

**LLOYDS
BANKING
GROUP**



SCOTTISH WIDOWS LIMITED

Report of the

Chief Actuary

on the proposed transfer of the European
International Life Insurance Business of SWL
to SWE

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Report of the Chief Actuary (SWL)

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REPORT OF THE CHIEF ACTUARY

1 SUMMARY

Purpose

- 1.1 The purpose of this report is to review the impact on all policyholders currently in Scottish Widows Ltd ("SWL") (the "Transferor") of the proposed transfer (the "Transfer") of
- (i) Long-term insurance business originally written primarily in Germany, Italy and Austria via International Life Division Europe ("ILDE") branches;
 - (ii) Long-term insurance business originally written via CMI Insurance (Luxembourg) S.A. ("CMIL");
- collectively the "Transferring Policies" to Scottish Widows Europe SA ("SWE") (the "Transferee"). These policies will be referred to as International Financial Services ("IFS") policies.
- 1.2 The Transfer will take effect by means of an insurance business transfer scheme under Part VII of the Financial Services and Markets Act 2000 ("FSMA"), (the "Scheme"). The "Scheme Effective Date" will be 28 March 2019.
- 1.3 In this report I consider the Transfer from the perspective of the transferring policyholders and whether the Transfer has any materially adverse impact on the security, benefit expectations and servicing of these policyholders. I also use the same criteria to consider the impact on those policies remaining in SWL (the "Non-Transferring Policies"). This report does not consider any alternative schemes.

Background

- 1.4 At the point that the United Kingdom ("UK") leaves the European Union ("EU") and European Economic Area ("EEA"), UK insurance companies will no longer be authorised to carry out new business sales in Europe. Furthermore, the European Insurance and Occupational Pensions Authority ("EIOPA") have indicated that the outcome of the negotiations may also result in the loss of servicing rights for existing inforce business where the policyholder is domiciled not in the UK but in one of the other twenty seven EU countries (referred to as "EU27").
- 1.5 As a result, SWL has chosen to set up a new Luxembourg Insurance company, SWE, into which existing European policies (i.e. where the policyholder was domiciled in the EU27 when taking out the policy) can be transferred in order to continue to service those policies after the UK has left the EU.
- 1.6 SWL is a life insurance subsidiary of Scottish Widows Group Ltd ("SWG") which is itself a subsidiary of Lloyds Banking Group plc ("LBG"), the ultimate parent company. SWL was formed when all of the UK life insurance business of the insurance subsidiaries of SWG was transferred into one company on 31 December 2015. This was accomplished by way of the LBG Insurance ("LBGI") 2015 Scheme

("LBGI 2015 Scheme"). All LBG's UK life insurance holdings are collectively referred to as LBGI.

- 1.7 The ILDE policies were originally written through the European branch structures of Clerical Medical Investment Group Limited ("CMIG"). CMIG was the receiving entity under the LBGI 2015 Scheme and was renamed SWL at the time of the transfer.
- 1.8 The CMIL policies were originally written by a Luxembourg subsidiary of the LBG Insurance Group and were transferred, by Ministerial Decree, to SWL at 31 December 2015.
- 1.9 SWE will be a company domiciled in Luxembourg. It will be a wholly-owned subsidiary of SWL, and will be formed for the express purpose of receiving and servicing the Transferring Policies.
- 1.10 SWE has held discussions with Commissariat aux Assurances ("CAA"), the Luxembourg regulator, with regards to obtaining authorisation to undertake insurance business and has submitted a final licence application. It is expected that the licence will be granted with an effective date of 31 January 2019.
- 1.11 SWE will not be actively seeking new business. It is possible, however, that SWE will be used in the future as a receiving entity for any further European business that may need to be transferred from SWL or any European business that forms part of any future acquisitions made by SWL.
- 1.12 SWL will transfer the Transferring Policies via the Scheme into the new insurance company SWE in Luxembourg.
- 1.13 The Transferring Policies are unit-linked and unitised with-profits life and pension savings products. These products permit the investment of units into a range of SWL's unit-linked funds as well as into SWL's Clerical Medical With-Profits Fund ("CM WPF").
- 1.14 Some of these Transferring Policies have additional death benefits.
- 1.15 At maturity, a number of the Transferring Policies will vest, or have the option to vest, from a pension savings product into a with-profit annuity-in-payment. At 31 December 2017, a very small number of policies had already vested into annuities-in-payment and these policies will also be transferring. It is expected that this number will grow over time as more policies vest.
- 1.16 Under the Transfer, assets and liabilities, including future liabilities of the Transferring Policies, will transfer to the Transferee from the Transferor. The assets and liabilities so transferred will be determined in accordance with the Scheme.
- 1.17 Under the Transfer, the Transferring Policies will become directly-written business of SWE. The with-profits investment element of the Transferring Policies and any with-profit annuities already in payment at the Scheme Effective Date will be reinsured back to SWL's CM WPF. The cost of any guarantees related to the

conversion of Transferring Policies (whether with-profits or unit-linked) to with-profit annuities will also be reinsured back to SWL.

Key impacts of the Scheme

1.18 I have considered the impact of the Transfer on the Transferring Policies and the Non-Transferring Policies and in my view, the key features to note are:

- A key design principle in developing the Scheme and reinsurance arrangement between SWE and SWL has been to ensure that policyholder benefits for Transferring Policies can continue to be determined in materially the same way as they would be if the Transfer were not taking place.
- The Transferring Policies' terms, conditions and charges will not change as a result of the Scheme.
- The Transferring Policies' unit-linked funds are transferring to SWE but a servicing agreement with Lloyds Bank plc will result in SWL continuing to calculate the unit price and carry out box management of these unit-linked funds which means that the unit linked funds will continue to operate in the same way as they were prior to transfer.
- The with-profits investment element of the Transferring Policies and with-profit annuities in payment liabilities, at the Scheme Effective Date, will be reinsured back to SWL's CM WPF. Future with-profit annuities coming into existence due to obligations, or the exercise of options under the Transferring Policies including the cost of any guarantees related to the conversion of Transferring Policies (whether with profits or unit linked) to with-profit annuities will be reinsured back to SWL;
- SWE will withhold the reinsurance premium to keep back assets equal to the greater of the Luxembourg Generally Accepted Accounting Principal ("GAAP") Reserves and the Solvency II Best Estimate Liabilities for the reinsured business helping to mitigate SWE from counterparty risk.
- Transferring with-profit policy benefits will not change as a result of the Transfer (i.e. will continue to be determined in line with the Principles and Practices of Financial Management ("PPFM") of the CM WPF).
- In addition, a deed of charge, which will be implemented at the time of the Transfer, will mean SWE's reinsurance arrangement with SWL will rank *pari passu* to (i.e. equal to, and alongside) SWL's direct-written business in respect of any policyholder claims over and above the withheld funds, in the unlikely event of SWL insolvency;
- Although SWE will have their own management structure there will be no change to the administration of the Transferring Policies which will continue to be serviced according to the existing outsourcing agreements.
- The liability in respect of overseas litigation risk for the inforce Transferring Policies will transfer to SWE. However, subject to a separate agreement that will be implemented at the time of the Transfer, SWL will provide an indemnity

in respect of the majority of this liability in the unlikely event of SWL insolvency.

- The indemnity provided by SWL will also protect SWE from any additional losses arising on the Transferring business as a result of conduct or administration prior to the Scheme Effective Date (these losses, if they occurred, would currently be covered by SWL).
- The deed of charge will also result in this indemnity for SWE ranking pari passu to (i.e. equal to, and alongside) SWL's direct-written business in the unlikely event of SWL insolvency.
- SWE will be capitalised to the extent that it will maintain a level of capital over and above its Regulatory Capital Requirements. The way in which this excess capital buffer is determined will be similar to how it is currently determined for SWL.

Conclusions on the Scheme

1.19 I have considered the potential impact of the Scheme on the security, servicing and benefit expectations of the Transferring Policies and the Non-Transferring Policies. Based on my considerations and taking into account the key features of the Transfer outlined above (and the discussion of these and other matters contained in the remainder of this report), it is my view that:

- The Transferring Policies represent a non-material proportion of SWL's liabilities and the impact of the Transfer on the Non-Transferring Policies will not be material;
- The Scheme will not result in a materially adverse impact on the security and benefit expectations of the Transferring Policies;
- There will be no significant impact on the servicing that any policyholders will receive as a result of the Scheme; and
- The proposed communications plan is appropriate and has paid due regard to the interests of policyholders and the need to treat them fairly, as well as their information needs.

2 INTRODUCTION

- 2.1 The purpose of this report is to review the impact of the Scheme on the security, servicing and benefit expectations of the Transferring Policies and the Non-Transferring Policies.
- 2.2 The Transfer will take effect by means of the Scheme.
- 2.3 In this report I consider the Transfer from the perspective of the holders of the Transferring Policies and the holders of the Non-Transferring Policies and whether the Transfer has any materially adverse impact on these policyholders. This report does not consider any alternative schemes.
- 2.4 This report is written primarily for the Board of SWL in my capacity as Chief Actuary for SWL. The report is also written for the Board of SWE in my capacity as Group Chief Actuary, in the absence of a duly appointed SWE Chief Actuary at the time of writing.
- 2.5 This report should be read in conjunction with the Scheme, the report of the With-Profits Actuary ("WPA") of SWL and the report of the Independent Expert ("IE").

Status and Disclosure

- 2.6 I am a Fellow of the Institute & Faculty of Actuaries, having qualified in 1998 and hold a Chief Actuary certificate issued by the Institute & Faculty of Actuaries. I joined Lloyds Banking Group as Chief Actuary in 2015. Between 1999 and 2015, I worked for Ernst & Young where I was a partner of the firm between 2005 and 2015. In my role at Ernst & Young, I advised on a number of business transfers (including acting as the Independent Actuary) and held Actuarial Function Holder and Reviewing Actuary certificates issued by the Institute and Faculty of Actuaries.
- 2.7 I am an employee of Lloyds Bank plc which is a wholly owned subsidiary of LBG.
- 2.8 I currently act in the Approved Role (under Solvency II regime as discussed in Section 3) of Chief Actuary for SWL (the parent of SWE) and of Chief Actuary for SWG.
- 2.9 I hold an individual unit-linked pensions policy with SWL, which is not included in the Transferring Policies. I have a direct interest in shares of LBG (including share options) and am a member of the LBG defined contribution pension scheme.
- 2.10 Notwithstanding my holdings described in 2.9, I consider myself to be free from conflict that would prevent me from assessing the impact of the Scheme on policyholder benefits, the security of those benefits and the servicing of those benefits.
- 2.11 In particular, whilst in my role of Chief Actuary for SWL and as Chief Actuary for SWG (the wider Scottish Widows Group), I have been involved in developing the capital policy for SWE and its ongoing relationship with SWL, I do not believe that

this creates any conflict of interest. Indeed, I believe it gives greater insight and understanding for assessing the impact of the Transfer on policyholders.

