**Proposed Scheme for the transfer to Scottish Widows Limited of certain long-term insurance business of Zurich Assurance Ltd**

**Report of ZAL's**

**Chief Actuary**

**on the Proposed Transfer of**
**Business Pursuant to Part VII of the Financial Services and Markets Act (2000) ("FSMA").**

Keith Jennings, FIA
Chief Actuary
01 February 2019

## Contents

# 1 Introduction

## *1.1 Background*

1.1.1 The purpose of this report (this 'Report') is to describe the impact on the policyholders of Zurich Assurance Ltd ('ZAL') of the proposed insurance business transfer scheme under Part VII of the Financial Services and Markets Act 2000 (the 'Scheme'), the objective of which is to transfer the Transferring Policies (being the majority of ZAL's Group Defined Contribution business, Zurich Corporate Savings, 'ZCS'), to Scottish Widows Limited ('SWL').

Please note that the Scheme refers to Transferred Policies and the Transferred Business but in this Report I refer to Transferring Policies and the Transferring Business.

1.1.2 In particular, this Report states how the proposed Scheme would affect the security of the policyholders' benefits and their reasonable benefit expectations, and how, in my view, the Scheme is consistent with the regulatory requirement to treat customers fairly.

1.1.3 I am writing this Report in my capacity as the Chief Actuary of ZAL. This Report is addressed to the Board of Directors of ZAL, but will also be provided to the ZAL With-Profits Actuary, the Independent Expert, the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA') in order to assist their assessments of the proposals. It should be read in conjunction with the Scheme, the With-Profits Actuary's Report on the Scheme, and the Independent Expert's Report on the Scheme.

1.1.4 In this Report I have not restricted my assessment of the proposed Scheme to adverse effects.

1.1.5 I will provide a supplementary report (the 'Supplementary Report') nearer the date of the Court hearing in order to update my conclusions to reflect any published financial information or significant events after the date of the finalisation of this Report.

## *1.2 Independent Expert*

1.2.1 John McKenzie of Hymans Robertson LLP has been approved as the Independent Expert for this Scheme, his appointment was approved by the Prudential Regulation Authority ("PRA"), having consulted with the Financial Conduct Authority ("FCA").

## *1.3 Disclosures*

1.3.1 I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 2003, and hold a certificate issued by the Institute and Faculty of Actuaries to act as Chief Actuary (Life). I joined Zurich as Chief Life Actuary in October 2018 and obtained PRA approval to perform the SIMF20 Chief Actuary regulated role on 31 December 2018. I have worked closely during that period with David King, the preceding SIMF20 Chief Actuary. I have over 15 years of experience working in the UK insurance industry, including 10 years performing a Chief Actuary role.

1.3.2 I hold a savings insurance policy with ZAL which would be transferred under the Scheme to SWL. I am a member of the Zurich Financial Services UK Pension Scheme defined contribution pension arrangement. I have a direct interest in shares of the Zurich Insurance Group Ltd ('ZIG'), and I am entitled to participate in the Zurich Group's Long Term and Short Term Incentive Plans.

1.3.3 I confirm that my financial and personal interests in ZIG have not influenced me in reaching any of the conclusions detailed in this Report.

1.3.4 I do not hold any policies with SWL and have no direct interest in the shares of SWL or their investors.

## *1.4 Compliance with Actuarial Standards*

1.4.1 The Financial Reporting Council has issued standards known as Technical Actuarial Standards (TAS). Two standards applicable to this Report were in effect at the date of its preparation:

- Technical Actuarial Standard 100: Principles for Technical Actuarial Work, effective 1 July 2017
- Technical Actuarial Standard 200: Insurance, effective 1 July 2017

This Report has been prepared in accordance with these standards.

1.4.2 This Report has also been prepared in accordance with the Actuarial Professional Standard APS X2: Review of Actuarial Work. The drafting of this Report included an internal review by a senior actuary in the company, Matthew Brownlie FIA.

## *1.5 Guidance on usage*

1.5.1 This Report should be read in conjunction with the Scheme, the Independent Expert's Report, ZAL's With-Profits Actuary's Report, the Reports by SWL's Chief Actuary and With-Profits Actuary.

## *1.6 Reliances*

1.6.1 In preparing this Report, I have been provided with information from SWL on the financial position and practices of SWL, including pro forma estimates of the solvency position of SWL post-transfer. I have also had access to SWL management to discuss this information. I have reviewed this information for consistency and reasonableness using my knowledge of the UK life assurance industry, SWL's published 2017 Annual Reports and Accounts and Solvency and Financial Condition Report for 31 December 2017, but have not otherwise verified this information.

1.6.2 I have read the Report prepared by Mr Martin Godwin, the With-Profits Actuary of ZAL. I have considered his comments on the effect of the Scheme on the various With-Profits policyholders and his conclusions.

1.6.3 I have read the Report prepared by Mr James Hillman, the Chief Actuary of SWL. I have considered his comments on the effect of the Scheme on the various policyholders and his conclusions.

1.6.4 I have read the Report prepared by Mr Alasdair Smith, the With-Profits Actuary of SWL. I have considered his comments on the effect of the Scheme on the various With-Profits policyholders and his conclusions.

1.6.5 I have read the Report prepared by Mr John McKenzie, the Independent Expert to the Scheme. I have considered his comments on the effect of the Scheme on the various policyholders and his conclusions.

1.6.6 In coming to my conclusions, I have relied upon the accuracy of this information and set out in the reports noted above.

### *1.7 Definitions and Abbreviations*

1.7.1 A list of the definitions and abbreviations that I have used in this document is included in Appendix A.

### *1.8 Structure of the Report*

1.8.1 This Report is structured as follows:

- Section 2 provides an overview of ZAL;
- Section 3 provides an overview of SWL
- Section 4 outlines the proposed Scheme;
- Section 5 considers the estimated financial position before and after the proposed Scheme;
- Section 6 sets out the effect of the Scheme on the remaining ZAL policyholders;
- Section 7 sets out the effect of the Scheme on the transferring ZAL policyholders;
- Section 8 sets out my conclusions;
- Appendix A lists the definitions and abbreviations used in this Report.

# 2 Overview of ZAL

## *2.1 Background*

2.1.1 ZAL is a UK registered, wholly-owned indirect subsidiary of ZIG, a company incorporated in Switzerland, which is the ultimate holding company of the Zurich group of companies. ZAL is regulated in the UK.

2.1.2 ZAL is authorised by the PRA and regulated by the FCA and the PRA.

2.1.3 The company was formed in 1990 as Climbcourt Limited, with the name changed to Eagle Star Life Assurance Company Limited (ESLAC) later that year. The UK long-term business of Eagle Star Insurance Company Limited was subsequently transferred into ESLAC in 1991.

In 2004, the name of ESLAC was changed to Zurich Assurance Ltd (i.e. ZAL). Immediately following that in 2005, other long-term insurance business was transferred into ZAL, namely that of:

- Allied Dunbar Assurance plc
- Zurich Assurance plc
- City of London Insurance Company Limited; and
- Pilot Assurance Company Limited

ZAL has continued writing a wide range of new business since this time, some of which has been marketed under the Sterling brand name.

