

**Report of the Independent Expert on the proposed
Scheme to transfer a block of the European
International Life Insurance Business of Scottish
Widows Limited to Scottish Widows Europe SA**

Prepared by Tim Roff FIA

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1 Executive Summary

Introduction

- 1.1 Scottish Widows Limited (SWL or Transferor) is a private limited life insurance company incorporated in England and Wales and domiciled in the United Kingdom (UK). SWL operates under the UK Companies Act 2006, is authorised by the Prudential Regulation Authority (PRA) and is regulated by both the PRA and the Financial Conduct Authority (FCA) (together the UK Regulators). The principal activity of SWL is the transaction of long-term insurance business.
- 1.2 Under European Union (EU) regulations, UK insurance companies can sell policies and service business written in European Economic Area (EEA) countries on a Freedom of Services or Freedom of Establishment basis (commonly referred to as "EU passporting rights"). SWL has previously written life insurance and pensions business, primarily in Germany, Austria and Italy under EU passporting rights. SWL is not currently actively seeking new business outside of the UK.
- 1.3 On 23 June 2016, the UK voted to leave the EU. On 29 March 2017, the UK government officially notified the European Council of the UK's intention to withdraw from the EU (Brexit). It is uncertain whether or not UK insurance companies will continue to be able to service business written in EEA countries outside of the UK, under EU passporting rights, after 29 March 2019. Therefore, unless suitable transitional or grandfathering arrangements between the UK and the EU are agreed, it is expected that it will become illegal for SWL to continue to service its policies written in the EU from that date.
- 1.4 SWL has decided to establish a new wholly-owned subsidiary life insurance company in Luxembourg, Scottish Widows Europe SA (SWE), which is expected to be authorised by the Luxembourg Insurance Supervisory Authority, Commissariat aux Assurances (CAA) by the end of January 2019. After court and regulatory approval, and once SWE has been authorised, SWL will transfer its existing business that was originally written in EU countries (Transferring Business) to this subsidiary.

Business being transferred

- 1.5 I have classified the Transferring Business into two main groups:
- Transferring unitised with-profits business (Transferring UWP Business) – business currently invested in Guaranteed Growth Funds (GGFs) which reside in SWL's Clerical Medical (CM) with-profits fund (WPF) (CM WPF), written primarily in Germany, Austria and Italy under EU passporting rights. This group also includes a small number of vested annuities as at 31 December 2017. It is expected that this number will grow over time as more policies vest
 - Transferring unit-linked business (Transferring UL Business) – business currently invested in unit-linked (UL) funds that reside in the SWL Combined Fund, written primarily in Germany, Austria and Italy under EU passporting rights. These unit-linked funds are exclusive for policies of the Transferring UL Business (Transferring UL Policies).
- 1.6 The table below sets out the policy count and the Best Estimate Liabilities (BEL) for the Transferring Business as at 31 December 2017.

	Number of Policies	BEL (investment element only) (£m)	Total BEL* (£m)
Transferring UWP Business	61,408	1,766	1,753
Transferring UL Business	26,995	318	360
Total	88,403	2,084	2,113

All numbers in the above table are rounded to the nearest whole number.

** BEL for the non-investment element is based on Luxembourg Generally Accepted Accounting Principles (GAAP) basis.*

- 1.7 Immediately following the transfer, the unitised with-profits (UWP) business will be reinsured back to SWL through a reinsurance agreement (the Reinsurance Agreement), which will include the associated collateral arrangements known as funds withheld (FWH). To provide further security for the Transferring Business, SWL will enter into a floating charge agreement (the Charge Agreement) with SWE. The Transferring UL business will remain with SWE, but to ensure that the operations of the UL business remain unchanged, SWE will enter into a service agreement with Lloyds Bank Plc (LB) to enable them to provide support for the back office management tasks related to the Transferring UL Business (Unit Linked Service Agreement), as happens at present for SWL.
- 1.8 Additionally, to provide protection for SWE against any litigation claims resulting from SWL's actions prior to the transfer of business to SWE, SWL will enter into an indemnity agreement (the Indemnity Agreement) with SWE. The Charge Agreement will also cover the obligations of SWL under the Indemnity Agreement.
- 1.9 In this report, I refer to the Reinsurance Agreement (including FWH), Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement together as "Associated Arrangements".

Legal process

- 1.10 The proposed transfer of business will be carried out using a legal process known as a Part VII Transfer of insurance business (under the Financial Services and Market Act 2000 (as amended) (FSMA)). The terms of the proposed transfer are set out in a document known as the Scheme.
- 1.11 It is a requirement that when the Scheme is submitted to the High Court of Justice of England and Wales (the High Court) for approval, it is accompanied by a report from an independent expert (Independent Expert). The High Court will consider the contents of the Independent Expert's report (the Report) when deciding whether or not to sanction the Scheme. SWL has nominated me, Tim Roff, to act as the Independent Expert and to provide the Report in respect of the Scheme. The PRA has approved my appointment in consultation with the FCA. I owe a duty to the High Court, which overrides any duties I owe to SWL, the PRA and the FCA.
- 1.12 The Scheme will be submitted for sanction by the High Court under Section 111 of Part VII of FSMA. If approved, it is expected that the Scheme will become operative and take effect on 28 March 2019 (the Effective Date).

The purpose of the Report

- 1.13 The Report describes the impact of the Scheme and the Associated Arrangements (together the Transfer) on the policyholders whose policies will be transferred as a result of the Transfer (Transferring Policyholders) and the policyholders of SWL whose policies will not transfer (Non-transferring Policyholders). In each case, I have considered the security of the benefits, benefit expectations and contractual rights of the policyholders. I have also considered how the Transfer will impact policyholder protection, service levels and any other factors (eg governance, tax and expenses) that might result in a material adverse effect for any group of policyholders.
- 1.14 I give an opinion on whether I consider the position of any group of policyholders to be "materially adversely affected" as a result of the Transfer. The definition of what is "material" depends on the matter being discussed, but if a potential effect is very unlikely to happen and does not have a large impact, or if it is likely to happen but has a very small impact, I do not consider it material.
- 1.15 The Report also describes the impact of the Transfer on the current external reinsurers of SWL whose treaties cover the risks associated with the policies of the Transferring Business (Transferring Policies).

Key Dependencies

- 1.16 I have prepared the Report on the assumption that a number of actions take place either on or before the Effective Date. If these actions are not completed by the Effective Date, the conclusions in the Report may not be valid. I will revisit my conclusions based on the latest developments in my supplementary report (Supplementary Report) which I will provide to the High Court shortly before the

Scheme is submitted for sanction. Accordingly, I consider these actions to be key dependencies. These dependencies are:

- SWE receives authorisation from the CAA. Without the relevant authorisations, it would not be possible for the Scheme to be implemented
- SWE receives an initial capital injection from SWL that is sufficient to capitalise SWE at its target capital level (see paragraph 6.19), taking into account the transfer of assets under the Scheme
- SWE and SWL enter into the Associated Arrangements, namely the Reinsurance Agreement, Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement, to be effective immediately following the Effective Date.

Summary of my conclusions

- 1.17 I am satisfied that the implementation of the proposed Scheme, along with the Associated Arrangements, will not have material adverse effects on the security of benefits or the future benefit expectations for Transferring Policyholders or Non-transferring Policyholders.
- 1.18 It is also my opinion that the Transfer will have no material adverse effect on the governance or service standards experienced by the Transferring Policyholders and the Non-transferring Policyholders.
- 1.19 In forming these conclusions, I have taken into account the loss of the Financial Services Compensation Scheme (FSCS) protection that is currently given to all of the policyholders in the Transferring Business. The FSCS provides protection to policyholders of UK based insurers and EEA branches of UK based insurers throughout the terms of their policies. After the Transfer, the policyholders of the Transferring Business will hold policies with a Luxembourg based insurance company and they will lose entitlement to this protection (although if the claim results from an event which occurs prior to the transfer it will continue to be covered by the FSCS). The purpose of the Scheme is to enable the continued servicing (eg receiving premiums and paying claims) of the Transferring Business regardless of the outcome of the Brexit negotiations. In my opinion, having certainty that policies in the Transferring Business can continue to be serviced lawfully after Brexit is very important. The loss of the FSCS protection is a consequence of achieving this certainty. In addition, the FSCS provides protection to covered policyholders in an insolvency event. Given that SWE will be well capitalised and will comply with the Solvency II Directive (Solvency II) in EU law, the likelihood of the insolvency of SWE is, in my opinion, remote. I will provide an update in my Supplementary Report on the latest relevant Brexit negotiations, and the impact of these on my conclusions regarding the loss of FSCS protection for the Transferring Policyholders.
- 1.20 The Reinsurance Agreement and Charge Agreement form an important part of the Transfer as they are being put in place to ensure that the Scheme does not result in the need to split the CM WPF or manage business materially different to the current management of these policies. It is my opinion that the Reinsurance Agreement allows the policyholders of the Transferring UWP Business (Transferring UWP Policyholders) to continue to benefit from the funds in which their policies are currently allocated. Provisions within the Reinsurance Agreement for the FWH in Luxembourg together with the Charge Agreement provide security for SWE in the unlikely event that SWL fails to meet its obligations under the Reinsurance Agreement or Indemnity Agreement.
- 1.21 In the event that the Reinsurance Agreement is terminated in the future, I am satisfied that there is adequate protection for policyholders to ensure that they will be treated fairly.
- 1.22 The Unit Linked Service Agreement will enable LB to provide SWE with back office functions relating to the calculation of the unit price and box management activities for the Transferring UL Business. It is my opinion that the Unit Linked Service Agreement enables the UL business to continue to operate in the same way before and after the Transfer.
- 1.23 In addition, the Indemnity Agreement is also an important part of the Transfer, which protects SWE against any claims arising from SWL's conduct of business prior to the Transfer. The Charge

Agreement also secures payments due under the Indemnity and provides further protection in the remote event of SWL becoming insolvent.

- 1.24 The Transfer does not result in any change to the administration of the Transferring Policies as they will continue to be serviced by the existing outsourcing companies under the same outsourcing agreements.
- 1.25 Luxembourg regulations require insurers to hold the maximum of SII technical provisions or Luxembourg GAAP reserves as Tied Assets with a custodian bank. In the unlikely event of SWE's insolvency, the Transferring Policyholders will have priority ranking on the Tied Assets. Further, if the Tied Assets are insufficient to meet policyholder liabilities, the Transferring Policyholders will have preferential rights on the remaining assets of SWE. These provisions provide security to meet SWE's policyholder liabilities in the unlikely event of SWE's insolvency.
- 1.26 The reinsurance premium covering the reinsurance of the Transferring UWP Business, including vesting annuities, will be retained within SWE and be known as the FWH. In the unlikely event of SWL's insolvency, SWE will keep the FWH, up to the amount owed to them by SWL, to pay the liabilities for the Transferring UWP Policyholders. This will result in the Transferring Policyholders ranking higher than the Non-transferring Policyholders in respect of the liabilities covered by the FWH. However, as the Transferring Policyholders represent only 2% of SWL's overall business and the likelihood of SWL becoming insolvent is very remote, I consider the impact of this higher ranking, of the Transferring Policyholders on the benefit expectations of the Non-transferring Policyholders in case of the SWL's insolvency, to be immaterial.
- 1.27 I am also satisfied that the change made to the 2015 Scheme to ensure that the payments under this Scheme related to the Reinsurance Agreement qualify as allowable payments, will not impact the maintenance and operation of the funds for the Non-transferring Policyholders.

Regulatory Background

- 1.28 The transfer of business from a PRA authorised entity to a CAA authorised entity means that there is a change in the regulatory regime for the Transferring Business. The UK and Luxembourg are, however, both subject to Solvency II. Solvency II harmonises solvency requirements across EU Member States using an economic risk-based approach for determining solvency requirements.
- 1.29 In Section 3, I set out a summary of the current UK and Luxembourg regulatory regimes as well as the main differences between them.

Background to SWL and SWE

- 1.30 SWL is a life insurance subsidiary of Scottish Widows Group (SWG), which is a subsidiary of Lloyds Banking Group plc (LBG), the ultimate parent company. SWL has a total of around six million policyholders and £112 billion BEL as at 31 December 2017. Prior to the Transfer, SWL's long-term business consists of the Scottish Widows With-Profits Fund (SW WPF), CM WPF and Combined Fund.
- 1.31 The Scottish Widows insurance business was a mutual office founded in 1815. In 2000, Scottish Widows demutualised to become part of the Lloyds TSB Group. It is now the insurance arm of Lloyds Banking Group, which was formed in 2009, following the takeover of HBOS plc by Lloyds TSB. This takeover included the Clerical Medical demutualised company that originated from the Medical Clerical, and General Life Assurance Society set up in 1824, which was purchased by Halifax in 1996 and then subsequently became owned by HBOS when Halifax merged with Bank of Scotland in 2001.
- 1.32 In 2015, all UK life insurance and pension business of LBG was consolidated into Clerical Medical Investment Group (CMIG) via a Part VII Transfer (known as "the 2015 Scheme"). As part of the 2015 Scheme, the name of the company was changed to SWL.
- 1.33 The Transferring UWP Business is currently allocated to the CM WPF, and the Transferring UL Business is currently allocated to the unit-linked funds that are exclusively set-up for this business in the Combined Fund.

- 1.34 In Section 4, I set out the background on SWL and its current fund structure.
- 1.35 SWE currently has no policyholders and is not expecting to actively seek new business following CAA authorisation. SWE may however be used in the future as a receiving entity for any future European business, subject to obtaining appropriate permissions.
- 1.36 In Section 6, I set out the background on SWE.

Outline of the Scheme

- 1.37 Under the terms of the Scheme, all liabilities, rights and obligations associated with the Transferring Business will be transferred to SWE.
- 1.38 For the Transferring UL Business, unit-linked funds corresponding to those within the Combined Fund will be set-up within SWE. Notional funds will be set-up to mirror the GGFs in the CM WPF for the policies of the Transferring UWP Business (Transferring UWP Policies).
- 1.39 At the Effective Date:
- the Transferring UWP Business will transfer from the CM WPF to SWE
 - the Transferring UL Business will transfer from the unit-linked funds in the Combined Fund to unit-linked funds within SWE
- 1.40 The 2015 Scheme will be updated to ensure that payments under this Scheme related to the Reinsurance Agreement qualify as allowable payments.
- 1.41 In Section 7, I provide a more detailed outline of the Scheme.

Challenges associated with the Scheme

- 1.42 SWL has identified that there are challenges associated with the Scheme. I briefly summarise the main challenges below, and I discuss them in further detail in Section 8.
- 1.43 In the case of the UWP business, only a proportion of the policies allocated to the CM WPF are to be transferred under the Scheme. To identify and transfer a fair share of the assets in respect of these policies would be a complex and time-consuming process (a "Fund Split"). The process would need to take account of the Transferring Policyholders' interest in the estate (ie the part of the with-profits fund that is not allocated to policyholders liabilities) of the CM WPF, as well as the policy liabilities. There is insufficient time ahead of 29 March 2019 to complete the Fund Split in a fair and controlled manner, as it requires complex analysis and the approval of a large number of stakeholders. To address this challenge, the investment element of the Transferring UWP Business will be transferred to SWE under the Scheme, and reinsured back to the CM WPF within SWL immediately following its transfer to SWE on the Effective Date. The Reinsurance Agreement will also reinsure to SWL any vested with-profit annuities as well as future with-profit annuities purchased due to obligations, or the exercise of options, under the Transferring Business.
- 1.44 To ensure that the majority of the litigation risks for claims on the Transferring Business are borne by SWL, there will be an Indemnity Agreement that will sit alongside the Scheme.
- 1.45 To ensure that the operation of the Transferring UL Business remains the same, the Unit Linked Service Agreement will be put in place between LB and SWE. Under this agreement LB will provide support for box management and unit pricing activities for the Transferring UL Policies after the Transfer.

The Reinsurance Agreement, the Charge Agreement and the Indemnity Agreement

- 1.46 On the Effective Date, the investment element of the Transferring UWP Business will be reinsured back to SWL via the Reinsurance Agreement. SWE will retain the expense, additional mortality and morbidity risks on this business. The Reinsurance Agreement will also include any vested with-profit annuities as well as future with-profit annuities purchased due to obligations, or the exercise of options, under the Transferring Business.

- 1.47 The reinsurance premium covering the reinsurance of the Transferring UWP Business, including vesting annuities, will be retained within SWE and be known as the FWH. Subsequently, ongoing payments will be made between SWE and SWL, for policyholder premiums received, applicable tax deductions including any Loyalty Bonus units created under the policy terms and conditions, and claims payments. Whilst these payments will be reflected within the FWH, an operational rebalancing of the FWH will be carried out every quarter to allow for differences between the change in value of the FWH assets and the change in value of the reinsurance reserves in SWL.
- 1.48 Subject to certain conditions, the Reinsurance Agreement may be terminated at a future date. If a termination were to happen, SWL will pay SWE a termination amount, which must be certified fair and reasonable by an independent actuary. In addition, non-objection to the termination amount must be obtained from both the Luxembourg and UK Regulators.
- 1.49 As a result of the Reinsurance Agreement, SWE is exposed to the financial position of SWL. Additionally, without further steps, SWE policyholders would not be treated in the same way as the SWL direct policyholders in the unlikely event of SWL becoming insolvent. This is because SWE would be an unsecured creditor of SWL, and rank behind the direct policyholders of SWL for any claims greater than the FWH. To mitigate this:
- SWE will hold the FWH, up to the amount owed to them by SWL, and would not be required to repay the FWH amount in the unlikely event of SWL insolvency
 - SWE and SWL will enter into the Charge Agreement.
- 1.50 The Charge Agreement provides insolvency protection and further security to SWE in the event that SWL becomes insolvent and fails to honour its obligations under the Reinsurance Agreement.
- 1.51 To mitigate the exposure to litigation claims in relation to the Transferring Business, SWL and SWE will also enter into the Indemnity Agreement. The Indemnity Agreement will expose SWE to counterparty risk with SWL, which will be managed by covering this exposure under the Charge Agreement.
- 1.52 In Section 9, I provide a description of the Reinsurance Agreement and the Associated Arrangements.
- 1.53 The following table summarises the potential challenges and the proposed mitigants described above.

Potential Challenge	Proposed Mitigant
Ensure that SWL policies sold on a Freedom of Services or Freedom of Establishment basis can continue to be serviced post-Brexit.	The Scheme
Identifying and transferring a fair share of assets in respect of the CM WPF in a fair and controlled manner. Maintaining a with-profits fund for the Transferring UWP Policyholders with similar protection to those provided by FCA's Conduct of Business Sourcebook (COBS).	The Scheme and Reinsurance Agreement
Setting-up teams and systems to carry out unit related operations for the Transferring UL Business.	Unit Linked Service Agreement
SWE is exposed to the financial position of SWL as a result of the Reinsurance Agreement and Indemnity Agreement. SWE policyholders' being disadvantaged for any claims greater than the FWH in the unlikely event of SWL's insolvency.	Charge Agreement
SWE is exposed to the risk of misconduct or misadministration by SWL prior to the Transfer.	The Indemnity Agreement
Ensuring that policyholders are treated fairly in the event of termination of either, or both of, the Reinsurance Agreement and the Indemnity Agreement.	The Scheme, Reinsurance Agreement and Indemnity Agreement

- 1.54 I have considered the Associated Arrangements in detail, including the conditions under which they can be terminated. I have also consulted with the counsel (Independent Counsel) in respect of the Charge Agreement, to confirm that the legal mechanisms are designed to work as intended.

- 1.55 I am satisfied that the Reinsurance Agreement, the Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement have been designed to achieve their purpose of enabling the Transferring Business to continue as before. In Section 9, I set out my analysis and conclusions on the terms, security, capital implications and governance of the Associated Arrangements.
- 1.56 Having concluded that the Associated Arrangements have been designed to address the challenges identified, I then analysed the risk profiles of SWL and SWE, before and after the Transfer. I also considered SWL's and SWE's capital positions. The risk profiles and capital positions of SWL and SWE are key considerations, because any significant changes would potentially have an impact on policyholder security.

The Impact of the Transfer on Transferring Policyholders

- 1.57 In Section 11, I set out my detailed analysis and conclusions of the impact of the Transfer on the Transferring Policyholders. Below, I summarise the findings that apply to all of the Transferring Policyholders, and then I summarise my main findings that apply to the individual sub-groups of Transferring Policyholders.

Findings that apply to all Transferring Policyholders

Security of policyholder benefits

- 1.58 Security for policyholder benefits is provided by insurance companies holding a higher level of assets than is needed to cover their liabilities (after allowing for any reinsurance). The difference between the value of the assets and the liabilities is a measure of the insurer's solvency. My analysis of the impact of the Transfer on policyholder security considers the level of capital available to SWL and SWE, their ability to satisfy their solvency requirements, their capital management policies and their internal assessment of their current and projected capital positions.
- 1.59 Across the EU, insurance companies must satisfy solvency standards by maintaining a level of capital at or above what is known as their Solvency Capital Requirement (SCR). Using the information provided to me by SWL, I have reviewed the level of assets and liabilities and the extent to which the SCR is covered for SWL and SWE as at 31 December 2017, had the Transfer been implemented at that time. This is the most recent date at which this information was available. I have also used information provided to me by SWL to review the projected SCR Cover Ratio (a ratio of Own Funds to SCR) for SWE immediately after the Effective Date. These calculations show that both SWL and SWE expect to hold capital well above their SCR.
- 1.60 An insurance company's solvency position can change over time. This can be due to changes in market conditions that may affect the value of assets and liabilities. Insurers generally seek to control this by having agreed management policies aimed at safeguarding the solvency cover. These include a risk framework and an agreed risk appetite within which insurers operate. I have been provided with internal management information regarding the governance arrangements, risk appetite, and capital management framework for SWL and those proposed for SWE. I am satisfied that these represent a sensible approach to safeguard solvency cover.
- 1.61 In addition to considering the current solvency position, I have reviewed projections of SWE's solvency position both on a best estimate basis and in stressed scenarios. I have concluded that there are management actions available to SWE that enables them to bring their solvency position back towards its target level following some extreme stress scenarios.
- 1.62 Therefore, I am satisfied that the Transfer will not have any material adverse effect on the security of benefits of the SWL and SWE policyholders, including both the Transferring Policyholders and Non-transferring Policyholders.
- 1.63 In Section 10, I set out my analysis of the capital positions of SWL and SWE.
- 1.64 I also note that Luxembourg regulations require insurers to hold the maximum of SII technical provisions or Luxembourg GAAP reserves as Tied Assets with a custodian bank. In the unlikely event of SWE's insolvency, the Transferring Policyholders will have priority ranking over the Tied Assets. Further, if the Tied Assets are insufficient to meet policyholder liabilities, the Transferring Policyholders

will have preferential rights over the remaining assets of SWE. These provisions provide security to meet SWEs policyholder liabilities in the unlikely event of SWEs insolvency. I discuss this in more detail in Section 3.

External bodies providing further policyholder protection

FSCS

- 1.65 The Transferring Business is currently covered by the FSCS, which is a compensation scheme of last resort in the UK and protects policyholders if a financial services company were to fail. The FSCS provides protection to policyholders of UK based insurers or EEA branches of UK based insurance companies. After the Scheme is implemented, the policyholders of the Transferring Business will hold policies with a Luxembourg based insurance company and will lose entitlement to this protection (although if the claim results from an event which occurs prior to the transfer it will continue to be covered by the FSCS). There is no equivalent to the FSCS in Luxembourg.
- 1.66 The purpose of the Scheme is to enable the continued servicing (eg receiving premiums and paying claims) of the Transferring Business, regardless of the outcome of the Brexit negotiations. In my opinion, having certainty about how the policies in the Transferring Business will be serviced after Brexit is very important. The loss of the FSCS protection is an unavoidable consequence of providing this certainty. In addition, the FSCS provides protection to covered policyholders in an insolvency event. Given that SWE will be well capitalised and will comply with the Solvency II regulations in EU law, the likelihood of the insolvency of SWE is, in my opinion, remote.

Ombudsman

- 1.67 Currently the Transferring Policyholders, whose policies operate on a Freedom of Service basis, can contact either the UK Financial Ombudsman Services (FOS) or their local system of complaints handling if there is a dispute regarding their policies. However, in practice the vast majority of these policyholders raise their disputes with their local system of complaints handling rather than the UK FOS. After the Transfer, these policyholders will lose access to the UK FOS, but will continue to be able to access their local system of complaints handling. They will also be able to contact the CAA, the National Consumer Ombudsman Service (NCOS), the Association of Insurers and Reinsurers (ACA) or the Luxembourg Union of Customers (ULC). Within this Report, I refer to the NCOS, ACA and ULC mediation services together as the Luxembourg Ombudsman Service (LOS).
- 1.68 I have compared the services and powers of both the UK FOS and CAA and LOS and can confirm that both offer a free service in a timely fashion with the LOS offering services in a range of languages. While the decisions of the UK FOS are legally binding, the decisions of the CAA and the LOS are not legally binding. The CAA supports the policyholder in reaching a mediated solution. In the event that this cannot be reached, the policyholder is able to pursue a judicial process using CAA's copy of their opinion or recommendation on the complaint.
- 1.69 The Transferring Policyholders whose policies operate on a Freedom of Establishment basis have access to their local system of complaints handling if there is a dispute regarding their policies but do not have access to the UK FOS. After the Transfer, they will continue to be able to access their local system of complaints handling.
- 1.70 Policyholders of the Transferring Business will still be able to bring complaints to the UK FOS for any activities carried out by SWL for policies under Freedom of Service basis that occur prior to the Transfer.
- 1.71 Therefore, in my opinion policyholders will not be adversely affected by any loss of policyholder protection with respect to the UK FOS as a result of the Transfer.

Conduct of business regulations (COBS)

- 1.72 Before the Transfer, the Transferring Business is subject to the UK COBS. After the Transfer, the Transferring Business will be subject to Luxembourg regulations which include the CAA's conduct related mission statements as set out in the Luxembourg Insurance Act. However, these are not as detailed as the UK COBS and do not include any specific requirements for with-profits business.

- 1.73 As the Transferring UWP Business will be reinsured to SWL it will continue to participate in the CM WPF which is operated in line with UK COBS and will therefore indirectly benefit from UK COBS. This will include being subject to the requirements of the Principles and Practices of Financial Management of the CM WPF (CM WPF PPFM) and the With-Profits Committee (WPC). Therefore, in my opinion these policyholders will not be adversely affected by any loss of policyholder protection with respect to the prevailing UK COBS regulations as a result of the Transfer.
- 1.74 Unit-linked business is a common life insurance business line in Luxembourg. As mentioned in Section 3, the CAA's mission statements include references to investment rules and restrictions related to the unit-linked products. The unit-linked governance structure for SWE will be similar to that of SWL, with all major decisions around discretion being taken by the senior leadership team with the advice of the Chief Actuary and submitted to the International Insurance Governance Committee (IIGC) for comment. The Unit Linked Service Agreement will enable the current service providers to carry out box management and unit pricing activities in the same manner before and after the Transfer. SWE will follow the Group's Treating Customers Fairly policy. In my opinion, these rules, restrictions and governance arrangements provide appropriate protections for the Transferring UL Policyholders.

Governance Arrangements

- 1.75 SWE's governance structure has been designed to be in line with SWL's governance framework and also comply with Luxembourg regulations. Overall, I am satisfied that the Transfer will not result in the weakening of governance applicable to the Transferring Business.

Expense, Charges and Tax

- 1.76 The one-off expense of the Transfer Scheme will be borne by the SWL shareholders and any exceptional expenses that result from the Transfer will not be charged to the estate of the CM WPF. The costs related to the Italian surrender option will be borne by the shareholders of SWL.
- 1.77 There is limited scope to increase policy charges in the event that there is an increase in ongoing expenses after the Transfer. Any change in charges would be in line with the terms and conditions of the policies and will need the approval of the SWE Board after taking account of appropriate actuarial advice and unit pricing implications.
- 1.78 There are no material adverse tax effects on the policyholders of the Transferring Business as a result of the Transfer.
- 1.79 I am satisfied that there is no material adverse impact related to expenses, charges or tax as a result of the Transfer.

Administration and service standards

- 1.80 The policy servicing of the Transferring Business is currently outsourced to three providers based in Luxembourg, Germany and Italy. These outsourcing agreements will be novated to SWE, and the same providers and teams will continue to carry out the administration of the Transferring Policies. Therefore, I am satisfied that these policies will not experience any change in service standards and service targets as a result of the Transfer.

Transferring UWP Business

- 1.81 The Transferring UWP Business makes up a significant proportion (34% of the BEL as at 31 December 2017) of the CM WPF. The Scheme has the effect of transferring this business from the CM WPF in SWL to SWE. Ordinarily, a transfer such as this would require the assets of the CM WPF to be split between Transferring and Non-transferring Policyholders of the fund. This would require a calculation of the Transferring UWP Policies interest in the estate of the CM WPF, which would be a complex process and one not likely to be completed before the date of Brexit, 29 March 2019. The Reinsurance Agreement (as discussed in Section 9) negates the need to split the CM WPF at the Effective Date and allows the CM WPF to be managed materially in the same way after the Transfer as it is currently.

Policyholders benefit expectations and contractual rights

- 1.82 There will be no material change to any of the terms and conditions for policies in the Transferring UWP Business under the Scheme, except that benefits will be paid by SWE rather than SWL.
- 1.83 The Reinsurance Agreement ensures that these policies will be maintained in the same way before and after the Transfer. There will be no change in investment strategy and no material change to the governance around bonus distribution. SWL and SWE do not have any intentions to terminate the Reinsurance Agreement in the foreseeable future, however, on termination of the Reinsurance Agreement, a termination amount will need to be determined. The process involved will take into consideration the fair distribution of the estate within the CM WPF and will be undertaken with oversight by an independent actuary and no objections from the Luxembourg and UK Regulators.
- 1.84 Overall, I am satisfied that there is no material adverse effect on policyholder benefit expectations for the Transferring UWP Business.

Reinsurance Agreement, Charge Agreement and Indemnity Agreement

- 1.85 I am satisfied that the Reinsurance Agreement allows the Transferring UWP Business' interests to be managed in materially the same way after the Transfer as they were before. I am also satisfied that the Charge and Indemnity Arrangement provide an appropriate level of financial protection to the Transferring UWP Business in the event of SWL failing to honour its obligations under the Reinsurance Agreement.
- 1.86 I am also satisfied that the Reinsurance Agreement contains adequate provisions to protect policyholders in the event that the Reinsurance is terminated. More information on this can be found in Section 9.

Vesting annuities

- 1.87 The Reinsurance Agreement covers the vested with-profits annuities as well as those that will vest in the future and ensures that they will be maintained in the same way as they would have been in SWL prior to the Transfer. There will be no change to the pricing of the annuities and no material change to the governance around bonus distribution, as discussed in more detail in Section 11. I am satisfied that the Transfer will not materially adversely impact these policyholders.

Conclusion

- 1.88 Overall, I am satisfied that there is no material adverse effect on the policyholders of the Transferring UWP Business as a result of the Transfer.