Other Advice and Opinions

- 2.12 Mr Tim Roff of Grant Thornton UK LLP has been appointed as IE and has been approved as such by the PRA. In finalising my report, I have read a draft of his report on the terms of the Scheme and considered his conclusions. A copy of my report has also been provided to Mr Roff.
- 2.13 I have read and considered the report of the WPA, Mr Alasdair Smith, assessing the impact of the Scheme on the holders of with-profits investments under the Transferring Policies and Non-Transferring Policies. A copy of my report has also been provided to Mr Smith.
- 2.14 In producing this report, I have placed reliance on the following assurances that I expect to be supplied by SWE's Board once they are in situ:
- Assurances provided by SWE's Board with regard to its compliance with the LBG Capital Policy;
 - Assurances provided in the Scheme that SWE will follow the decisions made by SWL with regard to bonus declarations, market value adjustments and similar matters (e.g. estate distribution, smoothing etc.) for the Transferring Policies; and
 - Assurances to be provided by SWE with regards to the future administration of the Transferring Policies (in particular relating to the servicing levels to be provided to policies and the approach to be taken to reviewable policy charges).
- 2.15 I note that a copy of this report and the Independent Expert's report will be provided to SWE's Board when it is in place. As an actuary has yet to be appointed by SWE, a separate actuarial report on the Transfer has not been prepared for the SWE Board but my report considers the implications for the Transferring Policies.

Definitions and Abbreviations

- 2.16 A list of the defined terms and abbreviations in this report is included in Annex A.

Compliance with Technical Actuarial Standards

- 2.17 This report has been prepared in accordance with, and complies with, the Technical Actuarial Standards 100 and 200.
- 2.18 In producing this report I complied with the Actuarial Profession Standard X1: Applying Standards to Actuarial Work and APS X2: Review of actuarial work.

Structure of Report

2.19 This report is structured as follows:

- Section 3 provides an overview of the regulatory solvency regimes that apply to the companies involved in the Scheme.
- Section 4 provides an overview of SWL within the wider context of LBGI and provides an overview of the Transferring Policies;
- Section 5 outlines the proposed Scheme;
- Section 6 discusses the capital policy of SWL and SWE;
- Section 7 considers the impact of the Transfer on the financial position and risk profile of SWL, and on the security of the Transferring Policies and Non-Transferring Policies;
- Section 8 considers the impact on the benefit expectations of the Transferring Policies and the Non-Transferring Policies as a result of the Transfer;
- Section 9 contains consideration of the impact of the Scheme on taxation, administration, complaint escalation, governance, cancellation rights and considers the process being adopted to notify policyholders of the intended transfer and court process;
- Section 10 sets out my conclusions; and
- Annex A lists the defined terms and abbreviations used in this report.

3 THE REGULATORY ENVIRONMENT

- 3.1 Insurance companies are required, by regulation, to maintain a minimum level of capital resources to reduce the risk that they are unable to meet their future obligations to policyholders.
- 3.2 The Transfer involves SWL and SWE which are situated in different regulatory territories (the UK for SWL and Luxembourg for SWE).
- 3.3 This means that there are two different Regulators relevant to the Transfer. However, both territories have implemented the EU-wide Solvency II regulatory regime; hence there are material similarities between the two. This section gives a brief overview of each of these.

Background on solvency assessments in UK

- 3.4 SWL is regulated in the UK by the Prudential Regulation Authority ("PRA") and by the Financial Conduct Authority ("FCA").
- 3.5 On 1 January 2016 the Solvency II regime came into force across all EU member states, replacing the individual states' local Solvency I regimes.
- 3.6 The underlying liabilities in the solvency assessment are best-estimate (i.e. with no margin for prudence). This is referred to as the "Best Estimate Liabilities" in this report. Solvency II also requires an additional liability (the "Risk Margin") to be held. The Best Estimate Liabilities and Risk Margin together are referred to as the "Technical Provisions"
- 3.7 The Solvency II regime permits the use of certain "transitional" measures, the intention of which is to smooth the impact of the move to Solvency II from the prior Solvency I regime. In particular, SWL has received approval to use the transitional deduction to Technical Provisions the impact of which acts to broadly offset the Risk Margin relating to the business that was in-force at 31 December 2015.
- 3.8 Solvency II requires companies to make an assessment of the capital they need to hold, based on the risks to which the firm is exposed, such that they would remain able to meet their liabilities to policyholders in all but the most extreme situations (this is calibrated to cover a 1 in 200 year stress event over a one year time horizon). This is referred to as the "Regulatory Capital Requirement" in this report.
- 3.9 For the purpose of calculating the Regulatory Capital Requirement, SWL uses an internal model that is approved by its regulator, the PRA.
- 3.10 SWL publishes a Solvency and Financial Condition Report annually on its website, and submits detailed quantitative reports to the PRA on a quarterly basis.
- 3.11 As the framework contained in the Solvency II Directive regime has been implemented in UK law and the PRA Rulebook, and as the Government's stated intention is to transpose EU regulation into UK legislation (through The European

Union (Withdrawal) Act 2018”), the regime in the UK after leaving the EU27 in 2019 will be very similar to the Solvency II regime, at least in the short to medium term.

Background on solvency assessments in Luxembourg

- 3.12 SWE is seeking insurance authorisation in Luxembourg. The Luxembourg regulator for SWE will be the CAA.
- 3.13 As Luxembourg is an EU27 member state, the relevant regulatory regime is also that of Solvency II, and hence is the same as the UK regime outlined above.
- 3.14 Whereas SWL calculates its capital requirement using an Internal Model, SWE will calculate (at least initially) its capital requirement using the Standard Formula. Any deviation from this will require supervisory approval from the CAA.
- 3.15 In addition, whereas SWL applies the Transitional Deduction on Technical Provisions, SWE will not (at least initially) seek approval for the use of this measure.
- 3.16 In these last two respects, the regulatory solvency assessment for SWE is expected to be more conservative than that currently applied for SWL in respect of the Transferring business.

Solvency bases used in this report

- 3.17 All numbers in this report are as at 31 December 2017 unless stated otherwise and are on a Solvency II basis.

4 OVERVIEW OF SWL, THE TRANSFERRING POLICIES AND SWE

SWL

Background

- 4.1 SWL was formed on 31 December 2015 as a result of the implementation of the LBGI 2015 Scheme on that date. The LBGI 2015 Scheme is a legal scheme under which seven life insurance subsidiaries of Scottish Widows Group Limited were transferred to an eighth; CMIG – an existing insurance holding of LBGI and a subsidiary of SWG. At the time of the Transfer CMIG was renamed SWL.

Summary of the Business

- 4.2 SWL includes two separate with-profits funds, the Scottish Widows WPF and the CM WPF, and a 'Combined Fund' which holds the assets not attributed to the WPFs.
- 4.3 The main categories of business of SWL (with reference to Best Estimate Liabilities held for the business under the Solvency II regime at 31 December 2017) are summarised in the table below:

Table 4.1: SWL Best Estimate Liabilities at 31 December 2017

Business line	Best Estimate Liabilities (£m)
Unit-linked pensions and savings business	81,270
With-profits fund business	15,169
Scottish Widows With-profits fund business	9,997
Clerical Medical With-profits fund business	5,172
Annuities and Other (including protection products providing cover against death, critical illness and sickness)	15,075
Accepted Reinsurance	696
Health Reinsurance	214
Total	112,424

- 4.4 As a consequence of its business mix, SWL's risk profile is balanced and includes a mix of market, insurance (i.e. longevity, mortality and morbidity), business (i.e. expense and persistency) and operational risks. SWL holds capital against its risk exposures in line with Regulatory Capital Requirements and internal risk appetite policy.
- 4.5 SWL actively markets new business in the UK.
- 4.6 The table below presents a high-level summary of the risk exposures in SWL. It should be noted that this shows the relative exposure to risk within SWL and does not attempt to reflect the different sizes of risks that might exist compared to other companies in this report.

Table 4.2: SWL Risk Profile

Risk Type	Exposure
Market	✓✓✓
Longevity	✓✓
Mortality / Morbidity	✓
Business	✓✓
Operational	✓✓
Reinsurance counterparty	✓
Other	✓
Actively marketing new business	✓✓
Insurance Subsidiaries	x
Non-insurance subsidiaries	✓

Key:

- x No exposure to this risk type
- ✓ Some exposure to this risk type
- ✓✓ Material exposure to this risk type
- ✓✓✓ Key risk exposure

Transferring Policies

- 4.7 Under the terms of the Scheme, Transferring Policies will be transferred from SWL to SWE.
- 4.8 Outsourcing agreements currently exist to service the international business originally written through the ILDE branches and CMIL. These are shown in the table below:

Policies	Serviced by
German & Austrian ILDE Policies	Heidelberger Leben Services Management GmbH
Italian ILDE policies	Information Technology Outsourcing S.R.L
Luxembourg (ex-CMIL) policies	Pack Assurance Management SA

- 4.9 The Transferring Policies are long-term unitised insurance contracts offering:
- With-profits investments in SWL's CM WPF;
 - Unit-linked investments linked to SWL's unit-linked funds; and
 - A few of the above policies that have vested into with-profit annuities-in-payment.
- 4.10 The unitised with-profit investment products are invested in a series of "Guaranteed Growth Funds" the performance of which determine the bonuses payable to policyholders. The benefits payable also carry underlying guarantees such that the amount payable at defined points (or on death) may be subject to a minimum value.

