



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

**Report of ZAL's  
With-Profits Actuary  
on the Proposed Transfer of  
Business Pursuant to Part VII of the Financial Services and Markets Act (2000) ("FSMA").**

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01 February 2019



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## **1 Introduction**

### **1.1 Background**

1.1.1 The purpose of this report (this 'Report') is to describe the impact on the With-Profits policyholders of Zurich Assurance Ltd ('ZAL') of a Part VII Scheme under 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 I am writing this Report in my capacity as the With-Profits Actuary for ZAL. This Report is addressed to the Board of Directors of ZAL, but will also be provided to the Independent Expert, the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA') in order to assist their assessments of the proposals. In particular, this Report states how the proposed Scheme will affect the security of the With-Profits policyholders' benefits and their reasonable benefit expectations, and how, in my view, the Scheme is consistent with the requirements to treat With-Profits customers fairly.
- 1.1.3 This Report places reliance on the calculations considered by the Chief Actuary (CA) in his report (the 'CA's Report') on the Scheme. While I have reviewed those calculations, I have not sought to reproduce them here.
- 1.1.4 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.
- 1.1.5 Consequently, this Report should be read in conjunction with the Scheme, the CA's Report on the Scheme, and the Independent Expert's Report on the Scheme.
- 1.1.6 This Report considers the adverse and favourable impacts of the Scheme for all classes of ZAL With-Profits policies.
- 1.1.7 I will provide a 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 Disclosures**

- 1.2.1 I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1993, and hold a certificate issued by the Institute and Faculty of Actuaries to act as With-Profits Actuary (WPA). I have been WPA for ZAL since 2008. I have over 25 years of experience working in the UK life assurance industry.
- 1.2.2 I am an employee of Zurich Employment Services Ltd. Zurich Insurance Group Ltd (ZIG) is the ultimate parent of both Zurich Employment Services and ZAL.
- 1.2.3 I hold a life insurance policy with ZAL (non-profit term assurance) and a motor policy with another company in the Zurich Group. In addition, I am a member of the Zurich Financial Services UK Pension Scheme defined benefit pension arrangement (which is now closed to new accruals) and I am a member of the Zurich Financial Services UK Pension Scheme defined contribution arrangement. I have a direct interest in shares of the Zurich Group, and am entitled to participate in the Zurich Group's Short Term Incentive Plan.

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

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

### **1.3 Compliance with Actuarial Standards**

1.3.1 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.

1.3.2 This Report should be read in conjunction with the Scheme, the CA's Report on the Scheme, and the Independent Expert's Report on the Scheme.

1.3.3 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 another senior actuary in the company, Matthew Brownlie FIA. The Scheme is subject to independent review by the Independent Expert which provides a further review of the conclusions of this Report.

### **1.4 Definitions and abbreviations**

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

### **1.5 Structure of report**

1.5.1 This Report is structured as follows:

- Section 2 outlines the proposed Scheme;
- Section 3 sets out the impact of the Scheme on ZAL With-Profits policyholders;
- Section 4 sets out my conclusions;
- Appendix A lists the definitions and abbreviations used in this Report.

## **2 Summary of the proposed Scheme**

### **2.1 Background**

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

2.1.2 The ZCS business administers defined contribution pension schemes on behalf of UK companies' pension schemes – this includes both trust based and contract based schemes. The costs and charges associated with this business are accounted for within the Defined Charge Participating (DCP) Fund.

2.1.3 Most of the associated policies were written in the UK. 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.

2.1.4 No ZAL With-Profits policies are in the scope of the Scheme, as the Scheme explicitly excludes workplace pension plans that are invested in, or have the option to invest in, ZAL's With-Profits funds.

### **2.2 Scheme summary**

2.2.1 Under the proposed Scheme the Transferring Policies will be transferred to SWL on the proposed Effective Date (1<sup>st</sup> of July 2019). Following this date, the Transferring Policies will become solely the responsibility of SWL and ZAL will cease to be responsible for these policies. 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.

2.2.2 In 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.

2.2.3 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 of ZAL.
- 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.