Transferring Unit-Linked Policyholders

- 1.89 Under the Scheme, the Transferring UL Business will move out of the Combined Fund in SWL into the UL Funds in SWE. As the Transferring UL Business is exclusively invested in the relevant unit-linked funds within the Combined Fund, a split of these funds between the Transferring Policyholders and Non-transferring Policyholders will not be required.
- 1.90 In Section 11, I discuss the effect of the Transfer for the transferring unit-linked policyholders (Transferring UL Policyholders). I have summarised my conclusions below.

Policyholder benefit expectations

- 1.91 There will be no material changes to the terms and conditions of the policies following the Transfer. SWE will take on all existing rights and obligations of SWL and the Transferring UL Policyholders will become direct policyholders of SWE rather than SWL.
- 1.92 Overall, I am satisfied that there is no material adverse effect on policyholder benefit expectations of the Transferring UL Business.

Unit Linked Service Agreement

- 1.93 To ensure that the operation of the Transferring UL Business remains the same the Unit Linked Service Agreement will be put in place between LB and SWE. Under this agreement LB will provide support for box management and unit pricing activities for the Transferring UL Policies after the Transfer.
- 1.94 I am satisfied the Unit Linked Service Agreement ensures that the Transferring UL Policies operate in the same manner before and after the Transfer. I have discussed this in more detail in Section 9.

Conclusion

- 1.95 Overall, I am satisfied that there is no material adverse effect on the policyholders of the Transferring UL Business as a result of the Transfer.

The Impact of the Transfer on Non-transferring Policyholders of SWL

- 1.96 In Section 12, I set out my analysis and conclusions in respect of the impact of the Transfer on the Non-transferring Policyholders. For these policyholders, the Scheme will not change:
- their insurer
 - the administration of their policies
 - the expense policy applied to their policies
 - the tax applied to their policies
 - the terms and conditions of their policies
 - the way their policy benefits are determined
 - the capital management framework of SWL that applies to their policies
 - the governance arrangements that are in place in respect of their policies.
- 1.97 The reinsurance premium covering the reinsurance of the Transferring UWP Business, including vesting annuities, will be retained within SWE and be known as the FWH. In the unlikely event of SWL's insolvency, SWE will retain the FWH, up to the amount owed to them by SWL, to pay the liabilities for the Transferring UWP Policyholders. This will result in the Transferring Policyholders ranking higher than the Non-transferring Policyholders in respect of the liabilities covered by the FWH. However, as the Transferring Policyholders represent only 2% of SWL's overall business and the likelihood of SWL becoming insolvent is very remote, I consider the impact of this higher ranking of the Transferring Policyholders on the benefit expectations of the Non-transferring Policyholders in case of the SWL's insolvency to be immaterial.
- 1.98 The Transfer impacts two distinct groups of the Non-transferring Policyholders differently. I consider separately the Non-transferring Policyholders in the CM WPF, and the Non-transferring Policyholders who are not in the CM WPF ("Other Non-transferring Policyholders"), and summarise my main findings for the Non-transferring Policyholders below.

Non-transferring Policyholders in CM WPF

- 1.99 The Transferring UWP Business represents c.34% of the BEL of the SWL CM WPF, with the remaining 66% of the BEL representing the business for the Non-transferring Policyholders (Non-transferring Business) in CM WPF.
- 1.100 The Scheme will not result in any changes to the policy terms and conditions for the Non-transferring Policyholders in CM WPF. There will be no changes to the governance or operation of these policies (Non-transferring Policies), especially around management discretion within SWL.
- 1.101 While the Reinsurance Agreement is in place, CM WPF will continue to be managed as a whole without having to split between the Transferring Business and Non-transferring Business.

- 1.102 If the Reinsurance Agreement is terminated, the CM WPF will need to be split between SWL and SWE. A termination amount will be determined considering the fair distribution of the estate within the CM WPF, with oversight of an independent actuary and the UK and Luxembourg Regulators. This process is designed to ensure that the outcome is fair to policyholders, including those remaining in the CM WPF.
- 1.103 I am satisfied that there will be no material adverse effect on the Non-transferring Policyholders in CM WPF as a result of the Transfer.

Other Non-transferring Policyholders

- 1.104 Other Non-transferring Policyholders include a majority of the policyholders from the unit-linked and non-profit business within the Combined Fund, and all policyholders from the SW WPF. The Transferring UL Policyholders from the unit-linked business within the Combined Fund represent an immaterial proportion, 0.4% of the unit-linked BEL of the Combined Fund.
- 1.105 The Scheme and the Associated Arrangements will be independent of the SW WPF. Therefore, there will be no impact to the benefit expectations and contractual rights of the Non-transferring Policyholders who reside in the SW WPF, as a result of the Transfer.
- 1.106 The unit-linked funds in which the Transferring UL Policies are investing are exclusive to those policies. Therefore, the Transfer will not have an impact on the Non-transferring Policyholders from the Combined Fund.
- 1.107 I am satisfied that there will be no material adverse effect on the Other Non-transferring Policyholders as a result of the Transfer.

Conclusion

- 1.108 The only change to the Non-transferring Policyholders is the change in ranking in the unlikely event of SWL's insolvency with respect to the liabilities held in the FWH for the Transferring Business. However, I consider the likelihood of SWL's insolvency to be a remote event and, based on my comments above, I am satisfied that the impact on the benefits of the Non-transferring policyholders will be immaterial. Overall, I am satisfied there will be no material adverse effect on any of the Non-transferring Policyholders as a result of the Transfer.

Communications with policyholders in relation to the Transfer

- 1.109 Transferring Policyholders will be sent a Policyholder Pack, unless a waiver has been obtained from communicating with the relevant policyholder. The Policyholder Pack will be available in English, German, Italian and French and will include:
- a brief notification letter called the Policyholder Letter
 - an important information sheet
 - a more detailed Planholder Guide.
- 1.110 In addition, the Scheme and the Report will also be available on request, and on the websites: www.scottishwidows.co.uk, www.clericalmedical.com/de/index.asp, www.clericalmedical.com/austria/index.asp and www.clericalmedical.com/it/index.asp.
- 1.111 I have reviewed the communications that will be sent in relation to the Transfer and I am satisfied that they are accurate, appropriate and not misleading
- 1.112 Any policyholder who feels he or she may be adversely affected by the Transfer can raise objections to SWL, Herbert Smith Freehills (solicitors to SWL) or the High Court. I will issue a Supplementary Report where I will consider any such objections when concluding on the appropriateness of the Transfer, as well as updated financial information and any other matters that may become known following the issue of this Report.

The impact of the Transfer on the existing external reinsurer of Transferring Business

- 1.113 SWL makes use of a reinsurer to manage its business, including the Transferring Business. The two treaties with Swiss Re for the Transferring Business will be transferred to SWE at the Effective Date. There will be no change to any of the terms and conditions of the reinsurance contracts as a result of the Transfer as at the Effective Date.
- 1.114 Given that there will be no change to the external reinsurance contracts, save for updating them to reflect the change of ownership following the Transfer, I am satisfied that there will be no material impact of the Scheme on any of the external reinsurers of SWL whose treaties cover the Transferring Business.

2 Introduction

Background

- 2.1 Under European Union (EU) regulations, United Kingdom (UK) insurance companies can sell policies and service business written in the European Economic Area (a free-trade zone created in 1994, composed of the states of the EU together with Iceland, Norway and Liechtenstein, the EEA) countries on a Freedom of Services or a Freedom of Establishment basis (commonly referred to as “EU passporting rights”). Scottish Widows Limited (SWL or Transferor) has previously written life insurance and pensions business, primarily in Germany, Austria and Italy, under EU passporting rights.
- 2.2 On 23 June 2016, the UK voted to leave the EU and on 29 March 2017, the UK officially notified the European Commission of its intention to withdraw from the EU (Brexit). Brexit is expected to take effect on 29 March 2019. It is uncertain whether or not UK insurance companies will continue to be able to sell policies and service business written in EEA countries outside of the UK, under EU passporting rights, after 29 March 2019. Therefore, unless suitable transitional or grandfathering arrangements between the UK and the EU are agreed prior to the 29 March 2019, it is expected that it will become illegal for SWL to continue to service the policies written under EU passporting rights.
- 2.3 SWL has decided to establish a new wholly-owned subsidiary life insurance company in Luxembourg, Scottish Widows Europe SA (SWE), which is expected to be authorised by the Luxembourg Insurance Supervisory Authority, Commissariat aux Assurances (CAA) by the end of January 2019. Once authorised, SWL will transfer its existing business that was originally written in EU countries (Transferring Business) to this subsidiary.
- 2.4 The proposed transfer of these policies will be carried out using a legal process known as a Part VII transfer under the Financial Services and Market Act 2000 (as amended) (FSMA). The terms of the proposed transfer are set out in a document known as the Scheme. The Part VII transfer of these policies from SWL to SWE (Transferring Policies), together with the associated reinsurance agreement, charge agreement, servicing agreement and the indemnity agreement that sits alongside the Scheme, are referred to as “the Transfer”. The Transfer is dependent on the authorisation of SWE’s application by the CAA.
- 2.5 Moving the Transferring Business from the UK to Luxembourg, a Member State of the EU, will allow SWE to legally continue to settle claims, service contracts, or renew policies previously written by SWL under EU passporting rights.

Consequence of the Scheme not being implemented

- 2.6 If the Scheme is not implemented, the business being transferred under the Scheme will remain with SWL and in the event of the UK losing EU passporting rights after Brexit, in the absence of an appropriate political agreement between the UK and EU, there would be material concerns over the ability of SWL to continue to lawfully service the business originally written under EU passporting rights. For example, in the absence of suitable alternative arrangements, SWL may be unable to collect premiums, pay claims and allow increments on its policies written in EEA countries outside of the UK, after Brexit.
- 2.7 By implementing the Scheme, SWL intends to provide certainty that Transferring Policies can continue to be lawfully serviced. SWL is aware that the Brexit negotiations could result in arrangements that would allow the continued servicing of SWL policies written in EEA countries outside of the UK. However, there is insufficient time for SWL to wait for the outcome of the Brexit negotiations because if no such agreement is reached and SWL has not taken action it will not be possible to implement a Part VII Transfer before 29 March 2019.

Business being transferred

- 2.8 I have classified the Transferring Business into two main groups:

- Transferring unitised with-profits (UWP) - business currently invested in Guaranteed Growth Funds (GGFs) which reside in SWL's Clerical Medical (CM) with-profits fund (WPF) (CM WPF), written primarily in Germany, Austria and Italy under EU passporting rights. This group also includes a small number of vested annuities as at 31 December 2017. It is expected that this number will grow over time as more policies vest. The business for the Transferring UWP is referred to as the "Transferring UWP Business", its policies are referred to as the "Transferring UWP Policies" and its policyholders are referred to as the "Transferring UWP Policyholders"
- Transferring unit-linked (UL) - business currently invested in funds that reside in SWL's Combined Fund (described in Section 4), written primarily in Germany, Austria and Italy under EU passporting rights. These unit-linked funds are exclusively invested for this business. The business for the Transferring UL is referred to as the "Transferring UL Business", its policies are referred to as the "Transferring UL Policies" and its policyholders are referred to as the "Transferring UL Policyholders".

2.9 The table below sets out the policy count and the Best Estimate Liabilities (BEL) for the Transferring Business as at 31 December 2017.

	Number of Policies	BEL (investment element only) (£m)	Total BEL* (£m)
Transferring UWP Business	61,408	1,766	1,753
Transferring UL Business	26,995	318	360
Total	88,403	2,084	2,113

All numbers in the above table are rounded to the nearest whole number.

* BEL for the non-investment element is based on Luxembourg Generally Accepted Accounting Principles (GAAP) basis.

- 2.10 As part of the Transfer, the UWP business will be reinsured back to SWL through a new reinsurance agreement (Reinsurance Agreement), which will include the associated collateral arrangements known as funds withheld (FWH). The UL business will remain with SWE but, to ensure that the operations of the UL business remain unchanged, SWE will enter into a service agreement with Lloyds Bank Plc (LB) to enable them to provide support for the back office management tasks related to the Transferring UL Business (Unit Linked Service Agreement), as happens at present for SWL.
- 2.11 Additionally, to provide protection for SWE against any litigation claims resulting from SWL's actions prior to the Transfer, SWL will enter into an indemnity agreement (Indemnity Agreement) with SWE.
- 2.12 To provide further security for the Transferring Business, SWL will enter into a floating charge agreement (Charge Agreement) with SWE.
- 2.13 In this Report, I refer to the Reinsurance Agreement including FWH, Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement together as "Associated Arrangements".

Purpose of this Report

- 2.14 When a scheme of transfer of insurance business from one company to another is proposed, it must be submitted to the High Court of Justice of England and Wales (the High Court) for approval and be accompanied by a report from an Independent Expert (the Report).
- 2.15 The proposed transfer of business will be carried out using a legal process known as a Part VII Transfer of insurance business. The terms of the proposed transfer are set out in a document known as the Scheme.
- 2.16 The Independent Expert must be approved by the Prudential Regulation Authority (PRA), having consulted with the Financial Conduct Authority (FCA) (together the UK Regulators).
- 2.17 SWL has nominated me to act as an Independent Expert and to provide the Report in respect of the Transfer. The PRA has approved my appointment in consultation with the FCA. The shareholders of

SWL will meet the costs of my appointment through the Combined Fund of SWL. However, I owe a duty to the High Court that overrides any duties I owe to SWL, the PRA and the FCA.

- 2.18 The Scheme will be submitted to the High Court for sanction under Section 111 of Part VII of the FSMA. If approved, it is expected that the Scheme will become operative and take effect on 28 March 2019 (the Effective Date). This Report and any supplementary report (Supplementary Report)¹ that I may issue (together my Reports) will be presented to the High Court. The High Court will consider the contents of these Reports in deciding whether or not to sanction the Scheme.
- 2.19 In preparing the Report, I have considered the terms of the Scheme only and have not considered whether or not any other schemes might provide a more efficient or effective outcome. I have reviewed the aspects of the Scheme to consider whether there would be detriments to Transferring Policyholders and/or Non-Transferring Policyholders and I commented on these in this Report, ie the impact of holding FWH in SWE in Sections 9, 11 and 12, the impact of the loss of FSCS in Section 11 and differences in conduct of business rules between the UK and Luxembourg in Sections 7, 9 and 11. SWL investigated a number of other scheme options and I have reviewed their rationale for their conclusions. Another option that could be considered would be to apply for a UK authorisation for SWE and I commented on this in 11.43.
- 2.20 To the best of my knowledge, all material facts have been considered when assessing the impact of the Transfer and during the preparation of the Report.
- 2.21 The Report describes the impact of the Transfer on policyholders transferring as a result of the Scheme (Transferring Policyholders), and the likely effect of the Transfer on Non-transferring Policyholders of SWL (Non-transferring Policyholders). I also consider the impact of the Transfer on the current reinsurer of SWL, whose treaties cover the risks associated with the policies of the Transferring Policyholders.
- 2.22 The Transfer is dependent on the authorisation of SWE's application by the CAA. SWE started its engagement process with the CAA in early September 2018, with authorisation by the CAA expected by 31 January 2019. Therefore, this Report is based on the information available prior to the authorisation of the CAA. I will provide an update on the authorisation in my Supplementary Report.

Key dependencies

- 2.23 I have prepared the Report on the assumption that a number of actions take place on or before the Effective Date. If these actions are not completed by the Effective Date, the conclusions in the Report may not be valid. Accordingly, I consider these actions to be key dependencies. I list below the key dependencies:
- SWE receives authorisation from the CAA. Without the relevant authorisation, it would not be possible for the Scheme to be implemented
 - SWE receives an initial capital injection from SWL that is sufficient to capitalise SWE at its target capital level, taking into account the transfer of assets under the Scheme
 - SWE and SWL enter into agreements associated with the Scheme, namely the Reinsurance Agreement, Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement, to be effective immediately following the Effective Date.

The Independent Expert

- 2.24 I am a Fellow of the Institute and Faculty of Actuaries and I have over 30 years' experience in the life insurance industry. I am a partner of Grant Thornton UK LLP (Grant Thornton). I joined Grant Thornton as a partner in October 2014. Prior to this date, I held senior roles at a number of firms including

¹ In order to reflect any updated financial information or any other matter that comes to light following the issue of the Report, nearer the date of the High Court sanction hearing I will provide a Supplementary Report to update my opinions in respect of the Scheme.

partner roles at EY and KPMG. Appendix A provides details of my experience. Appendix B is an extract from the letter of engagement between Grant Thornton and SWL, setting out the agreed scope of my work.

Independence

- 2.25 I confirm that, in my opinion, I have no conflict of interest that would compromise my ability to perform my role as Independent Expert. In reaching this opinion, I have considered the factors set out below and confirm that to the best of my knowledge and belief:
- I am not and never have been a director or employee of SWL or SWE
 - I have not provided any material consulting services or acted in any advisory capacity to SWL in the last three years that create a conflict with me acting as the Independent Expert
 - I have not invested in either SWL or SWE through commercial loans, savings and pensions
 - I have not been part of an external audit of either SWL or SWE
 - I do not hold any directorships in common with any of the directors or advisors of SWL or SWE
 - I do not have any family ties with the directors, senior employees or advisors of SWL or SWE.
- 2.26 I have considered the most recent guidance issued by the Actuarial profession regarding conflicts of interest and have identified no conflict of interest that might compromise my independence. In addition, I confirm that I am of independent character and judgement.
- 2.27 Grant Thornton is a large consulting firm and has advised SWL on various assignments. I do not believe that any of the assignments carried out for SWL compromise my independence, create a conflict of interest, or compromise my ability to report on the proposed Scheme. These assignments were disclosed to the UK Regulators prior to their approval of me as the Independent Expert.

Regulatory and professional guidance

- 2.28 The Report has been prepared in accordance with guidance contained in Chapter 18 of the Supervision Manual of the FCA's Handbook of Rules and Guidance (SUP 18) and the Statement of Policy: The PRA's approach to insurance business transfers, dated April 2015. See Appendix C for details of how these requirements have been met.
- 2.29 I have also paid regard to the FCA's guidance FG18/4: guidance on our approach to the review of Part VII insurance business transfers. See Appendix D for details of how these requirements have been met.
- 2.30 The Financial Reporting Council (FRC) has issued standards that apply to certain types of actuarial work. I have prepared this Report, with the intention that it, and the work underlying it, should meet the requirements of Technical Actuarial Standards TAS 100 (Principles for Technical Actuarial Work) and TAS 200 (Insurance). I believe that this Report and my work underlying it do so in all material respects.
- 2.31 I confirm that I have also complied with the Actuarial Profession Standard (APS) X1: Applying Standards to Actuarial Work, APS X2: Review of actuarial work and APS X3: The Actuary as an Expert in Legal Proceedings, and considered Actuarial Practice Standard L1: Duties and Responsibilities of Life Assurance Actuaries, issued by the Institute and Faculty of Actuaries.

Materiality

- 2.32 This Report, and the analysis undertaken in order to produce this Report, apply the concept of materiality. The test I have applied is whether or not the position of any group is, in the round materially adversely affected. This phrase is used in the context of considering policyholder security in SUP 18. For any group of policyholders, there may be some changes for the better and some for the worse. If there are some changes for the worse this does not necessarily mean that the Transfer is unfair or unreasonable, as they might be either outweighed by other benefits, or they might be

extremely small. The word 'material' is not defined in SUP 18, so where there are adverse changes I have attempted to give some context as to their size or likelihood of occurring. If a potential effect is very unlikely to happen and does not have a large impact, or if it is likely to happen but has a very small impact, I do not consider it material.

Reliance

- 2.33 In preparing this Report, I have relied on the accuracy and completeness of data and information provided to me, both written and oral, by SWL. Reliance has been placed upon, but not limited to, the information detailed in Appendix E. I have reviewed the information for consistency and reasonableness using my knowledge of the UK life insurance industry but have not otherwise verified it. I have also consulted Independent Legal Counsel on the operation of the provisions in the Charge Agreement and the provisions for FWH in the Reinsurance Agreement and their effect on the protection offered to policyholders, should the agreements terminate due to either insolvency or by the other termination events. SWL has been advised by its own legal advisers in the UK and Luxembourg in respect of certain matters, and I have reviewed some of the advice provided and have relied on some of that advice in reaching certain conclusions. For the avoidance of doubt, SWL's legal advisers have no liability to me in respect of their advice.
- 2.34 The Report has been prepared for the purpose of the Scheme in accordance with Section 109 of the FSMA. A copy of the Report will be sent to the UK Regulators, and will accompany the Scheme application to the High Court.
- 2.35 This Report is not suitable for any other purpose. No liability is accepted or assumed for any use of this Report for any other purpose other than that set out in paragraphs 2.14 to 2.22 above.
- 2.36 The Report must be considered in its entirety, because individual Sections, if considered in isolation, may be misconstrued.
- 2.37 The findings contained in this Report are based on data and financial information as at 31 December 2017. Future results could be affected by future events which cannot be either predicted or controlled, including, without limitation, changes in business strategies, the development of future products and services, changes in market and industry conditions, changes in management and changes in law or regulation. I accept no responsibility for future results or future events.

Legal jurisdiction

- 2.38 This Report will be governed and construed in accordance with English law, and the English court will have exclusive jurisdiction in connection with all disputes and differences arising out of, under or in connection with this Report.

Duty to the High Court

- 2.39 In reporting on the Scheme as the Independent Expert, I understand that I owe a duty to the High Court to assist on matters within my expertise. This duty overrides any obligation to SWL, the FCA or the PRA. I confirm that I have complied with this duty.
- 2.40 I confirm that I am aware of the requirements applicable to experts set out in Part 35 of the Civil Procedure Rules: The Practice Direction and Protocol for Instruction of Experts to give Evidence in Civil Claims. As required by Part 35 of the Civil Procedure Rules, I confirm that I have understood my duty to the High Court.

Statement of Truth

- 2.41 I confirm that I have made clear which facts and matters referred to in the Report are within my own knowledge and which are not. Those that are within my own knowledge, I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on matters to which they refer.

- 2.42 The Report has been seen by SWL, which has agreed that it is correct in terms of all factual elements of the Transfer.
- 2.43 The Report has been peer reviewed by a fellow actuary, Derek Smith, who has over 25 years of experience in the insurance industry and specialises in reviewing insurance transactions.

Exchange Rate

- 2.44 Throughout this Report, I refer to numbers measured in pound sterling and euros with the use of an exchange rate of 1.12717 observed on 29 December 2017.

My approach

- 2.45 My approach to assessing the likely effects of the Transfer has been to:
- understand the nature and scope of the SWL business
 - understand the nature, structure and terms of the Scheme
 - understand the nature and effect of the Reinsurance Agreement, Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement that are being put in place alongside the Scheme
 - identify the groups of policyholders that are likely to be affected by the Transfer
 - assess the financial positions of the companies involved before and after the Transfer takes effect
 - consider whether or not, as a result of the Transfer, there is any material adverse effect on the security of benefits provided to the affected policyholders
 - consider whether or not, as a result of the Transfer, there is any material adverse effect on the level of benefits and contractual rights provided to the affected policyholders
 - consider whether or not, as a result of the Transfer, there is any material adverse effect on the levels of customer service and policyholder protection for affected policyholders
 - consider any other factors (eg regulation, governance, tax and expenses) that could result in a material adverse effect for any group of policyholders
 - consider the implications of the Transfer on the current reinsurer of SWL whose treaties cover the risks associated with the Transferring Policies.
- 2.46 My approach to the analysis and conclusions within this Report includes the review of all relevant information I have received. This is supplemented by desktop reviews, face-to-face meetings, challenge and questioning of information and additional research where required. In addition, I have discussed relevant issues with executives within SWL and their legal advisors. I have consulted with the Independent Counsel where required. I have also had discussions with the Chief Actuary and With-Profits Actuary of SWL, and considered their reports on the Transfer. At the time of authoring the Report, SWE has not been authorised by the CAA. SWE has not written any policies, and the appointment of the SWE Chief Actuary has not been confirmed. I intend to consider any report on the Transfer prepared by the SWE Chief Actuary when I prepare the Supplementary Report.
- 2.47 In order to form my opinions, I have taken into account:
- the appropriateness of the methods used by each of SWL and SWE to calculate the estimates of capital requirements
 - the relative capital strength of SWL and SWE immediately before and after the Transfer
 - the absolute capital strength of SWL and SWE immediately before and after the Transfer, and based on projections from this, into the future
 - the difference in the expected risk profile of SWL and SWE
 - the likelihood of specific adverse events occurring

- the difference in the regulatory regimes in the UK and Luxembourg.

Layout of the Report

2.48 The Report is structured as follows:

- Section 1 provides a summary of the Report
- Section 2 sets out the purpose of the Scheme, and provides details of my independence and the approach I have taken in preparing this Report
- Section 3 describes the regulatory background for both countries (UK and Luxembourg) relevant to the Scheme
- Section 4 describes the background on SWL
- Section 5 describes the background on the Transferring Business
- Section 6 describes the background on SWE
- Section 7 describes the Scheme
- Section 8 describes the structure of the Transfer
- Section 9 describes the Reinsurance Agreement, Charge Agreement and Indemnity Agreement, and my analysis of them
- Section 10 describes the impact of the Transfer on risk profiles of SWL and SWE and their capital projections
- Section 11 describes the impact of the Transfer on the Transferring Policyholders
- Section 12 describes the impact of the Transfer on the Non-transferring Policyholders of SWL
- Section 13 describes the impact of the Transfer on the current reinsurer of SWL whose treaties cover the risks associated with the Transferring Policies.

3 Regulatory background

Introduction

- 3.1 In this Section I describe the current UK and Luxembourg regulatory regimes that govern the regulatory requirements of SWL and SWE respectively. This Section provides the context against which I have assessed the impact of the Scheme. I detail in later Sections when these regulations apply.

Overview of the UK regulatory regimes

- 3.2 In the UK, the financial services industry, including insurance companies, is regulated by the PRA and the FCA using a system of dual regulation. The FCA is a statutory body set up under the Financial Services Act 2012, while the Bank of England exercises its functions as the PRA through its Prudential Regulation Committee.
- 3.3 The PRA is part of the Bank of England and is responsible for:
- prudential regulation of banks, building societies and credit unions, insurers and major investment firms
 - promoting the safety and soundness of the firms it regulates, seeking to minimise the adverse effects that they can have on the stability of the UK financial system
 - contributing to ensuring that insurance policyholders are appropriately protected.
- 3.4 The FCA is a separate institution with a strategic objective of ensuring that its regulated markets function well and is responsible for:
- conduct regulation of all financial firms
 - prudential regulation of those financial services firms that are not supervised by the PRA.
- 3.5 A Memorandum of Understanding has been established between the PRA and the FCA, which sets out the high-level framework under which the two regulatory bodies will co-ordinate their activities. In particular, the PRA and FCA are required to co-ordinate with each other in advance of insurance business transfers under Part VII of the FSMA.

Solvency framework overview

- 3.6 Firms are required to assess solvency under the Solvency II Directive (Solvency II) in EU law. This is a relatively new regime which came into effect from 1 January 2016. A high-level summary of the Solvency II framework is set out in paragraphs 3.7 to 3.12 below.
- 3.7 Solvency II is a European wide framework. Under Solvency II, solvency requirements have been harmonised across Member States of the EU and an economic risk-based approach has been adopted.
- 3.8 Solvency II is a principles-based regime, based on three pillars:
- under Pillar I, quantitative requirements define a market consistent framework for valuing a company's assets and liabilities, and determining the Solvency Capital Requirement (SCR)
 - under Pillar II, insurers must meet certain standards for their corporate governance, and also for their risk and capital management. There is a requirement for permanent internal audit, compliance, risk management and actuarial functions. Insurers must regularly carry out an Own Risk and Solvency Assessment (ORSA)
 - under Pillar III, there are explicit requirements governing disclosures to regulators and public disclosure.
- 3.9 Under Solvency II, firms may choose to calculate the SCR using either a "Standard Formula", as defined in the Solvency II rules, or they can choose to develop their own "Internal Model". Where a Standard Formula approach is used, there is a requirement for both the firm and the local regulator to

assess the appropriateness of using the Standard Formula. Where an Internal Model is used, the model must be approved by the local regulator.

- 3.10 If certain conditions are met, the local regulator may require a firm that calculates its capital requirements using the Standard Formula to hold additional capital (known as a capital add-on) to cover certain risks specific to an individual firm, that the local regulator deems not to be adequately captured by the Standard Formula.
- 3.11 Subject to approval by the local regulator, firms may make a number of adjustments to their Solvency II results. The types of adjustments that may be applied for include the following:
- transitional measures on technical provisions (TMTP). This is calculated as the difference between the technical provisions calculated under the previous regulatory regime (Solvency I) and the Solvency II technical provisions, and decreases linearly over a 16 year period
 - transitional measures on the risk-free interest rate. This allows firms to phase in any reduction in the discount rate used under Solvency II compared to that permitted under Solvency I
 - matching adjustment (MA) and volatility adjustment (VA). These are adjustments to the risk free interest rates used to discount insurance obligations. The main difference between the MA and VA adjustments is that the MA is calculated by firms based on a specifically identified portfolio of assets and liabilities, whereas the VA is set in accordance with the Solvency II Directive on the basis of technical information published by the European Insurance and Occupation Pensions Authority (EIOPA).
- 3.12 Under Solvency II Pillar II, the ORSA captures the insurer's own assessment of its risk profile and capital position, which provides a more company-specific assessment compared to the prescribed methods under Pillar I. As part of an insurer's risk management procedures, firms are required to set a risk appetite, which quantifies the level of risk an insurer is prepared to take, and a capital policy, which ensures the company is managed in line with its risk appetite.

Conduct principles

- 3.13 The FCA is responsible for conduct regulation of all financial firms, including insurers. Rules and guidance for firms are set out in the FCA Handbook. The Handbook includes 11 principles for business, which are high-level standards that all firms regulated by the FCA must meet. These are as follows:
- Integrity - A firm must conduct its business with integrity
 - Skill, care and diligence - A firm must conduct its business with due skill, care and diligence
 - Management and control - A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems
 - Financial prudence - A firm must maintain adequate financial resources
 - Market conduct - A firm must observe proper standards of market conduct
 - Customers' interests - A firm must pay due regard to the interests of its customers and treat them fairly
 - Communications with clients - A firm must pay due regard to the information needs of its clients and communicate information to them in a way which is clear, fair and not misleading
 - Conflicts of interest - A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client
 - Customers: relationships of trust - A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely upon its judgement
 - Clients' assets - A firm must arrange adequate protection for clients' assets when it is responsible for them

- Relations with Regulators - A firm must deal with its regulators in an open and co-operative way and must disclose to the FCA appropriately anything relating to the firm of which that regulator would reasonably expect notice.

Policyholder protection

- 3.14 As well as through the PRA solvency framework and the FCA conduct principles, policyholders are also provided with further protection through the Financial Services Compensation Scheme (FSCS) and the Financial Ombudsman Service (FOS).

FSCS

- 3.15 FSCS is a statutory "fund of last resort" which compensates customers in the event of the insolvency of a financial services firm authorised by the PRA or FCA. Insurance protection exists for private policyholders and small businesses (those with an annual turnover of less than £1,000,000) in the situation when an insurer is unable to meet fully its liabilities. For long term insurance policies, the FSCS will pay 100% of any eligible claim. The FSCS is funded by levies on firms authorised by the PRA and FCA.