- 4.11 Certain unit value linked investment products also have embedded guarantees under which the unit price will be subject to a floor.
- 4.12 All policies have a basic death benefit of at least 101% of policy value on death. Some policies also have extended life or sickness/disability cover.
- 4.13 A number of the Transferring Policies have the option, or a requirement in some cases, at maturity to vest from a pension savings product or deferred annuity into a with-profits annuity-in-payment. At 31 December 2017, a very small number of policies had taken this option. However, it is expected that this number will grow over time as more policies vest.
- 4.14 In respect of the Transferring Policies SWL has received a number of complaints relating to policies sold by independent intermediaries principally in Germany, but also in Austria and Italy during the late 1990s and early 2000s. SWL holds provisions for these complaints in both its accounts and regulatory solvency assessment, which have been set taking into consideration relevant decisions from the Federal Court of Justice in Germany. The risk of additional, or increased value of, complaints claims is referred to as “overseas litigation” risk in this document.
- 4.15 The table below presents a high-level summary of the risk exposures relating to transferring business. It should be noted that this is based on SWL’s Internal Model and shows the relative exposure to risk within the transferring block of business; it does not attempt to reflect the different size of risk compared to the SWL exposure shown above. The risk from overseas litigation has been included in Operational risk.

Table 4.3: Risk Profile of Transferring Business

Risk Type	Exposure
Market	✓
Longevity	✓
Mortality / Morbidity	✓
Business	✓✓✓
Operational	✓✓
Other	✓
Actively marketing new business	x

Key:

- x No exposure to this risk type
- ✓ Some exposure to this risk type
- ✓✓ Material exposure to this risk type
- ✓✓✓ Key risk exposure

4.16 The following table illustrates the actuarial valuation of the insurance liabilities of the Transferring Policies on the Solvency II basis at 31 December 2017.

Table 4.4: Transferring Policies as at 31 December 2017

Business category	Number of policies	Best Estimate Liabilities (investment element £m)
With-Profits Benefits	61,408	1,766
Unit-Linked Benefits	26,995	318
Total	88,403	2,084

Reinsurance arrangements

4.17 SWL is party to a number of external reinsurance arrangements. The reinsurance arrangement relevant to the Transferring Policies are two treaties with Swiss Re to cover death benefits and sickness/disability (mainly for waiver of premiums), subject to a minimum retention. At 31 December 2017, the reinsured sum at risk was c£0.3bn and the reinsurance premiums paid for 2017 were c£0.9m.

4.18 These treaties will transfer to SWE under the Scheme.

SWE Overview

- 4.19 SWE will be a company domiciled in Luxembourg. It will be a wholly-owned subsidiary of SWL, and will be formed for the express purpose of receiving and servicing the Transferring Policies.
- 4.20 SWE has held discussions with the CAA with regards to obtaining authorisation to undertake insurance business and has submitted a final licence application. It is expected that the licence will be granted with an effective date of 31 January 2019.
- 4.21 SWE will not be actively seeking new business. It is possible, however, that SWE will be used in the future as a receiving entity for any further European business that may need to be transferred from SWL or any European business that forms part of any future acquisitions made by SWL.
- 4.22 SWE will have its own:
 - Management Board;
 - Risk, Actuarial and Finance Departments;
 - Risk policies and Risk Appetite Statements; and
 - Capital Policy (discussed in Section 6).
- 4.23 The Finance services will be outsourced to Lloyds Bank plc and VAT Tax and Support Activities will be outsourced to Lloyds Bank plc, although the SWE Heads of Departments will be employed by SWE.
- 4.24 SWE will be General Data Protection Regulation (GDPR) compliant in a similar manner to SWL. To facilitate this SWE intends to have two individuals appointed as Mandataire General, who will also be formally recognised as branches for the purpose of insurance regulations under Solvency II, one in Germany and one in Italy.
- 4.25 As a result of the Scheme the outsourcing agreements currently with SWL (as mentioned in paragraph 4.8) that exist to service the international business originally written through the ILDE branches and CMIL will transfer to SWE. These are restated in the table below:

Policies	Serviced by
German & Austrian ILDE Policies	Heidelberger Leben Services Management GmbH
Italian ILDE policies	Information Technology Outsourcing S.R.L
Luxembourg (ex-CMIL) policies	Pack Assurance Management SA

- 4.26 SWL will transfer the Transferring Polices via the Scheme into the new Luxembourg insurance company SWE.

5 OUTLINE OF THE SCHEME

Overview of the Scheme

- 5.1 The Scheme will result in the transfer of the Transferring Policies from SWL to SWE. All liabilities, rights and obligations under the Transferring Policies will transfer to SWE. There will be an associated transfer of assets to SWE. The Scheme is expected to be effected on 28 March 2019.
- 5.2 A key aspect of the Scheme is the requirement that the unitised with-profits investment elements and with-profit annuities in payment are reinsured back to SWL. The reinsurance will also cover the future with-profit annuities coming in to effect due to obligations, or the exercise of options, under the Transferring policies (whether unit-linked or with-profits) including the costs of any guarantees related to the conversion of the funds into a with-profits annuity. The Scheme sets out the criteria for making changes, or terminating, this reinsurance arrangement to protect policyholders if either such event takes place.
- 5.3 In addition, the Scheme requires an indemnity to be set up between SWL and SWE so that the majority of the exposure to overseas litigation claims remains with SWL.
- 5.4 The Scheme requires that a floating charge arrangement is set up so that SWE ranks *pari passu* (for the claims under the reinsurance agreement in excess of the funds withheld, and indemnity liabilities) with the other SWL policyholders in the unlikely event of SWL suffering an insolvency event.
- 5.5 Lastly, to be allowed to make a payment out of the CM WPF the 2015 Scheme has to be updated to allow payments under Part VII Transfers as an allowable payment type.

Policy administration

- 5.6 The administration outsourcing agreements that SWL currently has with its three outsourcers, (Heidelberger Leben Services Management GmbH , Pack Assurance Management SA and Information Technology Outsourcing S.R.L), will transfer to SWE and policies will continue to be serviced by the same outsourcer as was the case pre Transfer. The administration of the Transferring Policies will therefore be unchanged by the Scheme.

Assets and liabilities transferring

- 5.7 Under the Transfer, assets and liabilities will transfer to SWE from SWL. The assets and liabilities so transferred will be determined in accordance with the Scheme.
- 5.8 Alongside the Scheme a reinsurance agreement will be put in place between SWE and SWL covering the with-profit investment element of Transferring Policies pre vesting and the with-profits annuities in payment post vesting. In addition, this reinsurance will cover the future with-profit annuities coming in to effect due to obligations, or the exercise of options, under the Transferring policies (whether unit-

linked or with-profits) including the costs of any guarantees related to the conversion of the funds into a with-profits annuity.

- 5.9 However, SWE will withhold the payment of the premium for this reinsurance. These withheld funds will equal the higher of the Luxembourg GAAP Reserves and the Solvency II Best Estimate Liabilities for the reinsured business with the assets retained from the CM WPF subject to a maximum of the WP Solvency II Best Estimate Liabilities excluding any allowance for estate distribution.
- 5.10 Although these withheld assets remain with SWE within the reinsurance agreement there will be an agreement:
- On how these withheld funds can be used to meet claims arising on the reinsured Transferring WP policies;
 - That SWL's CM WPF will continue to have the economic benefit from the assets withheld from the CM WPF and can continue to instruct SWE to invest these assets so they are invested in line with the CM WPF's requirements; and
 - That the amount of withheld funds will be reviewed and rebalanced on a quarterly basis.
- 5.11 The quarterly review and rebalancing of the withheld funds is to ensure that SWE continues to withhold an appropriate amount of assets to cover its reinsured liabilities. Any rebalancing requirement would arise as a result of the assumptions on which the liabilities are based being different from actual experience, as well as reflecting any change in that assumption basis during the period.
- 5.12 For the Transferring policies the unit-linked assets underlying the unit-linked funds they invest in will be transferred across into duplicate unit-linked funds set up in SWE. These will operate and be managed in the same way as the SWL unit-linked funds were pre Transfer.
- 5.13 As a result of the indemnity agreement that is being implemented, SWE will be responsible for 10% of the claims related to overseas litigation risk, up to a maximum of €60m. As a result assets covering 10% of SWL's provisions for overseas litigation in respect of the Transferring Policies will transfer to SWE.
- 5.14 Lastly, under the Scheme an amount of physical assets will transfer from SWL to SWE covering any additional amount required to cover the net of reinsurance Luxembourg GAAP reserves that will be required by SWE. It is expected that this will be paid by transfer of cash or cash type assets.
- 5.15 Alongside the Scheme, at the time of the Transfer there will be a further payment into SWE from SWL in respect of capital. The capital payment will be an amount that ensures that after the Transfer SWE will have sufficient assets to cover its Capital Policy requirements. The actual amount of the payment will not be confirmed until closer to the time of the Transfer.

Transferring Policies with investments in the CM WPF

- 5.16 As a requirement of the Scheme, the Transferring Policies with investments in the CM WPF will become direct business of SWE and the with-profits investment element for pre vesting policies and the with-profits annuities in payment at the Scheme Effective Date for post vesting policies will then be reinsured back to the CM WPF of SWL. The reinsurance will also cover the future with-profit annuities coming into effect due to obligations, or the exercise of options, under the Transferring Policies (whether unit-linked or with-profits) including the costs of any guarantees related to the conversion of the funds into a with-profits annuity.
- 5.17 Administration and mortality charges will accrue or be charged to SWE based on the policy terms and the terms of the reinsurance arrangement. SWE will correspondingly be responsible for the expenses of administering the business and mortality costs for the policies from which it receives charges.
- 5.18 SWE will withhold assets equal to the greater of the Luxembourg GAAP reserves and Solvency II Best Estimate Liabilities for the investment element of the Transferring With-Profits policies and the with-profit annuities in payment being reinsured from the reinsurance premium paid to SWL. This is to provide security for the Transferring Policyholders in the unlikely event of SWL becoming insolvent (this is discussed in paragraphs 7.51 to 7.54).
- 5.19 Of the withheld assets an amount not exceeding the WP Solvency II Best Estimate Liabilities will have been withheld from the CM WPF. Under the Reinsurance Agreement SWL's CM WPF will continue to have the economic benefit from the assets withheld from the CM WPF and can continue to instruct SWE to invest the assets so they are invested in line with the CM WPF's requirements.
- 5.20 As a result, the CM WPF will continue to be a ring-fenced fund in SWL and the way it is run will not change materially as a result of the Transfer (i.e. it will continue to be run in accordance with its PPFM and the LBGI 2015 Scheme).
- 5.21 The SWE Board will be responsible for with-profits' bonus setting, determination of market value adjustments or similar matters (e.g. estate distribution, smoothing etc.) for the Transferring Policies with with-profits investments. As confirmed in the Scheme the SWE Board will resolve that that the bonuses, market value adjustments and similar matters will follow the decisions made by SWL in respect of the reinsurance of these policies in all reasonably foreseeable circumstances.