2.1.4 ZAL manages its business as five separate funds including a Shareholder Fund. The other four funds are the 90:10 With-Profits Fund, the 100:0 With-Profits Fund, the Defined Charge Participating Fund and the Non-Profit Fund.

2.1.5 Shareholders are entitled to 100% of any surplus from the Non-Profit Fund. The policies in the Defined Charge Participating Fund (DCP) do not participate in any profits of the company, but a percentage of the surplus arising in the fund is required to be transferred to the 100:0 With-Profits Fund. The operation of this transfer is described more fully in section 6.2.9. The shareholder is entitled to the remaining surplus arising in the DCP Fund. The 90:10 With-Profits Fund and 100:0 With-Profits Fund contain With-Profits business. The surplus in these funds is required to be distributed between policyholders and the shareholder in the ratios 90:10 and 100:0 as applicable for each fund.

2.1.6 As required by Solvency II, ZAL manages the 90:10 With-Profits Fund and the 100:0 With-Profits Fund as separate ring-fenced funds, meaning that the assets in these funds can only be used in respect of these funds. This causes a small restriction on ZAL's total Own Funds, as assets in each ring-fenced fund cannot be used to support liabilities arising outside that fund. This means that excess assets in the ring-fenced funds are not available to support ZAL's solvency ratio and hence an adjustment is applied to remove those excess assets from the solvency calculation.

### 2.2 Business

2.2.1 Below is a summary of the in-force business of ZAL at 31 December 2017:

**Table 1: ZAL Solvency II Technical Provisions at 31 December 2017**

| Line of Business | Gross of Reinsurance (£m) | Reinsurance Ceded (£m) | Net of Reinsurance (£m) |
|---|---|---|---|
| Health Insurance | 315 | (137) | 178 |
| Insurance With-Profits Participation | 1,462 | 1 | 1,462 |
| Index-Linked and Unit-Linked Insurance | 49,022 | (16,048) | 32,975 |
| *Of which: Estimated Share Associated with Transferring Policies* | *21,191* | *(16,045)* | *5,146* |
| Other Life Insurance | 1,440 | (962) | 477 |
| Technical Provisions | 52,239 | (17,146) | 35,092 |
| Other Liabilities | 910 | | 910 |
| **Total Liabilities** | **53,149** | **(17,146)** | **36,003** |

2.2.2 ZAL writes a wide range of life insurance business, with new business focussed on the individual and corporate protection markets.

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## 2.3 Solvency Ratio of ZAL

2.3.1 ZAL's Solvency II capital position at 31 December 2017 was as follows:

**Table 2: ZAL Solvency Position as at 31 December 2017**

| All figures are in £m | 31/12/2017 |
|---|---|
| Total Assets | 55,165 |
| Total Liabilities | (53,149) |
| Excess of Assets over Liabilities | 2,016 |
| Adjustment for Restricted Own Funds Items in Respect of Ring Fenced Funds | (132) |
| Foreseeable dividends, distributions and charges | 0 |
| Subordinated Liabilities | 0 |
| Total Eligible Own Funds to Meet the Solvency Capital Requirement | 1,885 |
| Solvency Capital Requirement | 1,177 |
| ***Ratio of Eligible Own Funds to Solvency Capital Requirement*** | ***160%*** |

## 2.4 Risk Profile of the ZAL Business

2.4.1 The risk profile of ZAL is characterised by the fact it writes a broad range of life insurance business and is exposed to the risks typical of long term insurance, including:

- Market risk from the impact of market movements on the assets ZAL holds backing policyholder liabilities;
- Insurance risks, particularly in respect of mortality, longevity, lapses and expenses;
- Operational risk, including in respect of strategic initiatives to develop ZAL's business;
- Credit risk, particularly in respect of holdings in investment grade corporate bonds; and
- Counterparty risk as a result of reassurance placed with other insurers.

2.4.2 Zurich operates a pension scheme for UK employees with both defined benefit and defined contribution sections. The defined benefit sections of the pension scheme are closed to new entrants and, with effect from 1 January 2016, to future benefit accrual. All employees are now eligible to participate in the defined contribution section. ZAL is not directly exposed to pension scheme risk as two management services companies (Zurich Employment Services Limited for Life business staff and Zurich UK General Employee Services Limited for General business staff) are the participating employers in the pension scheme and ZAL would not normally be responsible for making any payments to reduce any deficit. ZAL does, however, hold capital against the risk associated with the staff pension scheme as part of its Solvency Capital Requirement.

## 2.5 Capital Management Policy

2.5.1 In line with insurance companies across the European Union, ZAL moved to managing its capital on a Solvency II basis from 1 January 2016. The Solvency Capital Requirement ('SCR') that ZAL is required to hold under Solvency II is a risk-based measure which allows for the nature of ZAL's business.

2.5.2 ZAL holds a capital buffer above its regulatory minimum to protect itself against short term volatility. ZAL's capital management policy sets out a target range for the capital buffer, such that ZAL's SCR cover is appropriately protected against movements in capital resources and capital requirements whilst avoiding holding an excessive level of capital.

2.5.3 If ZAL's solvency were to fall below the target range, actions would be taken to restore this, such as by reducing the risks ZAL is taking (e.g. by reducing sales of new business), or by obtaining capital funding from another Zurich Group company. If ZAL's solvency were to rise above the target range, ZAL would consider making a distribution to the shareholder to reduce its solvency to the upper level of the target range, subject to any other constraints.

2.5.4 Before making any distribution ZAL would also consider its Own Risk and Solvency Assessment (ORSA), which is ZAL's forward looking assessment of its expected future risk profile and solvency position.

## *2.6 Contingent Funding Agreement*

2.6.1 ZAL has an agreement in place with ZIG which would provide up to £833m of contingent funding to ZAL if certain events occur:

- Up to £200m will be made available following a Regulatory Event.
- Up to a further £633m will be made available following an Insolvency Event.

For these purposes a Regulatory Event means

*a)* the eligible own funds of ZAL available to cover its SCR are less than the 99.6% confidence level over a one year time frame; or

*b)* some other equivalent regulatory capital requirement of the relevant supervisory authority remains unfulfilled.

and an Insolvency Event means that ZAL is within £50m of becoming insolvent for the purposes of Section 123 of the Insolvency Act 1986.

2.6.2 The amount of the funding available is reduced in certain circumstances, for example where additional share capital is issued. The termination date of the funding agreement is 28 November 2043. To date ZAL has not drawn down any capital under this agreement.

# 3 Overview of SWL

### *3.1 Background*

3.1.1 In this section I present an overview of SWL, using information from the 2017 Scottish Widows Group ('SWG') Solvency and Financial Condition Report ('SFCR') and information provided to me by SWL.

3.1.2 SWL was incorporated in 1996 under the name Clerical Medical Investment Group Limited but its name was changed to SWL on 31 December 2015, at the same time as the implementation of the Lloyds Banking Group Insurance ('LBGI') 2015 Scheme, under which the business of seven other life insurance subsidiaries of SWG were transferred to SWL.