Policyholders' rights in insolvency

- 3.16 In case of insolvency of a life insurance company, a liquidator will first seek to transfer the business as a going concern to another insurer. FSMA 2000 prevents the liquidator from doing otherwise without an order of the High Court.
- 3.17 To the extent the High Court grants an order, it is possible that a liquidator may seek to realise assets and distribute the proceeds to creditors. Where an insurer writes both long-term and general insurance business, there is a segregation of assets and liabilities associated with each business. However, if the insurer writes only long-term business, the segregation does not apply.
- 3.18 The order of priority of payments in a liquidation is as follows:
- expenses of the winding up
 - contributions to occupational pension schemes and employee remuneration
 - proceeds from realising the assets covered by a floating charge which must be set aside and made available to satisfy unsecured debts (insurance debts have priority over other unsecured claims)
 - floating charge creditors
 - remainder of insurance debts including insurer's own direct policyholders and claims assigned to FSCS
 - other debts.

FOS

- 3.19 The UK FOS is an independent body set up to mediate individual complaints that consumers and financial businesses are not able to resolve themselves.
- 3.20 Consumers must first give the business they are unhappy with the opportunity to look into the complaint itself. If the complainant and the business cannot reach an agreement, then the ombudsman service can make a decision on the dispute. The business has a maximum of eight weeks to resolve the complaint. If it does not resolve it within eight weeks, or the consumer is not happy with the response received, then the consumer can refer the complaint to the ombudsman service.
- 3.21 The ombudsman has the authority to either request or require a company to offer financial compensation, correct a consumer's credit file, or offer an apology, as a means of dispute resolution. The decisions issued by the UK FOS are binding.

Governance of long-term insurers

- 3.22 Generally, a long-term insurer will have a Board of Directors (the Board), which governs the entity. They will be responsible for the strategy, culture, day-to-day management and approval of the insurer's financial statements.
- 3.23 On 7 March 2016, the PRA introduced the Senior Insurance Managers Regime which defines and details the responsibilities of Senior Insurance Management Functions, including:
- SIMF1 - Chief Executive Officer (CEO)
 - SIMF2 - Chief Financial Officer (CFO)
 - SIMF4 - Chief Risk Officer (CRO)
 - SIMF5 - Head of Internal Audit
 - SIMF20 - Chief Actuary
 - SIMF21 - With-Profits Actuary (firms containing with-profits business) (WPA)
 - SIMF22 - Chief Underwriting Officer (general insurance firms only).
- 3.24 Individuals fulfilling each of the above roles must be approved by the PRA prior to taking up their responsibilities. This regime aims to ensure that individuals performing the above roles have the required skills and experience to act in that particular capacity.

Risk appetite and Capital policy

- 3.25 The Board is responsible for setting the entity's risk appetite and capital policy, which ultimately manages the entity's exposure to risk.
- 3.26 It is usual for firms to express their risk appetite in terms of a target capital level, which will be set in excess of the SCR. This helps to ensure that day-to-day fluctuations do not lead to a breach of the regulatory capital requirements. The level of the buffer above SCR will be set out in the firm's capital policy. This policy will be set by the Board, and any changes would be subject to Board approval with consultation of the UK Regulators also being required.

Management of with-profits business within the UK

- 3.27 Section 20 of the UK Conduct of Business Sourcebook (COBS) sets out the FCA's rules in relation to managing with-profits business, including the governance and management of with-profits funds, treating with-profits policyholders fairly, the Principles and Practices of Financial Management (PPFM) and communications with with-profits policyholders.
- 3.28 In particular, Section 20.3 of the UK COBS sets out the requirement for all firms that conduct with-profits business in the UK to define and make publicly available the PPFM that are applied in the management of their with-profits funds.
- 3.29 In managing with-profits business firms rely on their use of discretion, particularly in relation to the investment strategy followed and the smoothing and bonus policy used to determine payments to policyholders. The purpose of the PPFM is to explain the nature and extent of discretion available and how this discretion will be applied across different groups and generations of with-profits policyholders.
- 3.30 The FCA rules² also set out the governance arrangements that must be put in place for with-profits business. This includes a requirement to appoint a with-profits committee (where the majority of members are independent of the firm or, where there is an equal number of independent and non-independent members, chaired by an independent member) or a with-profits advisory arrangement.
- 3.31 Ultimate responsibility for managing a with-profits fund rests with the firm through its governing body. The role of either the with-profits committee or advisory arrangement is, in part, to act in an advisory

² FCA Handbook: COBS 20.5

capacity to inform the decision-making of a firm's governing body. The with-profits committee or advisory arrangement also acts as a means by which the interests of with-profits policyholders are appropriately considered within a firm's governance structures.

- 3.32 Under the PRA rules³ a firm carrying on with-profits business must appoint one or more actuaries to perform the role of WPA. The duties of the WPA include a requirement to advise the firm's management, at the level of seniority that is reasonably appropriate, on key aspects of the discretion to be exercised affecting those classes of the with-profits insurance business of the firm in respect of which he or she has been appointed. A with-profits committee or advisory arrangement will usually be expected to work closely with the WPA, and obtain his or her opinion and input as appropriate.
- 3.33 When a firm ceases to effect new contracts in a with-profits fund it must submit a run-off plan to the appropriate UK Regulator within three months of closure of the with-profits fund to new business⁴. The run-off plan should include an up-to-date plan to demonstrate how the firm will ensure a fair distribution of the closed with-profits fund, and its inherited estate (ie the part of the with-profits fund that is not allocated to policyholders liabilities, if any); and be approved by the firm's governing body.

Management of unit-linked business within the UK

- 3.34 There are fewer regulations around the management of unit-linked business, within the UK, compared to those for with-profits business. The main source of regulation for unit-linked business is within the UK COBS.
- 3.35 Section 21 of the UK COBS sets out the FCA's rules in relation to managing unit-linked business, including the fair and accurate determination of unit values, policyholder notification of a unit fund's risk profile, the use of reinsurance for unit-linked business and restrictions on unit-linked assets.

Overview of the Luxembourg regulatory regimes

- 3.36 The Ministry of Finance is responsible for the supervision of the Luxembourg financial market. It discharges this responsibility through the CAA, which is the public institution that supervises the insurance sector in Luxembourg. The Ministry authorises the CAA to regulate insurance companies in Luxembourg.
- 3.37 The insurance and reinsurance companies, professionals and the intermediaries in Luxembourg are subject to "the Law of 7 December 2015 on the insurance sector" (Law of 2015). In addition, "the amended Regulation 15/03 of 7 December 2015" (CAA Regulation 15/03), published by the CAA, contains further rules applicable to insurance and reinsurance companies. The Law of 2015 replaced the prior insurance regulations and updated the insurance law in line with the Solvency II requirements.
- 3.38 The Luxembourg Regulator CAA reviews applications for authorisation of insurance and reinsurance companies and pension funds. It also:
- exercises prudential oversight over Luxembourg insurance and reinsurance companies and other regulated professionals in the insurance sector
 - supervises the activities in Luxembourg of authorised entities established in the EEA that operate in Luxembourg under the free provision of services principle or through a branch.
- 3.39 The CAA is also tasked with:
- issuing regulations relating to the insurance sector
 - carrying out on-site inspections
 - issuing injunctions and imposing sanctions in cases of breach by persons subject to its supervision

³ PRA Rulebook/Solvency II Firms/Actuaries/Appointment of Actuaries/2.2

⁴ COBS 20.2.53

- initiating requests to the competent court for dissolution and winding up in cases listed in the Law of 2015.
- 3.40 The CAA lists the following responsibilities in its mission statement:
- ensuring the protection of insurance policyholders and beneficiaries
 - examining applications for approval of (re)insurance companies and insurance intermediaries
 - the prudential regulation of (re)insurance companies and insurance intermediaries
 - assisting with the development of common standards across Europe and internationally
 - ensuring the supervision of the insurance market in order to ensure compliance with the regulatory obligations related to anti-money laundering and the fight against the financing of terrorism
 - presenting to the Luxembourg Government any suggestion likely to improve the legislative and regulatory environment relative to the business of insurance and reinsurance
 - drafting of laws and regulations relating to the insurance sector
 - coordinating efforts for an orderly expansion of activities of the insurance sector in Luxembourg.

Solvency framework overview

- 3.41 The solvency framework applicable to insurance entities in Luxembourg is the same European Solvency II framework as described above in paragraphs 3.6 to 3.12. The CAA expects the insurance companies to hold a capital buffer over their regulatory requirement.

Conduct principles

- 3.42 Conduct principles for insurers are currently not defined under one law in Luxembourg. The CAA is, however, responsible for monitoring the conduct of the insurers.
- 3.43 A new law is expected to come into effect in October 2018, which defines the rules and expectations on conduct principles, however this will only apply to the business written after the law comes into effect. The CAA will be responsible for monitoring the companies against this law.
- 3.44 There are some conduct related principles included in different regulations issued by the CAA; for example the CAA circular letter 15/03 on investment rules for life insurance products linked to investment funds (CAA Circular letter 15/03), requires the investment of assets to be made in line with the "prudent person principle". The definition of this principle includes the following:
- insurers shall only invest in assets and instruments entailing risks that they can identify, measure, monitor, manage, control and declare adequately, and that they can adequately take into account for their solvency needs
 - the assets representing the technical provisions shall be invested in the best interest of all policyholders and all beneficiaries, taking account of any published goal
 - if a conflict of interest arises, insurers or their appointed asset managers shall ensure that investments are made in the best interest of the policyholders and beneficiaries.
- 3.45 The CAA Circular Letter 15/03 also defines types of investment that can be held in unit funds, in the similar way to the permitted links rules in the UK COBS.
- 3.46 According to the common civil law principles, insurance companies have the duty to act at all times loyally and in good faith towards their contractual counterparties (ie policyholders).

Policyholder protection

- 3.47 Policyholder protection can be split into compensation, following the insolvency of an insurer, and compensation/complaints resolution based on unfair practices of an insurer.

Compensation scheme

- 3.48 Luxembourg does not have a compensation scheme similar to the FSCS in the UK; however, the insurance system comprises a series of rules specifically aimed at protecting insurance creditors in the case of insolvency of an insurance company.

Policyholders' rights in insolvency

- 3.49 Article 118 of the Law of 2015 stipulates that the assets backing the technical provisions, based on the higher of Luxembourg GAAP and Solvency II technical provisions, held for policyholders, must be segregated as "assets underlying the technical provisions" (Tied Assets) and must be deposited with a custodian under the conditions defined by the CAA. Insurance companies must keep a permanent inventory of Tied Assets and report this quarterly to the CAA. Policyholders have super preferential rights on these Tied Assets which ensures that they receive their guaranteed benefits. Upon liquidation and wind-up of an insurer, policyholders will be reimbursed by using the Tied Assets.

- 3.50 The liquidation of Tied Assets, in the winding up and liquidation proceedings, is about to be substantially amended upon publication of a law amending the Insurance Act. Following this change, the life insurance classes will be categorised in different pools:

- for all or part of insurance claims for which the investment risk is borne by the policyholder, the claim shall equal to the number of units held in the underlying asset(s) on the day of the opening of the liquidation, as such units number is documented for each asset in the management system of the undertaking in liquidation (Pool A)
- for the other claims or parts of claims corresponding to a saving operation of a life insurance contract or a capitalisation bond, the claim shall equal to the value of the corresponding technical provisions calculated on the day of the opening of the liquidation according to the valuation rules of Chapter 7 of the law on the annual accounts (Pool B)
- claims corresponding to the technical provisions for risks shall equal to the amounts of technical provisions setup in the insurer's books (Pool C).

- 3.51 On insolvency:

- policyholders in Pool A will have priority ranking over the Tied Assets backing the value of units
- policyholders in Pools B and C will have equal priority ranking over the Tied Assets backing the technical provisions for these liabilities
- policyholders in Pools A, B and C to the extent that their claims have not already been satisfied, as well as other insurance claims, will have preferential rights over remaining Tied Assets.

- 3.52 Article 119 of the Insurance Act provides that, if the separate pool of Tied Assets is not sufficient to cover all insurance claims (eg in case of an unexpected depreciation of certain assets), the winding-up of the insurance company may only be carried out via a reduction of the entitlement of the policyholders in proportion to the amount of their claim.

- 3.53 In order to reinforce the protection of the insurance creditors, Article 119 further provides for 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.

- 3.54 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 chambers.

Mediation and Ombudsman Services

- 3.55 In Luxembourg, complaint handling schemes are handled by three alternative dispute resolution bodies, as summarised below, however, their decisions are not legally binding.

- 3.56 One of the CAA's missions is to receive and examine the claims and complaints issued by either policyholders or other interested parties against insurance undertakings. The CAA assesses each individual complaint and issues either an opinion or recommendation as to how the concerned insurance undertaking should, in the CAA's view, handle the matter. The insurance undertaking is then asked to take a formal position with respect to the CAA's opinion. If the insurance undertaking agrees to follow the CAA's opinion, the complaint is resolved. If not, the CAA informs the complaining party and provides him or her with the copy of its opinion, enabling the policyholder to take the matter to the High Court by relying on the CAA's opinion where needed.
- 3.57 The National Consumer Ombudsman Service (NCOS) is an authority in charge of handling disputes relating to a sales or service agreements between professionals established in Luxembourg and consumers having their residence in either Luxembourg or another EU Member State.
- 3.58 In addition, the Association of Insurers and Reinsurers (ACA) and the Luxembourg Union of Customers (ULC) provide a joint ombudsman service for policyholders of ACA members. This service provides mediation proceedings between the relevant parties residing in Luxembourg or abroad. It is a voluntary service for the insurance companies to participate in.
- 3.59 The NCOS and the joint ombudsman service by ACA and ULC may propose a mediated solution to the parties that have participated in the mediation, with the possibility but not obligation for the relevant parties to accept such solution. Therefore, their decisions are not binding.
- 3.60 The above procedure is currently in the process of being formalised as regulation. As stated earlier, within this Report, I refer to the NCOS, ACA and ULC mediation services together as the Luxembourg Ombudsman Service (LOS).

Governance of long term insurers

- 3.61 Articles 71 to 81 of the Law of 2015 detail the governance regime of insurers in Luxembourg. The Luxembourg text is based on the Systems of Governance detailed in the Solvency II Directive.
- 3.62 The key aspects of this governance regulation are set out below:
- insurers must establish an effective system of governance that is proportionate to the nature, scale and complexity of the insurance undertaking
 - as a minimum, the following written policies must be in place: risk management, internal control, internal audit and, where relevant, outsourcing
 - those that either run the undertaking or hold key functions within the undertaken must be fit and proper, and any changes to these persons must be highlighted to the CAA for approval
 - an effective and well integrated risk management system must be in place with explicit risk areas included (eg underwriting and reserving)
 - each undertaking must perform an own risk and solvency assessment
 - premiums must be actuarially sufficient to meet the obligations of the business and ensure appropriate technical provisions can be established
 - the insurer must have adequate internal control and compliance, internal audit and actuarial functions, all subject to specific function relevant regulation.
- 3.63 Insurance companies are deemed to be public interest companies in Luxembourg. The regulations require a Board to have a minimum of three directors, one of whom has to be independent. The directors have to be approved by the CAA. The executive management is required to include a CEO, who has to be resident in Luxembourg, a CRO, and a CFO, and all have to be approved by the CAA. The establishment of a committee structure is not mandatory although it is recommended as best practice. However, an Audit Committee is needed unless the parent company maintains an Internal Audit Committee and explicitly covers the Luxembourg entity within it.
- 3.64 The regulations require certain key functions to be set up, in line with Solvency II. These are Risk, Actuarial, Internal Audit and Compliance.
- 3.65 The Actuarial Function is mainly responsible for:

- the calculation of technical provisions; ensuring the appropriateness of the methodologies, underlying models and assumptions made in the calculation of technical provisions
- giving opinion on the underwriting and reinsurance policies
- contributing to the effective implementation of the risk management system, in particular with respect to the risk modelling underlying the calculation of the capital requirements.

3.66 The Chief Actuary is the key function holder of the Actuarial Function, and needs to be approved by the CAA.

Risk appetite and capital policy

3.67 The CAA expects insurance companies to hold capital with a buffer over their regulatory capital requirement. The Board is responsible for setting the entity's risk appetite and capital policy, which ultimately manages the entity's exposure to risk. As part of this exposure management, the entity will want to keep a buffer well above the regulatory minimum to demonstrate its financial strength.

Management of with-profits business within Luxembourg

3.68 The Luxembourg regulations provide flexibility around product design allowing servicing of a wide variety of life insurance products. Although these could include products with profit-sharing elements, there are no specific regulations that govern the profit sharing in Luxembourg. The UK type of with-profits business is not common in the market. As such, the existence of a PPFM, WPA or With-Profits Committee (WPC) for the management of with-profits business is not a requirement. The regulations require all policies to be managed in line with their policy terms and conditions.

Management of unit-linked business within Luxembourg

3.69 Unit-linked business is a common life insurance business line in Luxembourg. The CAA Circular Letter 15/03 details the investment rules and restrictions to be complied with by the Luxembourg insurance companies with respect to their unit-linked products. The unit-linked life insurance contracts can be invested in:

- "external funds"; which correspond to collective investment funds issued by third parties
- "internal collective funds"; which are pools of assets set up by the relevant life insurance company in compliance with the applicable regulatory rules
- "dedicated internal funds"; which are individual pools of assets set up by the relevant insurance company in compliance with the applicable regulatory restrictions and the investment policy defined by the policyholder
- "specialised insurance funds"; which are individual pools of assets set up by the relevant insurance company in compliance with the applicable regulatory restrictions and can be managed by the policyholder according to a contractual framework designed by the life insurance company.

3.70 The unit-linked contracts typically do not offer any guarantee, however, there are also "guaranteed funds" which are internal funds for which the insurance company bears the investment risk; they guarantee either an annual return or an index link for which the insurance company shall bear the risk of default of the counterparty. When they set up a guaranteed fund, the insurance companies have to notify the CAA about the investment strategy that will be used for the fund. Insurance companies are also required to keep separate accounting for these funds.

3.71 The insurance companies are required to send the policyholders information on their policy on an annual basis.

Main differences between UK and Luxembourg regulations

3.72 The main differences between the UK and Luxembourg regulations are summarised below:

- compensation scheme: there is no equivalent to the FSCS in Luxembourg for life insurance business

- policyholders' rights in insolvency of the insurer – segregation of assets:
 - In the UK, on winding-up, segregation of assets and liabilities only applies if the insurer writes both long-term and general insurance business
 - In Luxembourg, the assets backing the technical provisions of policyholders are segregated and allocated to a custodian bank. In case of insolvency of the insurer, these assets are used to meet the liabilities to policyholders. If the segregated assets are not sufficient to cover the liabilities, the policyholders have preferential rights over the assets of the insurer
- policyholders' rights in insolvency of the insurer – statutory order of priority:
 - In the UK, direct policyholders have preferential rights over other debtors but rank below the senior ranking creditors
 - In Luxembourg, the Tied Assets are allocated to policyholders only; in case these assets are not sufficient to cover the policyholder liabilities, 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 chambers
- ombudsman services: While the UK has an ombudsman scheme, the UK FOS, decisions of which are legally binding, the decisions of the CAA and the LOS are not legally binding. The CAA supports the policyholder in reaching a mediated solution. In the event that this cannot be reached, the policyholder is able to pursue a judicial process using the CAA's copy of its opinion or recommendation on the complaint
- conduct principles for unit-linked business: While the UK has structured conduct principles and requirements, and a separate body, the FCA, regulating and monitoring them, Luxembourg currently does not have a similar regime regarding conduct of business. A law is expected to come into effect in October 2018 regulating the conduct of business, although, this will only apply to business written after the law comes into effect. Therefore, this law will not be applicable to the Transferring Business. The CAA Circular Letter 15/03, however, defines types of investment that can be held in unit funds, in a similar way to the permitted links rules in the UK COBS. In addition, there are principles such as the prudent person principle that insurers are required to comply with for the investment of assets. The common civil law principles also require insurance companies to have the duty to act at all times loyally and in good faith towards their contractual counterparties (ie policyholders)
- governance of with-profits business:
 - within the UK it is necessary for firms with with-profits policies to appoint a WPA, this is not a requirement in Luxembourg
 - there is no requirement in Luxembourg for with-profits funds to maintain a PPFM
 - there is no requirement in Luxembourg for firms to have a with-profits committee
 - there is no requirement in Luxembourg for firms to have a run-off plan for closed with-profits funds.

3.73 Currently, the UK and Luxembourg follow the same solvency regulations, Solvency II. Following Brexit, it is possible that UK solvency rules will depart from those in Luxembourg in the future.

4 Background on SWL

Introduction

- 4.1 SWL is a private limited company incorporated in England and Wales and domiciled in the UK. It is a life insurance subsidiary of Scottish Widows Group (SWG), which is a subsidiary of Lloyds Banking Group plc (LBG or Group), the ultimate parent company. SWL was formed when all of the UK life insurance business written by SWG's insurance subsidiaries was transferred into one company on 31 December 2015. The principal activity of SWL is the transaction of long term insurance business. SWL has unit-linked, non-profit and with-profits business and primarily writes pensions, bonds and protection business.
- 4.2 In this Section, I look at the history of SWL and how it has come to be in its current form. This information is relevant to later Sections of the Report. I also detail the company and fund structure of SWL, and provide particular details relating to the funds of SWL that are relevant to this Scheme.

History

- 4.3 The Scottish Widows insurance business was founded in 1815. In 2000, Scottish Widows demutualised to become part of the Lloyds TSB Group. It is now the insurance arm of LBG, which was formed in 2009, following the takeover of HBOS plc by Lloyds TSB.
- 4.4 Clerical Medical was originally known as the Clerical Medical, and General Life Assurance Society, and was set up in 1824. Clerical Medical became a mutual office in 1961, demutualised, and was purchased by the Halifax in 1996. It subsequently became part of HBOS plc in 2001. In 2009, following the acquisition of HBOS by Lloyds TSB, Clerical Medical became part of LBG.
- 4.5 SWL was formed into its current structure by means of the 2015 Scheme, as summarised in paragraphs 4.7 to 4.13 below.

Other Schemes

- 4.6 Other business transfers of SWL and the corresponding Schemes are described below.

The 2015 Scheme

- 4.7 In 2015, all UK life insurance and pension businesses of LBG including those from Scottish Widows plc (SW) were consolidated into Clerical Medical Investment Group Limited (CMIG) via a Part VII transfer (the "2015 Scheme"). Post the Transfer, CMIG was renamed to SWL.
- 4.8 The 2015 Scheme replaced all previous schemes at the time and became the governing Scheme for SWL's existing funds.
- 4.9 Prior to the 2015 Scheme:

SW:

- SW consisted of unit-linked pensions and savings business, protection, with-profits business and conventional pension annuities in payment
- the SW Shareholder Fund included exposure to annuity business through a wholly owned insurance subsidiary
- the SW Long-Term Fund consisted of Scottish Widows With Profit Fund (SW WPF), SW Non-Profit Fund (SW NPF), and also included other unit-linked and pension management businesses through wholly owned insurance subsidiaries.

CMIG:

- CMIG was the Clerical Medical arm of LBG and mainly consisted of unit-linked individual pensions, unit-linked savings, with-profit business, and conventional pension annuities in payment and protection business in the UK and Europe

- CMIG had CMIG With Profit Fund (CMIG WPF), CMIG Non-Profit Fund (CMIG NPF) and CMIG Shareholder Fund (CMIG SHF)
 - CMIG was owned by the SW Shareholder Fund.
- 4.10 As part of the 2015 Scheme:
- CMIG WPF continued to operate as a distinct and ring-fenced WPF known as the CM WPF, and the GGFs continued to form part of CM WPF
 - all of the assets, liabilities and policies within SW WPF were transferred to the newly created ring-fenced fund within CMIG, which continued to be referred to as the SW WPF
 - all of the assets, liabilities and policies within the SW NPF and the funds of SWL's insurance subsidiaries that contained non-profits business, were transferred to the CMIG NPF
 - all other assets and liabilities were transferred to the CMIG SHF
 - immediately after the transfer, the CMIG SHF and the CMIG NPF were combined into the Combined Fund
 - CMIG was then renamed as SWL.
- 4.11 For the Transferring Policies:
- The majority of the Transferring Business was originally written by CMIG's International Life Division Europe (ILDE) under EU passporting rights primarily in Germany, Austria and Italy over the period 1995 to 2014. CMIG, was renamed to SWL as part of the 2015 Scheme, so these policies have always resided within SWL
 - The remainder of the Transferring Business was originally written through a Luxembourg insurance company, CMI Insurance (Luxembourg) S.A. (CMIL), a subsidiary of LBG Insurance Group. This was transferred to SWL at 31 December 2015 by a Ministerial Decree.
- 4.12 The with-profits annuities and any UWP element of the Transferring Business currently reside within the CM WPF; the rest of the Transferring Business is in the Combined Fund.
- 4.13 The 2015 Scheme sets out the allocation of businesses into funds, maintenance and operation of the funds and the controls around the merger and closure of the funds under SWL.

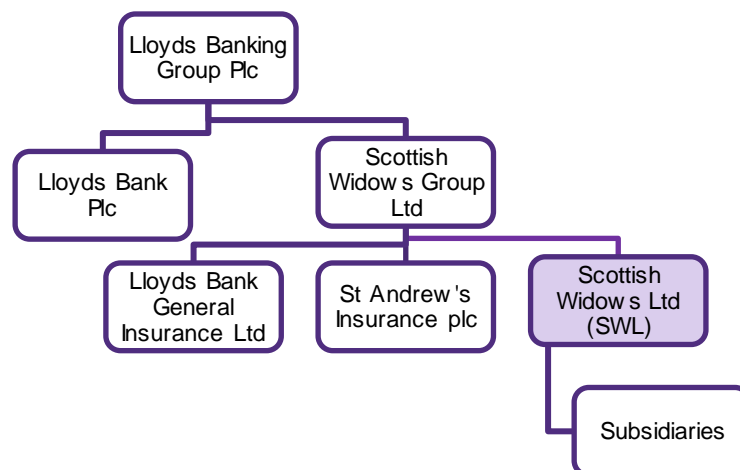
Zurich Assurance Scheme

- 4.14 SWL is in the process of acquiring the workplace pensions business of Zurich Assurance Limited through a Part VII transfer to take effect in mid-2019, ie after the Transfer has taken place. The transfer of the workplace pensions business is neither dependent on nor related to this Scheme. The transfer of Zurich Assurance Limited business has been going through a corresponding Part VII Transfer and a separate Independent Expert review process as part of its own scheme.

Structure

Company structure

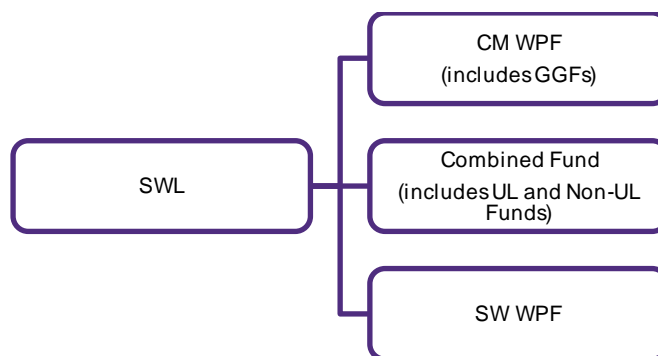
- 4.15 SWL is a fully owned subsidiary of SWG. As well as SWL, SWG also includes Lloyds Bank General Insurance Limited and St Andrew's Insurance plc; together they are referred to as the Insurance Group. In this Report, SWG and the Insurance Group are used interchangeably.
- 4.16 An abbreviated current company structure is shown in the below diagram.



Fund structure

4.17 SWL's current fund structure comprises the CM WPF that includes GGFs, the Combined Fund that includes unit-linked and non-unit linked funds, and the SW WPF. These funds were formed as part of the 2015 Scheme.

4.18 The below diagram summarises the current fund structure of SWL.



Summary of business written in SWL

4.19 SWL has a total of around six million policyholders and £112 billion BEL as at 31 December 2017. The table below shows the BEL by fund and business line, excluding TMTP.

BEL of SWL by Fund and Business Line	SW WPF (£m)	CM WPF (£m)	Combined Fund (£m)	Total (£m)
Unit-linked pensions and savings business			81,270	81,270
With-profits fund business	9,997	5,172		15,169
Annuities and other (including protection business)			15,075	15,075
Accepted reinsurance			696	696
Health reinsurance			214	214
Total	9,997	5,172	97,255	112,424

All numbers in the above table are rounded to the nearest whole number.

- 4.20 As indicated in the above table, the majority of SWL's business is unit-linked pensions and savings business in the Combined Fund.
- 4.21 The Transferring UWP Business resides in the CM WPF. The Transferring UL Business is currently within the unit-linked pensions and savings business in the Combined Fund. SW WPF does not include any of the Transferring Business.

Types of new business written

- 4.22 SWL writes a range of long term insurance business covering the majority of products available in the UK marketplace. SWL is open to new business in the UK, predominantly writing UK pensions, protection and annuity business, including both individual and bulk annuity business. SWL no longer sells business under EU passporting rights.
- 4.23 SWL does not actively seek new with-profits business, other than that arising on the exercise of rights or options attaching to existing policies.

Management of CM With-Profits Business

- 4.24 The management of the CM WPF in which the Transferring UWP Business resides is summarised below.

Management of the Estate

- 4.25 The CM WPF, which does not actively seek new business, is in run-off and undertaking distribution of the estate. All policies allocated to the CM WPF are managed in accordance with the principles and practices set out in its PPFM (CM WPF PPFM). As detailed in the CM WPF's PPFM, the CM WPF will be managed in such a way as to ensure that the size of the estate in relation to the with-profits liabilities, calculated on a realistic basis, is maintained, while having regard to the fair treatment of with-profits policyholders.
- 4.26 The estate is managed with the aim of ensuring that it enables the fund to at least meet the following primary purposes:
- to meet the guarantees the fund provides on with-profits policies
 - to enable smoothing of pay-outs on with-profits policies
 - to allow the desired degree of investment freedom
 - to enable fair distribution of the estate
 - to provide capital as a buffer against risk.
- 4.27 SWL aims to ensure that a sufficient amount of the estate remains to safeguard the security of remaining policy benefits. Therefore, the distribution of the estate is done gradually by means of regular bonus and claim bonuses, as defined in the PPFM. Any changes to methods and parameters are approved by the Board with the advice of the WPA and, where necessary, the WPC.
- 4.28 The investment strategy of the assets backing the asset shares and the estate is decided by the Board based on the advice from the WPA, WPC and its Investment Committee and is regularly reviewed.
- 4.29 For the UWP business within the fund, the charges are deducted from either policyholders' premiums or the UWP funds, in accordance with the policy terms and conditions.
- 4.30 Most of the cost of guarantees on with-profit policies are charged to the asset shares within the fund at an aggregate level.
- 4.31 The CM WPF may either close or merge with the SW WPF if the CM WPF falls below £500m in value. This could only happen if it is expected that there would be no material adverse effect on the benefit expectations of with-profits policyholders. A certificate from an independent actuary would be required and there would have to be no objections from the UK Regulators to achieve this.