Transferring Policies with unit-linked investments

- 5.22 For the Transferring policies the unit-linked assets underlying the unit-linked funds they invest in will be transferred across into duplicate unit-linked funds set up in SWE.
- 5.23 A servicing agreement is being put in place with Lloyds Bank plc so that the box management, and unit pricing for these unit-linked funds will operate in the same way as it did pre Transfer.

- 5.24 This means that the unit-linked funds will continue to operate in the same way as they were prior to transfer.
- 5.25 The reinsurance with SWL will cover the future with-profit annuities coming into effect due to obligations, or the exercise of options, under the Transferring unit-linked policies including the costs of any guarantees related to the conversion of the unit funds into a with-profits annuity.
- 5.26 After the Transfer the SWE Board will be responsible for the limited discretion allowed in relation to the charges on unit-linked Transferring Policies.

Policyholder protection

- 5.27 As a result of the reinsurance arrangement that will be put in place to put the with-profits investment element pre vesting and the annuities in payment post vesting of the Transferring Policies back with SWL and cover the costs related to any guarantees around the conversion of funds (whether unit-linked or with-profits) to with-profits annuities, absent a security arrangement, SWE (as a reinsurance creditor) would rank behind the direct policyholders of SWL for any claims greater than the withheld funds in the unlikely event that SWL entered insolvency proceedings. This would place SWE policyholders at risk of recovering less than they would have, had they remained a direct policyholder of SWL.
- 5.28 To mitigate this risk two actions are being taken:
- SWE has withheld funds equal to the greater of the Luxembourg GAAP reserves and the Solvency II Best Estimate Liabilities for the reinsured with-profits business from the reinsurance premium paid to SWL; and
 - a deed of charge will be put in place at the time of the Transfer so that SWE will rank pari passu to (i.e. equal to, and alongside) SWL's direct-written business in the unlikely event of SWL insolvency.
- 5.29 This deed of charge will mean that if SWL becomes insolvent SWE, as the reinsured party, will have the same ranking position for reinsurance claims in excess of the funds withheld as the Transferring Policies currently have pre Transfer.
- 5.30 In addition, in Luxembourg as there is no Financial Services Compensation Scheme (FSCS), described in section 7.61 to 7.65, the CAA require that assets equal to the greater of the Solvency II Technical Provisions (i.e. Solvency II Best Estimate Liabilities plus Risk Margin) and the reserves based on Luxembourg's GAAP are held in a tripartite custodian agreement with the CAA as one of the parties. These assets are held separately to ensure they are available to cover the policyholders' liabilities of SWE in the unlikely event of SWE insolvency.
- 5.31 The appropriate amount of assets will be put into such an agreement on the Scheme Effective Date.

- 5.32 The liability in respect of overseas litigation risk for the inforce Transferring Policies will transfer to SWE.
- 5.33 A separate agreement that will be implemented at the time of the Transfer under which SWL will provide SWE with an indemnity in respect of 90% of the overseas litigation liability. The remaining 10% liability will remain with SWE, up to a maximum amount of €60m, above which SWL will bear 100% of the liability.
- 5.34 The indemnity provided by SWL will also fully protect SWE from any additional losses arising on the Transferring business as a result of conduct or administration prior to the Scheme Effective Date.
- 5.35 As a result of the deed of charge this indemnity for SWE will also rank pari passu to (i.e. equal to, and alongside) SWL's direct-written business in the unlikely event of SWL insolvency.
- 5.36 For the avoidance of doubt the liability in respect of overseas litigation risk for out-of-force Non-Transferring Policies will not transfer to SWE, and hence will remain 100% with SWL.

Costs of implementing the Scheme

- 5.37 The costs associated with the implementation of the Scheme will be met by the shareholders of SWL (via the Combined Fund). This means that policyholders will not bear any of the costs of the Transfer.

6 CAPITAL POLICY

6.1 This section provides a summary of the capital policy that applies to SWL and SWE.

Capital Policy at SWL

- 6.2 In order to protect the interests of policyholders, insurance business is subject to significant regulatory oversight by the PRA. In particular, regulations set out requirements for how much capital an insurer should maintain to cover the risks associated with its liabilities.
- 6.3 In addition to these Regulatory Capital Requirements, additional capital ("Risk Capital Buffer") is maintained by SWL in accordance with the LBG Board approved Capital and Risk Appetite Policy ("LBG Capital Policy"). The LBG Capital Policy aims to protect SWL from breaching its Shareholder's Regulatory Capital Requirements following an adverse event with a 1 in 10 year probability of occurrence. SWL's Shareholder's Regulatory Capital Requirements are the Regulatory Capital Requirements for the SWL Combined Fund (which includes any burn through from the With Profit Funds).
- 6.4 This LBG Capital Policy is reviewed at least annually by the LBG Board. The capital position of SWL against the LBG Capital Policy is subject to regular monitoring and is also shared with the PRA (as part of a close and continuous monitoring relationship).
- 6.5 LBG has a Capital Management Plan that has various actions that the LBG companies, including SWL, can take when their solvency drops below the LBG Capital Policy target with the aim of restoring SWL's solvency to the target level. These include, but are not restricted to:
- More frequent solvency monitoring;
 - Hedging;
 - Retention of dividends and
 - Sale of credit assets.
- 6.6 As well as the Capital Management Plan there is also a Capital Recovery Plan for when any of the LBG companies, including SWL, solvency drops close to, or below, the Shareholder's Regulatory Capital Requirement. The Capital Recovery Plan includes actions that allow subsidiaries to look to their parent companies for capital support¹.
- 6.7 The above framework helps provide comfort that policyholder security should not be materially affected by the Transfer.

¹ Although the LBG Capital Policy looks to ensure that all its subsidiaries are adequately capitalised parent companies are under no legal obligation to provide the capital support requested.

Capital Policy at SWE

- 6.8 As part of its risk management approach, SWE will operate a Capital Policy which follows the LBG approach, both in terms of implementation and scale of Risk Capital Buffer.
- 6.9 This Capital Policy will mean that SWE's solvency will be monitored and managed in a similar way to SWL.
- 6.10 In line with LBG Capital Policy, SWE will pay any capital in excess of its risk appetite up to SWL, i.e. anything above what SWE requires to cover its Solvency II Pillar 2 Capital requirements (as discussed in paragraph 7.27) after a 1 in 10 adverse scenario, as dividends to its parent, SWL.

Overall Capital Support within LBG

- 6.11 SWL and SWE are both subsidiaries of SWG, itself a subsidiary of LBG, which all follow the LBG Capital Policy, including the Capital Management Plan and Capital Recovery Plan. The Capital Recovery Plan allows each subsidiary to look to its parent company for capital support² if they are close to, or below, their Regulatory Capital Requirement.
- 6.12 This will mean that SWE can look to SWL for capital support² if it is close to, or below, its Regulatory Capital Requirement and similarly SWL can look to SWG for capital support² if it is close to, or below, its Regulatory Capital Requirement.
- 6.13 SWG could itself call on LBG for capital support² if it is close to, or breaching, its Regulatory Capital Requirement.
- 6.14 The above all means that SWL and SWE benefit from being part of the group headed by LBG.

² Although the LBG Capital Policy looks to ensure that all its subsidiaries are adequately capitalised a parent company is under no legal obligation to provide the capital support requested.

7 IMPACT OF TRANSFER ON FINANCIAL POSITION AND RISK PROFILE OF THE COMPANIES

- 7.1 This section contains information on the financial impact of the Transfer on the overall balance of risks that policyholder benefits are exposed to and covers the particular matters relating to issues that are of relevance to the security of the Transferring Policies and the Non-Transferring Policies.
- 7.2 This section also contains information on the financial impact of the Transfer on SWL and SWE. This information is useful in providing some quantitative assessment of the impact of the Transfer on the security of the Transferring Policies and the Non-Transferring Policies.

Impact of the Transfer on Risk Profile

- 7.3 Pre Transfer, the Transferring Policies are exposed to the remote risk that SWL is unable to meet its obligations to all of its creditors (including policyholders). The key risks that could impair SWL's financial position and increase the risk of such an event are summarised in Paragraph 4.6.
- 7.4 Post Transfer, the Transferring Policies will be direct business of SWE and so will be exposed to the remote risk that SWE is unable to meet its obligations to all of its creditors (including policyholders).

Risk profile of SWE

- 7.5 The key risks relating to the Transferring business were summarised in Paragraph 4.15. In addition, to these risks, SWE will also be exposed to additional risk relating to the reinsurance arrangement with SWL (counterparty risk) and further expense/operational risks relating to operation of an insurance entity. The withheld funds under the reinsurance agreement help to mitigate the counterparty risk.
- 7.6 The Operational Risk in SWE is reduced, compared to the summary in paragraph 4.15, as a result of the indemnity from SWL that has been put in place.

7.7 The risk profile of SWE following the Transfer is summarised below³.

Table 7.1: SWE Risk Profile

Risk Type	Exposure
Market	✓
Longevity	✓
Mortality / Morbidity	✓
Business	✓✓✓
Operational	✓
Reinsurance counterparty	✓✓
Other	✓
Actively marketing new business	×
Insurance Subsidiaries	×
Non-insurance subsidiaries	×

Key:

- × No exposure to this risk type
- ✓ Some exposure to this risk type
- ✓✓ Material exposure to this risk type
- ✓✓✓ Key risk exposure

7.8 Post Transfer, the scale of risks to which the Transferring Policies will be exposed will be smaller and less diverse than the current exposure in SWL (due to the relative sizes of the businesses and wider range of risks to which SWL is exposed).