- 2.2.4 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.
- 2.2.5 The majority of ZAL's policies are not included within the Scheme and so will not be transferred by the Scheme. ZAL will continue to be responsible for these Remaining Policies and would continue to pay claims and service these policies in the normal manner.
- 2.2.6 No changes will be made to the terms and conditions of Remaining Policies (including any With-Profits policies) as a result of the Scheme.
- 2.2.7 No ZAL With-Profits policies will be transferred to SWL.
- 2.2.8 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.
- 2.2.9 The Excluded Policies are administered on another of the Zurich Group's administration systems known as the 'Group DC Platform', this will continue to be the case following the transfer.

### **3 The effect of the Scheme on With-Profits policyholders**

#### **3.1 Background**

3.1.1 In this section, I consider the impact of the proposed Scheme on the With-Profits policyholders of ZAL.

#### **3.2 Factors considered**

3.2.1 In considering the likely impact of the Scheme, I have considered the following factors:

- Security of policyholder benefits
- Benefit expectations
- Governance
- Service standards
- Taxation
- Policyholder communications

In doing so, I have considered and taken into account the requirement to treat customers fairly.

#### **3.3 Security of policyholder benefits**

3.3.1 A key consideration in assessing the Scheme from my perspective as WPA is whether there is any significant impact on the security of policyholder benefits as a result of the Scheme. I have discussed the financial impact of the Scheme with the CA and relied on the calculations that he has produced to formulate my opinions on the impact of the Scheme on the financial security of ZAL's With-Profits policyholders.

##### **3.3.2 Solvency**

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. The 90:10 With-Profits Fund contains conventional With-Profits and unitised With-Profits business. The 100:0 With-Profits Fund consists entirely of unitised With-Profits business.

ZAL manages the five funds such that under normal circumstances only the assets of a given fund are used to meet the liabilities of that fund. However, under insurance company law, the funds are counted as one fund and all the assets are theoretically available to meet the liabilities in that fund. ZAL recognises this possibility by making 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) in certain circumstances.

The With-Profits policies will remain in ZAL and continue to be protected by the same arrangement. The Scheme has no adverse impact on ZAL's solvency. As detailed in the CA's report, the Scheme will slightly improve ZAL's solvency ratio.

3.3.3 Overall, I conclude that there is no material adverse impact on the security of benefits of the With-Profits policyholders of ZAL. The Scheme will slightly improve ZAL's solvency ratio, therefore With-Profits policyholders have slightly greater security as a result of this transaction.

### 3.4 *Benefit expectations*

- 3.4.1 No changes will occur as a result of the Scheme to investment strategy, or to the methodology for setting or allocating bonuses, setting surrender values or setting policy charges for existing policyholders within the ZAL With-Profits funds.
- 3.4.2 The investment expenses charged to 90:10 With-Profits fund (and allocated to With-Profits policies' asset shares) are based on the actual incurred expenses of the fund. The CA has stated in his report that these will not change as a result of the proposed Scheme.

#### 3.4.3 90:10 Fund Expense Allocation – Group Pension

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, these expenses will be allocated across a lower number of remaining policies. This will result in changes to the expenses allocated to remaining policies.

All 90:10 policies, except a class of group pension policies, will be unaffected by this. The maintenance and claim expenses allocated to the With-Profits Fund (and to With-Profits policies' asset shares) on their behalf are set by an expense agreement, and will not change.

The expenses allocated to 90:10 group pensions policies 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 policies are not affected by the Scheme.

- 3.4.4 I therefore conclude that there is no material adverse impact on the 90:10 With-Profits expense allocations as a result of the Scheme.

#### 3.4.5 90:10 Fund Expense Allocation – Future Vesting Annuities

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). Any impact on the cost of the annuity will not affect policyholders' guaranteed benefits. 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. Whilst the cost of the annuity is not guaranteed, my opinion is that any impact from this expense change will not be material and certainly not material relative to the other factors that may affect the cost of the annuity 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 90:10 estate, follows ZAL's established practice and ensures that the 90:10 fund pays a fair cost for the annuity benefits based on ZAL's best estimate valuation.