3.1.3 Following the implementation of the LBGI 2015 Scheme, SWL comprises two separate With-Profits funds (the Scottish Widows With-Profits Fund and the Clerical Medical With-Profits Fund") and a 'combined fund', which comprises all of SWL's assets and liabilities not attributed to the With-Profits funds.

3.1.4 SWL is a proprietary company authorised by the PRA and regulated by the FCA and the PRA.

### *3.2 Business*

3.2.1 SWL's technical provisions are outlined by broad line of business in the table below:

**Table 3: SWL Solvency II Technical Provisions at 31 December 2017**

| Line of Business | Gross of Reinsurance (£m) | Reinsurance Ceded (£m) | Net of Reinsurance (£m) |
|---|---|---|---|
| Health Insurance | 217 | (53) | 163 |
| Insurance With-Profits Participation | 15,239 | (22) | 15,217 |
| Index-Linked and Unit-Linked Insurance | 81,159 | (7,777) | 73,382 |
| Other Life Insurance | 15,595 | (183) | 15,412 |
| Accepted Reinsurance | 710 | - | 710 |
| Technical Provisions | 112,919 | (8,036) | 104,884 |
| Other Liabilities | 7,586 | - | 7,586 |
| **Total Liabilities** | **120,505** | **(8,036)** | **112,469** |

Source of figures: 2017 Scottish Widows Group SFCR – Table SWL - S.12.01.02

3.2.2 SWL's With-Profit funds are closed to new business other than in relation to increments or other similar contractual rights. For all other product lines SWL actively markets new business in the UK.

### *3.3 Solvency Ratio of SWL*

**Table 4: SWL Solvency Position as at 31 December 2017**

| All figures are in £m | 31/12/2017 |
|---|---|
| Total Assets | 128,687 |
| Total Liabilities | (120,505) |
| Excess of Assets over Liabilities | 8,182 |
| Adjustment for Restricted Own Funds Items in Respect of Ring Fenced Funds | (925) |
| Foreseeable dividends, distributions and charges | (540) |
| Subordinated Liabilities | 1,696 |
| Total Eligible Own Funds to Meet the Solvency Capital Requirement | 8,412 |
| Solvency Capital Requirement | 6,014 |
| ***Ratio of Eligible Own Funds to Solvency Capital Requirement*** | ***140%*** |

Source of figures: 2017 Scottish Widows Group SFCR – Tables SWL - S.02.01.02 and SWL - S.23.01.01

### *3.4 Risk Profile of the SWL Business*

3.4.1 The most material risks facing the Scottish Widows Group, of which SWL is the largest legal entity, are:

- Market risk, particularly those in relation to equity and credit spreads on corporate bond and loan assets;
- Underwriting risks, of note are exposures to the risks associated with longevity; persistency and expenses;
- Operational risk, the largest components of which come from regulatory risk, German litigation, financial reporting, conduct, business and information security.

### *3.5 Capital Management Strategy*

3.5.1 In line with insurance companies across the European Union, SWL moved to managing its capital on a Solvency II basis from 1 January 2016. The Solvency Capital Requirement (SCR) that SWL is required to hold under Solvency II is a risk-based measure which allows for the nature of SWL's business.

3.5.2 The 2017 Scottish Widows Group SFCR confirms the capital management strategy followed by the Scottish Widows group, namely that:

*"The insurance group's objectives when managing capital are:*

- *to have sufficient capital to safeguard the insurance group's ability to continue as a going concern so that it can continue to provide returns for the shareholder and benefits for other stakeholders;*
- *to comply with the insurance capital requirements set out by the PRA in the UK;*
- *when capital is needed, to require an adequate return to the shareholder by pricing insurance and investment contracts according to the level of risk associated with the business written; and to meet the requirements of the Schemes of Transfer.*

*The capital management strategy is such that the insurance group will hold capital in line with the stated risk appetite for the business, which is to be able to withstand a stress event without reaching the capital requirements. It is intended that all surplus capital above that required to meet risk appetite limits will be distributed to LBG."*

# 4 Summary of the Proposed Scheme

## *4.1 Background*

4.1.1 Following a review of its business, ZAL concluded that group defined contribution business within its ZCS segment is no longer a core part of its business strategy. As a result, ZAL agreed to the sale of the ZCS business to SWL.

This is in keeping with the Zurich Group's overarching strategy, to grow in markets where it is performing strongly and to focus on markets where it can best serve its customers and distributors. Following a review of its business in the UK, ZAL's Board concluded that a disposal of its workplace pensions business, together with the Zurich Group's policy administration system known as the 'Corporate Savings Platform', would be in line with that strategy.

4.1.2 The ZCS business administers defined contribution pension schemes in respect of UK companies. This business comprises Investment Only Policies, Trust Based Policies and Contract Based Policies. The costs and charges associated with this business are accounted for within the accounts for the Defined Charge Participating ('DCP') Fund.

4.1.3 While the business was focussed on UK companies, there are a small number of policies held by policyholders resident in Guernsey and ZAL also holds a Jersey insurance permit. As such, separate insurance business transfer schemes will be required to be undertaken in these two jurisdictions.

## *4.2 Scheme Summary*

4.2.1 On 1 July 2019 (the 'Effective Date'), the Transferring Policies would be transferred from ZAL to SWL. Thereafter, these policies would become solely the responsibility of SWL and ZAL would cease to be responsible for these policies.

**Note:** The Effective Date is after the intended date for the United Kingdom to leave the European Union ('Brexit'). I have separately considered the impact of Brexit in each of sections 5, 6 and 7 .

4.2.2 In the remainder of this report I use the term 'Remaining Policies' to refer to all of ZAL's policies that are not Transferring Policies, and 'Remaining Policyholders' and 'Transferring Policyholders' to refer to the respective policyholders.

4.2.3 The Transferring Policies constitute the majority of the ZCS business. Certain policies of the ZCS business are excluded from the transfer ('Excluded Policies') as follows:

- Those relating to certain policies issued to trustees resident in the Channel Islands.
- Where one or more members of the associated workplace pension plan is invested in, or has the option to invest in, the With-Profits funds.
- Where one or more members of the associated workplace pension plan is invested in, or has the option to invest in, the Zurich Secure Managed fund.
- Certain policies that ZAL and SWL have agreed will be excluded from the transfer for specific, commercial reasons (for example if a trustee has notified the parties of its intention to end its ZCS policy).

For the avoidance of doubt, Excluded Policies are a subset of the Remaining Policies.

4.2.4 Certain liabilities relating to the Transferring Policies will not be transferred under the Scheme, including certain liabilities accrued or referable to the period up to and including the Effective Date. These liabilities will remain with ZAL following the transfer.

4.2.5 The majority of ZAL's policies are not included within the Scheme and so would not be transferred by the Scheme. ZAL would continue to be responsible for these Remaining Policies and would continue to pay claims and service these policies in the normal manner. In Section 6, I consider the impact on policies that are not transferring under the Scheme.

4.2.6 ZAL's share of the legal and other costs incurred in preparing and implementing the Scheme will be met by the Shareholder Fund of ZAL.