7.9 A number of the Transferring Policies have either an obligation, or option, to purchase a with-profits annuity-in-payment. These policies are expected to remain with SWE for a significant period of time, the lifetime of the policyholders, and as a result expose SWE to expense inflation risk. In addition, as the administration of this business is outsourced SWE is exposed to the ongoing risk that the outsourcers cannot continue to administer the policies. These make up the Business Risk which is a key risk for SWE.

7.10 As a result of the reinsurance arrangement being put in place between SWE and SWL there is a material exposure to default by SWL (Reinsurance Counterparty), although as current SWL policies they are currently exposed to the risks that would cause SWL to default. However, as part of the reinsurance agreement SWE will withhold the reinsurance premium due to SWL. These withheld funds will be owned by SWE, which as a result reduces SWE's exposure to SWL and so reduces SWE's counterparty risk. The amount of assets withheld will be reviewed and rebalanced on a quarterly basis to ensure SWE withholds the appropriate amount of assets to cover its reinsured liabilities.

³ As before, the table is intended to show the relative exposure to risk within the SWE and does not attempt to reflect the different size of risk compared to the SWL exposure shown above.

- 7.11 In addition, the Operational Risk for SWE has reduced in relation to the Operational Risk of the Transferring Policies on their own (as per paragraph 4.15) due to the Indemnity Agreement that is being put in place with SWL to protect SWE from litigation claims.
- 7.12 The key issue is not the risk exposure in isolation but the extent to which the solvency position and capital management approach of SWE provide sufficient capital resources within SWE to protect the transferring policyholders from the risk exposure. This is considered below (see Paragraphs 7.25 to 7.27) as part of a wider discussion of the impact of the Transfer on the financial strength of SWL and SWE.

Risk profile of SWL

- 7.13 SWL's risk profile will not change materially as a result of the Transfer. This is because the Transferring Policies make up a non-material proportion of the SWL business (as discussed further in Paragraphs 7.16 to 7.22 below).
- 7.14 It is also, however, because SWE is a subsidiary of SWL, meaning that whilst SWL may not be directly exposed to the risks associated with the Transferring Policies post Transfer, other than those reinsured back, it will continue to be indirectly exposed through its ownership of SWE.
- 7.15 SWL will also be exposed to some degree of increased operational risk as a result of the creation of an insurance subsidiary. However, to the extent that SWE operates a similar prudent management approach to that of SWL and will be subject to Group oversight, this would not represent a material new risk exposure.

Financial Impact of the Transfer on SWL

- 7.16 As shown in Section 4, the Transferring Policies constitute a small proportion of SWL's total liabilities (the best estimate liabilities of the Transferring Policies being c1.8% of SWL's best estimate liabilities at 31 December 2017 before allowing for the reinsurance arrangement and c0.2% after allowing for the reinsurance arrangement).
- 7.17 The table below summarises the impact of the Transfer on SWL's Solvency II required capital at 31 December 2017. In this, the Working Capital Ratio provides an indicator of the immediate impact of the Scheme on the level of benefit security provided to the Non-Transferring Policies.

Table 7.2: SWL solvency position pre and post Transfer at 31 December 2017

£m	SWL Pre Transfer				SWL Post Transfer			
	SW WPF	CM WPF	Combined Fund	Total	SW WPF	CM WPF	Combined Fund	Total
Available Capital ⁴	1,183	395	7,760	8,412	1,183	395	7,592	8,244
Regulatory Capital Requirement	(417)	(235)	(5,361)	(6,014)	(417)	(235)	(5,397)	(6,050)
Working Capital	766	159	2,398	2,398	766	159	2,194	2,194
Working Capital ratio	284%	168%	145%	140%	284%	168%	141%	136%

7.18 In this table the SWL Post Transfer results allow for SWE as a subsidiary of SWL by including SWE's Available Capital in SWL's Available Capital and SWE'S Regulatory Capital Requirement in SWL's Regulatory Capital Requirement. The SWE values can be found in Table 7.4.

7.19 This table shows that, had the Transfer taken place at 31 December 2017, while SWL's Working Capital Ratio decreases from 140% to 136% it would have continued to meet its Solvency II requirements after the Transfer. SWL's Combined Fund's solvency continues to meet SWL's Capital Policy target.

7.20 In addition, the table also shows that there is no change in the financial position of the WPFs, other than due to the reduced support available from SWL's Combined Fund due to the reduced Working Capital.

Table 7.3: Movement in SWL solvency position from pre Transfer to post Transfer at 31 December 2017

£m	Pre Transfer	Impact of Removing Transferring Policies ⁵	Impact of Creating and Adding SWE Subsidiary	Post Transfer
Available Capital	8,412	(105)	(63)	8,244
Regulatory Capital Requirement	(6,014)	+89	(125)	(6,050)
Working Capital	2,398	(16)	(188)	2,194
Working Capital ratio	140%	0.3%	(3.9)%	136%

7.21 This table highlights:

- The low materiality of the Transferring Policies in terms of SWL's current overall business and operation.

⁴ Note that the Total Available Capital does not equal the sum of the Available Capital of the SW WPF, CM WPF and Combined Fund as SWL is restricted to only recognising the Available Capital in the SW WPF and CM WPF required to meet their respective Regulatory Capital Requirements.

⁵ After allowing for the reinsurance agreement and indemnity

- The inefficiencies in splitting the business into a separate subsidiary; principally arising due to:
 - additional expenses,
 - the introduction of inter-company counterparty exposures,
 - loss of diversification and
 - moving to a Standard Formula measurement of capital requirements and Risk Margin for SWE.

Some of this impact might be mitigated if an Internal Model were to be adopted for SWE and if SWL's current approach of adding in the Available Capital and Regulatory Capital Requirement for subsidiary companies were to be amended to reflect a position where inter-company relationships between SWE and SWL were consolidated out and where risks between SWE and SWL were allowed to diversify against one another.

- 7.22 However, I note that as SWE is a subsidiary of SWL with the exception of the additional expenses related to having a subsidiary, and potentially some capital fungibility issues, as a group SWL is exposed to the same risks post Transfer as it was pre Transfer.
- 7.23 It is also noted that, post Transfer, SWL would continue to operate under its existing LBG Capital Policy, Capital Management Plan and Capital Recovery Plan which would allow SWL to look to SWG for capital support⁶ if required.
- 7.24 Overall, I am satisfied that the Transfer does not have a materially adverse impact from the perspective of SWL's coverage of its Regulatory Capital Requirement nor significantly change the economic risks that SWL is exposed to. I am therefore satisfied that there will be no materially adverse impact on the security of Non-Transferring Policies.

Financial Impact of the Transfer on Transferring Policies

- 7.25 In order to assess whether or not the security of the Transferring Policies will be materially adversely affected by the Scheme, it is useful to consider the reported solvency position of SWL before the Transfer against the expected solvency of SWE after the Transfer.
- 7.26 The table below shows the pre Transfer Solvency II position of SWL and the estimated post Transfer Solvency II position of SWE. As described previously, the Working Capital Ratio provides an indication of the immediate impact of the Scheme on the level of benefit security provided to the Transferring Policies.

⁶ Although the LBG Capital Policy looks to ensure that all its subsidiaries are adequately capitalised SWG is under no legal obligation to provide the capital support requested.

Table 7.4: SWL pre Transfer and SWE post Transfer Solvency II position at 31 December 2017

£m	SWL Pre Transfer	SWE Post Transfer
Available Capital	8,412	175
Regulatory Capital Requirement	(6,014)	(125)
Working Capital	2,398	50
Working Capital ratio	140%	140%

7.27 SWE's Regulatory Capital Requirement in the table above includes an add on in respect of overseas litigation risk that is not strictly required by the Solvency II Standard Formula. The CAA has indicated that they would be unlikely to require this add-on for the formal Solvency II Pillar 1 regulatory reporting. Hence the Solvency II Pillar 1 regulatory working capital ratio would be higher than the 140% shown above. As SWE intends to hold capital for the overseas litigation risk for Solvency II Pillar 2 capital and risk appetite assessment purposes, we have included it in the table above to provide appropriate comparability.

7.28 The results show that, after the Transfer, SWE would more than meet its Solvency II requirements, and would be capitalised to approximately the same level as SWL pre Transfer. Note that SWE would be capitalised according to the Standard Formula, which is arguably prudent when compared to the existing Internal Model approach⁷. Therefore there is prudence within the SWE solvency impact shown above.

7.29 I also note that as a subsidiary of SWL, and a member of the group headed by SWG, which itself is a subsidiary of LBG, SWE would have the ability to look for support⁸ from SWL (and the wider group) if it was breaching its capital management policy.

SWE Capital Projection

7.30 In addition to reviewing SWE's capital position immediately after the Transfer, I have also considered SWE's projected capital position. To do this I reviewed the base projection of SWE's SCR Cover Ratio within its five-year business plan.

7.31 This showed that SWE's SCR Cover Ratio was projected to remain above its Capital Policy requirements throughout the projection period.

Sensitivity Testing

7.32 In addition to the base and projected positions above I have also considered adverse sensitivity testing that has been carried out for SWE. These sensitivities

⁷ This increase in capital requirement also results in a greater Risk Margin for SWE compared to the same business within SWL.

⁸ Although the LBG Capital Policy looks to ensure that all its subsidiaries are adequately capitalised SWL is under no legal obligation to provide the capital support requested.

considered the SWE Solvency II balance sheet and Regulatory Requirement after 1 in 20 year events. The sensitivities covered were:

- Increased Expense levels;

This is a one off fixed percentage increase in expenses that then remains for the duration of SWE's business.

- Increased Expense Inflation;

This involves a fixed percentage increase to the level of inflation that is applied to SWE's expenses each year for the duration of SWE's business.

- Counterparty Risk

This sensitivity considers the impact on SWE if SWL, as SWE's main counterparty, has its Credit Rating reduced by one level (from A to BBB based on Standard & Poors). This is actually more severe than a 1 in 20 year event.

- Increase in Lapse Level

This allows for a one off fixed percentage increase in lapse levels experienced each year by the Transferring Policies with SWE.

- A Mass Lapse Event

This is a one off instantaneous lapse by a significant number of Transferring Policies with SWE.

- A one off fall in Equity Values

This is a significant fall in the equity assets that are held by SWE.