With-Profits policies, with the option to convert to an annuity plan without guaranteed rates, can purchase an annuity from ZAL or other providers at prevailing market rates at the time of vesting. Therefore, since these policyholders' expectation is to have the option to purchase an annuity at



whatever rates are prevalent at the time, the Scheme has no material adverse impact on the benefit expectation of these policyholders.

3.4.6 I therefore conclude that the impact of the Scheme on the cost of future vesting annuities is within the scope of normal business activity, and has no material adverse impact on With-Profits policyholders' benefit expectations.

3.4.7 100:0 Fund Expense Allocation – Charges levied

The policy terms and conditions for 100:0 policies define the charges levied, rather than an allocation of actual expenses. ZAL has the right to increase the charges levied on 100:0 With-Profits policies subject to the policy terms and conditions. The degree of discretion is limited by the duty to treat customers fairly which is unaffected by the Scheme.

3.4.8 The CA has confirmed in his report that no changes will be made to the charges applied to the 100:0 With-Profits Fund as a result of the Scheme.

3.4.9 100:0 Fund transfers from DCP Fund

Transfers of 1% of the surplus arising in respect of the DCP Fund between financial year 2005 and 2024 are made into the 100:0 With-Profits Fund, subject to a maximum of initially £1m, increasing each year with UK Retail Prices Index inflation as published by the Office for National Statistics. This transfer is defined on the Solvency I Regulatory Return basis.

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 CA has stated in his report that transfers from the DCP Fund into the 100:0 With-Profits Fund may possibly increase in the short term as a result of the Scheme, as ZAL will release the prudent reserves held in respect of the Transferring Policies at the Effective Date, but that no further transfers are expected. The Scheme does not change the longer-term prospects for this arrangement.

3.4.10 I conclude that the Scheme has no material adverse impact on 100:0 With-Profits policyholders. The transaction may possibly result in a DCP surplus and hence a transfer to the 100:0 With-Profits Fund which would not have otherwise arisen and, therefore, may be beneficial to the 100:0 With-Profits Fund.

3.4.11 I therefore conclude that there will be no material changes to the benefit expectations of existing ZAL 90:10 With-Profits policies or ZAL 100:0 With-Profits policies as a consequence of the Scheme.

### **3.5 Governance**

3.5.1 The ZAL 90:10 With-Profits Fund has the following governance procedures in place:

- The Board of ZAL is responsible for managing the With-Profits business, including setting bonus rates. ZAL has published the Principles and Practices of Financial Management ('PPFM') which it applies in managing its With-Profits business.
- ZAL has also established procedures so that the Board can satisfy itself at regular intervals that the With-Profits business is being managed in accordance with the PPFM. Key aspects of those procedures include:

- The appointment of me as With-Profits Actuary to advise the Board on the exercise of discretion and the management of the With-Profits business. The Board also calls upon advice from other senior managers with knowledge and experience of the business as required;
- The appointment of Steve Dixon as the Independent Person (who is independent of the Zurich Group), to provide an assessment of compliance with the PPFM. Mr Dixon also advises the Board on how any competing or conflicting rights and interests of policyholders and shareholders have been addressed.

3.5.2 Each year ZAL publishes a report on its website which tells policyholders whether it has complied with its obligations in the PPFM. In developing that report the Board takes advice from both Mr Dixon and myself. As there are no With-Profits policies included in the Scheme, there will be no changes required to the governance of the With-Profits funds, which will continue as before.

### **3.6 Service standards**

- 3.6.1 The services to ZAL's With-Profits policyholders, which are provided by ZAL, and the currently outsourced service companies on behalf of ZAL, will remain unchanged as a result of the Scheme. Therefore, there will be no impact on the services provided to With-Profits policyholders as a result of the Scheme. I note that ZAL could consider alternative servicing solutions in the future. 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.
- 3.6.2 I therefore conclude that there is no reason to expect any change in the standard of service provided to With-Profits policyholders as a consequence of the Scheme.