4.2.7 Below is a summary of the policies proposed to be transferred under the Scheme as at 31st December 2017.

**Table 5: Transferring Policies as at 31 December 2017**

| | Number of Policies | Value of Unit Fund (£m) |
|---|---|---|
| Trust Based | 239,909 | 4,042 |
| Contract Based | 68,790 | 1,032 |
| Stakeholder | 55,824 | 994 |
| Investment Only | 71 | 15,114 |
| **Total Transferring** | **364,594** | **21,182** |
| **Total ZCS Business** | **378,106** | **21,547** |

**Note:** For the Trust Based, Contract Based and Stakeholder categories in the table above the policy count refers to the number of members, within the ZCS business, for which ZAL holds records for the purpose of administering the business.

Due to the nature of the Investment Only products, the count for that category refers to the number of contracts rather than the count of underlying members.

The product categories described above are described in Appendix A: Terms and definitions.

4.2.8 The technical provisions (gross of reinsurance) for the Transferring Policies amounted to approximately £21bn as at 31 December 2017, almost all of which relates to the unit funds held on behalf of the associated customers. The value of technical provisions associated with the Transferring Policies will change over time in response to investment performance and through the actions of policyholders, for example, members leaving or joining a pension scheme.

4.2.9 If the Scheme has not taken effect by 1 October 2019 (or if later, in the case of the Jersey Scheme and the Guernsey Scheme, three months after the Effective Date), and unless otherwise extended with the approval of the Court, the Scheme will lapse and ZAL will retain the Transferring Policies, assets and associated liabilities.

<u>Changes to Terms and Conditions:</u>

4.2.10 In addition to the changes to the terms and conditions of the Transferring Policies that are necessary in order to substitute SWL for ZAL, the Scheme will also make further limited amendments to the terms and conditions of certain categories of the Transferring Policies (namely Occupational Money Purchase Plans, Group Stakeholder Pension Plans and Group Transfer Plans).

4.2.11 At the moment, the terms and conditions of these Transferring Policies make reference to certain activities being carried out by a separate "platform operator", "website provider" and "payment agent" (being Sterling ISA Managers Ltd, 'SIML', in the case of the platform operator and website provider roles, and Scottish Widows Administration Services Ltd, 'SWASL', in the case of the payment agent). The references to these separate roles in the terms and conditions reflects the way Zurich has historically operated its workplace pension business. However, following the Effective Date, SWL intends to be directly responsible for carrying out all aspects of the administration of the Transferring Policies and the Scheme therefore includes provisions that will amend the terms and conditions so that SWL will carry out all of the activities previously carried out by the platform operator, website provider and payment agent.

# 5 Financial Position Before and After the Proposed Scheme

## *5.1 Introduction*

5.1.1 The Solvency II regulatory regime came into effect on 1 January 2016. This is a European Union (EU) regulatory framework for insurers covering capital adequacy requirements, risk management and disclosure.

The Solvency II regime will remain the relevant regulatory regime for UK insurance companies up until the intended date for the UK to leave the European Union ("Brexit"), and is likely to remain so during any subsequent transitional period negotiated between the UK and the EU. Beyond this date, the regulatory regime is nevertheless expected to remain broadly aligned as the UK regulators seek to negotiate a status as a Solvency II equivalent regime.

However, given the uncertainty, I will provide an update in my Supplementary Report detailing the likely impact on this Scheme of any Brexit related regulatory changes.

5.1.2 Under Solvency II, insurance liabilities are valued using best estimate assumptions plus a risk margin to allow for uncertainty. In addition to the insurance liabilities, insurers must hold capital to protect against adverse events. As noted in section 2.5.1, the capital insurers must hold under Solvency II is referred to as the SCR.

5.1.3 Firms may choose to calculate the SCR using either the "standard formula", as prescribed by the European Insurance and Occupational Pensions Authority (EIOPA), or subject to PRA approval, an internal model. ZAL has chosen to adopt the standard formula approach, whereas SWL has chosen to adopt an internal model.

Under the standard formula the SCR is calculated by considering the impact of specified stresses, then combining the impact of these stresses in a specified way.

5.1.4 ZAL has assessed the appropriateness of using a standard formula approach as opposed to an internal model and ZAL has concluded that the standard formula approach, alongside its Capital Management Policy (section 2.5), is currently considered appropriate in order to ensure that ZAL maintains sufficient capital.

5.1.5 SWL has confirmed that an internal model approach, alongside its Capital Management Policy, is currently considered appropriate for its risk profile.

5.1.6 Both ZAL and SWL are required to hold own funds at least equal to the SCR at all times. Should a company's own funds fall below the SCR, the company must put in place an action plan to rectify the position.

5.1.7 The SCR is intended to ensure the company can meet its liabilities in full, even in a severe adverse scenario that might only be expected to occur once every 200 years. Both ZAL and SWL also choose to hold a capital buffer on top of the SCR as outlined in section 2.5 and 3.5 respectively.

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## 5.2 *ZAL's Solvency II Capital Position*

5.2.1 The table below shows ZAL's Solvency II capital position as if the transfer had happened at 31 December 2017, but adjusted to allow for known changes since this date.

There is a small improvement in ZAL's solvency as at 31st December 2017 when comparing the position 'As Reported' against the 'Pro Forma Estimate Pre-Scheme'. This arises because ZAL allowed for the expected reduction in economic interest and some of the associated risks on the policies covered by the Scheme in its Solvency II returns.

**Note:** The capital requirements associated with operational risk, counterparty default risk and expense risk on the Transferring Policies were included in ZAL's Solvency II returns as at 31st December 2017.

5.2.2

**Table 6: ZAL Solvency II Pro Forma As at 31/12/2017**

| | As Reported (£m) | Pro Forma – Estimate Pre-Scheme (£m) | Pro Forma - Estimate Post-Scheme (£m) |
|---|---|---|---|
| Total Assets | 55,165 | 55,165 | 33,984 |
| Total Liabilities* | (53,149) | (53,102) | (31,958) |
| Excess of Assets over Liabilities | 2,016 | 2,063 | 2,026 |
| Adjustment for Restricted Own Funds Items in Respect of Ring Fenced Funds | (132) | (132) | (132) |
| Total Eligible Own Funds to Meet the Solvency Capital Requirement | 1,885 | 1,932 | 1,894 |
| Solvency Capital Requirement | 1,177 | 1,230 | 1,129 |
| ***Ratio of Eligible Own Funds to Solvency Capital Requirement*** | ***160%*** | ***157%*** | ***168%*** |

*Where Total Liabilities includes the Risk Margin

5.2.3 The estimates of ZAL's solvency ratio as at 31st December 2017, both Pre- and Post- Scheme, were above the upper boundary of its capital management policy described in section 2.5. In line with its capital management policy, ZAL may therefore consider paying a dividend to its shareholder. This would reduce ZAL's solvency ratio down from the figures in Table 6. However, the impact of the Scheme on ZAL's solvency, own funds and SCR would be materially the same after any such dividend.

5.2.4 As shown in the above assessment, relative to the position reported at 31st December 2017, there is expected to be a further improvement in ZAL's solvency following the proposed Scheme. This arises because the following risks associated with the transferring business will no longer be borne by ZAL, but will instead be borne by SWL:

- Counterparty default risk in relation to the reassurance of insured funds invested on behalf of the ZCS business.