Tax on with-profits funds

- 4.32 An allowance is made for tax within the asset share calculation. The CM WPF incurs tax as if it was a standalone mutual insurance company. Each policy's asset share incurs tax at a rate consistent with such a basis. No deductions for tax are made for pension policies except where taxes incurred overseas cannot be reclaimed.

Expenses on with-profits funds

- 4.33 In the CM WPF, which includes both unitised and conventional with-profits business, the expenses are met either by deductions from premiums or charges to the asset shares of the policyholders, as set out in the policy literature.

Capital support arrangements

- 4.34 Insufficient assets to meet capital requirements for the CM WPF could potentially arise from a number of events, such as adverse market movements that would cause a reduction in the value of assets backing the capital requirements and/or an increase in the cost of guarantees. In the event that capital support is required for the CM WPF, it will be provided by the Combined Fund.

Reinsurance arrangements

- 4.35 As is common across insurance firms, SWL makes use of reinsurance to help manage its business. SWL has reinsurance treaties in place with reinsurers for both the Transferring Business and the business that is not transferring as a part of the Transfer (the "Non-transferring Business"). There are two active reinsurance treaties with Swiss Re that cover the Transferring Policyholders. One of the treaties covers the mortality and morbidity risks for those that have enhanced life covers. These were mainly written in Germany and Austria. The other treaty covers the waiver of premium benefit.

Financial position

- 4.36 SWL has prepared its Solvency II results using its Internal Model, which has been approved by the PRA.
- 4.37 SWL allows for the following adjustments in its Solvency II calculations, all of which have been approved by the PRA:
- SWL applies an MA to its individual and bulk non-profit pension immediate and deferred annuity business, which includes both non-linked and index-linked annuities
 - SWL makes use of the TMTP.

Solvency II Pillar 1

- 4.38 The table below sets out SWL's Solvency II Pillar 1 results as at 31 December 2017. These results have been subject to external audit.

SWL Solvency II Pillar 1	(£m)
Total Assets	128,917
Total Liabilities	120,505
Excess of Assets over Liabilities	8,412
Total available Own Funds to meet the Solvency Capital Requirement (A)	8,412
Solvency Capital Requirement (B)	6,014
Solvency Cover Ratio (A / B)	140%

All numbers in the above table are rounded to the nearest whole number.

- 4.39 The figures shown in the above table are consistent with the regulatory reporting view and restrict the surplus from the fully ring-fenced funds on consolidation.

- 4.40 The solvency cover ratio of 140% indicates that SWL has a 40% buffer above its capital requirements as at 31 December 2017.
- 4.41 I note that as at 31 December 2017, £8.4 billion of assets were held in respect of Own Funds (i.e. the excess of an insurer's admissible assets over its liabilities on a Solvency II basis). A total of £6.7 billion of assets held in respect of Own Funds are categorised as Tier 1 capital, with the remaining £1.7 billion of assets held in respect of Own Funds classified as Tier 2 capital. This is compliant with the Solvency II requirements.

Solvency II Pillar 2

- 4.42 SWL's Solvency II Pillar 2 results are set out in its ORSA. I have reviewed SWL's 2017 ORSA, which was approved by SWG's insurance Board (Insurance Board) on 22 March 2018. The ORSA is a risk management tool to assess the overall solvency needs of the firm taking into account the firm's own assessment of its specific risk profile. As part of my review of the ORSA, I have taken into account the range and depth of the analysis contained in the ORSA and the extent to which the key risks have been subject to an appropriate range of stress and scenario tests. Stress and scenario testing is a key part of SWL's risk management and business planning process as it helps the company identify, evaluate and manage the key areas of risk.
- 4.43 SWG had approval from the PRA to produce a single Insurance Group level ORSA for 2017 based on its internal view of capital. SWL's ORSA has been incorporated into the SWG ORSA for 2017.

Economic Capital view

- 4.44 SWL regularly monitors its solvency on an economic capital (Pillar 2) basis as well as a regulatory (Pillar 1) basis. The economic capital view is reported within the ORSA and is the solvency measure to which SWL's SRA is linked. The economic capital basis is similar to SWL's Internal Model basis, and includes the credit taken for TMTP, but excludes Own Funds within the WP funds and excludes risks within the WP funds from the SCR.

Risk Management Framework and Capital Management Plan

- 4.45 SWL follows SWG's Insurance Group level Risk Management Framework (RMF) and Capital Management Plan (CMP), with the objective of safeguarding future solvency levels. This Section of the Report describes the RMF and CMP at the Insurance Group level in general, unless they are specified at the SWL level.

Risk Management Framework

- 4.46 As a subsidiary of LBG, SWG has aligned its RMF to the RMF of LBG, while incorporating elements of supporting methodologies to address requirements under the Solvency II regime. The RMF states that it aims to cover the full spectrum of risks that SWG and subsidiary companies are exposed to; it includes the identification, assessment, measurement and management of risks.
- 4.47 Risk is managed by using a "three lines of defence" model and the effectiveness of the RMF is regularly assessed. The "first line of defence" has the primary responsibility for risk decisions, monitoring, controlling the risk and implementing the RMF. The "second line of defence", which includes the Risk Function, is responsible for providing oversight and challenge to the effectiveness of risk decisions taken by the first line business management. The "third line of defence", which is Group Audit, provides independent, objective assurance to improve the organisation's operations.

Solvency Risk Appetite

- 4.48 SWL's Solvency Risk Appetite (SRA) is set and managed by SWL's Board, which makes decisions with reference to the SWG Insurance Board's risk preferences and agreed risk strategy, in line with the Insurance Group risk policies.
- 4.49 SWL has a target Solvency Cover Ratio (SCR Cover Ratio, i.e. ratio of Own Funds to the SCR). This includes a large enough capital buffer for SWL to still be able to cover its Pillar 2 capital requirement following a 1-in-10 year stress event.

Capital Management Plan

- 4.50 The CMP aims to restore the internal risk capital buffer in stressed conditions.
- 4.51 The CMP uses a traffic light system with colours “Red”, “Amber” and “Green” (RAG classification) to monitor the capital position. Capital levels above the target SCR Cover Ratio, ie enough capital to cover SCR and the target capital buffer, is considered to be in the Green zone. Between the SCR and the target SCR Cover Ratio, there are two zones, Red and Amber.
- 4.52 Within the Red zone, where the capital buffer is below a specified level, the Recovery Plan approved by the Insurance Board would be put into effect to restore the SCR Cover Ratio.
- 4.53 Within the Amber zone, management actions will be implemented to restore the capital position. Although the exact course of action is not specified at the outset, SWL’s CMP has various actions to take when the solvency drops below the target level, depending on the current and the projected capital positions within the next year. These include but are not restricted to:
- more frequent solvency monitoring
 - hedging
 - retention of dividends
 - sale of credit assets
 - management of new business volumes.

Governance arrangements

Company governance

- 4.54 SWG has a Corporate Governance Framework (CGF). This applies to SWG and other companies within the Insurance Group including SWL.
- 4.55 Ultimate responsibility for the operation of SWG and its subsidiaries rests with the Insurance Board (also known as SWG Board). The SWG Board comprises 11 members, two of whom are Executive Directors and nine of whom are Non-executive Directors. Seven of the Non-executive Directors are independent. The same members serve both the SWG Board and the SWL Board.
- 4.56 The day-to-day governance of SWG is overseen by committees of the SWG Board. These include the Insurance People Committee and the Insurance General Purposes Committee, as well as the following committees that are relevant to the Transfer:
- Insurance Risk Oversight Committee (ROC) – this committee is responsible for assisting the SWG Board in risk oversight, reviewing risk appetite and risk profile, reviewing the effectiveness of the Risk Management Framework, reviewing the methodology and assumptions used to determine capital requirements, reviewing stresses and scenarios for analysis. This committee is currently made up of six members, all of whom are independent non-executive directors
 - Insurance With-profits Committee (WPC) – this committee applies to SWL only and acts in an advisory capacity to inform decision-making in relation to the management of the with-profits funds. It has responsibility to provide an independent view on the management and operations of the with-profits business of SWL and to ensure the interests of with-profits policyholders are appropriately considered. This committee consists of four members, one of whom is an independent non-executive director and three of whom are independent members
 - Insurance Audit Committee (IAC) - this committee is responsible for the oversight of the quality and integrity of the Group’s accounting and reporting practices, internal controls and financial statements. This committee is currently made up of three independent non-executive directors
 - Insurance Independent Governance Committee (IGC) – this committee, which applies to SWL only, is responsible for the oversight of UK based workplace pension schemes of SWL,

represents the interest of members and operates independently of SW. This committee is made up of five members. The majority of the committee, including the Chairman, are independent members

- Insurance and Wealth Executive Committee (IWE) – this committee assists the Insurance and Wealth Group Director who has executive responsibility for overall management of LBG's insurance business. This is the principal executive management committee of SWG, and has a series of subsidiary committees. This committee is currently made up of 14 members including the CEO, CFO, Chief Operating Officer (COO), CRO, Company Secretary and nine directors, none of whom is independent.

4.57 SWL (like all subsidiaries of SWG) has its own Board. It also sets up committees for the matters relevant to its own operations (eg the Insurance With-Profits Committee).

4.58 In addition, SWG Board has a sub-committee, Insurance International Governance Committee (IIGC), which has delegated authority granted by the SWL Board and is responsible for assisting the management of the insurance businesses outside of the UK.

With-Profits business governance

4.59 The with-profits governance arrangements within SWL apply to both of SWL's with-profits funds.

4.60 Each with-profits fund has its own PPFM. It is the responsibility of the Board to ensure that the with-profits funds are managed in line with their respective PPFMs.

4.61 There are typically areas of discretion in the management of with-profits funds. The Board has appointed a WPA whose role includes the provision of advice on such areas.

4.62 In addition, there is a WPC, which provides independent oversight and advice in relation to the management of with-profits business.

4.63 The SWL Board is ultimately responsible for the appropriate management of with-profits business, taking advice from the WPA and the WPC.

Unit-linked business governance

4.64 Although the benefits on unit-linked business are generally fixed, and determined in relation to the value of units, there are a number of areas where the policy benefits may be subject to the discretion of the firm. These include:

- changes to annual management charges of unit-linked policies
- reviewable risk charges or premiums
- allowance for transaction costs and future tax in unit pricing.

4.65 Proposals for the use of discretion on unit-linked business are developed by the Core Business Function team, and are submitted to the Insurance & Wealth Customer and Product Committee, which is a sub-committee of IWE for approval. This committee has delegated authority granted by the SWL Board. However the proposals for the unit-linked business outside of the UK are approved by the IIGC.

Non-profit business governance

4.66 Benefits on non-profit business are generally fixed by the policy terms and conditions. Proposals for the use of discretion on non-profit policies are submitted to the Insurance & Wealth Customer and Product Committee for approval, to ensure customer outcomes are fully considered in decisions affecting customer treatment. This committee has delegated authority granted by the SWL Board.

Other expenses

Deferred Benefit Pension Scheme costs

- 4.67 All defined benefit pension schemes are held within LBG plc. LBG meets all costs of funding the schemes. SWL is recharged by LBG for the current service cost relating to the defined benefit pension scheme members working for SWL, but has no liability for managing the pension scheme deficit.

Litigation provision

- 4.68 SWL has received a number of complaints and claims relating to policies sold by independent intermediaries principally in Germany, but also in Austria and Italy, during the late 1990s and early 2000s. These affect both in force and terminated policies. As a result, SWL holds provisions for complaints claims in both its accounts and regulatory reserves. The provision held as at 31 December 2017 is £138 million. In the remainder of this Report, these claims will be referred to as “German business litigation claims”. These are covered by SWL shareholders and held in the Combined Fund. SWL takes account for this risk in its operational risk SCR.

Vesting annuities

- 4.69 SWL currently has a number of pension accumulation products and (non-pension) life deferred annuities on its book. These are invested in the SW WPF, CM WPF and Combined (including unit-linked) funds. Some of these will vest at maturity, ie will be converted to or replaced with an annuity. Some of the products will have guaranteed annuity options (GAOs), giving the policyholder the option of converting to / buying an annuity at a price specified in the original policy rules rather than at the price currently charged for new annuities.
- 4.70 The Transferring Policies include deferred annuity policies (both UL and UWP), pension accumulation policies (both UL and UWP) and a small number of with-profits annuities in payment. While it is mandatory for all Transferring UL pension accumulation policies to vest into with-profits annuities at retirement; this is not mandatory for all Transferring UWP pension accumulation policies. All deferred annuities policies can either vest into with-profits annuities or be converted to a cash sum.
- 4.71 The transferring deferred life annuities and pension policies with mandatory vesting annuities all have attaching GAOs, offering the choice between the accumulated cash and a with-profits annuity based on a specified price. If the GAO bites and is exercised, the cost of the guarantee (the price of the annuity at current rates less the accumulated cash) is met by the Combined Fund. The accumulated cash and cost of the GAO together make up the price of the with-profits annuity and are transferred into the CM WPF.
- 4.72 At 31 December 2017, there were two with-profits annuities in payment within the Transferring Policies.

Policy administration

- 4.73 Policies are either administered internally by intra group arrangements, or externally by outsourcers.
- 4.74 The intra group arrangements are services provided by LBG to SWG and its underlying entities and include client servicing, risk management, finance and compliance. These services are detailed within an Intra Group Service Agreement, which is agreed by the Insurance Board and includes service standard targets. Group standards regarding administration are set out in the Service Provision Policy. Reviews are performed and reported in line with LBG Group's Operational Risk Framework requirements.
- 4.75 The outsourcing agreements are governed by a contract that includes details of the service standards that the outsourcer is required to meet. Group standards regarding administration are set out in the Group's Sourcing Policy and reviews are performed and reported in line with LBG Group's Operational Risk Framework requirements.

5 Background on Transferring Business

Introduction

- 5.1 The purpose of this Section is to provide details of the Transferring Business including summarising the run-off projection, and details on the German business litigation claims provisions for existing customer complaints and claims.

Types of Transferring Business

- 5.2 I have classified the Transferring Business into two main categories, as described in paragraph 2.8.

Size of Transferring Business

- 5.3 The policy count and the BEL for the Transferring Business as at 31 December 2017 are set out in paragraph 2.9. The table below compares the BEL of the entire SWL business with that of the Transferring Business on 31 December 2017.

BEL by Fund and Business Line	SWL			
	SW WPF (£m)	CM WPF (£m)	Combined Fund (£m)	Total (£m)
With-profits business	9,997	5,172	-	15,169
Unit-linked business	-	-	81,270	81,270
Other	-	-	15,985	15,985
Total	9,997	5,172	97,255	112,424
Of which, the Transferring Business	-	1,753	360	2,113

All numbers in the above table are rounded to the nearest whole number.

- 5.4 The numbers in the table show that the Transferring Business represents c. 2% of SWL's business and the majority of the Transferring Business is UWP business allocated to the CM WPF.
- 5.5 The Transferring UWP Business is invested in GGFs within the CM WPF and represents c. 34% of the BEL of the CM WPF.
- 5.6 The Transferring UL Business is invested in the unit-linked funds, which are exclusively for the Transferring UL Policies, and are within the Combined Fund. Around half of the Transferring UL Business is invested in funds known as Guaranteed Access Funds, which are unit-linked funds with investment guarantees. The Transferring UL Business represents only 0.4% of the £81.3 billion BEL of the SWL unit-linked business.

Product features of Transferring Business

- 5.7 The transferring business is made up of:
- savings and whole of life policies (both unit-linked and UWP)
 - (non-pension) deferred annuities (both unit-linked and UWP)
 - pension accumulation policies (both unit-linked and UWP)
 - with-profits annuities.
- 5.8 The savings and whole of life policies have a basic death benefit of at least 101% of the policy value on death. Some policies have enhanced life cover in the form of a higher percentage of fund value at death or return of premiums and some policies also include sickness and disability cover. They also have an option to request regular or ad-hoc unit encashment.

- 5.9 The deferred annuity and pension policies both have the possibility of converting to annuities or being used to buy with-profits annuities at retirement (“vesting”). For the pensions business, conversion to annuities at maturity is compulsory for Transferring UL Policies and for some Transferring UWP policies. The transferring deferred life annuities and pension policies with mandatory vesting annuities all have attaching GAOs. As at 31 December 2017, approximately £127 million of funds that would be eligible for an annuity were invested in the CM WPF and approximately £94 million in unit-linked funds within the Combined Fund. Before the Transfer, the cost of any GAOs on the Transferring Business (ie the difference between policy proceeds and the price charged by the CM WPF for writing an annuity) is met by the Combined Fund. This will continue after the Transfer as the vested with-profits annuities will be reinsured to SWL.
- 5.10 As at 31 December 2017 there were only two with-profits annuities within the Transferring Policies. The number of annuities within SWE will increase over time after the transfer as the deferred annuities and pensions vest.
- 5.11 The Transferring UWP Policies have a number of guarantees including a guarantee on fund prices, return of premiums and fund growth rates. The cost of these guarantees is generally charged to the CM WPF, the exception being the cost of the return of premium guarantee on German Occupational Pensions which is charged to the Combined Fund.
- 5.12 There are also investment guarantees on the Guaranteed Access Funds in the Transferring UL Business. The cost of these guarantees is met by SWL shareholders. This will continue after the Transfer.

Projection of Transferring Business

- 5.13 The table below shows the projected BEL for the Transferring Business over the next six years. This projection includes the WP annuities.

Projected BEL of Transferring Business (£m)		2017	2018	2019	2020	2021	2022	2023
Retained in SWE	Investment element of Transferring UL Business	318	318	312	304	296	287	280
	Non-investment element of Transferring UWP Business and Transferring UL Business	29	29	30	31	31	32	33
Reinsured to SWL	Investment element of Transferring UWP Business	1,766	1,760	1,734	1,719	1,688	1,644	1,613

All numbers in the above table are rounded to the nearest whole number.

- 5.14 I have reviewed the run-off profile of the Transferring Business. The Transferring Business has a longer run-off profile of c. 40 years compared to the Non-transferring Business. By 2030, the Transferring Business will comprise of over 50% of the projected BEL of the CM WPF.

Litigation provision

- 5.15 In respect of the Transferring Policies, SWL has received a number of complaints and claims relating to policies sold by independent intermediaries, principally in Germany, but also in Austria and Italy during the late 1990s and early 2000s. As described in Section 4, I refer to them in this Report as German business litigation claims.
- 5.16 SWL holds provisions for these German business litigation claims, for both in-force and terminated policies. These provisions are covered by the shareholders and held in the Combined Fund. The German business litigation claims risk is also included in SWL’s operational risk SCR calculation.

- 5.17 The Transferring Business includes business that is subject to these German business litigation claims. As a result of the Scheme, SWE will be exposed to these claims. However, SWL and SWE will put in place the Indemnity Agreement to limit SWE's exposure to these claims. This is explained in the later Sections of the Report.

6 Background on SWE

Introduction

- 6.1 In accordance with its decision to set up a subsidiary in Luxembourg, SWL will make an application to the Luxembourg Regulator, the CAA, to authorise SWE. Once the CAA approves the application, SWE will be a life assurance entity domiciled in Luxembourg. It will remain a subsidiary of SWL and its entire issued share capital will be held by SWL.
- 6.2 SWE will be set up specifically to allow SWL to continue to service policies written under EU passporting rights following Brexit. SWE does not have existing business. The information on its financial position and business plan provided to me by SWL is based on the assumption that the set-up of SWE and the Transfer occurred on 31 December 2017. I will provide an update on the financials within my Supplementary Report.
- 6.3 In this Section, I set out background information on SWE based on the business plan as part of SWE's engagement process with the CAA, and on the proposed structure of SWE immediately after the Transfer. I also refer to the Transferring Business as described in Section 5, and the Scheme, Reinsurance Agreement, Indemnity Agreement and Unit Linked Service Agreement in Sections 8 and 9 of this report.

Structure

Company structure

- 6.4 SWE will be a wholly-owned subsidiary of SWL. SWL is a fully owned subsidiary of SWG, which is itself a wholly owned subsidiary of LBG. An abbreviated company structure for LBG is shown in Section 4.

Fund structure

- 6.5 In Luxembourg, life assurance companies are not required to set up separate funds for different types of business, as is the case in the UK. However, as mentioned in Section 3, they have to be able to hold the Tied Assets and deposit these assets in a custodian bank approved by the CAA. SWE will set up arrangements in compliance with this requirement, as summarised in Section 7. In addition, SWE will set up internal accounting processes and controls needed to manage funds for the Transferring UWP Business and Transferring UL Business.
- 6.6 Fund structures of SWE for the Transferring UWP Business and Transferring UL Business are described in Section 7.

Types of business written

- 6.7 Following the Transfer, the Transferring Business will be the only business serviced by SWE. The Transferring Business is summarised in Section 5 above.
- 6.8 SWE will not actively seek new business. SWE may, however, be used in the future (subject to obtaining appropriate permissions) as a receiving entity for further European business, following future acquisitions for example.

Reinsurance arrangements

External reinsurance

- 6.9 SWL currently holds two treaties with an external reinsurer, Swiss Re, covering the Transferring Business. These will be transferred to SWE as part of the Transfer. These treaties cover the additional death, disability, sickness benefits for the policies which have enhanced life covers and the waiver of the premium benefits on the Transferring Policies.

Internal reinsurance

- 6.10 There will be an intra-company reinsurance agreement between SWL and SWE as part of the Transfer. The Scheme and Associated Arrangements are described in Sections 7, 8 and 9 of this Report.

Financial position

- 6.11 As SWE is yet to be set up following its authorisation from the CAA, it does not have any financial history.
- 6.12 The table below summarises the (pro-forma) assets that would be on SWE's Solvency II balance sheet immediately after the Transfer, assuming the Transfer occurred on 31 December 2017.

SWE post-Transfer Solvency II Assets		£m
Assets physically transferred under the Scheme to cover:	Transferring UWP Business, including non-investment reserve	1,935*
	Transferring UL Business, including non-unit reserve	388
	Transferring German business litigation liability	14
	Subtotal	2,337
Reinsurance**		1,766
Indemnity**		130
Capital Injection		78
Total		4,311

All numbers in the above table are rounded to the nearest whole number.

* Of which £1,766m relates to investment component

** Recoverable under the Reinsurance Agreement and Indemnity Agreement

- 6.13 The above table shows that, as well as £2,337m of assets being physically transferred from SWL to SWE, and a capital injection of £78m, SWE would have two recoverables on the asset side of the balance sheet, representing the Reinsurance and Indemnity Agreements.
- 6.14 The £1,766m value of reinsured UWP liabilities would appear twice on the asset side of the balance sheet:
- as the £1,766m value of the reinsurance recoverable
 - within the £1,935m value of the assets transferred over under the scheme to cover Transferring UWP Business, (with this £1,766m being withheld by SWE rather than paid over to SWL as a reinsurance premium).
- 6.15 The £1,766m would also appear twice on the liability side of the balance sheet:
- as the FWH
 - within the insurance liabilities transferred over by the Scheme.

SWE post-Transfer Solvency II Liabilities	£m
BEL of Transferred Policies	2,127*
Funds withheld	1,766
German litigation claims	130
Other liabilities**	113
Total	4,136

All numbers in the above table are rounded to the nearest whole number.

* Of which £1,766m relates to investment component of UWP

** Includes deferred tax liability and Risk Margins

- 6.16 As part of the application process to the CAA, SWE has prepared its Solvency II results for the Transferring Business as summarised below. While SWL uses an Internal Model, SWE will utilise the Standard Formula.
- 6.17 SWL has made a high-level assessment on the appropriateness of determining SWE's SCR using the Standard Formula (rather than using an Internal Model for SWE). I discuss this in more detail in Section 10.
- 6.18 SWE does not use MA, VA or TMTP, but may consider making an application to CAA for approval in the future as part of its ongoing capital management.

Solvency II Pillar 1

- 6.19 The table below sets out the Solvency II Pillar 1 pro-forma results for SWE as at 31 December 2017. These results are based on the assumption that the Transfer and set-up of SWE occurred on 31 December 2017.

SWE Solvency II Pillar 1	£m
Total Assets	4,311
Total Liabilities	4,136
Excess of Assets over Liabilities	175
Total available Own Funds to meet the SCR	175
SCR	125
SCR Cover Ratio	140%

All numbers in the above table are rounded to the nearest whole number.

- 6.20 I note that at the Effective Date, 100% of the assets held in respect of Own Funds are expected to be categorised as Tier 1 capital. This is compliant with the Solvency II requirements.

Solvency II Pillar 2

- 6.21 The first full report of SWE's ORSA is expected to be produced in 2019, under the Luxembourg regulatory requirements.

Risk Management Framework and Capital Management Plan

- 6.22 The work on determining the RMF and CMP for SWE is still ongoing as part of the application for CAA authorisation. The framework described in this Section is based on the draft information that has been provided to me.

Risk Management Framework

- 6.23 An RMF broadly similar to that of SWL is expected for SWE, in order to comply with Solvency II requirements and to operate within LBG's and SWG's overall RMFs.
- 6.24 The RMF for SWE will be tailored to ensure compliance with Luxembourg law and regulatory requirements, and to be compatible with the size and nature of the business of SWE and the requirements of its management.
- 6.25 The SWE Board will be responsible for managing the RMF in compliance with CAA requirements.
- 6.26 SWE expects to operate a "Three Lines of Defence" model similar to SWL, as outlined in paragraph 4.47.

- 6.27 Outsourced activities and processes that are material in terms of risk to the business will be managed in line with the applicable legal and regulatory requirements. The intention to outsource any additional material function or activity will be notified to the CAA.

Solvency Risk Appetite and Capital Management Plan

- 6.28 SWE proposes to set its own solvency risk appetite (SRA) which reflects the size, nature and scope of its activities, while also remaining within the Group appetite. The SRA of SWE is expected to be the same as that of SWL, so that SWE would be able to withstand a 1-in-10 year event and still meet its Pillar 2 capital requirement.
- 6.29 The SWE Board will be responsible for SWE's business activities, with particular focus on developing SWE's business strategy and risk appetite. Breaches of the target SRA position will be escalated to the Board. The SRA will be monitored monthly and will be refreshed and approved by the SWE Board at least annually.
- 6.30 SWE is also expected to adopt a similar approach to CMP to SWL including the RAG classification and relevant management actions based on the target SCR Cover Ratio, as summarised in Section 4.

Capital support arrangements

- 6.31 SWE expects to receive an initial capital injection from SWL to reach its target capital level, as shown in the table in paragraph 6.12 above. The actual amount will vary depending on circumstances close to the Effective Date of the Transfer.
- 6.32 There will be no further formal capital support from SWL to SWE to maintain the target SCR Cover Ratio.

Governance arrangements

Company governance

- 6.33 The work to determine the governance arrangements for SWE is still ongoing as part of the preparation of the application for authorisation to the CAA. The arrangements described in this Section are based on the draft information I have been provided with.
- 6.34 In total, there will be approximately twenty roles in SWE, with more than half based in Luxembourg. In addition, there will be five oversight roles provided by the Group.
- 6.35 As required by the Luxembourg regulations, SWE will be managed by the Board with a minimum of three members who will need to be approved by the CAA:
- the CEO of SWE based in Luxembourg
 - an independent non-executive Board member accountable for the Internal Audit Function, who will be supported by the Internal Audit from LB
 - an insurance executive from LBG based in the UK.
- 6.36 SWE will recruit the CEO in line with Article 49 of Law of 2015, meeting all fit and proper requirements as set out in Article 72 and 73 of Law of 2015 on the Insurance Sector. The CEO will also hold the role of SWE Money Laundering Reporting Officer.
- 6.37 SWE will also recruit the following executive and key function roles as defined under Luxembourg regulations, which will also require CAA approval:
- a CFO who will be based in Luxembourg
 - the Chief Actuary based in Luxembourg, who will also perform the role of the CRO, advising the SWE Board. The Chief Actuary will be supported by SWL Actuarial Operations in the UK, and have access to all appropriate information regarding the management of with-profits business to help with their advice on bonus distribution and other with-profits related matters. The Chief Actuary will also be accountable for the Actuarial and Risk Key Functions
 - the Operations Manager who will be accountable for the Compliance Key Function.

- 6.38 SWE will not have separate committees from the Insurance Group.
- 6.39 The SWE Board members will make business decisions for SWE. They will have representation in the committees of SWG and will attend the committee meetings when SWE related matters are discussed. The terms of reference of these committees will be amended to include the representation of SWE.
- 6.40 Other expert personnel will include:
- the Lead Technical Product Manager, based in the UK as currently, who will be a product actuary supported by two Technical Product Managers
 - the Operations Manager, who will be based in Luxembourg, supported by two external Supplier Managers, who will be based in Luxembourg and Germany, one internal UK-based Supplier Manager, one Luxembourg-based Operations Assistant and two Business Unit Control Function Support Managers based in the UK.
- 6.41 The existing outsourcing arrangements in Germany, Italy and Luxembourg will be novated to SWE as part of the Transfer. The Operations Manager, who will manage all outsourcing agreements, will monitor and evaluate the service providers' performance.
- 6.42 CAA require the existence of branch offices where the outsourcing service providers are outside Luxembourg for data protection and control purposes. Therefore, a regulatory branch office will need to be set up in Germany and a corporate branch office will need to be set up in Italy. These branches will only exist for the purpose of compliance with CAA requirements and SWE will appoint two representatives, one in Germany and one in Italy, for this.
- 6.43 In addition, SWE will enter into service agreements with LB to provide support on internal audit, risk, data privacy (through a Jurisdictional Data Privacy Officer (JDPO)), actuarial and finance functions.

With-profits business governance

- 6.44 The Transferring Business contains UWP business, which will be reinsured back to SWL.
- 6.45 Following the Effective Date of the Transfer, in the light of the Transferring UWP Business being reinsured back to SWL, the SWL Board, supported by the WPA and WPC, will continue to provide governance over the with-profits investments of the Transferring UWP Policies. The CM WPF will continue to be run in the same way as it was prior to the Transfer (ie in accordance with CM WPF's PPFM and the 2015 Scheme). In particular:
- with regard to bonus declarations, market value adjustments and similar matters (such as estate distribution, smoothing etc), these will technically be the responsibility of the SWE Board but the reinsurance passes responsibility for these decisions back to SWL and requires the SWL Board to continue to make these decisions using the same framework and controls as currently. Paragraph 16.4 of the Scheme requires the SWE Board to follow the decisions made by the SWL Board unless the mitigating circumstances in 6.46 apply
 - the reinsurance agreement ensures that the CM WPF retains the financial interest in the withheld assets and the Scheme allows SWL to direct the investment strategy of these funds so that it follows CM WPF's requirements.
- 6.46 The SWE Board will have principal oversight on the decisions and management of the Transferring Business and will receive appropriate actuarial advice from the SWE Chief Actuary to ensure compliance with the relevant Luxembourg regulatory requirements. The SWE Board will follow the decisions of the SWL Board closely in relation to any bonus distribution, market value adjustment or similar matters (such as estate distribution, smoothing etc), unless, it would be deemed inappropriate to do so after taking into account appropriate actuarial advice and paying due regard to policyholders' collective interests. A non-objection from the CAA is also required if SWE is to deviate from SWL's decisions on these matters.
- 6.47 The SWE Chief Actuary will have access to appropriate information regarding bonus distributions to help with advising the SWE Board.

