmental body that regulates the UK insurance industry.

FSA Handbook of rules and guidance is issued by the FSA from time to time made pursuant to the FSMA together with the rules and regulations implemented pursuant thereto.

FSMA is the Financial Services and Markets Act 2000.

GRB is gross roll up business.

HMRC is HM Revenue and Customs, the government department responsible for collecting and administering taxes.

Hybrid Policy is a policy with attaching unit-linked and unitised with-profits investment elements.

Independent Expert refers to Mr David Murray of Deloitte MCS Limited whose appointment, which has been approved by the FSA, involves producing a Scheme Report under the requirements of the FSMA, reflecting the guidance provided by SUP 18.2 of the FSA Handbook.

Individual Capital Assessment (“ICA”) is a component of the regulatory capital framework specified in the FSA Handbook, specifically in relation to the Pillar 2 capital measure for companies.

Individual Capital Guidance (“ICG”) is any additional amount of capital which the FSA may require a company to hold in addition to its ICA.

LL means London Life Limited, a company incorporated in England and Wales with registered number 1179800, which was formerly known as London Life Managed Funds Limited.

LLLA means London Life Linked Assurances Limited

Long-Term Insurance Capital Requirement (“LTICR”) is a component of the regulatory capital framework specified in the FSA Handbook, specifically in relation to the Pillar 1 capital measure for life insurance companies.

Non-Profit Policy is a policy (including any unit-linked policy unless stated otherwise) which is not entitled to share in the profits of the company in which it is located, including term assurance and income protection policies where specified benefits are payable on death or incapacity.

Non-Transferring NPLL Policy is a policy in the in the long-term insurance fund of NPLL which is not intended to transfer to PLL under the Scheme.

NPIL means NPI Limited, a company incorporated in England and Wales with registered number 3725037.

NPIL 2006 Scheme means the scheme approved by order of the Court dated 8 June 2006 and amended by order of the Court dated 14 September 2006, providing for the transfer to NPIL of the long-term insurance business of Pearl Assurance (Unit Linked Pensions) Limited, Pearl Assurance (Unit Funds) Limited and London Life Linked Assurances Limited.

NPLL means National Provident Life Limited, a company incorporated in England and Wales with registered number 3641947.

Overseas Schemes are the local schemes in Jersey and Guernsey to effect the transfer of long-term insurance business based in those jurisdictions to PLL.

PAULP means Pearl Assurance (Unit Linked Pensions) Limited.

PAUF means Pearl Assurance (Unit Funds) Limited.

Pearl means Pearl Assurance Limited, a company incorporated in England and Wales with registered number 1419.

Pearl SERP Scheme means the scheme approved by the order of the Court dated 9 February 2010 providing for the transfer to Pearl of part of the long-term insurance business of NPLL.

PGMS is Phoenix Group Management Services.

PGS is Pearl Group Services Limited.

Pillar 1 is one of the bases of the regulatory capital framework specified by the FSA Handbook, required to be calculated by UK insurance companies in order to report their solvency positions to the FSA and for public disclosure in the FSA Returns.

Pillar 2 is one of the bases of the regulatory capital framework specified by the FSA Handbook, required to be calculated by UK insurance companies in order to privately report their solvency positions to the FSA.

PLL means Phoenix Life Limited, a company incorporated in England and Wales with registered number 1016269.

PLL NPF is the non-profit sub-fund of the long-term insurance fund of Phoenix Life Limited.

PLL With-Profits Committee means the With-Profits and SPI WPF Supervisory Committee of PLL with responsibility for supervising the PLL with-profits funds in accordance with the 2009 Scheme and 2011 Scheme.

Principles and Practices of Financial Management (“PPFM”) is a public document required to be produced by any life insurance company writing with-profits business, which expresses the principles and practices governing operation of the with-profits business, including (inter alia) investment policy and bonus policy.

QIS5 is the fifth Quantitative Impact Study which took place in 2010, to estimate the possible impact of the introduction of the Solvency II requirement.

Resilience Capital Requirement (“RCR”) is a component of the regulatory capital framework specified in the FSA Handbook, specifically in relation to the Pillar 1 basis for life insurance companies who are not required to report under the realistic peak.

Realistic Peak is a calculation performed on a realistic, market consistent basis, with an RCM, as a regulatory requirement under the Pillar 1 basis for life insurance companies with a with-profits fund in excess of £500m.

Regulatory Peak is a calculation performed as a regulatory requirement under the Pillar 1 basis for all life insurance companies, where asset values are based on market value, liabilities are valued with prudential margins and solvency capital, expressed as a percentage of liabilities and a rate per mille of sums at risk, is required in addition to the liabilities.

Report is this Report, as required under the terms of FSMA, Chapter 8 (109).

Reserves are determined by performing a calculation, in respect of a policy or group of policies, of the present value of future benefits and expenses less premiums or charges, using specified assumptions for future experience.

Risk Capital Margin (“RCM”) is the amount of Capital Resources that the company must hold under the realistic peak calculation within the Pillar 1 assessment.

Scheme is the proposed transfer of long-term insurance business from NPLL and NPIL to PLL under Part VII of the FSMA.

Transferring NPIL Policies are all policies of the NPIL long-term insurance fund.

Transferring NPIL Policyholders are the holders of Transferring NPIL Policies.

Transferring NPLL Policies are annuity policies reinsured to NPIL which are intended to be transferred from NPLL to PLL under the Scheme.

Transferring NPLL Policyholders are the holders of Transferring NPLL Policies.

Transferring Policies are all Transferring NPIL Policies and Transferring NPLL Policies.

Solvency II is the new solvency regime for all EU insurers and reinsurers, due to come into effect on 1 January 2013.

Transfer Date is the date on which the Scheme is expected to become operative (subject to the approval of the Court), which is expected to be 27 February 2012.

Unitised With-Profits Policy is any policy under which the value of the benefits is or may be measured in whole or in part by reference to the number and price of with-profits units (a notional unit whose value varied by reference to bonuses declared by the company) allocated to that policy.

With-Profits Actuary is the actuary responsible for advising the directors of a company on discretionary aspects of with-profits business.

With-Profits Benefit Reserve (“WPBR”) forms part of the realistic peak calculation and generally represents the sum of the asset shares of the with-profits business.

With-Profits Fund is a fund where holders of with-profits policies have a right to share in the profits of the company or part thereof.

With-Profits Insurance Capital Component (“WPICC”) is an addition made to the Pillar 1 regulatory peak capital requirements to account for the difference if excess assets after the RCM on the realistic peak are less than those under the regulatory peak.

With-Profits Policy is a policy which is entitled to share in some of the profits of the company or part thereof.

2009 Scheme means the scheme approved by order of the Court dated 30 January 2009, providing for the transfer to PLL of certain of the long-term insurance businesses of Scottish Mutual Assurance Limited and Scottish Provident Limited and providing for the management of the PLL long-term insurance fund.

2011 Scheme means the scheme approved by order of the Court dated 11 February 2011, providing for the transfer to PLL of the long-term insurance business of Phoenix & London Assurance Limited.

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