- Expense risk associated with administering the ZCS business.

5.2.5 Immediately after the Effective Date of the proposed Scheme, the risk margin and SCR in respect of these residual risks would be released leading to an improvement in ZAL's solvency.

5.2.6 Following the proposed Scheme, the capital requirement for Operational risk is also expected to reduce, however, the capital requirements will not reflect this change for a period following the Effective Date of the Scheme and so this has not been included in the above assessment.

5.2.7 The above analysis considers the impact on ZAL as if the transfer had occurred on 31 December 2017. If the transfer had taken place as at 30 June 2018, the estimated impact of the Scheme would also have been a small improvement to ZAL's solvency.

5.2.8 In advance of the Effective Date, ZAL intends to approach a subset of pension schemes in scope of the Scheme with the option to migrate their pension scheme to SWASL's Corporate Savings Platform. This is with the intention of migrating the associated policies in advance of Effective Date.

This will act to reduce the impact of the Scheme from that displayed in Table 6 as the solvency improvement associated with those pension schemes would be crystallised on migration rather than on transfer.

# 6 The Effect of the Scheme on the Remaining ZAL Policyholders

## *6.1 Security of Policyholder Benefits*

6.1.1 Section 5 showed that, following the Scheme, the solvency position of ZAL would be improved as ZAL would no longer be exposed to the residual risks, primarily counterparty default risk, associated with the Transferring Policies.

6.1.2 As noted in section 5.2.3, ZAL's solvency ratio is above the upper boundary of its capital management policy described in section 2.5. In line with its capital management policy, following the publication of its 2017 annual returns, ZAL could consider paying a dividend to its shareholder. This could bring ZAL's solvency ratio down to the upper boundary. However, the same policy would be followed both before and after the Scheme, and in the event of any dividend being paid ZAL's capital resources would remain above the regulatory SCR.

6.1.3 I note the Scheme will not materially change ZAL's risk profile with respect to market or demographic risks, with the exception of counterparty default risk which will decrease as a result of removing exposures to ZAL's fund reinsurers.

6.1.4 Following the transfer of liabilities, the security of the Remaining Policyholders' benefits would no longer be exposed to the counterparty default risk, operational risk, persistency risk and market risk of the policies proposed to be transferred.

6.1.5 In the event of a deterioration in ZAL's solvency, the Remaining Policyholders would benefit from the contingent funding agreement with ZIG described in section 2.6, which would not be affected by the proposed Scheme.

6.1.6 In the unlikely event of ZAL being unable to pay policyholder benefits in full, eligible policyholders would be entitled to claim compensation under the Financial Services Compensation Scheme ('FSCS'). Any compensation would be subject to the rules of the FSCS at that point in time. Eligibility for Remaining Policyholders to claim would not be affected by the proposed Scheme.

6.1.7 I conclude, therefore, that there will be no material change in the security of the benefits of Remaining Policyholders as a result of the proposed Scheme.

## *6.2 Benefit Expectations – With-Profits Policyholders*

6.2.1 No changes will occur as a result of the Scheme to investment strategy, or the methodology for setting bonuses, policy charges, or surrender values for existing policyholders within the ZAL With-Profits funds.

6.2.2 In certain circumstances, ZAL would make financial support available for the 90:10 With-Profits Fund and/or the 100:0 With-Profits Fund from the Defined Charge Participating Fund and the Non-Profit Fund (or, if necessary, from the Shareholder Fund). The Scheme will not alter this arrangement.

6.2.3 <u>90:10 Fund Expense Allocation – Group Pensions</u>

ZAL will reduce its expenses as a result of transferring the Transferring Policies. The Scheme will also reduce the total number of policies in ZAL and so, in the future, the overhead expenses will be allocated across a lower number of Remaining Policies. This will result in changes to the expenses allocated to remaining policies.

Most 90:10 With-Profits policies will not be affected by this since the maintenance and claim expenses charged to asset shares and allocated to the 90:10 With-Profits Fund are set by an expense agreement, which will not change.

The expenses allocated to 90:10 group pension policies expenses are based on an assessment of actual costs. While there is expected to be a small reduction in the overhead expenses allocated, since the revised expense base will not be known for certain until after the transfer we will ensure that the unit cost allocation to remaining With-Profits policies will not increase as a result of the transfer.

Guaranteed benefits on With-Profits are not affected by the Scheme.

6.2.4 The investment expenses charged to asset shares of 90:10 With-Profits policies are based on the actual incurred expenses of the fund. These will not change as a result of the proposed Scheme.

6.2.5 <u>90:10 Fund Expense Allocation – Future Vesting Annuities</u>

Some 90:10 With-Profits pension policies have the option to convert to an annuity plan on guaranteed rates. It is current practice for the 90:10 With-Profits Fund to purchase the required annuity from the DCP Fund, with any guarantee cost charged to the estate of the 90:10 With-Profits Fund. The small expected reduction in the expenses resulting from the re-allocation of overheads may affect the cost of the annuity and, therefore, the cost to the 90:10 With-Profits Fund (which may in turn have a small effect on bonus distribution). The cost of this annuity from the DCP Fund charged to the 90:10 With-Profits Fund is not guaranteed and is dependent on actuarial assumptions at the time of purchase. Many factors, such as ZAL's assumptions of future mortality rates or management expense initiatives, can affect the cost of annuities in the future. This approach, of purchasing the annuity from the DCP fund and charging the cost of the annuity (without any profit margin) to the estate of the 90:10 With-Profits Fund, follows ZAL's established practice and ensures that the 90:10 With-Profits Fund pays a fair cost for the annuity benefits based on ZAL's best estimate valuation.

6.2.6 I consider the impact of any variance in the cost of these guaranteed annuities to not be material and within the scope of normal business activity. Any variance that does arise will not impact any policyholder's guaranteed benefits, but will be charged to the estate of the 90:10 With-Profits Fund.

6.2.7 I do not expect that changes in expenses associated with this Scheme will result in any material effect on the benefits of 90:10 With-Profits policies.

6.2.8 <u>100:0 Fund Expense Allocation</u>

The expenses charged to the 100:0 With-Profits Fund and its policies are defined in each policy's terms and conditions, rather than by an allocation of actual expenses. ZAL has the right to vary the charges deducted subject to the policy terms and conditions. The degree of discretion is limited by the duty to treat customers fairly which will remain a regulatory requirement for ZAL and will therefore be unaffected by the Scheme. No changes will be made to the expenses charged to 100:0 With-Profits policies as a consequence of the proposed Scheme.

6.2.9 <u>100:0 Fund transfers from DCP Fund</u>

Each year from 2005 to 2024, ZAL is required to transfer 1% of the surplus arising in the DCP Fund, from the DCP Fund to the 100:0 With-Profits Fund. This transfer is subject to a limit of initially £1m, increasing each year with UK Retail Prices Index inflation as published by the Office for National Statistics. The transfer is defined on the Solvency I regulatory basis, being based on the surplus that would have been reported on the old PRA return Form 58.

Any transfer made increases the estate of the 100:0 With-Profits Fund and may therefore increase the rate of estate distribution paid to customers leaving the fund.