Unit-linked business governance

- 6.48 The benefits for the Transferring UL Policies are determined in relation to the value of units. However, there are a number of areas where policy charges, and therefore benefits, may be subject to the discretion of SWE. These include:
- changes to annual management charges
 - reviewable risk charges or premiums
 - allowance for transaction costs and future tax in unit pricing.
- 6.49 Although SWE will retain the Transferring UL Business, the governance around the use of discretion for the UL business will be similar to that under SWL.
- 6.50 Following the Transfer and the set-up of SWE, the SWE Board will make decisions on areas subject to discretionary management actions.
- 6.51 Any major discretionary decisions will be escalated to the SWE CEO. Once an internal view is formed with the involvement of senior management team members (SWE Chief Actuary, CFO and CRO) where relevant, it will then be submitted to the IGC for comment. However, ultimately any decisions affecting SWE policyholders will be the responsibility of the SWE Board.
- 6.52 Members of the core business team, ie the Lead Technical Product Manager and the two Technical Product Managers of SWE, will make minor, individual policy related discretion decisions on the clauses of policy terms and conditions.
- 6.53 LBG also has Group level policies, including the "Customer Treatment Policy". As a subsidiary of SWL, SWE will be expected to comply with this policy when managing the Transferring UL Business.

Expenses and Charges

Expenses

- 6.54 SWE will meet the expenses of administering the Transferring Business as well as those of running a subsidiary company in Luxembourg.
- 6.55 As SWE will not actively seek new business, per-policy expenses are likely to increase as a result of the diseconomies of scale while the business runs off. SWE's technical provisions will allow for the expected increases in the expenses.

Charges

- 6.56 Expenses on the Transferring Business are met by policy charges, ie management charges and policy fees taken from the premiums of the policyholders as described in the policy literature.
- 6.57 In relation to the material charges:
- the monthly monetary charge in euros increases in line with the UK Average Weekly Earnings Index (AWE). SWL and SWE cannot increase the charge at a greater rate than AWE, but can choose not to apply any increase
 - the annual fund management charge is defined in the terms and conditions as a percentage of fund value. There is no scope for either SWL or SWE to increase these charges above those stated in the policy literature (in fact, they were reduced for certain funds of UL business in the past following a change in investment strategy)
 - the enhanced death benefit charge varies in line with mortality rates in accordance with the terms and conditions.
- 6.58 There is therefore limited scope to increase these charges in the event of an increase in expenses. Any proposed change in charges would need to be in line with the terms and conditions of the policies (as set out in product literature) and policyholders' reasonable expectations.

- 6.59 Any decision on changing charges would be made by the SWE Board after receiving appropriate actuarial advice and liaising with SWL on unit pricing implications. Any expenses in excess of charges will be met by SWE shareholders.
- 6.60 The cashflows between SWE and SWL under the Reinsurance Agreement are described in Section 9.

Other expenses

Defined Benefit Pension Scheme costs

- 6.61 All defined benefit pension schemes are held within LBG. LBG meets all costs of funding these schemes. SWL is recharged by LBG for the current service cost relating to the defined benefit pension scheme members working for SWL but has no liability for managing the pension scheme deficit.
- 6.62 As part of its contribution to group expenses, SWE will contribute to current service costs for SWL and LBG staff, some of whom will be providing services to SWE. However, there will be no new defined benefit scheme created for SWE staff.

Litigation Claims

- 6.63 Paragraphs 4.68 and 5.15 set out the German business litigation claims, which have been made against the Transferring Business. Following the Transfer, SWE will be exposed to the risk of future litigation claims relating to the Transferring Business. SWE will include provisions for potential costs related to future litigation claims. For the purposes of the solvency positions shown in the Report, SWE's SCR (paragraph 6.19) also has an adjustment for this risk.
- 6.64 SWL and SWE will enter into an Indemnity Agreement alongside the Scheme, together with the Charge Agreement, to protect SWE from litigation claims in respect of the Transferring Business arising from SWL's conduct prior to the Transfer. These mitigating actions are explained in Sections 8 and 9 in detail. SWE's share of costs of these litigation claims will be met by the shareholders of SWE. As indicated in the table in 6.12 above, the assets that will be transferred to SWE will include £14m of provisions for the Transferring German business litigation claims. This is 10% (ie SWE's share of these litigation claims up to the €60m cap in line with the Indemnity Agreement) of the provision SWL holds against these claims prior to the Transfer.
- 6.65 SWE will be exposed to any claims arising from its business conduct after the Transfer.

Vesting annuities

- 6.66 Both the Transferring UWP Policies and Transferring UL Policies include:
- (non-pension) deferred life annuities
 - pension accumulation products
 - annuities in payment.
- 6.67 All Transferring UL and some Transferring UWP pension accumulation policies will vest into with-profits annuities at retirement; deferred annuities can either vest into with-profits annuities or be converted to a cash sum.
- 6.68 The with-profits annuities in payment within the Transferring Policies and any with-profits annuities resulting from the vesting of other Transferred Policies will be reinsured to SWL. This will allow them to be managed in the same way as if the Transfer had not taken place.
- 6.69 Any GAOs on Transferring Policies will be reinsured from SWE into the Combined Fund of SWL. Therefore, if a GAO bites and the price of the vesting annuity exceeds the policy proceeds, the shortfall will be funded by the SWL Combined Fund (the same fund that meets the cost of the GAOs pre-Transfer).
- 6.70 Under the Reinsurance Agreement, premiums and claims both before and after vesting will be 100% reinsured from SWE to SWL. Because SWE will be responsible for servicing any vested annuities within the Transferring Business, the Reinsurance Agreement includes payments from SWL to SWE to cover maintenance expenses.

- 6.71 For bonus distributions, the with-profits governance applied will be the same as the governance for the Transferring UWP Business as described in paragraphs 6.44 to 6.47. This applies post-vesting as well as pre-vesting.
- 6.72 SWL will provide the assets equal to the greater of SWEs investment element of Solvency II BEL and SWEs Luxembourg GAAP reserves as FWH for vesting with-profits annuities.

Italian Surrender Penalties

- 6.73 Clause 168, paragraph 3 of the Italian Code of Private Insurance gives SWEs Italian policyholders the option to surrender their policies without surrender penalties if a material aspect of their policies change. The Transfer will trigger this option because the change of domicile of a policy will count as a material change. Policyholders will have 60 days after the transfer in which to exercise this option.
- 6.74 If all eligible policyholders exercised the option, the cost to SWE would be about £25m. The cost would be borne by the shareholders. SWL will set up a prudent provision (c£25m) for the cost of the option, and this will be transferred to SWE under the Scheme. This is not material for SWL.

Policy Administration

- 6.75 Policy administration of the Transferring Business will continue to be made by the following three outsource providers as it has been before the Transfer. The outsourcing agreements that SWL has with these providers will be novated to SWE as part of the Transfer.
- Pack Assurance Management (PAM) SA servicing Luxembourg policies
 - Heidelberg Leben Services Management (HLSM) GmbH servicing German and Austrian policies
 - Information Technology Outsourcing (ITO) S.R.L servicing Italian policies.
- 6.76 Under the Unit Linked Service Agreement, LB will support SWE with the operations of the Transferring UL Business, including unit pricing and the day-to-day box management. This is described further in Section 9.

7 Outline of the proposed Scheme

Introduction

- 7.1 In this Section, I provide an outline of the proposed Scheme. The Scheme determines the policies that will be transferring and the funds into which they will transfer. The Scheme also sets out the protection that will be provided to Transferring Policyholders and provides details of how the funds will be operated and managed after the Transfer. I then consider the operational matters that are needed to effect the Transfer or that are a consequence of the Transfer.
- 7.2 Everything within this Section is relevant to understanding whether or not the Scheme will have a material adverse effect on policyholders. This Section is factual; my opinions on the impact of the Transfer on the various policyholder groups can be found in Sections 11 and 12.

Background and purpose of the Scheme

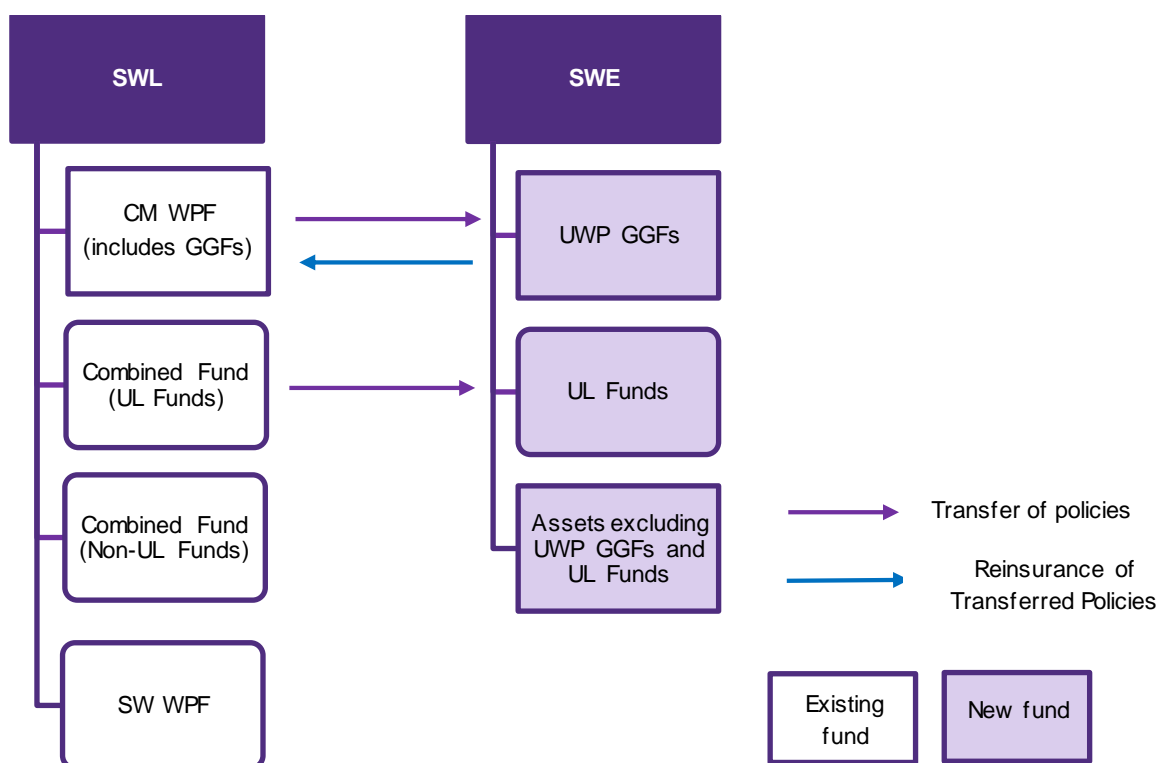
- 7.3 SWL is creating a new subsidiary, SWE, in order to protect its policyholders against the uncertainty over whether UK insurance companies will continue to be able to sell and service business written in the EEA after 29 March 2019. SWL intends to transfer its business written under EU passporting rights to SWE. The details of the transfer of business from SWL to SWE are set out in the Scheme.

Business to be transferred

- 7.4 The Transferring Business consists mainly of UWP business that sits in the CM WPF and UL business within the Combined Fund of SWL. Details of the business including the main features and run-off projections are provided in Section 5 above.

Fund structure post Transfer

- 7.5 In line with the Scheme, the Transferring UL Business, together with the UL assets that the Transferring UL Policyholders invest in, will be transferred from the Combined Fund of SWL into unit-linked funds that will be set up within SWE and these will be retained in SWE. As the assets have already been held in entities domiciled in Luxembourg, in effect, only their legal titles will be transferred from SWL to SWE.
- 7.6 In line with the Scheme and the Reinsurance Agreement, SWE will set up notional funds to mirror the GGFs that are currently in the CM WPF for the Transferring UWP policies. SWE will also hold FWH. This is described in Section 9.
- 7.7 The fund structure of SWL will be unchanged following the implementation of the Scheme.
- 7.8 The fund structures in SWL and SWE following the Transfer are shown in the diagram below. The arrows indicate the transfer of business into the new funds of SWE, and the reinsurance of the policies back to SWL.



7.9 In summary, as illustrated in the diagram above, the Scheme will:

- transfer SWL’s Transferring UWP Business from the CM WPF to SWE
- transfer all of SWL’s Transferring UL Business from the UL funds in the Combined Fund to the UL funds that will be established in SWE.

Fund structure for Transferring UWP Business

7.10 Under the Reinsurance Agreement, all Transferring UWP Policies will be reinsured back to the respective funds that they originally resided in within SWL.

7.11 In practice, as a result of the FWH arrangement, SWE will withhold the initial reinsurance premium rather than paying it to SWL. The remaining assets in the CM WPF invested for the Transferring UWP Policies, i.e. the assets backing the estate, will not be physically transferred but will remain in SWL.

FWH

7.12 As SWE will hold the legal title over the FWH, it will sit within SWE post Transfer. I provide more details on the FWH including how it works and the impact in Section 9.

Mirror GGFs

7.13 SWE will set up “mirror” GGFs that replicate the GGFs that currently exist in SWL for the Transferring UWP Business. These mirror funds will be notional as the business will in practice be fully reinsured back to SWL’s GGFs.

7.14 The notional funds mirroring the GGFs will not be ring-fenced funds as defined under Solvency II in the way that they are in CM WPF in SWL in the UK (it is not a requirement under Luxembourg regulations to hold ring-fenced funds). However, as the Transferring UWP Business will be reinsured back to the CM WPF, they will continue to be maintained in a ring-fenced fund. The same administration and box management systems at SWL will continue to be used for the GGFs after the Transfer, to ensure that transactions of the Transferring UWP Policyholders (eg number of units, charges and deductions) are tracked and the actual and notional GGFs will be aligned. All these transactions will be subject to appropriate reviews and governance including the process of setting the notional mirroring funds, to ensure the correct payments are made to the Transferring UWP Policyholders.

Tied Assets

- 7.15 Luxembourg regulations require insurers to identify Tied Assets as security for policyholders in the event of the insurer's insolvency. This is equal to the greater of Solvency II technical provisions (i.e. BEL plus Risk Margin (RM)) and reserves under Luxembourg GAAP. These assets are required to be deposited into a custodian bank under a tripartite custodian agreement with the CAA.

Fund structure for Transferring UL Business

UL funds

- 7.16 Following the transfer of the Transferring UL Business, SWE will set up unit-linked funds that are the same as those that the Transferring UL Policies were invested in prior to the Transfer. The assets backing these unit-linked funds, including associated derivative arrangements, will be transferred to SWE.
- 7.17 To enable the Transferring UL business to operate in the same way before and after the Transfer, SWE will enter into the Unit Linked Service Agreement with LB, described further in Section 9.

Tied Assets

- 7.18 As described for the Transferring UWP Business above, SWE will also be required to identify Tied Assets for the Transferring UL Business. This is equal to the greater of Solvency II technical provisions (ie BEL plus RM) and reserves under Luxembourg GAAP. These assets are required to be deposited into a custodian bank following a tripartite custodian agreement with the CAA.

Transferring Assets

- 7.19 On the Effective Date, SWL will transfer assets required to back:

- Transferring UWP Business
- Transferring UL Business
- 10% of the provision in respect of the German business litigation claims.

Were the Effective Date to have been 31 December 2017, the transferred assets would have been worth £2,337m. The value of the assets to be transferred on the actual Effective Date (28 March 2019) will be different to this.

- 7.20 SWL will also inject share capital into SWE, to ensure SWE can cover its target capital level. Were the Effective Date to have been 31 December 2017, this injection would have been £78m. The capital injection required on the actual Effective Date (28 March 2019) will be different to this.

Modifications and amendments to the Scheme

- 7.21 The Scheme defines the circumstances that allow SWL and SWE to make modifications and amendments to the Scheme, and defines the controls required when making these changes.

Merger and Closure of Funds

- 7.22 Under the Scheme, SWE can either merge or close unit-linked funds where the Transferring UL Business resides, after taking account of appropriate actuarial advice (this maintains the rights that SWL has under the 2015 Scheme). Where this results in the need for policyholders to switch funds, the cost of the first switch within a year after either the merger or closure of the relevant unit-linked fund will not be charged to the policyholders.
- 7.23 The Scheme refers to the 2015 Scheme for the circumstances and the terms of either the merger or closure of SWL WP funds, which contain the Transferring UWP Business. The 2015 Scheme requires the SWL Board, prior to either the merger or closure of the WP funds, to:
- have taken appropriate actuarial advice

- obtain a certificate from an independent actuary with the opinion that the merger or closure will not materially adversely affect the policyholders within the funds or the Non-transferring Policyholders
 - receive a notification of non-objection to the merger and closure of the funds from the PRA.
- 7.24 SWL and SWE, by mutual consent, can make amendments to the Scheme for the Transferring UWP Business regarding the closure of the CM WPF (and corresponding impact on SWE) after notifying the PRA, FCA and CAA.

Other modifications and amendments to the Scheme

- 7.25 SWL and SWE can go to the High Court to amend the terms of the Scheme, each with the consent of the other party, provided that:
- the CAA has been notified in advance to have the right to be heard at any hearing of the High Court
 - the PRA and the FCA have been notified in advance to have the right to be heard at any hearing of the High Court
 - the application is accompanied by a certificate from an independent actuary to the effect that in his opinion the proposed amendment will not have a material adverse effect on either the security or benefit expectations of the policyholders of SWL and SWE.
- 7.26 SWL and SWE are not required to apply to the High Court for consent to make amendments for the following:
- a) any amendments in the Scheme required to reflect specific provisions relating to the merger and closure of the CM WPF (subject to following the process as described in paragraphs 7.23 and 7.24)
 - b) minor and non-material amendments
 - c) amendments to the Scheme and the Reinsurance Agreement resulting from a change in regulatory requirements or taxation affecting life insurance companies in Luxembourg
 - d) any other amendments of the Reinsurance Agreement.
- 7.27 The amendments c) and d) above are subject to:
- obtaining a certificate from an independent actuary confirming that in his or her opinion, the proposed amendment will not have a material adverse effect on either the security or benefit expectations of the policyholders of SWL and SWE
 - the PRA and the FCA having been notified in advance and not objected within 30 business days of the notification
 - the CAA having been notified in advance and not objected within 30 business days of the notification.

Interaction with existing schemes

- 7.28 The Transferring Business has been subject to the 2015 Scheme under SWL. The essential protections provided in the 2015 Scheme will continue to apply as a result of the reinsurance and other provisions in this Scheme. However, alongside the Scheme, an application to amend the 2015 Scheme will be made to allow for the payment of assets from the CM WPF when there is a Court order pursuant to section 112 of FSMA. This enables the transfer of assets for the FWH of the Transferring UWP Business to SWE under this Scheme. The amendment together with the Reinsurance Agreement ensure that the CM WPF will continue to be managed as a whole fund without having to be split between the Transferring Business and Non-transferring Business. My certification for these changes to the 2015 Scheme is in Appendix F.
- 7.29 A “Scheme Destinations Table” which contains a high-level comparison of the 2015 Scheme and this Scheme has been provided by SWL’s legal advisors. Based on this table, where relevant, the provisions in the 2015 Scheme have either been replicated or have been referred to in this Scheme.

Associated Arrangements

- 7.30 Alongside the Scheme, SWE will enter into a Reinsurance Agreement, Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement which are described in more detail in Section 9.

Operational matters

- 7.31 This Section sets out the operational arrangements to support the implementation of the Scheme.

Existing reinsurance

- 7.32 There are currently two external reinsurance treaties between SWL and Swiss Re, covering the additional mortality and morbidity risks for the policies, which have enhanced life covers, and the waiver of premium insurance for the Transferring Business. These treaties will be transferred to SWE as part of the Scheme.
- 7.33 The sum at risk on death of the Transferring Business as at the end of 2017 is £814 million. The sum at risk ceded to Swiss Re as at the end of 2017 is £319 million.

Policy terms and conditions

- 7.34 As a result of the Scheme, the Transferring Policies will become policies of SWE, rather than SWL.

With-profits

- 7.35 There will be no material change to any of the terms and conditions of the Transferring UWP Policies as a result of the Scheme.
- 7.36 There will be no change to any of the options and guarantees available to Transferring UWP Policyholders as a result of the Scheme. The Reinsurance Agreement ensures that the rights of any with-profits policyholders to participate in the CM WPF do not change as a result of the Scheme.
- 7.37 The terms and conditions of these policies restrict the circumstances in which charges might be increased to cover expense risk. These restrictions will not change following the Transfer.

Unit-linked

- 7.38 There will be no material change to any of the terms and conditions of the Transferring UL Policies as a result of the Scheme. There will be no change to any of the options and guarantees available to Transferring UL Policyholders as a result of the Scheme.
- 7.39 The terms and conditions of these policies restrict the circumstances in which charges might be increased to cover expense risk. These restrictions will not change following the Transfer.

With-profits governance

- 7.40 Under Section 20 of the FCA's COBS rules, firms operating with-profits funds in the UK must have a PPFM, which sets out how the with-profits business is conducted. Prior to the Scheme, the Transferring Business resides in the UK and is therefore governed by PPFMs.
- 7.41 Luxembourg does not have a with-profits regime equivalent to that in the UK. In particular, there is no requirement in Luxembourg to either appoint a WPA or a WPC, or to have a PPFM in place.
- 7.42 As the Transferring UWP Policies are reinsured back to SWL's CM WPF, the original fund they were transferred from, CM WPF will continue to be managed as one fund including the assets of Transferring UWP Business, and the Transferring UWP Policies will still be covered by the PPFM of CM WPF. The PPFM of CM WPF is available in English, German and Italian, and it will be amended to reflect that, following the Transfer, the Transferring UWP Business would become reinsured business rather than direct business of SWL. However, there will not be an SWE equivalent of the PPFM. I will review the updated PPFM when it becomes available, which is expected to be after the submission of the Report. I will therefore comment on the updated PPFM in the Supplementary Report.
- 7.43 SWE will not have a separate WPC. The SWL WPC will continue to operate as it currently does, taking into account the reinsurance, with oversight of the Transferring Business as before the

Transfer. The SWE Chief Actuary will advise the SWE Board in particular on the bonus distribution for Transferring UWP Business and will have access to all appropriate information that SWL has on matters regarding the Transferring UWP Business.

- 7.44 The SWE Board will have principal oversight on the decisions and management of the Transferring Business and will receive appropriate actuarial advice to ensure compliance with the relevant Luxembourg regulatory requirements. The SWE Board will follow the decisions of the SWL Board closely in relation to any bonus distribution, market value adjustment or similar matters (such as estate distribution, smoothing etc), unless, it would be deemed inappropriate to do so after taking into account appropriate actuarial advice and paying due regard to policyholders' collective interests. A non-objection from the CAA is also required if SWE is to deviate from SWL's decisions on these matters.

Unit-linked governance

- 7.45 SWE will retain the Transferring UL Business. The governance around the use of discretion for the UL business is described in Section 6.

Costs of the Scheme

- 7.46 The costs incurred as a result of the formation of SWE in Luxembourg and as a result of the Transfer will be met by the shareholders of SWL via the Combined Fund.
- 7.47 There will be an increase in ongoing costs as a result of the Scheme. These are due to the inefficiencies caused by transferring the business into a new subsidiary. It is anticipated there will be a further cost due to Luxembourg Value Added Tax (VAT) that will apply to services provided to SWE including the outsourcing services and the services that will be provided by LB. The additional ongoing costs will be met by the shareholders of SWE.
- 7.48 The maximum expected cost of the Italian surrender option equal to £25m, discussed in Section 6 will be borne by the shareholders and included in the funds transferred from SWL to SWE as part of the Transfer.
- 7.49 SWE will be responsible for the administration of the Transferring Policies and will meet the on-going expenses. SWE will meet these expenses using the charges deducted from policyholder premiums or units.
- 7.50 As the Transferring Business will be in run-off, the per-policy expenses are likely to increase due to diseconomies of scale. There is limited scope to increase the charges paid by the Transferring Policyholders as summarised in Section 6. Therefore, the shareholders of SWE will meet excess costs if actual charges are insufficient to meet expenses.

Tax implications of the Scheme

Policyholder tax

- 7.51 I am not an expert in tax matters and therefore, in forming my opinion on the impact of policyholder tax, I have relied on documents produced by SWL's in-house tax experts, and summary papers produced based on the tax advice SWL has received from its tax advisors. I have reviewed this information to ensure it is consistent with my understanding from similar transactions. Grant Thornton's tax specialists have also reviewed this information, with no areas of disagreement being identified.
- 7.52 I do not anticipate that there will be a change in policyholder taxation for the Transferring Policyholders who are tax residents in Austria, Italy or Luxembourg, as the Transfer does not result in a material change to the terms and conditions of the Transferring Business. In particular, I understand SWL currently withholds tax on policy payments to Italian resident policyholders, with the process managed on its behalf by its Italian outsource provider; following the Transfer, this will be managed by SWE and the Italian outsource provider; an identical amount of tax will be withheld.
- 7.53 There will, however, be a change in the timing of the payment of policyholder tax in Germany. This is a result of SWE setting up a branch with a representative to comply with CAA data protection and

control requirements. In Germany, that branch will withhold the tax due to the German government on claim payments to comply with German taxation law. For the Transferring Policyholders that are domiciled in Germany this creates a timing difference in when tax payments are made as the tax will be withheld by the branch rather than declared in their tax return as it would be without a branch office. This does not however change the amount of tax actually paid. There is therefore no material adverse impact to the policyholders.

- 7.54 Therefore, based on the information provided to me by SWL's tax advisors, I do not expect there to be any change to any policyholder's tax liability as a result of the Transfer except for the change in the timing of the withholding tax of the policyholders in Germany.

Tax on UL funds

- 7.55 The taxation of the UL Funds within SWL will continue unchanged. The UL Funds in SWE will not be charged tax; this is consistent with their treatment before the Transfer.

Tax on with-profits funds

- 7.56 The CM WPF incurs tax as if it was a standalone mutual insurance company. The transfer of the Transferring Policies out of the CM WPF and their reinsurance back into it will have no impact on the tax charged to the CM WPF. SWL's in-house tax experts have investigated and concluded that withholding tax rules would not have an impact on the tax on with-profits funds as a result of holding the FWH in SWE rather than in SWL after the Transfer.

Corporation tax

- 7.57 An accounting IFRS loss is expected to arise from the Transfer within SWL, related to the difference in the valuation of liabilities under IFRS and Luxembourg GAAP, the costs of setting-up and administering a new entity and increased capital requirements due to additional risks and loss of diversification. This will be subject to UK corporation tax at 19%. The impact is expected to be a tax deduction in SWL.
- 7.58 There would potentially be a tax charge for SWL due to a Transfer pricing adjustment. There would be a corresponding tax relief for SWE (subject to analysis from Luxembourg tax authorities). This will be confirmed following the completion of the Transfer pricing valuation closer to the effective Date and I will provide an update on this in my Supplementary Report.
- 7.59 No further trading profits or losses are expected in SWE as a result of the Transfer. There will be no further direct Luxembourg corporation tax impact within SWE.
- 7.60 SWL's in-house tax experts have investigated and concluded that holding the FWH in SWE rather than in SWL after the Transfer would not have an impact on SWL and SWE's corporation tax.
- 7.61 The corporation tax position of SWL and SWE does not affect the Transferring Policyholders and Non-transferring Policyholders.

VAT

- 7.62 The Transfer will qualify as a transfer of going concern for VAT purposes. Luxembourg VAT will be charged on services provided to SWE, including outsourced services from SWL. These costs will be met by the shareholders of SWE.
- 7.63 There will be no UK or Luxembourg VAT arising from the Reinsurance Agreement or the Indemnity Agreement.

Tax clearances

- 7.64 Pre-clearance will be obtained from HMRC and the Luxembourg tax authorities. An update on this will be provided in the Supplementary Report.

Administration

- 7.65 There are currently three outsourcing agreements in place for the policy administration of the Transferring Business. These outsourcing agreements will be novated to SWE as part of the Transfer. There will be no change to the current terms and conditions or the service standards of the services provided.
- 7.66 As described in Section 6, certain services will be provided to SWE by LB, including the internal audit, actuarial and finance functions. These will be set out in service agreements. Whilst there will be new service agreements between SWE and LB, we would expect these to mirror the conditions and standards of the existing service agreements between SWL and LB. I will provide an update regarding these service agreements in my Supplementary Report.

Communication strategy

- 7.67 SWL proposes to use the following categories of communication to notify stakeholders of the Transfer:
- general communications: non-targeted, public communications via the media designed to raise awareness of the Transfer
 - individual communications: targeted communications informing particular stakeholder groups of the Transfer.

General communications

- 7.68 SWL will publish the Legal Notice of the Scheme in the London, Edinburgh and Belfast Gazettes.
- 7.69 SWL also proposes to advertise the Scheme in five national newspapers in the UK, two national newspapers in Austria, Germany and Italy and three national newspapers in Luxembourg. The Scheme will also be published in the international edition of the Daily Mail and the European edition of the Financial Times.
- 7.70 The Scheme and the Report will also be available on request and on the websites: www.scottishwidows.co.uk, www.clericalmedical.com/de/index.asp, www.clericalmedical.com/austria/index.asp and www.clericalmedical.com/it/index.asp.
- 7.71 The following will also be published on SWL's website:
- Scheme
 - Independent Expert's Report (the Report)
 - The Summary Report – an abridged version of the Report
 - Chief Actuary's Report on the Scheme
 - With-Profits Actuary's Report on the Scheme
 - Policyholder Pack (as described in paragraph 7.74 below)
 - Legal Notice of the Scheme.

Individual communications

- 7.72 Individual communications are targeted forms of communication, informing particular stakeholder cohorts of the Transfer. Individual communications will contain information relating to the Transfer and how this will affect the individual customer, the right to object, and the objections process. They will also provide details of where to find additional information about the Transfer and how to participate in the High Court process.
- 7.73 SWL intends to use a combination of regulatory notifications and direct mail (including email where possible) as the forms of individual communication.
- 7.74 SWL will send policyholders a Policyholder Pack unless a waiver has been obtained from communicating with the relevant policyholder as detailed in paragraph 7.80. The Policyholder Pack will be available in English, German, Italian and French and will include:

- a brief notification letter called the Policyholder Letter
 - an important information sheet
 - a more detailed Planholder Guide.
- 7.75 Connected parties, such as outsourced service providers, the external reinsurer and brokers who have serviced or continue to service the Transferring Policies, will receive regulatory notification letters, which will include similar content to the Policyholder Pack, which will be tailored according to the audience in question.

Dispensations and waivers

Paragraph 3(2)(a)

- 7.76 Paragraph 3(2)(a) of the Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001 requires a notice of the Transfer to be published in:
- the London, Edinburgh and Belfast Gazettes
 - in two national newspapers in the United Kingdom
 - in certain circumstances, in two national newspapers in certain EEA states other than the United Kingdom.
- 7.77 SWL will comply with most of the above requirements as described in paragraphs 7.68 and 7.69, but has sought specific dispensations from the Court with regards to the requirement contained in the aforementioned regulations to publish the legal notice in two national newspapers in each EEA country where there is a state of commitment or the State in which the risk is situated at policy inception in respect of a Transferring Policyholder.