- 7.33 The results for these adverse sensitivities show a decrease in SWE's ability to cover its Regulatory Capital Requirements with one of the sensitivities showing that SWE would no longer be able to meet its Regulatory Capital Requirements.
- 7.34 This is not unexpected as the LBG Capital Policy is designed for SWE to have a Capital Buffer that will meet a 1 in 10 year event and these are more severe 1 in 20 year events.
- 7.35 Under the majority of these sensitivities SWE would manage its solvency recovery through retaining profits and not paying dividends to SWL. This would result in SWE restoring its Capital Buffer to its target level within a year or two.
- 7.36 The sensitivity that had a larger impact and so requires further discussion is the Increased Expense Inflation.
- 7.37 Under the increase in expense inflation sensitivity as a result of the relatively large proportion of overhead expenses that SWE has combined with the long duration of its liabilities (due to the anticipated conversion to with-profit annuities-in-payment) SWE can no longer meet its Regulatory Capital Requirements.

- 7.38 In this scenario as well as retention of profits other management actions could include the hedging of further expense inflation risk and/or looking to SWL for capital support⁹. If the hedge of expense inflation was introduced then SWE would meet its Regulatory Capital Requirements. Once in situ the Board of SWE will consider whether to implement such a hedge.
- 7.39 It is also worth noting that under the Counterparty Downgrade sensitivity in the absence of the withheld funds under the reinsurance agreement SWE would be exposed to the downgrade of SWL as the Solvency II Standard Formula calculation of the Regulatory Capital Requirements that allows for a significant increase in the probability of default for a company with a credit rating of BBB rather than A.
- 7.40 This would have resulted in SWE being unable to meet its Regulatory Capital Requirements under the Counterparty Downgrade sensitivity.

Impact of Funds withheld by SWE

- 7.41 For Non-Transferring Policies there is potentially a concern around the funds that SWE have withheld. However, these assets relate directly to the liabilities of the Transferring Policies which are reinsured to SWL.
- 7.42 However, the withheld funds means that in the event of insolvency of SWL then either:
- a) there are sufficient SWL assets to meet all of the policyholders' liabilities (but not the lower ranking liabilities) and so there is no impact from these assets being withheld; or
 - b) there are insufficient SWL assets to meet all of the policyholders' liabilities and there is a haircut to payouts for SWL policies and the Transferring policies are potentially benefitting from the fact that assets equal to the greater of the Luxembourg GAAP reserves and the Solvency II Best Estimate Liabilities (excluding allowance for any estate distribution) are withheld by SWE.
- 7.43 In b) above the SWL Non-Transferring policyholders are potentially disadvantaged because as SWL has insufficient assets to meet all policyholder liabilities this leads to a reduction in the Non-Transferring policies' payouts. However, the value of the Transferring Policies' liabilities in relation to SWL liabilities as a whole are c1.8% (as discussed in paragraph 7.16) and so if there was (say) a 10% hair cut to the policyholders' payouts not being able to apply the haircut to the Transferring Policies would result in an extra c0.2% cut to the Non-Transferring Policies.
- 7.44 However, in this scenario the UK's FSCS would meet the reduction in their claim and there is no materially adverse impact on the SWL policyholders.

⁹ Although the LBG Capital Policy looks to ensure that all its subsidiaries are adequately capitalised SWL is under no legal obligation to provide the capital support requested.

Conclusions on the Financial Impact of the Transfer

7.45 Based on the discussion above:

- I am satisfied that the Transfer does not have a materially adverse impact on the financial position of SWL and as such does not have a material adverse impact on the security of Non-Transferring SWL policyholders.
- I am satisfied that, taking into account the capital policy of SWE, SWE will be capitalised to a level where the Transfer will not lead to a materially adverse impact on the security of the Transferring Policies at the point of Transfer.
- I am satisfied that SWE has appropriate management actions in place to facilitate recovery of its solvency position after significantly (i.e. 1 in 20 year events) adverse events.

Specific considerations in respect of changes in risk profile that arise from the Transfer and associated introduction of the reinsurance arrangement

7.46 Following the Scheme, the with-profits investment element and the with-profit annuities in payment (at the Scheme Effective Date) of the Transferring Policies will be reinsured back to SWL's CM WPF. These policies will be treated as if they have never left the CM WPF, e.g. for bonus declarations including estate distribution.

7.47 In addition the future with-profit annuities purchased due to obligations, or exercise of options, under the Transferring Policies (whether unit-linked or with-profits) including the cost of any guarantees related to the conversion of Transferring Policies, whether unit-linked or with-profits, into with-profit annuities will be reinsured back to SWL.

7.48 The withheld funds by SWE under the Reinsurance Agreement will be held under a tripartite custodian agreement to be available to meet policyholder claims if SWE was to go insolvent and will be separately identifiable from the other assets held under the custodian agreement. As part of the reinsurance agreement SWL will instruct SWE on how these assets should be invested so that they continue to be invested in line with the CM WPF's requirements.

7.49 This reinsurance arrangement will commence from the effective date of the Transfer and can only be altered (other than minor technical alterations) or terminated if:

- It is agreed by both parties; and
- A written report has been obtained from an independent actuary stating that policyholders are not materially adversely impacted; and
- There is no objection from the appropriate Regulator

Alternatively SWE may terminate the reinsurance arrangement if SWL suffers an insolvency event and no objection to such termination is received from CAA or PRA (where SWE would retain the withheld funds and an independent actuary would review the appropriateness of the termination amount).

- 7.50 This puts in place an appropriate framework for ensuring that the impact of any future alterations or termination of the reinsurance on policyholders, whether Transferring or Non-Transferring, considers the impact on the policyholders and allows an appropriate decision to be made at that time.
- 7.51 As a result of the Transfer and the implementation of the reinsurance arrangement between SWE and SWL, the Transferring Policies will be:
- a) Exposed to risk of default by SWL on its reinsurance obligations;
 - b) Exposed to the risk of SWE becoming insolvent, in this case, policyholder recourse would be to the resources of SWE rather than SWL.
- 7.52 However, in respect of a) the reinsurance agreement has SWE withholding the reinsurance premium. This means that if SWL was to default on its reinsurance obligations these withheld funds would be available for SWE to use to meet policyholder claims.
- 7.53 In addition, alongside the reinsurance agreement there is a deed of charge (that will be implemented at the time of the Transfer) under which SWE will rank *pari passu* to (i.e. equal to, and alongside) SWL's direct-written business in the unlikely event of SWL insolvency for any payments due to be made under the reinsurance agreement that are over and above the funds withheld.
- 7.54 This is intended to provide continued protection for the Transferring Policies in the unlikely event that SWL becomes insolvent.
- 7.55 It is also worth noting that currently, before they Transfer as part of SWL the Transferring Policies are exposed to the risks that would cause SWL to default on its reinsurance payments.
- 7.56 In respect of b):
- Prior to the Transfer, the Transferring Policies have recourse to the resources of SWL. Following the Transfer, the Transferring Policies will be directly written and insured by SWE and will therefore not have direct recourse to the resources of SWL.
 - SWE will be capitalised to similar level to SWL pre Transfer, as per paragraphs 7.25 to 7.28, and through its Capital Recovery Plan could look to SWL for capital support¹⁰ if SWE was close to, or below, its Regulatory Capital Requirements.
 - As discussed in paragraphs 7.61 to 7.65 Luxembourg regulations require that assets equal to the greater of the Solvency II Technical Provisions and the Luxembourg GAAP reserves are held under a tripartite custodian agreement so that they are available to meet policyholder claims if SWE becomes insolvent.

¹⁰ Although the LBG Capital Policy looks to ensure that all its subsidiaries are adequately capitalised SWL is under no legal obligation to provide the capital support requested.

- This means that the assets backing the policyholder liabilities are protected.

7.57 For the reasons discussed above, I do not believe that the security of the Transferring Policies will be materially adversely affected by the Transfer and the associated removal of direct recourse to the resources of SWL.

Swiss Re Reinsurance

7.58 As noted in Section 4, the Transferring Policies are currently covered by two reinsurance treaties with Swiss Re.

7.59 The Scheme will transfer these reinsurance treaties to SWE and the Transferring Policies will continue to be covered in the same way as currently.

Compensation Schemes

Outline of relevant compensation schemes

7.60 In the UK in the event of liquidation or winding up of an insurance company direct (i.e. not reinsurance) policyholders have preferential rights which overrides any other creditor's rights, except the specific preferred creditors; employees, the treasury, the municipalities, the national social security agencies and the professional bodies.

7.61 In addition, there is a Financial Services Compensation Scheme ("FSCS") for customers of authorised financial services firms. This means that FSCS must pay compensation if a firm is unable, or likely to be unable, to pay claims against it. FSCS is an independent body, set up under the Financial Services and Markets Act 2000, and is funded by a levy on authorised financial services firms

7.62 Luxembourg has no equivalent of the FSCS. However, the CAA stipulates that the assets backing the technical provisions, based on the higher of Solvency II and Luxembourg GAAP regulations, held for policyholders must be segregated ("Tied Assets") and must be deposited with a credit institution under the conditions defined by the CAA. These assets are allocated specifically for guaranteeing the payments to policyholders. Upon liquidation and wind-up of an insurer, policyholders will be reimbursed by using these segregated assets.

7.63 If the separate pool of Tied Assets is not sufficient to cover all insurance claims (e.g. in case of an unexpected depreciation of certain assets), the winding-up of the insurance undertaking may only be carried out via a reduction of the entitlement, on such pool of assets, of the insurance creditors (which includes policyholders), in proportion to the amount of their claim.

7.64 In order to reinforce the protection of the insurance creditors there is an additional preferential right for their benefit where the Tied Assets would not be sufficient in order to satisfy the claims of the insurance creditors in their entirety, the insurance creditors including policyholders retain a preferential right on the other assets of the insurance company.

- 7.65 Such additional preferential right overrides any other creditor's rights, except the specific preferred creditors; employees, the treasury, the municipalities, the national social security agencies and the professional bodies.