The Scheme will not result in a reduction in expected transfer to the 100:0 With-Profits Fund. In the short-term, the Scheme may possibly result in greater surplus arising in the DCP fund than would otherwise be expected, as ZAL will release the prudent reserves held in respect of the Transferring Policies at the Effective Date. Following the release of reserves at the Effective Date, no further surplus is expected to arise in the DCP fund, as was the case before the Scheme.

### *6.3 Benefit expectations – Non-Profit Policyholders*

6.3.1 The benefits and charges on non-profit policies are defined by the terms and conditions of each policy. On some policies ZAL has the right to vary the charges deducted. The degree of discretion is limited by the duty to treat customers fairly which, as described above, will be unaffected by the Scheme.

6.3.2 The charges and premiums on some non-profit policies are subject to regular review processes. ZAL will not be making any alterations to the processes and approach to reviewing any charges deducted from existing non-profit policies as a consequence of the proposed Scheme.

6.3.3 The current processes for reviewing charges on existing policies do not reference the Transferring Policies. For example, some expense deductions are subject to a regular review process which varies the expense deductions in line with the movements in inflation indices. These reviews will be unaffected by any change in ZAL's actual expenses that may arise from policies being transferred under the proposed Scheme.

6.3.4 Remaining Policies with an investment fund link will experience no changes to their linked funds as a result of the Scheme.

6.3.5 I therefore conclude that there will be no material changes to the benefit expectations of the remaining ZAL non-profit policyholders as a consequence of the proposed Scheme.

### *6.4 Service Standards*

6.4.1 At the Effective Date, the outsourcing arrangements with Scottish Widows for ZCS business will cease. Most of ZAL's remaining policies (i.e. those that are not ZCS policies) are unaffected and their servicing will continue unaffected. For those ZCS policies which are not transferring (the Excluded Policies) ZAL will continue to be responsible for their administration along with the rest of the Remaining Policies. Plans are in place for ZAL's outsource partner Capita Life and Pensions Regulated Services Limited to take over and carry out the administration for the Excluded Policies beyond the Effective Date. The outsourcing arrangement with Scottish Widows will automatically extend for a further two years should the Part VII transfer not be approved by the Court, so that the parties have sufficient time to make alternative arrangements and each party has a right to request an extension of the arrangement.

6.4.2 The service levels in respect of the Remaining Policies are, therefore, expected to be unaffected by the proposed transfer.

ZAL could consider alternative servicing solutions in the future for any part of its business. Any such changes would be subject to policy terms and conditions, a review for appropriateness and due consideration to the requirement to treat customers fairly. This is the case prior to the Scheme and remains the case should the Scheme go ahead.

6.4.3 I therefore conclude that there is no reason to expect any change in the standard of service provided to Remaining Policyholders following the proposed Scheme.

### *6.5 Taxation*

6.5.1 The Scheme is expected to have minimal impact on ZAL's tax position. To ensure that this is the case, ZAL and SWL plan to request corporation tax clearances in respect of the proposed Scheme from Her Majesty's Revenue and Customs ('HMRC').

*6.5.2* ZAL's internal tax team has advised that no changes are expected to the methodology for calculating deductions from ZAL's unit-linked life funds, or With-Profits funds, in respect of policyholder tax, as a result of the proposed Scheme.

### *6.6 Policyholder Communications*

6.6.1 A detailed communication plan has been produced, the implementation of which will ensure policyholders are adequately informed of the nature and effect of the Scheme. The communications package includes direct mailing, press adverts and web content.

6.6.2 An application is to be made to the Court for a waiver from the requirement to undertake a direct mailing of the majority of Remaining Policyholders on the grounds that the Scheme will not materially impact them. The exception being holders of Excluded Policies, who will be mailed with details of the Scheme.

As described above, the Scheme will have no material impact on the security of benefits, benefit expectations or service levels of the Remaining Policyholders. As such, I do not believe that there will be any material impact on the Remaining Policyholders. I agree with the basis for the waivers described above, i.e. that the transaction is not of sufficient materiality to warrant informing the Remaining Policyholders individually (subject to the notification of relevant holders of Excluded Policies).

*6.6.3* I am satisfied that the proposed communication plan is appropriate and consistent with the principles pertaining to the fair treatment of policyholders.

### *6.7 Effect of Brexit*

6.7.1 The impact of Brexit on Remaining Policyholders is expected to be materially unchanged by the proposed Scheme. However, given the uncertainty surrounding Brexit, I will provide an update on any material changes to this view in my Supplementary Report.

### *6.8 Report of the With-Profits Actuary ('WPA')*

6.8.1 In forming my opinion on the effect of the Scheme on existing With-Profits policyholders, I have taken into account the opinion of the WPA set out in a separate Report to the Board of ZAL on the impact of the Scheme on the fair treatment of With-Profits policyholders, the bonus expectations of With-Profits policyholders and the effectiveness of the communications strategy.

# 7 The Effect of the Scheme on the Transferring Policyholders

## *7.1 Security of Policyholder Benefits*

7.1.1 ZAL is regulated by the PRA and is required to maintain capital resources at least equal to the SCR. ZAL has a capital management policy of maintaining a buffer over the SCR. At 31 December 2017 ZAL's solvency ratio, at 160%, was above the target level.

7.1.2 In the event of an adverse scenario the security of ZAL's policyholders is also enhanced by the Contingent Funding Agreement described in section 2.6.

7.1.3 SWL is also regulated by the PRA and is required to maintain capital resources at least equal to the SCR.

7.1.4 I have been informed that SWL also has a capital management policy of maintaining a buffer over the SCR.

7.1.5 ZAL and SWL are both regulated by the PRA and are required to maintain capital at least equal to the Solvency II SCR. The level of the SCR is designed to protect the security of policyholder benefits in all but the most extreme scenarios, which would only be expected to occur once every 200 years.

7.1.6 At 31 December 2017 SWL's solvency ratio was 140% and I have been informed that SWL's solvency ratio would have been 137% had the Transfer occurred on that date, which is £2.3bn above its Solvency II capital requirement. This is slightly lower than ZAL's solvency ratio, although there can be no guarantee that this will continue to be the position in the future. For example, either company could choose to pay dividends in line with their capital management policies.

7.1.7 ZAL and SWL have different risk exposures. The key areas of risk within ZAL's SCR are counterparty default risk, lapse risk, expense risk and ZAL also holds capital against the risks associated with Zurich's UK staff pension scheme. SWL has confirmed that the key areas of risk within its SCR are market risk, longevity risk and operational risk.

7.1.8 The risks each company are exposed to and the amount of diversification between these risks is reflected in the amount of capital each company must hold under the Solvency II regime. The intention of which is to ensure that each company can meet its policyholder liabilities with a high degree of certainty.

7.1.9 The Transferring Policies would no longer benefit from ZAL's contingent funding agreement, but given the high level of security provided by the SCR, I do not believe this would result in a material reduction in the security of benefits for the Transferring Policyholders.

7.1.10 In the unlikely event of ZAL being unable to pay policyholder benefits in full, eligible policyholders would be entitled to claim compensation under the FSCS. Any compensation would be subject to the rules of the FSCS at that point in time.