Paragraph 3(2)(b)

- 7.78 Paragraph 3(2)(b) of the Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001 requires a notice of the application for the Transfer to be sent to every policyholder of both the transferor and the transferee (i.e. SWL and SWE). However, it is common practice for firms to seek a waiver so that they do not have to comply with this requirement in full, and instead send a communications pack only to certain policyholders.
- 7.79 SWL is to seek a waiver from this requirement. In determining whether a certain group of policyholders should be subject to a waiver, SWL has considered whether any of the following factors apply:
- impossibility
 - practicality
 - utility to the policyholder and the Court
 - availability of other information channels
 - proportionality
 - the objective of the Transfer, and
 - the impact of the Transfer on policyholders.
- 7.80 Based on a detailed assessment into whether any of the above factors are applicable to the various groups of policyholders, SWL is seeking a waiver for any policyholders that meet the criteria, and as such the following policyholders will not be mailed:
- Non-transferring Policyholders
 - policyholders for whom there is insufficient or invalid address data
 - assignees of Transferring Policies
 - trustees in bankruptcy, bankruptcy lawyers, receivers and administrative receivers of Transferring Policyholders

- contingent annuitants
- deceased policyholders
- members of occupational pension schemes
- the second life on joint life policies, where the address held on the database is the same for both lives
- trustees and beneficiaries
- beneficiaries resulting from court -orders in relation to pension payments to former spouses
- Transferring Policyholders whose policies have expired.

7.81 I provide my opinion of the communication strategy in respect of the different groups of policyholders in Sections 11 and 12.

Rights of Transferring Policyholders who object to the Scheme

7.82 SWL will use its existing multi-channel complaint handling process to identify objections. Objections can be raised during the period between the Directions and Sanctions Hearings.

7.83 SWL will put defined governance arrangements, systems and controls in place to oversee and control the complaint handling process.

7.84 SWL plans to send standard responses where possible (subject to appropriate oversight), with the option to use tailored responses where necessary. SWL has considered its resourcing needs to support communications and will utilise third party suppliers to provide additional headcount to handle increased objections volumes and stakeholder contact.

7.85 The objections process will go live on completion of the Directions Hearing in November 2018. The output of the objections process will be an important mechanism to identify any adverse effect not otherwise considered in the Report. In the Supplementary Report, I will assess any additional sources of adverse effect, in addition to forming conclusions regarding the adequacy and execution of the overall process.

7.86 Nevertheless, at the time of writing, I consider that the steps taken by SWL to establish the objections process to capture and respond to objections regarding the Transfer are adequate and robust.

8 Structure of the Transfer

Introduction

- 8.1 At the Effective Date, the Scheme and the Associated Arrangements come into effect simultaneously.
- 8.2 I am aware that the Scheme and the Associated Arrangements together present a complex set of interrelated legal agreements and will be provided to the High Court, only the first of which the High Court is being asked to sanction.
- 8.3 The purpose of this Section is to highlight some of the ways in which the Scheme may impact policyholders, and how the Associated Arrangements are intended to address this.

Overview of the purpose of the Scheme and related agreements

- 8.4 In Section 7, I provided an outline of the Scheme. The Scheme transfers the Transferring Policies to SWE to ensure that these policies can continue to be legally serviced after Brexit.
- 8.5 A Part VII Transfer has the effect of transferring assets and liabilities associated with the relevant transferring business. For unit-linked business it is relatively straightforward to identify and agree the associated assets and liabilities; although setting up the operational aspects, including administration of the policies, takes some time. The process for with-profits funds is more complex, because if only part of the with-profits fund is being transferred, then it may be necessary to split the fund. Typically, based on my experience, this process would take between 18 and 24 months, as it requires complex analysis and the approval of a large number of stakeholders. This means there is insufficient time ahead of 29 March 2019 to complete the Fund Split in a fair and controlled manner.
- 8.6 As set out in Section 7, the Transferring UL Business will be retained by SWE following the Transfer. This is a requirement of CAA, the Luxembourg Regulator. As stated above, setting up the operational aspects of the business will take time. To ensure this can be done before Brexit and that the Transferring UL Business will continue to operate as it has done under SWL, operational arrangements, including appropriate service contracts, will be put in place.
- 8.7 To mitigate the effects on the with-profits business, SWL and SWE propose entering into the Reinsurance Agreement. From the Effective Date, SWE will reinsure the Transferring UWP Business back to SWL through the Reinsurance Agreement. As a result of the Reinsurance Agreement, a split of CM WPF between SWL and SWE will not be required. The Reinsurance Agreement will also enable the Transferring UWP business to continue to benefit indirectly from the protection of elements of UK COBs and from SWL's expertise in managing with-profits funds.
- 8.8 The Reinsurance Agreement exposes SWE to the financial position of SWL. Without any security arrangements, SWE would rank behind the direct policyholders of SWL in the event of SWL's insolvency. To mitigate this, two actions will be taken:
- SWE will withhold assets backing the BEL for the reinsured element of the Transferring UWP Business, ie the FWH in SWE, as security to cover the majority of the policyholder liabilities for the Transferring UWP Business that will be reinsured to SWL
 - the Charge Agreement (described in Section 9) will be put in place to ensure that, in the event of SWL's insolvency, SWE will rank equally to the direct policyholders of SWL, for any shortfalls in the Transferring UWP Policyholders' liabilities (ie including the distribution of the CM WPF estate) compared to the amount of FWH.
- 8.9 Although the FWH will be held in SWE, SWL will still have the economic interest over these funds. Therefore, under the Reinsurance Agreement, these funds will continue to be managed in line with the investment strategy and the PPFM of CM WPF.
- 8.10 In Section 9, I detail the circumstances under which it is possible to terminate the Reinsurance Agreement and the payments to which SWE would be entitled on termination. Under the Reinsurance Agreement, the termination and the termination amount will be determined with oversight from an independent actuary and the regulators. The Reinsurance Agreement also necessitates that the independent actuary considers whether there will be an appropriate framework for running the

Transferring UWP Business in SWE after termination (if the termination or the Reinsurance Agreement is with mutual consent).

- 8.11 As a result of the Scheme, SWE will be responsible for all claims including German litigation claims relating to the conduct of SWL prior to the Transfer. The Indemnity Agreement (described in Section 9) is needed so that the majority of such claims remain the financial responsibility of SWL. The indemnity will also be covered under the Charge Agreement; therefore, SWE will have the same ranking as the direct policyholders of SWL with respect to these claims.
- 8.12 The table below summarises some of the challenges that arise as a consequence of the Scheme, and the proposed mitigating actions to be taken by SWL and SWE.

Potential Challenge	Main Mitigant
Ensure that SWL policies sold on a Freedom of Services or Freedom of Establishment basis can continue to be serviced post-Brexit.	The Scheme
Identifying and transferring a fair share of assets in respect of the CM WPF in a fair and controlled manner. Maintaining a with-profits fund for the Transferring UWP Policyholders with similar protection to those provided by FCA's Conduct of Business Sourcebook (COBS).	The Scheme and Reinsurance Agreement
Setting-up teams and systems to carry out unit related operations for the Transferring UL Business.	Unit Linked Service Agreement
SWE is exposed to the financial position of SWL as a result of the Reinsurance Agreement and Indemnity Agreement. SWE policyholders' being disadvantaged for any claims greater than the FWH in the unlikely event of SWL's insolvency.	Charge Agreement
SWE is exposed to the risk of misconduct or misadministration by SWL prior to the Transfer.	The Indemnity Agreement
Ensuring that policyholders are treated fairly in the event of termination of either, or both of, the Reinsurance Agreement and the Indemnity Agreement.	The Scheme, Reinsurance Agreement and Indemnity Agreement

- 8.13 I discuss below each of these issues in turn and consider the impact on various groups of policyholders in later subsections.

Potential effects of the Scheme

- 8.14 This subsection considers in more detail the potential challenges associated with the Scheme if it was implemented in isolation of the Reinsurance Agreement. This is purely to demonstrate why the Reinsurance Agreement is necessary, and it is important to note that, in practice, the Scheme would not be implemented in isolation.

With-profits governance

- 8.15 The with-profits regime in the UK is well-established, with formal governance requirements including the requirement for ring fencing, a WPA, a WPC and a PPFM. Although Luxembourg regulations enable the management of a variety of insurance products, they do not have an equivalent with-profits regime. Transferring the with-profits business to SWE means that the Transferring UWP Policies will be subject to Luxembourg regulations.
- 8.16 In addition, SWL has managed with-profits business for a number of years, and therefore has considerable experience of with-profits management. SWE will be a newly established company, and although it can be supported by SWL in this respect, it will not have the same level of experience of managing with-profits business.

Practicalities of implementation

- 8.17 The Transferring UWP Business is a subset of the CM WPF. Therefore, the Scheme would require splitting the CM WPF and this involves a complex process of identifying and transferring a fair share of assets in respect of the CM WPF. The process would need to take account of both Transferring UWP Policyholders and Non-transferring Policyholders' interest in the estate of the CM WPF as well as the policy liabilities. Typically, based on my experience, this process would take between 18 and 24 months as it requires detailed analysis and the approval of a large number of stakeholders. Therefore, it could not be completed ahead of 29 March 2019.

Fund economies of scale

- 8.18 In the absence of the Reinsurance Agreement the Scheme would result in splitting the CM WPF into two funds: one for the Non-transferring Policyholders and other for the Transferring UWP Policyholders. The CM WPF has assets of about £6.6 billion (BEL of about £5.2 billion) as at 31 December 2017, after the Fund Split the value of the CM WPF would reduce to about £4.8 billion as at 31 December 2017. The fund backing the Transferring UWP Business would be a small fund with only about £1.8 billion of assets at 31 December 2017, and will not have the same levels of economies of scale, which can lead to increasing per-policy expenses and put constraints on investment policy therefore reducing investment returns. A smaller estate under each fund would also be less able to absorb any adverse experience, potentially increasing the contagion risk for other policyholders.

The change in risk profile

- 8.19 Prior to the Effective Date, SWE will not have any business. Following the Transfer, SWE will be exposed to the risks associated with the Transferring UWP Business and Transferring UL Business and the risks relating to operation of an insurance entity. SWE's SCR cover may be more volatile with respect to the risks associated with the Transferring Business compared to SWL's current position, due to the sizes of the two businesses and the more diversified risk profile to which SWL is exposed.

Scheme risks mitigated by the Reinsurance Agreement

- 8.20 I describe the Reinsurance Agreement in Section 9. In the subsection below, I briefly set out how the Reinsurance Agreement aims to address the potential challenges associated with the Scheme identified above.

With-profits governance

- 8.21 While the Reinsurance Agreement is in place, the Transferring UWP Business will be managed in line with the CM WPF's PPFM and the provisions in the 2015 Scheme. This means that, for the Transferring UWP Policyholders of the CM WPF, there will be no material change to the way their policies are managed. In particular, the current principles and practices applicable to investment strategy and estate distribution will be followed. Further, the usual SWL framework for managing the with-profits business, which follows the UK regulatory requirements, will apply.
- 8.22 The SWE Board will have principal oversight on the decisions and management of the Transferring Business and will receive appropriate actuarial advice from the SWE Chief Actuary to ensure compliance with the relevant Luxembourg regulatory requirements. The Reinsurance Agreement creates additional governance requirements in relation to bonus declaration, market value adjustments and similar processes, which require the SWE Board to follow the decisions of SWL closely unless this would be deemed inappropriate after following the governance described in 6.46 and 7.44 above.

Practicalities of implementation

- 8.23 The Transferring UWP Business will operate without the need to split the CM WPF while the Reinsurance Agreement is in place.
- 8.24 While splitting the funds would not be completed by 29 March 2019, the Reinsurance Agreement can be put in place by the time Brexit occurs.

Fund economies of scale

8.25 While the Reinsurance Agreement is in place, the Transferring UWP Policies will participate in SWL’s CM WPF. The benefit of this is that the with-profits Non-transferring Policies in CM WPF and the Transferring UWP Policies will benefit from the economies of scale of the CM WPF.

The change in risk profile

8.26 While the Reinsurance Agreement is in place, the intention is that SWL bears the risks associated with managing the UWP funds that transfer under the Scheme. This means that the risk profile of SWE created by the Transfer is significantly different than it would be without the Reinsurance Agreement, although there is an increase in counterparty default risk associated with the Reinsurance Agreement.

8.27 As the Transferring UL Business will be retained, SWE will be exposed to all the risks associated with this business.

Impact of the Scheme and Reinsurance Agreement on different policyholder groups

8.28 In the table below, I summarise which of the different groups of policyholders are potentially affected by the Scheme across the four areas identified above. This table also shows the role of the Reinsurance Agreement in addressing each of the areas.

Policyholder group	Policyholder sub-group	Potential effect of the Scheme on:				Reinsurance and aim
		a) With-profits governance	b) Practicalities of implementation	c) Fund economies of scale	d) Change in risk profile	
Transferring Policyholders	UWP business in CM WPF	Yes	Yes	Yes	To some extent	The Reinsurance Agreement aims to address a), b) and c) and help manage d)
	CM WPF business	No	Yes	Yes	To some extent	The Reinsurance Agreement aims to address b) and c) and help manage d)
Non-transferring Policyholders	Other business	No	No	No	No	None

8.29 The table above illustrates that without the Reinsurance Agreement, the Scheme would result in challenges that could have an adverse effect on some of the groups of policyholders. I provide my opinion on the extent to which there is likely to be a material adverse effect when I consider the impact of the Transfer on the different groups of policyholders in Sections 11 and 12. Overall, I have concluded that there will be no material adverse effect on these policyholders as a result of the Transfer.

Pre-Transfer conduct risks mitigated by the Indemnity Agreement

8.30 As a result of the Transfer, SWE will become exposed to German business litigation claims and other claims arising from SWL’s pre-Transfer conduct of business on the Transferring Business. To mitigate this risk, alongside the Scheme, SWL and SWE will enter into an Indemnity Agreement for the

payment of these claims. The Indemnity Agreement will also cover other activities SWL carried out prior to the Transfer that could give rise to any claims.

- 8.31 I consider the Indemnity Agreement in detail in Section 9 and conclude that the Indemnity Agreement protects SWE and the Transferring Policyholders from exposure to German business litigation claims beyond the cap determined in the Indemnity Agreement and other claims that might arise due to the pre-Transfer conduct of SWL.
- 8.32 Further, as the Indemnity is covered by the Charge Agreement (discussed below and in more detail in Section 9), it enables SWE to have the same ranking as the direct policyholders of SWL with respect to the payment of indemnity claims in the unlikely event of SWL's insolvency.

Counterparty risk mitigated by the FWH and the Charge Agreement

- 8.33 As a result of the Transfer, the Transferring Policyholders will become direct policyholders of SWE rather than direct policyholders of SWL and, in the event of SWL becoming insolvent, SWE would be treated as a creditor of SWL not holding an insurance debt. Under the UK insolvency legislation, when an insurer is declared insolvent, direct policyholders (ie those holding insurance debts) are prioritised ahead of creditors not holding insurance debts and other unsecured creditors.
- 8.34 Holding the FWH in SWE as part of the Reinsurance Agreement decreases SWE's exposure to counterparty default risk and ensures that this risk only applies to liabilities in excess of the FWH. In the event of SWL's insolvency, SWE will keep the FWH, up to the amount owed to them by SWL, therefore in effect, SWE will have higher ranking than the direct policyholders of SWL over the assets in FWH.
- 8.35 Furthermore, the provisions in the Charge Arrangement have been structured in such a way that if SWL was to be declared insolvent, SWE would have the same ranking as the direct policyholders of SWL for liabilities in excess of the FWH.
- 8.36 I consider the FWH and the Charge Agreement in more detail in Section 9. I conclude that I am satisfied that these provide a reasonable approach in the context of this Transfer.

Termination of the Reinsurance Agreement

- 8.37 The Reinsurance Agreement can be terminated in very limited circumstances (as set out in Section 9). If the Reinsurance Agreement was to be terminated, the CM WPF would need to be split and a termination amount would have to be determined for the Transferring UWP Policyholders, including their fair share of the estate.
- 8.38 In order to terminate the Reinsurance Agreement, an independent actuary, together with the UK Regulators and the CAA, would be involved in ensuring the termination amounts calculated under the Reinsurance Agreement are fair to the Transferring Policyholders and Non-transferring Policyholders.
- 8.39 I consider the termination of the Reinsurance Agreement in more detail in Section 9 and conclude that there are sufficient protections to ensure that policyholders are treated fairly both at termination and in the ongoing operation of the funds in SWE

9 Associated Arrangements

Introduction

- 9.1 In this Section, I provide a description, analysis and my opinion of the Associated Arrangements and the impact of these on the Transferring Policyholders.
- 9.2 The Associated Arrangements consist of the Reinsurance Agreement including the FWH, the Charge Agreement, the Indemnity Agreement and the Unit Linked Service Agreement.
- 9.3 This Section is structured as follows:
- the Reinsurance Agreement – this part considers how the Transferring UWP Business will be managed in light of the Reinsurance Agreement including the FWH, and also contains a description of initial and subsequent cashflows between SWL and SWE. The Reinsurance Agreement is relevant to the Transferring UWP Business and to GAOs for vesting annuities on the UL business
 - termination of the Reinsurance Agreement – this part considers the circumstances in which the Reinsurance Agreement can be terminated and the governance process that must be followed for the termination
 - the Indemnity Agreement – this part considers how the Indemnity Agreement protects SWE against potential claims arising from SWL's conduct of the business prior to the Transfer. The Indemnity Agreement is relevant to both Transferring UWP and UL Business
 - the Charge Agreement – this part considers how the Charge Agreement operates to provide protection to SWE in the event of SWL's insolvency. The Charge Agreement is relevant to both the Reinsurance Agreement and Indemnity Agreement
 - the Unit Linked Service Agreement – this part considers how the Unit Linked Service Agreement ensures the operations of the Transferring UL Business, such as unit pricing and the day-to-day box management, remain unchanged post the Transfer. The Unit Linked Service Agreement is relevant to the Transferring UL Business only
 - Impact of counterparty default risk exposure on SWE – this part considers the additional counterparty default risk introduced because of the Reinsurance Agreement and Indemnity Agreement, mitigations for this risk via the Charge Agreement, and any impact of the additional counterparty default risk on SWE policyholders.
- 9.4 Each of the above areas is relevant to understanding whether or not the Associated Arrangements will have any material adverse effect on policyholders. I provide my opinion on how these would affect different groups of Transferring Policyholders and Non-transferring Policyholders, where relevant, for each of the above areas.
- 9.5 For Non-transferring Policyholders, I have considered two distinct groups:
- those with WP policies invested in SWL's CM WPF (Non-transferring Policyholders in CM WPF)
 - the Non-transferring Policyholders with policies in the Combined Fund and those in the SW WPF fund (together the "Other Non-transferring Policyholders").

The Reinsurance Agreement

- 9.6 The Reinsurance Agreement will be effective from the Effective Date of the Transfer. The aim of the Reinsurance Agreement is to allow the Transferring UWP Business to be managed in the same way before and after the Transfer, while meeting relevant CAA requirements.
- 9.7 In particular:
- the investment element of the Transferring UWP Policies, will be reinsured back to the CM WPF, where they were invested prior to the Transfer. The costs of any investment guarantees other than those in the next two bullets will continue to be borne by the CM WPF

- SWE shareholders will bear the risks associated with return of premium guarantees on German occupational pensions business, risks currently borne by SWL shareholders
 - any GAOs will be reinsured back to SWL, so the cost of any biting GAOs will continue to be borne by SWL shareholders
 - SWE shareholders will bear the expense risk (the risk that the policy fees and charges are insufficient to meet the expenses incurred in administering the policies and running the business), a risk currently borne by SWL shareholders
 - SWE shareholders will bear the additional mortality and morbidity risks (risks that the guaranteed death, sickness and disability claims exceed the fund value that will be recovered from SWL at the time of claim), risks currently borne by SWL shareholders.
- 9.8 There will be no change to the external reinsurance arrangement as a result of the Transfer.
- 9.9 The vesting annuity on the Transferring Business will be a SWE policy, however, both the guaranteed annuity and the future with-profits bonuses will be reinsured to SWL under the Reinsurance Agreement. Therefore, both the investment and longevity risks on the with-profits annuities will be reinsured to SWL but SWE will retain the expense risk for the with-profits annuity business.
- 9.10 As summarised in Section 8, the Transferring UL Business will not be reinsured back to SWL, but will be retained within SWE. However, the Reinsurance Agreement will cover the following in relation to the UL business:
- any switches between unit-linked funds and the GGFs
 - the investment and longevity risk on any WP annuities that vest from UL funds.
- 9.11 The Reinsurance Agreement creates additional governance requirements in relation to the operational aspects of managing the Transferring UWP Policies. SWE is required to maintain notional units for the purposes of calculating benefits payable to the Transferring UWP Policyholders. SWL must ensure that allocations or cancellation of units applied to the Transferring UWP Policies are consistent with those applied by SWE to the notional mirroring funds.

FWH

- 9.12 The reinsurance premium covering the reinsurance of the Transferring UWP Business, including vesting annuities, will be retained within SWE and be known as the FWH. This will be equal to, the higher of (i) Solvency II BEL backing the reinsured business excluding with-profit estate and (ii) Luxembourg GAAP reserves.
- 9.13 SWL has received legal advice and have confirmed that FWH as defined in the Reinsurance Agreement can be treated as eligible collateral under Standard Formula.
- 9.14 Although SWE will retain the legal title of the FWH, SWL will have economic interest in FWH, and will require SWE to invest the assets in the FWH in line with the CM WPF's investment strategy.
- 9.15 An operational rebalancing of the FWH will be carried out every quarter as described in 9.21 below.
- 9.16 Luxembourg regulations require the insurer to hold Tied Assets with a custodian bank as described in Section 7. SWE has decided to hold FWH as part of these Tied Assets. Without the FWH arrangement, SWE would have required a larger capital injection from SWL to provide them with enough assets to deposit with a custodian as SWE's reinsurance recoverable asset would not be acceptable as a Tied Asset.

Initial reinsurance cashflows

- 9.17 At the Effective Date SWE becomes liable to pay a reinsurance premium to SWL. This is held back as the FWH.
- 9.18 The initial premium will be the higher of (i) Solvency II BEL backing the reinsured business excluding with-profit estate and (ii) Luxembourg GAAP reserves.

Subsequent reinsurance cashflows

- 9.19 After the initial cashflows, the Reinsurance Agreement requires SWE to pay SWL:
- an ongoing premium, which will be the premiums received from the Transferring UWP Policyholders net of allocation charges and applicable tax deductions; including any Loyalty Bonus units created under the policy terms and conditions
 - any premiums net of allocation charges for Transferring UWP Policies that switch from unit-linked funds to GGFs in accordance with policy provisions.
- 9.20 SWL will pay SWE:
- other charges made by unit deduction (e.g. policy fees and mortality charges) to cover administration and benefit costs
 - for any reinsured Transferring UWP Policy that claims, the bid value of the units for the policy, after making allowance for any bonus or MVA at the time, as well as any guarantee uplift
 - annuity benefits that are payable post-Transfer, including guaranteed annuity payments and with-profits bonuses.
- 9.21 SWE will be able to utilise the assets in the FWH for the purpose of liquidity management (ie day-to-day transactions relating to premiums and claims). An operational rebalancing of the FWH will be carried out every quarter for differences between the change in value of the FWH assets and the change in value of the reinsurance reserves in SWL.
- 9.22 SWL will need to provide information to SWE for each fund on a daily basis to ensure the correct unit prices are used for all policyholder transactions, including for any claims at the time of death, surrender, or maturity. SWL will also provide SWE with details of relevant bonus and market value adjustments in relation to GGFs.
- 9.23 The Reinsurance Agreement requires SWE to provide SWL with details of regular premiums, additional single premiums, switches, claims and other adjustments in respect of unit funds for the purpose of validating payments to be made between SWL and SWE, which will be agreed with SWL.

Impact of the Reinsurance Agreement on policyholders

- 9.24 The intention of the Reinsurance Agreement is to allow the CM WPF to operate as it currently does, and therefore preserve the interests of both the Transferring UWP Policyholders and Non-transferring Policyholders in the CM WPF. In particular, as set out in 9.7, the split of risks on the Transferring Business between the CM WPF and shareholders will not change (although some risks previously borne by SWL shareholders will be borne by SWE shareholders after the Transfer).
- 9.25 As the Reinsurance Agreement does not impact the Transferring UL I will not be discussing this group of policyholders below.

Transferring UWP Policyholders

- 9.26 The Reinsurance Agreement allows the CM WPF to continue to operate as a whole fund, as it did before the Transfer, retaining the existing range of discretionary management actions that are available to manage the fund for the benefit of all policyholders.
- 9.27 The assets of the CM WPF, including those backing the Transferring UWP Policies, will continue to be managed in line with the CM WPF PPFM. This means that there is no material change to policy management for the Transferring UWP Policyholders, with regard to the investment strategy and the estate distribution, because the same principles and practices will be followed after the Transfer. Additionally, the terms of the 2015 Scheme, concerning either the separate maintenance of the CM WPF or the cessation of the CM WPF, will continue to be applicable after the Transfer.
- 9.28 The PPFM will be amended to reflect the change that the Transferring UWP Business will become reinsured business rather than direct business of SWL.

- 9.29 The SWE Board will have the principal oversight role for managing the business of SWE after taking appropriate actuarial advice. The SWE Chief Actuary, who will have access to all appropriate SWL information, will advise the SWE Board on matters regarding the management of the Transferring UWP Business. The Reinsurance Agreement creates additional governance requirements for the SWE Board to follow the decisions made by the SWL Board with regards to any bonus declaration, determination of market value adjustment or similar matter (such as estate distribution, smoothing etc), unless, to do so would be deemed inappropriate after following the additional governance described in 6.46 and 7.44. The SWL WPA and WPC will continue to provide advice on the management of the CM WPF, taking into account the reinsurance of the Transferring UWP Business.
- 9.30 In the unlikely event of SWL's insolvency, SWE will keep the FWH, up to the amount owed to them by SWL, to pay the liabilities for the Transferring UWP Policyholders, and will rank pari passu to the direct policyholders for any amount in excess of the FWH.

Conclusion

- 9.31 Overall, I am satisfied that the Reinsurance Agreement allows Transferring UWP Policyholders' interests to be managed in materially the same way before and after the Transfer. This is because:
- the CM WPF is governed effectively by a materially unchanged PPFM as it was before the Transfer, and the Transferring UWP Policies continue to be governed by the 2015 Scheme
 - the governance surrounding the operation and management of the Transferring UWP Policies, including the investment strategy and governance surrounding the distribution of the estate of the CM WPF to Transferring UWP Policies, is equivalent to that prior to the Transfer
 - the FWH provides additional liquidity to SWE and provides protection to the policyholders in the event of SWL becoming insolvent.

Non-transferring Policyholders

- 9.32 The Reinsurance Agreement allows the CM WPF to, in effect, continue to operate as a whole fund with broadly the same management arrangements, as it did before the Transfer. There will be no change to the investment strategy and estate distribution as a result of the Transfer. Therefore, there will be no material adverse effect on the management of business for the Non-transferring Policyholders in the CM WPF.
- 9.33 The Reinsurance Agreement aims to preserve the interests of both the Transferring Policyholders and Non-transferring Policyholders, but as SWE retains the legal title of the FWH, it will keep the FWH, up to the amount owed to them by SWL, in the remote event of SWL becoming insolvent. This, in effect, gives the Transferring UWP Business higher ranking over the FWH than the Non-transferring Policyholders, in the event of SWL's insolvency.
- 9.34 I have analysed the likelihood of insolvency of SWL and consider this to be an extremely remote event as discussed in paragraph 9.103.
- 9.35 In addition, as the Transferring Business represents only 2% of SWL's overall business, the impact of the higher ranking of the Transferring UWP Policyholders in respect of FWH will have an immaterial impact on the benefit expectations and security of the Non-transferring Policyholders in the unlikely event of SWL's insolvency.
- 9.36 The purpose of the Reinsurance Agreement is to enable the continued servicing of the Transferring Business regardless of the outcome of the Brexit negotiations. In my opinion, having certainty about how Transferring Policies will be serviced after the Brexit is very important. The higher ranking of SWE with respect to the FWH is an unavoidable consequence of providing this certainty.

Conclusion

- 9.37 Overall, I am satisfied that the Reinsurance Agreement allows Non-transferring Policyholders' interests to be managed in materially the same way after the Transfer as they were before. This is because:
- there will be no material impact on the management of business for the Non-transferring Policyholders

- as the Transferring Policyholders represent only 2% of SWL's overall business and the likelihood of SWL becoming insolvent is very remote, I consider the impact of the higher ranking on the benefit expectations of the Non-transferring Policyholders in the case of SWL's insolvency to be immaterial
- the higher ranking of SWE with respect to the FWH is an unavoidable consequence of ensuring certainty in servicing the Transferring Policies after Brexit.

Termination of the Reinsurance Agreement

- 9.38 The Reinsurance Agreement can be terminated either in its entirety or partially. The following subsections describe the scenarios under which the termination can happen, the governance required for the termination, how the termination amount is determined and the protections for the Transferring UWP Policyholders after the termination.

Scenarios in which the Reinsurance Agreement can be terminated

- 9.39 SWL and SWE do not have any intention to terminate the Reinsurance Agreement in the foreseeable future, however termination could happen under the following circumstances:
- (i) SWL and SWE may terminate the Reinsurance Agreement by mutual agreement; or
 - (ii) SWE may terminate the Reinsurance Agreement if:
 - SWL goes into voluntary liquidation other than for the purpose of reconstruction or amalgamation approved by SWE
 - SWL becomes unable to pay its debts as they fall due
 - SWL has entered into, or has taken steps towards entering into a general assignment, arrangement or composition with or for the benefit of its creditors
 - a judgement of insolvency or bankruptcy is made against SWL or a court order is made for its rehabilitation, winding up or compulsory liquidation
 - SWL seeks or becomes subject to the appointment of an administrator, liquidator, trustee, custodian or other similar official appointed over it or all (or substantially all) of its assets
 - SWL has a holder of any security over all or a substantial part of SWL's assets which takes steps to enforce that security or commences a procedure to enforce that security over all or a substantial part of SWL's assets which are subject to distress, execution, attachment, sequestration or other legal process, or
 - SWL causes or is subject to any analogous event with respect to it under the applicable laws of any jurisdiction to any of the events specified above.
- 9.40 SWL and SWE are not entitled to terminate the Reinsurance Agreement unilaterally under any other circumstances.

Governance for terminating the Reinsurance Agreement

- 9.41 The procedure to be followed for the termination is set out in the Reinsurance Agreement. The termination could occur provided that:
- (i) When the termination is with mutual agreement:
 - a report is obtained from an independent actuary confirming that neither Transferring Policyholders nor the Non-transferring Policyholders will be materially adversely affected by the termination and the termination amount that will be paid by SWL is fair and reasonable
 - the independent actuary will also consider matters regarding the ongoing protection and governance of the Transferring Policies after the termination and consider how

these compare to those in place prior to termination; (including but not limited to the protections provided by the PPFM, the 2015 Scheme and regulations concerning the fair treatment of customers)

- both parties have notified their regulators of the proposed termination, accompanied by the report of the independent actuary, details of the proposed termination amount payable and any further information required by the regulators, and received no objection to such termination and the termination amount within 60 business days of notification to the regulators.
- (ii) When the termination is due to the conditions listed in paragraph 9.39 (ii) above:
- the termination amount must be certified by an independent actuary confirming that the amount that will be paid by SWL is fair and reasonable
 - both parties have notified their regulators accompanied by the certificate of the independent actuary, and received no objection to such termination value within five days of notification.