Implications and conclusion

- 7.66 The Transferring Policies all currently qualify for the FSCS but will lose this protection post Transfer (although if your claim results from an event which occurs prior to the transfer it will continue to be covered by the FSCS).
- 7.67 However, as discussed in Section 6 SWE will hold significant capital over its Regulatory Capital Requirement. SWE targets a Risk Capital Buffer over its Regulatory Requirement sufficient to cover a 1 in 10 year stress event. As a result of holding this buffer in addition to its Regulatory Capital Requirement, SWE would need to suffer significant loss of capital before becoming technically insolvent, i.e. unable to cover its Technical Provisions.
- 7.68 In addition, SWE will have the Tied Assets held in a separate tripartite custodian agreement and these assets will be available to meet the policyholders' claims. These assets will be the greater of the technical provisions on a Solvency II and Luxembourg GAAP basis, and so are able to meet policyholder's liabilities.
- 7.69 Similar to SWE above, and as discussed in Section 6, and demonstrated by the results earlier in this section, SWL holds a significant Risk Capital Buffer over its Regulatory Capital Requirements. As a result, the risk of SWL becoming technically insolvent (i.e. being unable to cover its Technical Provisions on a Solvency II basis) is highly unlikely.
- 7.70 The risk of insolvency at either SWL or SWE should be reduced further by regular regulatory oversight through which it would be expected that the PRA and CAA would be made aware by SWL and SWE respectively, through regular management information, of any deterioration in solvency at an early stage and if necessary would take action to protect policyholders.
- 7.71 Finally, the purpose of the Scheme is to allow the continued servicing of the Transferring Policies after Brexit. It is my view that being able to legally service these policies post-Brexit is a much more crucial consideration for the Transferring Policyholders and the loss of the FSCS protection is an acceptable consequence.
- 7.72 As a result, I am satisfied the Transferring policyholders would not be materially adversely affected by the Transfer as a result of any changes in eligibility for compensation schemes.

Overall conclusions on the impact of the Transfer on security of policyholder benefits

- 7.73 Taking into account the discussion in this Section, I am satisfied that the Scheme will not result in a materially adverse impact on the security of the benefits payable under the Transferring Policies or the Non-Transferring Policies.

8 IMPACT OF TRANSFER ON BENEFIT EXPECTATIONS

8.1 This section considers the impact of the Transfer on policyholder benefit expectations.

General Points

8.2 With regard to the impact of the Transfer on benefit expectations, I note that the Scheme results in no material change to:

- Terms and conditions of either the Transferring Policies or the Non-Transferring Policies (whether unit-linked, with-profits or non-profit);
- The operation of Funds, unit-linked or with-profits, available to Transferring Policies or Non-Transferring Policies; or
- Charges applied to either the funds or the policies; again for both the Transferring Policies and Non-Transferring Policies (whether unit-linked, with-profits or non-profit).
- There will be no change to the non-profit policies.

8.3 Due to the reinsurance arrangement set out in Paragraphs 5.2 and 5.8 above, the Transferring Policies will continue to be invested in, and hence with-profits policy benefits linked to, the CM WPF as was the case prior to the Transfer.

8.4 As a result of these general points, I do not expect that policyholders will be materially adversely affected by the Scheme. Further comments for each of the main categories of policy are provided below.

Transferring Policies with unit-linked investments

8.5 The unit-linked funds that the Transferring Policies invest in are being transferred to SWE with all the same underlying investments. The new servicing agreement between SWE and Lloyds Bank plc will cover the box management and unit pricing of these unit linked funds.

8.6 This means that the investments held by the unit funds, the methodology of pricing units and box management will continue to be carried out in the same way as it was pre Transfer.

8.7 In addition, the ability of SWE to merge and / or close unit-linked funds will be the same as SWL's ability to do the same things currently as a result of the Scheme.

8.8 Also, as discussed in paragraphs 9.8 to 9.11 below the policy administration will continue to be carried out by the same outsourcers and so there will be no change to the way that Transferring policies are administered.

8.9 The SWE Board will be responsible for the limited discretion allowed in relation to the charges on unit-linked Transferring Policies. These cover:

- Monthly administration charge

Under the Transferring Policies' terms and conditions this increases in line with UK national average earnings index but can be increased by a lower level.

- Annual fund management charge

This is a defined charge set in the Transferring Policies' terms and conditions as a percentage of fund. The charge varies by the type of fund invested in. There is no scope to increase these charges. However, certain unit funds have had their charges reduced as a result of switching from a diversified asset mix to entirely cash-type assets.

- Enhanced Death Benefit

Where policies have chosen an enhanced death benefit cover, this is paid for by additional charges and the policy terms and conditions state that these charges are based on the policyholders' circumstances. These charges could be varied in line with mortality rates. SWE are expected to review using similar principles to SWL.

8.10 As the discretion on the unit-linked Transferring Policies is limited, and only allow reductions to the charges in the terms and conditions, the exercising of discretion will only improve the Transferring Policyholders benefits.

8.11 As a result I am satisfied there will be no materially adverse impact on the benefit expectations for the Transferring Policies with unit-linked investments.

Transferring Policies with with-profits investments

8.12 The Transferring with-profits policies will have their investment element, and the whole of the with-profits annuities in payment at the Scheme Effective Date, reinsured back to SWL's CM WPF. Although SWE is withholding reinsurance premium the CM WPF will retain the economic interest in the funds withheld from the CM WPF (i.e. in the sense that it will be entitled to the risks and rewards arising from income, gains and losses) and will instruct SWE how to invest these assets so they are invested in the way the CM WPF requires them to be.

8.13 In addition, the amount of withheld funds will be reviewed and rebalanced on a quarterly basis. This rebalancing will ensure that SWL withholds an appropriate amount of assets to cover its reinsured liabilities.

8.14 The Transferring with-profits policies will be treated as if they had never left the CM WPF with regards to eligibility for bonus setting including estate distributions.

8.15 The CM WPF will continue to be run in the same way post Transfer as it was pre Transfer (i.e. in accordance with its PPFM). The Scheme will not affect the merger and / or closure provisions regarding the CM WPF that are set out in the LBG 2015 Scheme.

- 8.16 Although the SWE Board will be responsible for with-profits' bonus setting, determination of market value adjustments or similar matters (e.g. estate distribution, smoothing etc.) for the Transferring Policies with with-profits investments, as confirmed in the Scheme the SWE Board will resolve that the bonuses, market value adjustments and similar matters will follow the decisions made by SWL in respect of these policies in all reasonably foreseeable circumstances.
- 8.17 As a result of the above, I am satisfied there will be no materially adverse impact on the benefit expectations of Transferring Policies with with-profits investments.

Non-Transferring Policies

- 8.18 As the impact of the Transfer is not material for SWL and as mentioned in 8.14 above the CM WPF will continue to operate in the same way as currently due to the reinsurance agreement, I am satisfied that there will be no material change to the way in which the Non-Transferring Policies (whether unit-linked, with-profits or non-profit) are operated or treated and that, as a result, there will be no materially adverse impact on the benefit expectations of Non-Transferring Policies.

Overall Conclusions on Impact of Transfer on Benefit Expectations

- 8.19 Taking into account the discussion in this section I am satisfied that the Scheme will not result in a materially adverse impact on the benefit expectations of Transferring Policies and Non-Transferring Policies.

9 OTHER CONSIDERATIONS

- 9.1 This section discusses the impact of the Transfer on taxation, administration, complaints escalation process and governance. It also discusses the policyholder notification process.

Taxation

- 9.2 Investigations into the tax impacts of the Transfer have revealed that the Transfer will not lead to a change in policyholder contractual terms/conditions and will not lead to changes in the underlying qualifying status of any policyholders.
- 9.3 As a result of SWE setting up an individual as Mandataire General, who is then recognised as a branch, in Germany that branch will withhold the tax due to the German government on claim payments. For the Transferring policyholders that are domiciled in Germany this creates a timing difference in when tax payments are made but not to the amount of tax actually paid. As a result there is no material adverse impact to the policyholders.
- 9.4 The post Transfer set up of SWE means that the unitised with-profits investment elements and the with-profit annuities in payment of the Transferring Policies will be reinsured back to SWL and will be taxed in the same way as they currently are, including the allowance for taxation in unit pricing.
- 9.5 The unit-linked funds being set up in SWE in Luxembourg will be taxed in a consistent way as the SWL unit-linked funds currently are, including allowance for taxation in in unit pricing.
- 9.6 Luxembourg Value Added Tax will be charged on policy administration services provided to SWE. These costs will be met by the shareholders of SWE.
- 9.7 As a result I do not expect the Scheme to give rise to any materially adverse impact on policyholder benefits as a result of changes in taxation treatment.

Administration

- 9.8 The administration of the Transferring Policies prior to the Transfer is outsourced by SWL to different service providers as indicated in the table below:

Policies	Serviced by
German & Austrian ILDE Policies	Heidelberger Leben Services Management GmbH
Italian ILDE policies	Information Technology Outsourcing S.R.L
Luxembourg (ex-CMIL) policies	Pack Assurance Management SA

- 9.9 Following the Transfer, the three arrangements above will transfer to SWE such that Transferring Policies will continue to be serviced via the same outsourcing

agreement as was the case prior to the Transfer. The administration of the Transferring Policies will therefore be unchanged by the Scheme.

- 9.10 As a result of these points, I would not expect the Scheme to lead to a materially adverse impact on policy servicing for the Transferring Policies.
- 9.11 In respect of the Non-Transferring Policies, the existing administration is not changed by the Scheme. As a result, I would not expect the Scheme to lead to a materially adverse impact on policy servicing for Non-Transferring policyholders.