7.1.11 SWL is also a member of the FSCS. In the unlikely event of SWL being unable to pay policyholder benefits in full, eligible Transferring Policyholders would also be entitled to claim compensation under the FSCS. Assuming no future changes, other than the proposed Scheme, eligibility for compensation would be assessed against the same set of rules as for ZAL policyholders.

7.1.12 I conclude, therefore, that there will be no material change in the security of the benefits of Transferring Policyholders as a result of the proposed Scheme.

## 7.2 Benefit Expectations

7.2.1 The benefits on these contracts are contractually defined in terms of the number of units allocated to a policyholder in a particular fund and the value of those units at a given date.

7.2.2 As noted in section 4.2, the Scheme includes some limited changes to the terms and conditions of certain categories of the Transferring Policies (namely Occupational Money Purchase Plans, Group Stakeholder Pension Plans and Group Transfer Plans). These changes are related to updating the terms and conditions to reflect the companies within the Lloyds Banking Group ('LBG') which will carry out certain services for the policies after the Transfer and are not expected to affect the benefit expectations of the Transferring Policies.

7.2.3 The Scheme includes specific provisions dealing with the transfer of the linked assets and associated liabilities comprised in each unit-linked fund in which the Transferring Policies are invested immediately prior to the Effective Date. These require SWL to establish its own notional linked funds equivalent to ZAL's linked funds and to allocate the Transferring Policies' units in those funds so that policyholders have the same value of units immediately following the Effective Date as they had as policyholders of ZAL immediately prior to the Effective Date. As such, the benefit expectations of Transferring Policies will be unchanged.

7.2.4 Many of the associated unit-linked funds are provided by means of reinsurance contracts with other insurance companies. In most cases, the existing reinsurance contracts will transfer from ZAL to SWL, or SWL will enter into a new contract with the relevant counterparty prior to the implementation of the Scheme (in which case ZAL will retain the existing reinsurance contract).

7.2.5 Access to certain unit-linked funds where ZAL is the discretionary investment manager will be maintained through a new reinsurance contract between ZAL and SWL.

7.2.6 As a result of the reinsurance contracts, some policies are exposed to the remote risk of reinsurer default where they invest in funds provided by means of reinsurance contracts with other insurance companies. Where this is currently the case it will continue to be the case after the Transfer. After the Transfer, it will also be the case for those certain unit-linked funds where a new reinsurance contract is put in place between ZAL and SWL.

SWL have confirmed that where policyholders have investments in such funds immediately prior to the Effective Date, SWL will not pass the risk due to the new reinsurance contract with ZAL on to the policyholder, and the Scheme contains specific provision to this effect.

Some policyholders (those whose terms and conditions mean that they bear the risk of reinsurer default) who are not invested in these funds immediately prior to the Effective Date, but who subsequently choose to do so after the Effective Date, will be exposed to the remote risk of reinsurer default due to the new reinsurance contract between SWL and ZAL. These classes of policy are held by investors who are considered to be capable of making an informed decision regarding this remote risk (for example pension scheme trustees). Given this, and the financial strength of ZAL and SWL, I do not consider this to be a material impact for those policies.

7.2.7 There are some limited circumstances in which ZAL has some discretion in making changes to policies, notably, in deciding:

- Fund based charges.
- Whether to close/cease offering access to particular funds

- What additional funds to offer.
- The basis used in determining unit prices associated with the funds offered.

7.2.8 The Chief Actuary of SWL has confirmed that, concerning this discretion, SWL will apply future practices having regard to the practices applied by ZAL prior to the transfer, alongside taking account of its obligation to treat customers fairly and prevailing market conditions. In exercising this discretion, SWL will be subject to the same conduct requirements as those that would apply to ZAL.

7.2.9 I conclude, therefore, that there will be no material change to the Transferring Policyholders' benefit expectations as a result of the proposed Scheme.

### *7.3 Service Standards*

7.3.1 From April 2018, SWASL has been carrying out the administration of the Transferring Policies, and at this point the associated staff were transferred from the Zurich Group to the Lloyds Banking Group using a TUPE Arrangement.

7.3.2 A Transitional Services Agreement ('TSA') has been entered into to cover interdependencies between the parties during the period until the Part VII transfer. The transitional services provided by Scottish Widows (as appropriate) include platform and plan administration services. The provision of these services will allow ZAL to maintain operational support for the schemes and products pending completion of the Part VII.

Services will continue to be provided by Scottish Widows until the Effective Date of the Scheme. Services still provided by Zurich will be provided until the later of the successful completion of the separation plan in relation to the specific service and the Effective Date.

The TSA will automatically extend for a further two years should the Part VII transfer not be approved by the Court, so that the parties have sufficient time to make alternative arrangements and each party has a right to request an extension of the TSA.

Following the Transfer SWL will be responsible for the administration of the Transferring Policies and this will be carried out by Lloyds Banking Group. The effect of this will be that LBG will provide the same services to the Transferring Policies using the same staff after the Transfer and that there will therefore be no material change to the administration of the Transferring Policies as a result of the Scheme.

7.3.3 I have been informed that, as part of the Scheme, a handover process will be put in place whereby policy data, documentation and correspondence will be passed over to SWL for the Transferring Policies.

*7.3.4* SWL will be responsible for ensuring that its policy administration, customer service processes and service levels comply with the terms and conditions of the Transferring Policies.

ZAL and SWL are reviewing these activities against ZAL's existing processes and service levels to ensure that there are no significant adverse changes.

As such, I do not expect there to be any material adverse change in policyholder service standards as a result of the Scheme but I will provide an update to the court detailing any material changes in my Supplementary Report.

## 7.4 Trading Suspension

7.4.1 The Transferring Policies will be affected by a trading suspension period, a period during which investment transactions will not take place. The trading suspension is intended to last for 5 business days and will be in place from 3:00 pm on 25 June 2019 and is expected to end at the close of business on 2 July 2019.

During this time, affected policyholders will not be able to carry out any investment transactions, such as buying or selling units or switching funds. Any investment instructions or payments received during this period will not be actioned until after the trading suspension period.

This period will allow ZAL and SWL to transfer the unit funds moving under the scheme in a controlled manner, avoiding the risks that would be associated with allowing transactions during the transfer process.

7.4.2 For the small number of drawdown benefits due to occur in the trading suspension period, ZAL and SWL will advance the payment of these benefits to the beginning of the trading suspension period. This is to avoid the situation where policyholders cannot meet their obligations due to late receipt of their drawdown benefits.

7.4.3 Where a policyholder transaction is scheduled to occur within the trading suspension period, the policyholder may be either advantaged or disadvantaged due to market movements occurring between the date the trade instruction is given and the date that trade takes place. This is similar to the risk that policyholders currently face during the period between an event influencing a decision to trade and that trade taking place, which is 1-2 days under normal circumstances.

7.4.4 To minimise the impact of the trading suspension, affected policyholders will be given advance notice through the planholder guide, reminder mailings and n#otices on the associated websites.