### **3.7 Taxation**

- 3.7.1 It is expected, subject to approval of the relevant clearances from HMRC, that there will be no material impact on the tax position of policyholders as a result of the Scheme. Therefore, there will be no material tax impact on the policyholders as a result of the Scheme.

### **3.8 Policyholder communications**

- 3.8.1 A detailed communication plan has been produced, the implementation of which will ensure affected policyholders are adequately informed of the nature and effect of the Scheme.
- 3.8.2 The regulations surrounding Part VII transfers require that, unless the Court otherwise orders, all policyholders in the affected companies should be written to in order to inform them of the proposed Scheme.
- 3.8.3 Among other waivers being sought, an application is to be made to the Court for a waiver to omit direct mailing of the ZAL With-Profits policyholders who are not Excluded Policyholders, on the grounds that the Scheme will not materially impact them.

Given that the scheme will have no material impact on the security of benefits, benefit expectations or service levels of the remaining policyholders, I do not believe that there will be any material impact on the remaining With-Profits policyholders. I agree that the transaction is not of sufficient materiality to warrant informing the remaining With-Profits policyholders individually.

- 3.8.4 With-Profits policyholders will receive an annual customer mailing between March 2019 and March 2020 which will comment upon the Scheme and its impact on the fund.
- 3.8.5 Each year ZAL publishes a report on its website which tells policyholders whether it has complied with its obligations in the PPFM. The report will comment upon the Scheme and its impact on the fund in the year in which the Scheme takes effect.
- 3.8.6 I am satisfied that the proposed communication plan described above is appropriate and consistent with the principles pertaining to the fair treatment of policyholders.

### **3.9 Report of the Chief Actuary**

- 3.9.1 In forming my opinion on the effect of the Scheme on ZAL's With-Profits policyholders, I have relied upon the calculations included in the CA's report. I have also taken into account, but not relied upon, the opinion of the CA, as set out in a separate Report to the Board of ZAL on the impact of the Scheme. Specifically, sections of the report detailing the fair treatment of all classes of policyholder, the bonus expectations of With-Profits policyholders and the effectiveness of the communications strategy.

## 4 Conclusion

4.1.1 It is my opinion that:

- (i) The security of benefits for the With-Profits policyholders in ZAL is not materially affected as a result of the Scheme.
- (ii) The Scheme does not result in material changes to the benefit expectations of the With-Profits policyholders. Policy terms and conditions are unchanged and there is no change to the methodology for setting policy charges. The circumstances under which policyholder benefits would be adversely affected are not materially changed as a result of the Scheme.
- (iii) The Scheme does not result in any policy being transferred in or out of any of ZAL's With-Profits funds.
- (iv) There are no changes to the principles or practices of financial management by which the ZAL With-Profits funds are managed, including the bonus setting methodology.
- (v) The administration and management of ZAL's With-Profits policies and the treatment of ZAL's With-Profits policyholders are unchanged as a result of the Scheme.

4.1.2 It is my opinion, therefore, that ZAL's With-Profits policyholders will not 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 ZAL's With-Profits policyholders, have no material adverse impact on their benefit expectations, and will not adversely impact the fair treatment of With-Profits customers.



Martin Godwin, FIA  
With-Profits Actuary  
01 February 2019

## Appendix A: Terms and definitions

### *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.
Excluded Policies	As defined in section 2.2 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).
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.
Policy or 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 Remaining Policyholders	As defined in section 2.2 of this report
Scheme	The insurance business transfer scheme that is the subject of this report.
Solvency II	A capital adequacy regime for the European insurance industry covering both capital requirements and risk management standards applicable from the 1 January 2016.
Transferring Policies or Transferring Policyholders	As defined in section 1.1 of this report
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.
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***Company Abbreviations Referred to in this Report***

SWL	Scottish Widows Ltd
ZAL	Zurich Assurance Ltd
ZIG	Zurich Insurance Group Ltd
Zurich Group	Collectively the companies and subsidiaries of the ultimate holding company ZIG

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