Determining the termination amount

9.42 Upon termination of the Reinsurance Agreement, SWL will pay SWE a termination amount agreed by both parties. The calculation of the termination amount will take into consideration the following factors:

- the PPFM in force, including any expectation of the policyholders arising from the eligibility to share in the distribution of the estate
- applicable policy provisions
- relevant provisions of the Scheme
- market and investment conditions prevailing at the relevant time
- the effects of the termination on the SWE and SWL policyholders in the CM WPF.

9.43 In the event of any dispute between the parties, the dispute will be referred to two arbitrators, one chosen by each party. If the two arbitrators cannot agree, then an umpire will be appointed to settle the dispute.

Legal advice on FWH in the event of the termination of the Reinsurance Agreement

9.44 I have discussed the provisions for the FWH with SWL and its legal advisers to provide understanding and challenge on the operations of the provisions. I have also consulted Independent Legal Counsel on the operation of these provisions and its effect on the protection offered to policyholders, should the Reinsurance Agreement terminate due to either insolvency or by the other termination events. Counsel has confirmed that, although untested in an insolvency event, they believe the provisions would operate as intended.

9.45 Therefore, given my own understanding of the Reinsurance Agreement and the advice I have received, I am satisfied that the FWH should work as intended.

Provisions in the Scheme regarding the amendments and modifications in the Reinsurance Agreement

9.46 The Scheme also has provisions regarding the amendments and modifications to the Reinsurance Agreement and the Scheme. These provisions require a report from an independent actuary and receiving no objection from the Luxembourg and UK regulators within 45 business days of notification for most of the changes except those related to minor technical changes or changes in tax or legislation.

Impact of termination of the Reinsurance Agreement on policyholders

- 9.47 The Reinsurance Agreement includes provisions that are intended to protect the Transferring Policyholders and Non-transferring Policyholders upon termination. I consider these provisions below.
- 9.48 As the Reinsurance Agreement does not directly impact the Transferring UL Policyholders or the Other Non-transferring Policyholders I will not be discussing these groups of policyholders below.

Transferring UWP Policyholders and Non-transferring Policyholders in CM WPF

- 9.49 On termination of the Reinsurance Agreement, there is a specific process that must be followed, including provisions around the division of the CM WPF.
- 9.50 The procedures involved in the event that SWE and SWL mutually decide to terminate the Reinsurance Agreement include consulting with an independent actuary to ensure the termination outcomes are fair for all policyholders, the termination amount is reasonable and receiving no objections from the UK Regulators and the CAA.
- 9.51 The termination of the Reinsurance Agreement would trigger the calculation of a termination amount. Calculation of this termination amount would necessitate that the assets within funds of SWL relevant to the Reinsurance Agreement are divided fairly between SWL's direct policyholders, ie Non-transferring Policyholders within the CM WPF and the Transferring UWP Policyholders. In particular, the estate associated with the CM WPF would need to be distributed fairly, between these two groups, after consideration of relevant factors as set out in paragraph 9.42.
- 9.52 The governance procedures, as described in 9.41 that must be followed if SWL and SWE mutually decide to terminate the Reinsurance Agreement safeguard the policyholders' benefits; these procedures are reasonable and consistent with what I have seen elsewhere under similar situations. Termination of the Reinsurance Agreement by mutual agreement cannot take place unless the independent actuary issues a report confirming that such future protections and governance will result in no material adverse impact for either the Transferring Policyholders or the Non-transferring Policyholders.
- 9.53 In case the Reinsurance Agreement is terminated unilaterally due to SWL's insolvency, the process requires obtaining a certificate from an independent actuary stating that the termination amount is fair and reasonable and with no objection from the Luxembourg and UK Regulators on the termination amount. The requirements around governance of the Transferring UWP Policies post termination are not as detailed as those under the termination by mutual consent. If SWL were to become insolvent, and the Reinsurance Agreement subsequently terminated, the priority would be to ensure the Transferring UWP Policyholders receive a fair and reasonable termination amount as quickly as possible rather than ensuring the governance and management of the Transferring UWP Policies is appropriate. However, I would expect the independent actuary, as part of his or her role, to consider the protections available for the policyholders after the termination. The SWE Chief Actuary will continue to advise the SWE Board in relation to actuarial matters under Luxembourg regulations. I expect the SWE Board, the SWE Chief Actuary and the other key function holders to continue to fulfil their obligations as defined in the Law of 2015 and the high level principles under Luxembourg common civil law which require the insurance companies to have the duty to act loyally and in good faith towards their policyholders at all times.
- 9.54 The Reinsurance Agreement cannot be terminated unilaterally in the event of SWE becoming insolvent. This is to prevent a potential adverse impact on the security of the Transferring UWP Policyholders as this termination would be at the time when SWE would be least able to operate and govern the reinsured business. The termination of the Reinsurance Agreement might also make it more difficult to transfer the business to a third party. However, the right to terminate by mutual agreement continues to exist under this situation if both parties determine that this is the best course of action. In such circumstances, maintaining provision of reinsurance cover would not have a material effect on the Non-transferring Policyholders as SWL does not have a material counterparty exposure to SWE.

Conclusion

- 9.55 Overall I am satisfied that the provisions governing the termination of the Reinsurance Agreement provide suitable protection for the Transferring UWP Policyholders and Non-transferring Policyholders within the CM WPF in the context of their interests in the CM WPF. This is because:
- the events under which the Reinsurance Agreement can be terminated are reasonable, being based on either mutual agreement or on objective measures of SWL being distressed, so do not allow SWL to terminate the agreement in a way that could cause material detriment to Transferring Policyholders, undermining risk transfer
 - the governance on the division of the CM WPF includes regulatory involvement, the involvement of an independent actuary, and the consideration of the PPFM in force including any expectation of the policyholders arising from the eligibility to share in the distribution of the excess estate. These are sufficient to ensure a fair outcome
 - when the termination is mutually agreed the independent actuary needs to consider the protections and governance of the business under SWL and SWE to ensure these do not materially adversely impact the policyholders
 - in case of termination due to insolvency of SWL the termination provisions require the involvement of an independent actuary to ensure that the termination amount is fair and require no objection from either the Luxembourg or UK Regulators within 60 business days. The termination process upon the insolvency of SWL is designed to ensure that SWE receives an appropriate termination amount as quickly as possible. The SWE Board, the SWE Chief Actuary and the other key function holders will continue to fulfil their obligations and act loyally and in good faith towards their policyholders at all times as required by the Luxembourg regulations.

The Indemnity Agreement

- 9.56 As mentioned in Section 4 and 6, SWL has experienced German business litigation claims in relation to the Transferring Business. Following the Transfer, the Transferring Business will become the responsibility of SWE, and SWE will become exposed to such claims. To mitigate this risk, SWL and SWE will enter into an Indemnity Agreement, as part of the Transfer. The Indemnity Agreement will ensure that SWL compensates SWE for the payment of these claims. The Indemnity Agreement will also include other activities carried out prior to the Transfer that could give rise to any litigation claims in the future.
- 9.57 The Indemnity Agreement sets out the proportion of litigation claims that will be borne by SWL and SWE. I have outlined these below:
- SWL will pay SWE for 90% of the costs of the German business litigation claims, including the associated expenses
 - SWE will be responsible for paying the remaining 10% of the costs up to a limit of €60million. After the claims paid by SWE reach €60million, SWL will pay 100% of the claims and the associated expenses thereafter
 - SWL will pay 100% of any other claims arising from SWL's actions in respect of the Transferring Policies prior to the Transfer.
- 9.58 The payments in SWL will be borne by the shareholders of SWL through the Combined Fund.
- 9.59 The initial capital injection from SWL to SWE includes provision for these claims and their impact on SWE's SCR.
- 9.60 SWE will meet 100% of any claims arising from its conduct of business post the Transfer.
- 9.61 The Indemnity Agreement outlines the process required to agree and settle these claims; this includes the requirement for SWE to notify and provide regular reports to SWL and the approval process to follow for the resolution of these claims. I am satisfied that this process ensures SWL will bear the cost for the claims under the Indemnity Agreement.

- 9.62 SWE is expected to adopt the procedures, which currently operate under SWL for the administration of the litigation claims.
- 9.63 The Indemnity Agreement can only be terminated by SWE under the scenarios defined under the Reinsurance Agreement, as shown in paragraph 9.39 (ii). If the Indemnity Agreement is terminated, the two parties will agree on an aggregate amount that SWL has to pay SWE. This will be determined by considering SWL's liability over the remaining life of the agreement, assuming it had not been terminated, and the reserves SWL holds in respect of these claims.
- 9.64 In the event SWL and SWE are unable to agree upon the termination amount within 45 business days of the termination, the disagreement will be referred to an independent actuary who will help determine a fair and reasonable amount to be paid by SWL. The Indemnity Agreement also defines an arbitration process in case of a disagreement between SWL and SWE under other circumstances.
- 9.65 The Indemnity Agreement will expose SWE to counterparty risk with SWL. To manage this risk, the exposure under the Indemnity Agreement will be covered by the Charge Agreement. In case a termination event is triggered due to the insolvency of SWL, the Charge will crystallise and SWE will have the same creditor ranking as the direct policyholders of SWL.
- 9.66 The Indemnity Agreement will be independent of the Reinsurance Agreement. If the Reinsurance Agreement is terminated with mutual agreement, the Indemnity Agreement could still continue to be in effect and covered by the Charge Agreement.
- 9.67 If there is a significant increase in litigation claims after the Charge is crystallised and termination amounts are paid to SWE for both reinsurance and the indemnity, then SWE will have to cover the increase in litigation claims. However, I consider the insolvency of SWL to be a remote event as discussed in paragraph 9.103.

Impact of the Indemnity Agreement on the policyholders

- 9.68 Within this Section I consider separately the impact of the Indemnity Agreement on the Transferring Policyholders and Non-transferring Policyholders.

Transferring Policyholders

- 9.69 The Indemnity Agreement protects SWE and the Transferring Policyholders against exposure to German business litigation claims beyond the cap determined in the Indemnity Agreement and any claims that may arise due to SWL's conduct of the business prior to the Transfer.
- 9.70 There are sufficient controls as described in 9.63, 9.64 in place to ensure that the security of benefits of the Transferring Policyholders will not be adversely impacted by the termination of the Indemnity Agreement.
- 9.71 As described in 6.64, SWE will hold provision for its share of the German business litigation claims. This will be met by the assets that will be transferred to SWE and corresponds to 10% of the provisions SWL holds for these claims prior to the Transfer. This is potentially more than SWE's share of these claims defined in the Indemnity Agreement considering SWE's share is limited with the cap. The adequacy of the provision that SWL holds for these claims is subject to regular reviews involving relevant committees of SWG and internal and external audit. Any increase in this provision and corresponding provision in SWE after the Transfer will be met by SWE shareholders.
- 9.72 Overall, I am satisfied that the Indemnity Agreement together with the Charge Agreement provide suitable protection for the Transferring Policyholders from litigation claims arising from SWL's conduct of business prior to the Transfer and SWE will hold provisions for its share of these claims and the assets that will be transferred to SWE will cover these provisions.

Non-transferring Policyholders

- 9.73 Prior to the Transfer SWL would have borne the German litigation claims, therefore the exposure of SWL to German litigation claims will not increase as a result of the Indemnity Agreement.
- 9.74 Overall, I am satisfied that the Indemnity Agreement allows the Non-transferring Policyholders' interests to be managed in materially the same way after the Transfer as they were before.

Tax implications of the Indemnity Agreement

- 9.75 I have relied on SWL's tax expert's advice that there will be no net UK or Luxembourg corporation tax impact arising from the Indemnity Agreement. If there were to be any tax impacts as a result of the Indemnity Agreement, these would be borne by the shareholders of SWL.

The Charge Agreement

- 9.76 In association with the Reinsurance and Indemnity Agreement, SWL and SWE will enter into the Charge Agreement. The aim of the Charge Agreement is to provide protection to SWE in the event of SWL's insolvency against the exposure to:
- the Reinsurance Agreement, in respect of the amount to be paid to the Transferring UWP Policyholders in excess of the FWH, such as estate distribution (Excess Amount)
 - the Indemnity Agreement.
- 9.77 The Charge will be placed over all of the assets of SWL, except the assets of the SWL WPF and those assets which are subject to security other than a pari passu floating charge. The taking of a floating charge is commonplace when firms negotiate commercial agreements
- 9.78 As a result of the Reinsurance Agreement, SWE will be treated as a reinsurance policyholder of SWL. Under UK insolvency legislation, when an insurer is declared insolvent, direct policyholders are prioritised ahead of reinsurance policyholders or other unsecured creditors. However, as well as entering into the Reinsurance Agreement and Indemnity Agreement, SWE and SWL will enter into the Charge Agreement. The Charge has been structured in such a way that if SWL were to be declared insolvent, SWE would have the same ranking as Non-transferring Policyholders prior to the Transfer (i.e. that of a direct policyholder). Below I describe how the Charge works and analyse whether, in my opinion, it works in the desired manner.
- 9.79 The Charge is a floating charge over all the assets of SWL (excluding assets of the SWL WPF and any asset subject to security other than a pari passu floating charge, including where prior consent would be required). The floating charge would crystallise into a fixed charge, should SWL become insolvent. As a result of the granting to SWE of the Charge, SWE will become a secured creditor of SWL and will therefore rank above the direct policyholders of SWL.
- 9.80 However, there are further provisions within the Charge, which limit the amount of recovery SWE is entitled to on the winding-up of SWL to such an amount as SWE would have been entitled to recover, had SWE been an ordinary direct policyholder of SWL.

Legal advice on the Charge Agreement

- 9.81 I have discussed these provisions and the floating charge with SWL and its legal advisers to provide understanding and challenge on this specific issue. I have also consulted Independent Legal Counsel on the operation of these provisions and floating charge, and its effect on the protection offered to policyholders, should the agreements terminate due to either insolvency or by the other termination events. Counsel has confirmed that, although untested in an insolvency event, they believe the provisions would operate as intended.
- 9.82 Therefore, given my own understanding of the Charge and the advice I have received, I am satisfied that the Charge should work as intended.

Negative pledge

- 9.83 The existence of a negative pledge in a security agreement may prohibit, to a certain extent, SWL from granting any further charges over the assets secured by that security agreement. SWL has existing charges that contain negative pledges. However, these charges are not over either the transferring policyholders' investment funds or SWL's free assets, they are over specific assets or custodian accounts.
- 9.84 The Charge associated with the Reinsurance Agreement and Indemnity Agreement does not include a negative pledge, and therefore does not prohibit any further charges, which SWL may wish to enter into in the future. Given the Charge is over all assets of SWL except those detailed in paragraph 9.77,

which in aggregate represents a group of assets much larger than the benefits covered by the Reinsurance Agreement or Indemnity Agreement, I do not believe the omission of the negative pledge materially changes the position of the Transferring Policyholders post the Transfer.

Conclusion

9.85 Overall I am satisfied that the floating charge will work as intended to provide equalisation of the Non-transferring Policyholders and Transferring Policyholders because:

- the provisions within the Charge align the recovery of SWE under the Reinsurance Agreement in relation to the Excess Amount and Indemnity Agreement with that of SWL's direct policyholders
- the omission of a negative pledge is not an issue for the reasons set out in 9.84
- whilst the provisions of the Charge are untested in an actual insolvency event, SWL's legal advice and Independent Counsel concur that it should work as intended.

Impact of the Charge on the policyholders

9.86 These provisions described above have the effect of aligning SWE and the Non-transferring Policyholders in relation to the distribution of the assets of SWL in the event of SWL being insolvent.

9.87 I have reviewed the likelihood of a shortfall under SWL's insolvency and consider this to be an extremely remote event. However, if there is a shortfall then without the Charge Agreement, SWE would be disadvantaged as even a relatively small shortfall could result in the recovery to which SWE would be entitled to reduce significantly. The Charge Agreement ensures that SWE would still share in the insolvency estate and rank pari passu with the direct policyholders.

9.88 Therefore, after the Transfer is put in place, I am satisfied that the Charge aligns the recoveries related to the Excess Amount under the Reinsurance Agreement and recoveries under the Indemnity Agreement for SWE with those of the direct policyholders of SWL, and thus ensures that SWE's position is the same as that held by direct policyholders of SWL.

The Unit Linked Service Agreement

9.89 To enable the continuity of the operations of the Transferring UL Business, SWE will enter into the Unit Linked Service Agreement with LB. This agreement will allow LB to provide support for the back office management tasks related to the Transferring UL Business, however, SWE will still be responsible for undertaking these functions.

9.90 The Unit Linked Service Agreement will become effective on the Effective Date and will provide support to SWE in relation to:

- box management of the unit-linked funds
- unit pricing
- carrying out appropriate controls and audits on the processes for unit pricing and box management relating to the unit-linked funds, with SWE receiving these audits to monitor the effectiveness of the outsourced services.

9.91 SWE shareholders will pay LB a variable fee for the support it provides under the Unit Linked Service Agreement. The fees payable will be in relation to the direct costs incurred by LB and include costs such as employee remuneration, training and development and IT equipment.

Requirement of a UK branch for SWE

9.92 SWL's internal legal team have advised that, as all regulatory activities and administration of policies will take place in the EEA, the Unit Linked Service Agreement will not require SWE to seek authorisation in the UK as a third country branch post-Brexit.

Impact of the Unit Linked Service Agreements on the policyholders

- 9.93 Within this Section I consider separately the impact of the Unit Linked Service Agreement on the Transferring and Non-transferring Policyholders.

Transferring UL Policyholders

- 9.94 The Unit Linked Service Agreement ensures that the operations of the Transferring UL Business will be managed in the same manner before and after the Transfer. The service standards and fund management of the Transferring UL Business will remain unchanged. The fees to LB for providing this service will be borne by the shareholders of SWE.
- 9.95 There will be no material impact on the operations of the Transferring UL Policies as a result of the Transfer.

Transferring UWP Policyholders and Non-transferring Policyholders

- 9.96 The Unit Linked Service Agreement will be independent of the Transferring UWP Business and the Non-transferring Business. Therefore, there will be no impact on the Transferring UWP Policyholders and the Non-transferring Policyholders as a result of the Unit Linked Service Agreement.

Impact of residual counterparty default risk exposure on SWE

- 9.97 The Reinsurance Agreement and Indemnity Agreement introduce additional counterparty default risk to SWE. This Section considers the impact of this increased counterparty default risk exposure on the Transferring Policyholders in light of the mitigation of this risk via the Charge Agreement. This section considers the economic exposure and not the Solvency II Standard Formula impact on the Charge Agreement.
- 9.98 As the residual counterparty default risk affects SWE, it is not applicable to the Non-transferring Policyholders, and they are therefore not considered in the paragraphs below.

Transferring Policyholders

- 9.99 The Charge Agreement discussed in paragraphs 9.76 to 9.88 above, helps to mitigate SWE's counterparty default risk exposure to SWL on insolvency, arising from the Reinsurance Agreement and Indemnity Agreement. There is residual exposure in the event of SWL having insufficient assets to cover all of its policyholder liabilities.
- 9.100 For the Transferring UWP Policyholders, the FWH ensures that the counterparty default risk only applies to liabilities in excess of the FWH. Any counterparty default risk related to the Indemnity Agreement will apply to SWL's share of litigation claims.
- 9.101 As SWE will not actively seek new business, SWE's counterparty default exposure to SWL will follow a similar pattern to the run-off profile of SWE's business, which would extend beyond 40 years taking into account the vesting with-profits annuities.
- 9.102 In the event of SWL's insolvency, the Charge Agreement will enable SWE to rank equally with the direct policyholders of SWL. For example, if upon the wind-up of SWL, there was a 10% shortfall between assets and liabilities, after paying priority charges, SWE would receive 90% of the amounts due in excess of the FWH under the Reinsurance Agreement, and 90% of the amount due under the Indemnity Agreement.
- 9.103 The probability of SWL winding up with insufficient assets is remote. Under Solvency II rules, SWL holds an SCR to cover 1-in-200 year adverse risk events. SWL also holds additional capital via the Risk Margin and the Capital Buffer. Whilst it is difficult to model extreme events, according to SWL's calculations, the probability of a risk event exhausting this capital within one year is less than 1 in 2000. The probability of a deficit as high as 10% is less than 1 in 100,000.

Conclusion

9.104 Although SWE is exposed to residual counterparty default exposure as a result of the Reinsurance Agreement and Indemnity Agreement, it will not materially adversely affect SWE because:

- SWL's reverse stress testing modelling shows that the probability of SWL's insolvency is remote and the probability of a shortfall is even more remote
- for the Transferring UWP Policyholders the FWH ensures that the counterparty default exposure is limited to the amounts due in excess of the FWH
- although the Transferring Business will be exposed to a residual risk that SWL is unable to meet its obligations, the risk of this is remote and could be expected to occur at similar probability levels as prior to the Transfer.

10 Consideration of SWL's and SWE's risk profile and capital projections, and the impact of these on the security of policyholder benefits

Introduction

- 10.1 When discussing whether or not the Transfer materially adversely affects policyholders, a key part of my consideration is the security of policyholder benefits, and the impact of the Transfer on this security.
- 10.2 My analysis of the impact of the Transfer on policyholder security considers the level of capital available to SWL and SWE, their ability to satisfy their solvency requirements, and their current and projected capital positions. A commonly used measure of security in the insurance industry is the SCR Cover Ratio. As this measure is widely used, I have considered this when assessing whether or not the Transfer materially adversely affects the security of policyholder benefits.
- 10.3 To support my assessment, it was necessary to understand the risk profile of SWL both before and after the Transfer, as well as the risk profile of SWE after the Transfer. Gaining this understanding was important as any significant change in risk profiles as a result of the Transfer, could potentially affect policyholder security.
- 10.4 Most insurers, including SWL and SWE, will have a target SCR Cover Ratio that they wish to maintain. To do so, they actively monitor their actual position against this target (note that the respective methodologies for determining the targets for SWL and SWE are provided in paragraphs 4.49 and 6.28). In the event that an insurer's SCR Cover Ratio falls below its target level, the insurer will implement contingency plans with the aim of restoring the SCR Cover Ratio to its target level. SWL's and SWE's target SCR Cover Ratios are determined by their SRAs. SWL's SRA is to be able to withstand a 1 in 10 stress and still cover its Pillar 2 capital requirement; SWE's is expected to be identical to this.
- 10.5 In this Section, I consider the following:
- security of benefits within SWL
 - security of benefits within SWE
 - how the solvency of SWL before the Transfer compares to that of SWE after the Transfer (relevant to Transferring Policyholders).
- 10.6 The Non-transferring Policyholders hold policies with SWL both before and after the Transfer, and therefore the impact of the Transfer on the financial position of SWL is of primary interest.
- 10.7 As a result of the Transfer, the Transferring Policyholders will become policyholders of SWE, and therefore they will be primarily interested in the financial position of SWE after the Transfer, and how this compares to the financial position of SWL before the Transfer. The Transferring Policyholders will continue to be exposed to the financial position of SWL through the Reinsurance Agreement, so this will also be of some interest to the Transferring Policyholders.

SWL security of benefits

Risk profile

- 10.8 I have reviewed the components of the SCR calculations carried out by SWL using its Internal Model as at 31 December 2017, and the top five risks are shown in the table below.

	Total SWL	SWL WP Funds only (CM WPF and SW WPF)
1	Credit spread	Interest rate
2	Longevity	Equity
3	Equity	Credit spread
4	Persistency	Model
5	Operational*	Longevity

* Operational risk excluding the risk associated with the German business litigation claims in business written under EU passporting rights, as described in 4.68.

- 10.9 The table above shows that the most material risks to SWL are credit spread, longevity and equity risks. The top five risks of the SWL with-profits funds are dominated by market risks (which account for c. 90% of the SCR for the CM WPF and SW WPF), as shown in the table above.
- 10.10 The Transferring Policies constitute a relatively small proportion of SWL's total BEL, therefore the Transfer does not result in any significant changes to SWL's risk profile. Although SWL will not be directly exposed to the risks associated with the Transferring Policies after the Transfer, other than those reinsured back to SWL, German litigation claims and any claims arising from SWL's conduct of business prior to the Transfer, it will continue to be indirectly exposed to these risks through its ownership of SWE. SWL will also be exposed to additional operational risk as a result of the establishment of an insurance subsidiary.

Conclusion

- 10.11 Overall, any changes to the risk profile in SWL following the Transfer is expected to be small. In addition, no changes are planned to the way SWL currently manages its risks.

Capital

Solvency capital

- 10.12 As described in paragraph 10.4, SWL holds capital in excess of its SCR in order to mitigate the risk of breaching the SCR (i.e. having an SCR Cover Ratio of less than 100%). SWL aims to hold a SCR Cover Ratio in line with its target level, calculated on the Solvency II Pillar 2 basis.
- 10.13 The table below shows the Solvency II Pillar 1 capital position of SWL, calculated using its Internal Model, before and after the Transfer as at 31 December 2017, assuming that the Transfer had taken effect on that date.

£m	SWL before Transfer				SWL after Transfer			
	SW WPF	CM WPF	Combined Fund	Total	SW WPF	CM WPF	Combined Fund	Total
Own Funds(*)	1183	395	7,760	8,412	1,183	395	7,592	8,244
SCR	417	235	5,361	6,014	417	235	5,397	6,050
Excess Capital over SCR	766	159	2,398	2,398	766	159	2,194	2,194
SCR Cover Ratio	284%	168%	145%	140%	284%	168%	141%	136%

All numbers in the above table are rounded to the nearest whole number.

() Note that the Total Own Funds does not equal to the sum of the Own Funds of the SW WPF, CM WPF and Combined Fund as SWL is restricted to only recognising the Own Funds in the SW WPF and CM WPF required to meet their respective SCR.*

- 10.14 The table above indicates that there is no change in the financial position of the SW WPF and CM WPF, but the excess capital over SCR and the SCR Cover Ratio of the Combined Fund are reduced as a result of the Transfer.
- 10.15 On a Pillar 2 basis SWL holds Own Funds in excess of its SCR both pre and post-Transfer. The SCR Cover Ratio of SWL decreases following the Transfer, however its solvency position sits within the Green zone considering its risk appetite as defined within its CMP.
- 10.16 The reduction in Own Funds is mainly due to the transfer of assets and liabilities associated with the Transferring Policies from SWL to SWE, putting in place the Reinsurance Agreement and the Indemnity Agreement and the cost of establishing SWE including the capital injection. The post-Transfer SCR increases as it includes SWE capital, which is more onerous as it is calculated using Standard Formula and there is loss of diversification due to the Transfer.

Conclusion for solvency capital

- 10.17 In my opinion, SWL is well capitalised both before and after the Transfer. It has a CMP that aims to maintain a strong capital level including appropriate management actions to withstand adverse economic scenarios and this policy will remain in place after the Transfer. There is a reduction in SCR Cover Ratio following the Transfer but its solvency position sits within the Green zone considering its risk appetite within its CMP.

Economic Capital

- 10.18 Firms often produce solvency information on an economic capital basis in order to present a firm's internal view of its capital requirement based on its risk appetite in addition to regulatory capital requirements.
- 10.19 SWL produces solvency information on a Solvency II Standard Formula basis and an Internal Model basis. In addition, SWL prepares solvency information on an economic capital basis. This is the same basis on which the ORSA is prepared, which is reported internally and monitored regularly.

Capital projections

- 10.20 In addition to reviewing the immediate capital positions before and after the Transfer, I also consider the projected capital position. I have been provided with SWG's ORSA, which includes analysis showing capital projections under a base scenario for SWL and SWG and adverse scenarios for SWG, over a five year planning horizon (from 2017 to 2021).
- 10.21 The best estimate projection within SWL's ORSA based on its economic capital basis shows an SWL capital position that remains in the Green zone, even after allowing for the payment of dividends.
- 10.22 The stress and scenario analysis I have been provided with (in the ORSA) is on SWG's economic capital position. However, it gives a good indication of the impact of scenarios on SWL as majority of SWG's capital requirement is due to SWL (SWL's SCR comprises c97% of the total SWG SCR).
- 10.23 The capital projections and the stress and scenario analysis are based on an economic capital basis. This is consistent with how SWL's internal risk appetite metrics are set and managed. In the capital projections, the level of dividends are set so that SWL has the target buffer it aims to operate for the five year planning period. The analysis indicates that SWL has a strong capital position and will be able to meet its regulatory requirement, target capital level and still pay dividends in the projection period.
- 10.24 SWL applied a number of adverse stress and scenario tests (as approved by the Insurance Board) and projected its SCR Cover Ratio under these circumstances. The majority of these stress and scenarios are 1-in-20 year likelihood, and one scenario is a 1-in-100 year likelihood. Under these tests:

- the regulatory capital requirements are met at all times over the five-year planning period for every test
 - with one exception, the SWL SCR Cover Ratio either remains within the Green zone or falls to within the Amber zone and increases towards the Green zone over the five-year planning period
 - the one exception relates to a severe bulk annuity scenario: within this scenario longevity and credit spreads are adversely stressed and MA approval is assumed to be delayed on a large annuity deal. This stress moves the SCR Cover Ratio into the Red zone. Under such a scenario, SWL would implement its Recovery and Resolution Plans as described in 10.26 below to return to the Green zone and might restrict volume or stop writing bulk annuities to help reduce further solvency strain.
- 10.25 In the event that SWL's current or projected (over the next twelve months) SCR Cover Ratio drops into the Amber zone, SWL's CMP sets out the potential management actions that SWL might take to restore its SCR Cover Ratio back to the target level. The management actions include more frequent solvency monitoring, asset hedging, withholding dividends and the sale of credit assets.
- 10.26 In the event that SWL's SCR Cover Ratio drops into the Red zone, SWL applies Recovery and Resolution Plans to move towards their target level. These plans include a variety of possible management actions that SWL can take to restore its SCR Cover Ratio back to its target solvency level. These management actions include, but are not limited to, withholding dividends, seeking capital support from LBG and cost savings. The Recovery and Resolution Plans also set out the viability measures for each of the actions:
- SWL's preference – a guide on preference depending on how difficult they are to implement and reputational impact
 - time to implement the action
 - impact on capital in base scenario and three different stress scenarios
 - impact on liquidity in base scenario and three different stress scenarios.

Conclusion for capital projections

- 10.27 The projections of SWL's SCR Cover Ratio are on an economic capital basis and I am satisfied that these provide a good indication of how the financial strength of SWL will develop in the future.
- 10.28 I have reviewed the stress and scenario tests within SWL's ORSA and am comfortable that they cover the main risks to which SWL is exposed. Additionally, SWL has taken a similar approach to that which I have observed at other insurers.
- 10.29 Based on my analysis above, SWL's position is stable over the projection period and it has a number of potential management actions available to control its solvency in adverse economic conditions. The medium term planning projections are not a cause for concern over SWL's future solvency.