7.4.5 While the trading suspension will limit transferring policyholders' access to their funds for a short period, the trading suspension acts to reduce the risk of administrative issues with the transfer and does not materially change the risk from the policyholder's decision to trade. The use of a trading suspension period is a normal industry practice when transferring funds between providers and the length of the proposed trading suspension period is consistent with this normal practice.

7.4.6 Given that the trading suspension will reduce the administrative risk associated with the transfer, does not materially affect the risk associated with policyholder investment decisions, will be clearly communicated in advance of the transfer, is a relatively short period, and where benefits are due during the trading suspension period those benefits will be paid before the trading suspension period, it is my opinion that the transferring policyholders are not materially adversely affected by the trading suspension.

## 7.5 Taxation

7.5.1 Any personal tax liability of policyholders in respect of their defined contribution benefits is expected to be unaffected by the transfer. ZAL intends to seek the relevant clearances from HMRC to ensure that this is the case.

## 7.6 Policyholder Communications

7.6.1 A detailed communication plan has been produced, the implementation of which will ensure policyholders are adequately informed of the nature and effect of the Scheme. The communications package includes direct mailing, press adverts and web content.

7.6.2 ZAL intends to mail Transferring Policyholders and Excluded Policyholders about the Scheme, but to seek waivers from mailing the rest of its Remaining Policyholders and certain categories of Transferring Policyholders on the grounds of:

(a) Impossibility, e.g. "gone-away" policyholders, policyholders for whom ZAL has identified that its policyholder registers do not contain a valid policyholder address;

(b) Practicality, e.g. for beneficial members of trust based schemes where ZAL has no legal or contractual relationship with any beneficiary of a policy in respect of which a trust may have been declared;

(c) Utility both to the policyholder and the court, e.g. because the Scheme will not adversely affect Remaining Policyholders;

(d) Availability of other information channels, e.g. publication of a notice within national and international newspapers;

(e) Proportionality, e.g. because it would be disproportionately costly to contact all Remaining Policyholders directly given that the Scheme will not have any material effect on these policyholders; and

(f) The impact of the transfer on policyholders, e.g. because the Scheme will not adversely affect Remaining Policyholders;

7.6.3 I am satisfied that the proposed communication plan described above is appropriate and consistent with the principles pertaining to the fair treatment of policyholders.

### *7.7 Effect of Brexit*

7.7.1 The impact of Brexit on Transferring Policyholders is expected to be comparable before and after the Scheme. However, given the uncertainty surrounding Brexit, I will provide an update on any material changes to this view in my Supplementary Report.

# 8 Conclusion

8.1.1 It is my opinion that:

(i) The Scheme would not result in a materially adverse effect to the security of policy benefits for any group of ZAL policyholders, including both the Remaining Policyholders and the Transferring Policyholders.

(ii) The Scheme would not result in a materially adverse effect to the reasonable benefit expectations for any group of ZAL policyholders, including both the Remaining Policyholders and the Transferring Policyholders.

(iii) The Scheme would not result in a material effect in service levels for any group of ZAL policyholders.

8.1.2 It is my opinion, therefore, that no class of ZAL policyholder will be materially adversely affected by the implementation of the proposed Scheme. In particular, I believe that the Scheme will maintain the security of benefits of the Remaining Policyholders and the Transferring Policyholders of ZAL, have no material adverse impact on their benefit expectations, and will not have any adverse impact on their fair treatment.

Keith Jennings

Keith Jennings, FIA
Chief Actuary
1st February 2019

# Appendix A: Terms and definitions

## *8.2 Terms used in this Report*

| | |
|---|---|
| Chief Actuary | The actuary appointed from time to time to perform the duties set out in the Actuaries Section of the PRA Rulebook and SUP 4.3.13 of the FCA Handbook. |
| Contract Based Policies | Policies where ZAL has a contract with the underlying members of the associated pension scheme.<br>This comprises policies from the Zurich Group Personal Pension Plan |
| Excluded Policies | As defined in section 4.2 of this report. |
| FCA | Financial Conduct Authority, the regulator of the financial services industry in the UK responsible for conduct of financial services firms including the fairness of financial services contracts. |
| FSMA | The Financial Services and Markets Act 2000 (as amended). |
| FSCS | The Financial Services Compensation Scheme |
| Independent Expert | The individual appointed to report on the terms of an insurance business transfer scheme and approved by the PRA and FCA pursuant to Section 109 of FSMA. |
| Investment Only Policies | Policies where ZAL has a contract to administer only the investments underlying the associated pension scheme.<br>This comprises policies from the Zurich Corporate Investment Plan and Zurich Group Investment Only. |
| Non-Profit Policyholders | Individuals or entities holding one or more policies that are not With-Profits |
| Policy<br>or<br>Policyholder | have the meanings set out in Financial Services and Markets Act 2000 (Meaning of "Policy" and "Policyholder") Order 2001 (SI 2001/2361); |
| PRA | Prudential Regulation Authority, the regulator of the financial services industry in the UK responsible for the safety and soundness of firms and securing an appropriate degree of protection for policyholders. |
| Remaining Policies or<br>Remaining Policyholders | As defined in section 4.2 of this report |
| Scheme | The insurance business transfer scheme that is the subject of this report. |

| | |
|---|---|
| SFCR | The Solvency and Financial Condition Report is an annual, publicly available, report summarising the Solvency and Financial position of the company. This is published in accordance with Articles 51, 53, 54 and 256 of Directive 2009/138/EC of the European Parliament and of the Council. |
| Solvency II | A capital adequacy regime for the European Union insurance industry covering both capital requirements and risk management standards applicable from the 1 January 2016. |
| Stakeholder Policies | Policies where ZAL has a contract with the underlying member and that contract satisfies specific government requirements, for example limits on charges.<br><br>This comprises policies from the Zurich Group Stakeholder Plan. |
| Transferring Policies or Transferring Policyholders | As defined in section 1.1 of this report |
| Trust Based Policies | Policies where ZAL has a contract with the trustees of the associated pension scheme.<br><br>This comprises policies from the Zurich Occupational Money Purchase Plan, Zurich Group Transfer Plan and Zurich AVC Plan. |
| TUPE Arrangement | An arrangement enabling employees to move to a new employer under the Transfer of Undertakings (Protection of Employment) Regulations. |
| With-Profits | Any business of an insurer that may affect the amount or value of the assets comprising a With-Profits fund as set out in the Glossary section of the FCA Handbook. |
| With-Profits Actuary, or WPA | The actuary appointed to perform the With-Profits Actuary function and the duties set out in the Actuaries Section of the PRA Rulebook and SUP 4.3.16A of the FCA Handbook. |

## *8.3 Company Abbreviations Referred to in this Report*

| | |
|---|---|
| ESLAC | Eagle Star Life Assurance Company Limited |
| LBG | Lloyds Banking Group Ltd |
| SIML | Sterling ISA Managers Ltd |
| SWASL | Scottish Widows Administration Services Ltd |
| SWG | Scottish Widows Group Ltd |
| SWL | Scottish Widows Ltd |

| | |
|---|---|
| ZAL | Zurich Assurance Ltd |
| Zurich Group or ZIG | Collectively the companies and subsidiaries of the ultimate holding company Zurich Insurance Group Ltd ('ZIG') |