Complaints Escalation Process

- 9.12 In the UK, there is an independent Financial Ombudsman Service (FOS) for dealing with policyholder complaints where the policyholder is not satisfied with how the insurance company resolved the complaint. The FOS has the authority, and powers, to make decisions on these complaints that are binding.
- 9.13 Luxembourg does not have a FOS but has several Alternative Dispute Resolution Bodies ("ADRB"), these are:
- The CAA whose decisions are not legally binding but can be presented as evidence if the complaint is escalated to the Court;
 - The Mediateur en assurance ("MEA") set up jointly by the Association of Insurers and Reinsurers ("ACA") and the Luxembourg Union of Customers ("ULC"). This service provides mediation proceedings between the relevant parties and its decision is not legally binding unless the insurer and complainant involved in the dispute have entered into a mediation agreement making the decision legally binding. The MEA is a voluntary service for the insurance companies to choose to participate in; and
 - The National Consumer Ombudsman Service ("NCOS"), which handles disputes relating to sales or servicing. This service provides mediation proceedings between the relevant parties and its decision is not legally binding unless the insurer and complainant involved in the dispute have entered into a mediation agreement making the decision legally binding. NCOS is a voluntary service for the insurance companies to choose to participate in.
- 9.14 The IFS Policies that are currently serviced by SWL's Luxembourg branch don't have access to the UK FOS pre Transfer but instead have access to the Luxembourg ADRBs. However, any complaints would be raised with the CAA as the Regulator (although they are also an ADRB).
- 9.15 Currently, rather than raising a complaint with the UK FOS, or Luxembourg ADRBs for the IFS Policies currently serviced by SWL's Luxembourg branch (other than the CAA as a Regulator), as they are entitled to, policyholders with IFS policies raise their complaint with the Regulator of the EU27 country in which their policy was written or where they are domiciled, e.g. Germany, Italy etc. This EU27 Regulator would then work with SWL so that SWL resolves the complaint appropriately.

- 9.16 If the policyholder is not satisfied with the resolution they retain the right to take their complaint to the court in the country which their policy was written or where they are domiciled.
- 9.17 Post Transfer, the Transferring policyholders will not be likely to use the Luxembourg ADRBs (other than the CAA as the Regulator) but rather would be expected to continue to raise complaints with the same Regulator as they currently do. That Regulator will then work with SWE to ensure that SWE resolves the complaint appropriately.
- 9.18 As pre Transfer if the policyholder is not satisfied with the resolution they retain the right to take their complaint to the court in the country in which their policy was written or where they are domiciled.
- 9.19 In addition, post Transfer the Transferring Policies that currently have access to the FOS can still take a complaint about activities that took place before the Scheme Effective Date to the FOS.
- 9.20 The Non-Transferring Policyholders will continue to be able to raise any unresolved complaints in the same way as they currently do.
- 9.21 In summary, I am satisfied that the Transfer will have no materially adverse impact on the complaints escalation process for either Transferring or Non-Transferring Policyholders.

Governance

- 9.22 Following the Scheme coming into effect, the LBGI Board, supported by the WPA and With-Profits Committee ("WPC"), will continue to provide governance over the with-profits investments of the Transferring Policies and the way in which the CM WPF is run will not change materially as a result of the Transfer (i.e. it will continue to be run in accordance with its PPFM and the LBGI 2015 Scheme).
- 9.23 The SWE Board will be responsible for with-profits' bonus setting, determination of market value adjustments or similar matters (e.g. estate distribution, smoothing etc.) for the Transferring Policies with with-profits investments. As confirmed in the Scheme the SWE Board will resolve that that the bonuses, market value adjustments and similar matters will follow the decisions made by SWL in respect of these policies in all reasonably foreseeable circumstances.
- 9.24 The SWE Board will be responsible for the limited discretion allowed in relation to the charges on unit-linked Transferring Policies. As discussed in paragraphs 8.9 and 8.10 this discretion would be expected to only allow the SWE Board to decrease the charges from the level allowed by the policies' terms and conditions.
- 9.25 Overall, I am satisfied that the Scheme will not result in a materially adverse impact on the way that the Transferring Policies and the remaining policies are managed or governed.

Cancellation Rights

- 9.26 Austrian and Italian regulations respectively give the transferring Austrian and Italian policyholders the option to surrender their policies as a result of the Transfer. For some of these policies such a surrender might be free of any surrender charges. The costs of foregoing such charges are expected to be met by the SWL shareholders. At the appropriate time, to be agreed with the regulators, SWE (or SWL if prior to the Transfer) will write to the affected policyholders informing them of their cancellation rights, explaining what this means for them, how long they have these cancellation rights and how to go about exercising their cancellation rights.
- 9.27 This would not be expected to have a materially adverse impact on the policyholders, whether Non-Transferring or Transferring, and the CM WPF but I will continue to monitor this and comment in a supplementary report if this expectation changes.

Notification to policyholders

- 9.28 LBGI will be writing to all of the holders of the Transferring Policies in order to inform them of the proposed Scheme. LBGI will be seeking waivers in respect of the following:
- The holders of the Non-Transferring Policies of the Transferor; and
 - Policyholders for whom no current address is held on record (Goneaways).
- 9.29 A detailed communication plan has been produced to ensure the holders of the Transferring Policies are adequately informed of the nature and effect of the Scheme in their native language. The communications package includes direct mailing, press adverts and web content. The intention is that the mailed package would meet the legal and regulatory requirements and provide an appropriate level of detail enabling the policyholders to understand the Transfer.
- 9.30 The application for a waiver for the holders of the Non-Transferring Policies is driven by the immaterial impact of the changes on these policyholders from the Scheme and the belief that were SWL to write out to them, along with all the accompanying documentation, the changes would appear to be more significant and give rise to some confusion.
- 9.31 The policyholders will be directed to specific website content where further technical information can be obtained or a contact for requesting additional printed material, all free of charge.
- 9.32 Overall, I am satisfied that the proposed communication plan is appropriate and has paid due regard to the interests of policyholders and the need to treat them fairly as well as their information needs. In particular, given the conclusions contained in this report and the general non-materiality of the Transferring Policies in the context of the wider business of SWL, I am satisfied that the Non-Transferring policyholders do not need to be contacted directly.

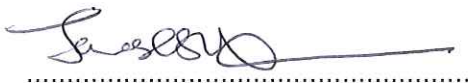
10 CONCLUSION

- 10.1 I have produced this report in my role as Chief Actuary for SWL, to set out the impacts of the Transfer on the Transferring Policies and the Non-Transferring Policies.
- 10.2 In assessing the potential impacts of this Scheme, I have given due consideration to the effects of the planned Transfer on the security, administration and benefit expectations of the holders of the Transferring Policies and the Non-Transferring Policies.
- 10.3 Based on my considerations and taking into account the key features of the Transfer outlined earlier (and the discussion of these and other matters contained in this report), it is my view that:
- The security of the Transferring Policies and Non-Transferring Policies policyholders' benefits will not be materially adversely impacted as a result of the Scheme;
 - The Scheme will not result in materially adverse changes to the benefit expectations of any with-profits, non-profit or unit-linked policyholders.
- 10.4 I therefore conclude that the Scheme will not result in a materially adverse impact on the security of policyholders or their benefit expectations compared to the status quo.
- 10.5 I am satisfied that there will be no significant impact on the servicing that policyholders will receive as a result of the Scheme and that the proposed communications plan is appropriate and has paid due regard to the interests of policyholders and the need to treat them fairly.

James Hillman FIA

Chief Actuary for SWL

19 November 2018



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11 ANNEX A – DEFINED TERMS AND ABBREVIATIONS USED WITHIN THIS REPORT

ACA	Association of Insurers and Reinsurers, who have set up the MEA with the ULC.
ADRB	Alternative Dispute Resolution Bodies, a term used to reference the various entities in Luxembourg who help to resolve disputes between customers and insurers.
APS	Actuarial Professional Services
Available Capital	The difference between the value of a company's assets and the value of its liabilities
Best Estimate Liabilities	The best estimate value of liabilities as defined under Solvency II regulations.
CAA	Commissariat aux Assurances (translation: Insurance Commissioner) - The Luxembourg regulator for SWE.
CM WPF	SWL's Clerical Medical With-Profits Fund
CMIG	Clerical Medical Investment Group Ltd
CMIIL	CMI Insurance (Luxembourg) S.A.
Combined Fund	Under Solvency II this is all the assets of a company excluding any ring-fenced with-profits funds
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
EU	European Union
EU27	The European Union, excluding the UK
FCA	Financial Conduct Authority
FOS	Financial Ombudsman Service
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Market Act 2000
GAAP	Generally Accepted Accounting Principal
IE	Independent Expert
IFS	International Financial Services
ILDE	International Life Division Europe
LBG	Lloyds Banking Group plc
LBG Capital Policy	This is the internal approach to capital management followed

by SWE or SWL (as defined in Section 6).

LBG	LBG Insurance
LBG 2015 Scheme	Legal scheme implemented on 31 December 2015 under which several of the subsidiaries of Scottish Widows Group Limited were transferred to SWL
MEA	Mediateur en assurance, a ADRB in Luxembourg set up jointly by the ACA and ULC
NCOS	National Consumer Ombudsman Service, a Luxembourg ADRB
Non-Transferring Policies	SWL policies which are out of scope of the Scheme
PPFM	Principles and Practices of Financial Management (of the Clerical Medical With-profits Fund)
PRA	Prudential Regulation Authority
Regulatory Capital Requirements	The capital over and above the Best Estimate Liabilities and Risk Margin that an insurer is required to hold under Solvency II regulations
Risk Capital Buffer	Additional capital held in accordance with the relevant capital and risk appetite policy.
Risk Margin	This is the additional capital that insurers have to hold under Solvency II regulations, based on the value of the projection of the non-hedgeable risks of the Regulatory Capital Requirement.
Scheme	An insurance business transfer scheme under Part VII of the Financial Services and Markets Act 2000 ("FSMA")
Scheme Effective Date	The date that the Scheme will come into existence, 28 March 2019
Shareholder's Regulatory Capital Requirements	The Regulatory Capital Requirements for the SWL Combined Fund (which includes any burnthrough from the With Profit Funds).
SWE	Scottish Widows Europe SA, the Transferee
SWG	Scottish Widows Group Limited
SWL	Scottish Widows Limited
Technical Provisions	This is the Best Estimate Liabilities plus Risk Margin
Transfer	Proposed transfer of the Transferring Policies from SWL to SWE
Transferee	Entity receiving business (SWE under the Scheme)
Transferor	Entity transferring business (SWL under the Scheme)
Transferring Policies	Inforce business originally sold by either ILDE or CMIL. These

are the policies which will be transferred from SWL to SWE under this Scheme.

UK	United Kingdom
ULC	Luxembourg Union of Customers, who set up the MEA in Luxembourg with the ACA.
Working Capital	The excess of the Available Capital over Regulatory Capital Requirement
Working Capital Ratio	The Available Capital divided by the Regulatory Capital Requirement expressed as a percentage.
WPA	With-Profits Actuary
WPC	With-Profits Committee
WPF	With-Profits Fund