Conclusion

- 10.30 Overall, I am satisfied that SWL is currently a well-capitalised entity and is expected to remain as such after the Transfer. My conclusions have been made based on capital projection information provided to me on request by SWL. I have reviewed the capital projections provided by SWL, and I am satisfied that they have been determined using an industry standard approach.
- 10.31 I have checked that the projections as well as the stress and scenario tests cover the main risks of SWL. I have also carried out high-level reasonableness checks of the trend in solvency ratios shown by the projections. I have not however, reproduced the numbers. I am satisfied that the projections are consistent with the opening Solvency II balance sheet as provided in this Report.
- 10.32 Much of the projection information is within SWL's ORSA, which has been subject to internal challenge and governance.

SWE security of benefits

Risk profile

- 10.33 Since SWE will be newly established to receive the Transferring Business from SWL under the Transfer, it does not have any pre-existing business. Further, SWE does not have plans for writing new business. Therefore, SWE's risk profile will be determined by the Transferring Business and the Scheme, together with the Associated Arrangements.
- 10.34 I have reviewed the components of SWE's expected day one SCR, based on the Transferring Business, the Scheme and the Associated Arrangements. The key risks that SWE will be exposed to following the Transfer are shown in the table below.

Rank	SWE Risks
1	Expense
2	Persistency
3	Counterparty default
4	Retained litigation claims
5	Equity

- 10.35 The Reinsurance Agreement enables SWE to transfer the investment guarantee risks associated with the Transferring UWP Business and the longevity risk associated with the vesting with-profit annuities to SWL. SWE will retain the other risks associated with the Transferring UWP Business. SWE will also retain the risks associated with the Transferring UL Business. As a result of the risks that will be retained by SWE, it will operate in a similar manner to an insurer that writes unit-linked business. There are, however, risks that SWE will have additional exposure to when compared to a typical insurer managing unit-linked business. These risks are expense and counterparty default risks.
- 10.36 The expense risk arises because SWE will have business in run-off and the per-policy expenses may increase as the business runs-off. The liabilities associated with the Transferring Business, especially after considering the vesting annuities included within the Transferring Business, will have a long duration. Therefore, SWE is also exposed to expense inflation risk. SWE will undertake various management actions to mitigate the impact of this risk and I discuss these further in 10.56 to 10.60.
- 10.37 SWE's counterparty risk relates to exposure to banks through cash holdings and exposure to SWL defaulting under the Reinsurance and Indemnity Agreement. SWE needs to hold capital for single counterparty exposure under the Standard Formula related to the cash holdings. The Charge reduces the economic exposure of SWE to SWL's possible insolvency or downgrade. However, credit cannot be taken for the Charge within the Standard Formula calculation of SWE's capital requirements. I consider the likelihood of the extreme scenarios resulting in a downgrade and the mitigation actions later in this Section.

Conclusion

- 10.38 Overall, under the Reinsurance Agreement, SWE transfers the investment guarantee risks associated with the Transferring UWP Business to SWL. However, as a result of the Transfer, SWE will be exposed to additional expense risk and counterparty default risk compared to typical insurers managing unit-linked business. I consider the mitigation plans SWE will be putting in place to address these risks later in this Section.

Standard Formula appropriateness

- 10.39 SWL uses an Internal Model for its regulatory SCR calculations and internal capital management. Following the Transfer, SWE's calculations for regulatory capital and internal capital management will be based on the Standard Formula.
- 10.40 SWL has performed a high-level assessment of the appropriateness of the use of the Standard Formula by SWE. This assessment demonstrates that the majority of SWE's risks are covered by the

Standard Formula (the exception being risks associated with the German litigation claims), and that the Standard Formula provides appropriate capital requirements for the material risks that SWE will face. The Solvency II Pillar 1 capital requirement figures within this Report assume that SWE calculates its SCR using the Standard Formula with an add-on to cover the retained litigation claims risk. The add-on represents additional capital to reflect both the exposure to this risk due to SWE's share of German business litigation claims and the impact of counterparty default risk on litigation claims under the Standard Formula. The Standard Formula together with the add-on is expected to produce a higher capital requirement than the Internal Model in aggregate.

- 10.41 Any capital add-on to the Standard Formula SCR is imposed by the Regulator and whether a capital add on will be added to the Solvency II Pillar 1 capital requirement is subject to the CAA's decision. However, regardless of the CAA's decision, SWE intends to hold capital for the retained litigation claims risk for Solvency II Pillar 2 capital and risk appetite assessment purposes as this is a sizeable risk for SWE which the Standard Formula does not cover.

Conclusion

- 10.42 Overall, I am satisfied with the appropriateness of the use of the Standard Formula (with the additional capital for retained litigation claims risk) for calculating SWE's Pillar 1 capital requirements, because:
- it covers all SWE's major risks except those related to German litigation claims
 - it produces appropriate capital requirements for SWE's most material risks
 - it is expected to be more onerous than SWL's internal model when applied to SWE's risk profile.

Capital

Solvency Capital

Movement in Own Funds

- 10.43 The table below shows the Solvency II Pillar 1 Own Funds of SWE after the Transfer as at 31 December 2017, assuming that the Scheme and the Associated Arrangements had taken effect on that date.

Solvency II Pillar 1	Assets (£m)	Liabilities (£m)	Own Funds (£m)
Transfer under the Scheme	2,337	2,127	210
Reinsurance	1,766	1,766	-
Indemnity	130	130	-
Capital Injections	78	-	78
Other Liabilities*	-	113	(113)
Total	4,311	4,136	175

All numbers in the above table are rounded to the nearest whole number.

**Other Liabilities include deferred tax liability and Risk Margin*

- 10.44 The movements in Own Funds are mainly due to sufficient assets being transferred under the Scheme to cover Luxembourg GAAP liabilities which are higher than Solvency II, creating a surplus on a Solvency II basis. There is no impact of the Reinsurance and Indemnity Agreement on the Own Funds as shown in the table.
- 10.45 The surplus generated on a Solvency II basis is sufficient to cover SWE's other liabilities. Even though there is a negative impact on Own Funds under Other liabilities, the surplus Own Funds under the Scheme and capital injections are sufficient to ensure that SWE is well capitalised.

Comparison of solvency between SWL pre-Transfer and SWE post-Transfer

- 10.46 The table below compares the SCR Cover Ratio of SWL prior to the Transfer to that of SWE after the Transfer assuming the Transfer took place on 31 December 2017.

Solvency II Pillar 1	SWL Pre-Transfer (£m)	SWE Post-Transfer (£m)
Total Assets	128,917	4,311
Total Liabilities	120,505	4,136
Own Funds	8,412	175
SCR	6,014	125
Excess Capital over SCR	2,398	50
Solvency Cover Ratio	140%	140%

All numbers in the above table are rounded to the nearest whole number.

- 10.47 The table above shows that after the Transfer, SWE would be capitalised to approximately the same level as SWL prior to the Transfer.
- 10.48 As a subsidiary of SWL, SWE would have the ability to look for support from SWL if it were struggling to meet its CMP, although SWL would not be under any legal obligation to provide such support.

Conclusion for solvency capital

- 10.49 Overall, I am satisfied that SWE will be adequately capitalised at the Effective Date and will be capitalised to the same level as SWL was prior to the Transfer. Additionally, both SWE and SWL have CMPs in place which are consistent.

Economic Capital

- 10.50 Figures are not yet available for SWE on an economic capital basis and will not be available before the Transfer. I am expecting SWE's solvency on an economic capital basis to be explored within its first ORSA. Even allowing for the lack of SWE figures on an economic capital basis, I am satisfied that enough information on current and projected solvency is available to draw conclusions for me to carry out my role as Independent Expert.

Capital projections

- 10.51 In addition to reviewing SWE's capital position before and immediately after the Transfer, I have also considered SWE's projected capital position.
- 10.52 To do this, I reviewed the base projection of SWE's SCR Cover Ratio within its five-year business plan. This showed that SWE's SCR Cover Ratio was projected to remain within the Green zone throughout the projection period.
- 10.53 I have also reviewed sensitivity and scenario analysis on SWE's capital projections. The sensitivity analysis includes five-year capital projections and was based on risk events with a 1-in-20 year likelihood covering SWE's key risks. This is more severe than SWL's and SWE's risk appetite, which requires SWL and SWE to hold sufficient capital to withstand a 1-in-10 year event.
- 10.54 The sensitivities of SWE's SCR Cover Ratio to a fall in equity prices, an increase in lapse assumptions for each duration and an instantaneous increase in lapse assumptions have been investigated separately and all are found to reduce the SCR Cover Ratio to a position within the Amber zone. However, management actions, including withholding dividends can in all three cases return SWE's SCR Cover Ratio to its target level over a reasonably short period.
- 10.55 As indicated in paragraph 10.35, the expense risk and counterparty default risk are the risks that SWE has additional exposure compared to a typical insurer managing unit-linked business. Therefore, I consider the impact of these risks further below.

Expense risk

- 10.56 Expense risk is a key risk for SWE as, after the Transfer, the Transferring Policies will be policies of SWE. The Transferring Business is a closed book of unit-linked and unitised with-profits business with a long run-off profile and limited scope to increase charges to meet higher expenses.
- 10.57 For the sensitivity analysis, 1-in-20 year event stress levels based on SWL's Internal Model risk calibrations have been used for both expense level risk and expense inflation risk.
- 10.58 The 1-in-20 year expense level stress causes SWE's SCR Cover Ratio to decrease to the Amber zone. However, as profit emergence in SWE results in a steady increase in the SCR Cover Ratio, the stressed position is expected to return to the Green zone over a period of around two years.
- 10.59 The expense inflation stress that has been applied decreases the SCR Cover Ratio to less than 100%. This is a result of a combination of a number of factors:
- the derivation and application of the 1-in-20 stress based on the SWL calibration appears to be relatively strong compared to what I have seen elsewhere
 - Transferring Policies having a long run-off profile
 - it is assumed that there will be no management actions in the stress to control the effect of future inflation.
- 10.60 Management have experience of dealing with this risk and in line with their general appetite for inflation risk expect to have appropriate mechanisms in place to monitor, manage and mitigate the risk once the company is fully operational. This includes the use of inflation hedging which, if put in place, could reduce the impact of the stress and help SWE to continue to cover its regulatory capital requirement after the stress. For example, if a 50% inflation hedge were to be in place before the stress, the protection afforded by the hedge would be sufficient to maintain the SCR Cover Ratio at over 100%. Implementing a partial internal model (subject to the approval by the CAA and depending on how the model is calibrated) along with the inflation hedge would result in the post stress SCR Cover Ratio that is above the Green zone.
- 10.61 In addition to the inflation hedge and partial internal model described above the following management actions are available to help restore its solvency position. A combination of the actions described below can be used to restore the post stress solvency position.
- withholding future dividends
 - implementing equity hedging
 - seeking capital support from SWL, SWG or LBG
 - implementing cost saving or further cost control measures.
- 10.62 The inflation and equity hedges will not be implemented until after SWE becomes fully functional as until the Transfer the inflation and the equity exposure of the Transferring Business is managed along with the Non-transferring Business through SWL's derivative strategy. Management are aware of this risk and intend to investigate this more closely soon after the authorisation of SWE. They intend to carry out the analysis of risk exposure, measure the extent of the risk and decide on the level of hedge and when to implement it taking into account SWE's risk appetite. However, if for example, inflation rates increase after the Transfer but before SWE puts in place an inflation hedge there would be a cost to SWE due to the losses that would be incurred as a result of not having the hedge in place and also potentially due to increases in the price of purchasing the hedge cover. This cost will be met by SWE shareholders.

Conclusion for expense risk

- 10.63 Overall, even though expense inflation stress results in a breach in SCR under an extreme stress scenario, I am satisfied that this will not adversely impact the Transferring Policyholders as management have experience of dealing with this risk and will implement appropriate mitigation measures to restore the solvency position back towards the Green zone.

Counterparty risk

- 10.64 As described in Section 9, SWE has exposure to counterparty default risk due to the Reinsurance Agreement and the Indemnity Agreement. The FWH provide protection in respect of the Reinsurance Agreement. There is also a Charge Agreement in place to provide further protection to SWE in the unlikely event of SWL becoming insolvent. In addition to the above SWE also has some counterparty exposure to banks through cash holdings. The management are aware that this results in an increase to the counterparty default risk SCR under Standard Formula related to single counterparty exposure.
- 10.65 To reduce the single counterparty exposure related to the cash holdings, SWE is planning to invest this cash in a liquid fund. This would result in the cash holding being subject to the spread and interest rate risk stress under Standard Formula. These stresses are less onerous than the counterparty default risk stress and would ensure the post stress SCR Cover Ratio is within the Green zone.
- 10.66 The measurement of counterparty default risk is onerous under Standard Formula because it does not allow SWE to recognise the economic value of the floating charge related to the Reinsurance and Indemnity Agreements and also applies some capital charge to the FWH. This exposes SWE to a risk, under the Standard Formula measurement of counterparty risk, as increased regulatory capital is required in the event of a credit rating downgrade of SWL.
- 10.67 At the time of drafting, SWL has a grade A rating (A by S&P, A2 by Moody's). Analysis has been performed to estimate the impact on SWE's SCR Cover Ratio of a downgrade of SWL's credit rating from A to BBB. This analysis showed that such a downgrade would result in a significant decrease in the SCR Cover Ratio of SWE, based on the Standard Formula approach. A further downgrade to BB would result in SWE's SCR increasing even more significantly, resulting in SWE being unable to cover its minimum regulatory capital requirements.
- 10.68 The probability of downgrade from A to BBB, based on Moody's one-year transition matrix, is 5.57%, which is a small probability however plans have been identified to manage this risk. I consider the probability of downgrade from A to BB of 0.34% to be remote.
- 10.69 In line with their general appetite for counterparty default risk exposure, management expect to have appropriate mechanisms in place to monitor, manage and mitigate the risk. This includes applying for a partial or full Internal Model for SWE to obtain a better measurement of the risk. Using a partial or full Internal Model (subject to the approval by the CAA), could enable SWE to take credit for the floating charge. This could, depending on how the model is calibrated, result in a much lower counterparty default risk SCR for exposure to SWL under the Reinsurance and Indemnity Agreements and enable the post stress SCR Cover Ratio to be in the Green zone.
- 10.70 In addition to applying for a partial internal model the following management actions are available to help restore its solvency position following the downgrade of SWL's credit rating:
- withholding future dividends
 - implementing an inflation and equity hedge
 - seeking capital support from LBG.

Conclusion for counterparty risk

- 10.71 By investing the cash holdings in the liquid fund SWE will be able to eliminate its exposure to any single counterparty under the Standard Formula
- 10.72 A downgrade of SWL's credit rating from A to BBB is considered remote and a further downgrade to BB is even more remote. However, in the event that SWL's credit rating was downgraded, the management will be able to implement mitigating measures including applying for an internal model which (subject to its approval by the CAA) could, depending on how the model is calibrated, restore the solvency position back towards the Green zone.

Winding up of SWE

- 10.73 As shown above, SWE is well capitalised and I consider the likelihood of its insolvency to be an extremely remote event. Nevertheless, I consider whether the Transferring Policyholders would be

materially adversely affected by it and compare how the Transferring Policyholders would be affected by winding up under SWL in the UK and under SWE in Luxembourg.

- 10.74 In line with the Luxembourg regulations, as described in Section 3, SWE needs to deposit the Tied Assets with a custodian bank. These assets will be segregated from any other assets and liabilities that SWE holds.
- 10.75 In the event of SWE's insolvency, the policyholders' liabilities will be paid using these Tied Assets. In the event that the Tied Assets may not be sufficient to pay policyholders' liabilities, then according to the winding up procedures in Luxembourg, as described in Section 3, the policyholders would have preferential rights over the remaining assets of SWE, compared to other creditors except the creditors defined in law.
- 10.76 I am satisfied that the Luxembourg winding up regulations provide policyholders a level of protection that is at least as good as the level of protection provided in the UK under winding up as:
- Tied Assets backing the policyholder liabilities remain segregated under winding up whereas in the UK, at the time of winding up, the fund structures dissolve and segregation of assets rules do not apply (except if the insurer has both long term insurance business and general insurance business)
 - if Tied Assets are not sufficient to cover the policyholder liabilities, policyholders have preferential rights over the remaining assets of SWE compared to other creditors. In the UK, policyholders have preferential rights over other debtors but rank below the senior ranking creditors.

Conclusion on Insolvency of SWE

- 10.77 Overall, I am satisfied that, SWE will be well capitalised after the Transfer. In the event of SWE's insolvency, Luxembourg winding up regulations will provide a level of protection that is at least as good as the level of protection in the UK under winding up.

Overall conclusion

- 10.78 I am satisfied that, after the Transfer, SWE will be a well-capitalised entity.
- 10.79 Although the expense inflation stress results in a breach in SCR under an extreme scenario, I am satisfied that this will not adversely impact the Transferring Policyholders as management have experience of dealing with this risk and will implement appropriate mitigation measures to restore the solvency position back towards the Green zone.
- 10.80 SWE is exposed to the risk of SWL default due to the Reinsurance Agreement and the Indemnity Agreement. This risk is mitigated through FWH, which reduces SWE's credit exposure to SWL. There is also a Charge Agreement in place, which provides SWE with further protection against SWL's insolvency. In the event that SWL's credit rating is downgraded, the management will be able to implement mitigating measures including applying for an internal model which (subject to its approval by the CAA) could, depending on how the model is calibrated, restore the solvency position back towards the Green zone.
- 10.81 In the event of SWE's insolvency, Luxembourg winding up regulations will provide a level of protection that is at least as good as the level of protection in the UK under winding up.

11 The impact of the Transfer on Transferring Policyholders

Introduction

11.1 In this Section, I consider the impact of the Transfer on Transferring Policyholders. Under the Transfer, all of the Transferring Policies will be transferred from SWL to SWE and will become policies of SWE.

11.2 I first consider the security of Transferring Policyholders' benefits, based on the analysis performed in Section 10. After considering the security of Transferring Policyholders' benefits, I then set out my opinions for each group of Transferring Policyholders (Transferring UWP Policyholders and Transferring UL Policyholders) in relation to:

- Policyholder benefit expectations and contractual rights – in this part I consider whether the Transfer alters the benefit expectations of the Transferring Policyholders by looking at any changes to fund management, with-profits governance and application of management discretion. I also consider any changes to the terms and conditions of the Transferring Policies and whether these alter their benefit expectations
- External bodies providing further policyholder protection – in this part I compare the current external bodies and regulations that provide some form of policyholder protection, namely the UK FOS, the FSCS and the relevant conduct of business regulations. This analysis allows me to opine on whether there is any weakening in these aspects of policyholder protection as a result of the Transfer
- Governance arrangements – in this part I consider the proposed governance arrangements including company level governance, with-profits governance or unit-linked governance. Following this analysis, I opine on whether the changes to the governance arrangements represent a weakening of the current position
- Associated Arrangements – in this part I consider whether the Reinsurance Agreement, Charge Agreement, Indemnity Agreement and Unit Linked Service Agreement materially adversely affect relevant groups of the Transferring Policyholders
- Vesting annuities – in this part I consider whether policyholders with pensions and deferred annuity business whose benefits will convert to a with-profits annuity at vesting will be materially adversely affected by the Transfer
- Tax implications – in this part I consider the various tax considerations and whether there is any change to taxation as a result of the Transfer. This allows me to opine on whether or not the tax impacts are likely to alter the benefit expectations of the Transferring Policyholders
- Expenses and charges – in this part I consider if the expenses arising from the Transfer would have any material adverse effect on the Transferring Policyholders
- Administration and service standards – in this part I consider any changes to the administration of the Transferring Policyholders and whether there is any change to the service standards. I then opine on whether the Transfer will lead to a reduction in the service standards experienced by the Transferring Policyholders.

11.3 The above considerations, in isolation and together, allow me to come to a conclusion as to whether or not the Transfer materially adversely affects the Transferring Policyholders.

11.4 I conclude this Section by discussing the planned communications with all Transferring Policyholders in relation to the Transfer.

Security of policyholder benefits for Transferring Policyholders

11.5 In this subsection, I consider the security of Transferring Policyholders' benefits and whether or not they are materially adversely affected as a result of the Transfer. In order to do this, I consider the financial strength of SWL and SWE, both before and immediately after the Transfer.

11.6 I consider all of the Transferring Policyholders together, as the Transfer has the same impact on the security of benefits for both Transferring UWP Policyholders and Transferring UL Policyholders. Much of the background to these considerations is in Sections 9 and 10. I refer to these Sections where appropriate.

Risk profile

11.7 In Section 10, I considered the risk profiles of SWL and SWE, before and immediately after the Transfer, by reference to the risk components of their SCRs. For Transferring Policyholders, the relevant consideration is the risk profile of SWL before the Transfer, and the risk profile of SWE upon the Transfer taking effect. The top five risks of each entity are given in the table below.

SWL Before the Transfer	SWE After the Transfer
Credit spread	Expense
Longevity	Persistency
Equity	Counterparty default
Persistency	Retained litigation claims
Operational *	Equity

* Operational risk excluding the risk due to German business litigation claims in business written under EU passporting rights.

11.8 The top five risks that the Transferring Policyholders are exposed to will change following the Transfer as seen in the table above.

11.9 Since SWE does not plan to write new business and will have a long-duration business in run-off it is exposed to expense risk.

11.10 Whilst the Transfer, through the Reinsurance Agreement, enables SWE to transfer the investment risks including investment guarantees associated with the Transferring UWP Business to SWL, it will introduce counterparty default risk in SWE. The Indemnity Agreement exposes SWE to a further risk of SWL failing to make payments under this arrangement.

11.11 SWE is exposed to the risk of not receiving a sufficient termination amount in case of SWL's insolvency, resulting in it bearing the risks of any future litigation claims after the termination of the Indemnity Agreement.

11.12 I have discussed these risks and relevant arrangements that SWL and SWE will put in place to mitigate them, in detail in Section 9 and 10.

11.13 In my opinion, adequate arrangements have been planned and are being put in place to manage these different risks as a result of the Transfer. Therefore I am satisfied that the Transferring Policyholders will not be adversely affected by the change in risk profile as a result of the Transfer.

Capital position

11.14 Within this subsection, I consider the capital position of SWL before the Transfer and that of SWE after the Transfer, and the impact the Transfer could have on the future financial positions of SWL and SWE.

11.15 My analysis in Section 10 concluded that SWE will be appropriately capitalised immediately after the Transfer and is projected to remain so over the five-year planning horizon, and it is able to maintain its SCR Cover Ratio, and that there are mitigation actions available to restore its SCR Cover Ratio under stressed scenarios.

11.16 The SWL Board and SWE Board are responsible for setting the respective capital policies and the target SCR Cover Ratio for each entity respectively. The capital policies of SWL and SWE are

described in Sections 4 and 6 respectively. Both SWE and SWL aim to hold capital within their Green zone. The RAG classifications used by both SWL and SWE are consistent.

- 11.17 The table below compares the Solvency II, Pillar 2 capital position of SWL immediately before the Transfer with that of SWE immediately after the Transfer, assuming that the Transfer had taken effect on 31 December 2017.

Solvency II Pillar 2	SWL Pre-transfer (£m)	SWE Post-transfer (£m)
Total available Own Funds to meet the SCR	8,412	175
SCR	6,014	125
Excess Own Funds	2,398	50
SCR Cover Ratio	140%	140%

All numbers in the above table are rounded to the nearest whole number.

- 11.18 The table above shows that after the Transfer, SWE would be capitalised to approximately the same level as SWL prior to the Transfer. Based on the expected RAG classification, this indicates that SWE's solvency position would be in the Green zone. The capital projections for SWE's business plan performed for its application for CAA authorisation indicate SWE will continue to be in the Green zone over the five-year planning horizon.
- 11.19 I further note that both the UK and Luxembourg operate risk-based solvency regimes, which require companies to hold capital specific to the risks to which they are exposed. Both SWL and SWE hold capital in line with their target SCR Cover Ratio ranges, which are in excess of the regulatory minimum.
- 11.20 SWE is a smaller company than SWL with a smaller aggregate level of Own Funds. SCR is a measure of the capital that is needed in a 1-in-200 year scenario. SWE is proposing to hold Own Funds significantly in excess of this level and can therefore withstand significant adverse events. In addition, the Charge, the Indemnity Agreement and the FWH provide strong protection in respect of SWE's exposure to SWL. Further, if the SCR Cover Ratio decreases below the Green zone then SWE will be able to implement appropriate management actions to bring the SCR Cover Ratio back to the Green zone.
- 11.21 For the reasons outlined above, I am satisfied that there is no material adverse effect on the security of benefits for Transferring Policyholders as a result of the Transfer.

Termination of the Reinsurance Agreement

- 11.22 In Section 9, I concluded that provisions in relation to termination of the Reinsurance Arrangement are adequate to protect Transferring UWP Policyholders whether the termination is by mutual consent or due to SWL becoming insolvent.

Insolvency of SWE

- 11.23 SWE is well capitalised, and I consider the likelihood of its insolvency remote. Nevertheless, I have still considered whether the Transferring Policyholders would be materially adversely affected by it.
- 11.24 Luxembourg regulations require the insurer to hold the maximum of SII technical provisions or Luxembourg GAAP reserves as Tied Assets in a custodian bank. These assets will be segregated from other assets and liabilities in SWE. In the unlikely event of SWE becoming insolvent, based on the legal advice provided to me by the legal advisors of SWL on the winding up rules I understand that the policyholders will have priority ranking over the Tied Assets. If the Tied Assets are not sufficient to meet the policyholder liabilities then they will have preferential rights over the remaining assets of SWE as described in Section 3.
- 11.25 Overall, I am satisfied that the Luxembourg winding up rules provide at least as much protection to policyholder benefits under winding up due to insolvency, as those provided by UK winding up regulations.

Conclusion

11.26 Overall, I am satisfied that there is no material adverse effect on the security of benefits of the Transferring Policyholders as a result of the Transfer because:

- SWE will be appropriately capitalised immediately after the Transfer, and is projected to remain so over the five-year planning horizon
- SWE has an appropriate CMP in place to manage its capital position under stress and scenario testing
- adequate arrangements have been planned and will be put in place to manage the risks that SWE will be exposed to due to the Transfer, including safeguards in relation to the termination of the Reinsurance Agreement
- in the unlikely event of SWE's insolvency, Luxembourg winding up rules including the Tied Assets will provide adequate protections for the policyholders' benefits.

Transferring UWP Policyholders

11.27 The majority of the Transferring Business comprises UWP policies currently residing in GGFs within SWL's CM WPF. As a result of the Transfer, this business will be transferred from SWL's CM WPF to the UWP GGFs in SWE. The policies will then be reinsured back to the CM WPF under the Reinsurance Agreement described in Sections 8 and 9.

Policyholder benefit expectations and contractual rights

11.28 In this subsection, I consider the impact of the Transfer on the benefit expectations and contractual rights of the Transferring UWP Policyholders. In particular, I consider the policy terms and conditions, fund management and management of discretion.

Terms and conditions

11.29 Under the Transfer, SWE will take on all existing rights and obligations of SWL in relation to the Transferring UWP Business. While the Transferring UWP Policyholders will become direct policyholders of SWE rather than SWL, the Reinsurance Agreement ensures that these policies will be maintained in the same way before and after the Transfer. There will be no change to investment strategy and no material change to the governance around bonus distribution as described in 6.45. I am satisfied that there will be no material changes to the terms and conditions of these policies as a result of the Transfer, and therefore no material impact on the contractual rights of these policyholders.

Fund structure

11.30 The fund structures of SWL and SWE in relation to the Transferring UWP Business are described in Sections 4, 6 and 7.

11.31 The CM WPF within SWL, in which the Transferring UWP Policies are currently invested, is maintained as a separate, ring-fenced fund in line with the UK regulations. It is not a requirement under Luxembourg regulations to hold ring-fenced funds. However, as described in Section 7, SWE will be setting up notional funds mirroring the GGFs in CM WPF. Although these will not be ring-fenced in the way that they are in CM WPF in SWL in the UK, they will continue to be maintained in CM WPF which is a ring fenced fund. The same administration and management systems at SWL will continue to be used after the Transfer to ensure the transactions of the Transferring UWP Policyholders are tracked and correct payments are made to the Transferring UWP Policyholders and the actual and notional GGFs will be aligned.

Fund management, with-profits governance and use of discretion

11.32 The Transferring UWP Policies are currently managed in accordance with the CM WPF's PPFM. As a result of the Reinsurance Agreement, they will continue to be managed in line with the CM WPF's PPFM. The CM WPF's PPFM will be amended for the Transfer to state that the Transferring UWP

Policies will be invested through reinsurance rather than as direct policies of SWL; there will be no changes to policies for bonus declarations or estate distribution. The provisions and protections in the 2015 Scheme will also continue to apply.

- 11.33 There will be no change to the investment strategy for the assets and the estate of the CM WPF following the Transfer.
- 11.34 There will be no additional charges on these policies besides those stated in the PPFM and the product literature.
- 11.35 In the areas where discretion is used, the SWL Board, supported by the WPA and WPC will continue to consider the Transferring UWP business in the management of the with-profits business and in their advice to the SWL Board. The SWE Chief Actuary will have access to appropriate information regarding bonus distribution, and will advise the SWE Board on management of with-profits business and the bonus distribution, in areas where discretion is used.
- 11.36 The SWE Board will have principal oversight on the decisions and management of the Transferring Business and will receive appropriate actuarial advice from the SWE Chief Actuary to ensure compliance with the relevant Luxembourg regulatory requirements.
- 11.37 The SWE Board will follow the decisions of the SWL Board closely in relation to any bonus distribution, market value adjustment or similar matters (such as estate distribution, smoothing etc), unless, it would be deemed inappropriate to do so after taking into account appropriate actuarial advice and paying due regard to policyholders' collective interests. A non-objection from the CAA is also required if SWE is to deviate from SWL's decisions on these matters.
- 11.38 SWL and SWE do not intend to terminate the Reinsurance Agreement in the foreseeable future. In the unlikely event of termination of the Reinsurance Agreement, SWE would recapture the Transferring UWP Business. A termination amount would be determined considering the fair distribution of the estate within the CM WPF, with oversight by an independent actuary and no objection of the CAA and UK Regulators.
- 11.39 If the reinsurance terminates based on mutual agreement, the Reinsurance Agreement requires that the independent actuary considers the ongoing protections and governance that will be provided after the termination compared to those in place prior to termination. These include but are not limited to the protections provided by the PPFM, 2015 Scheme and regulations concerning the fair treatment of customers. Termination of the Reinsurance Agreement by mutual agreement cannot take place unless the independent actuary issues a report confirming that such future protections and governance will result in no material adverse impact for either the Transferring Policyholders or the Non-transferring Policyholders.
- 11.40 If the Reinsurance Agreement terminates as a result of the unlikely event of SWL's insolvency, the governance arrangements are less crucial (because non-termination is not a viable alternative to termination). However, I would expect the independent actuary, as part of his or her role, to consider the protections available for the policyholders after the termination. The SWE Chief Actuary will continue to advise the SWE Board in relation to actuarial matters under Luxembourg regulations.

Conclusion

- 11.41 Based on the above comments, I am satisfied that the Transfer will not have any material adverse effect on the benefit expectations and contractual rights of the Transferring UWP Policyholders. This is because:
- there are no material changes to the policy terms and conditions
 - the Transferring UWP Policies will continue to be managed in accordance with CM WPF's PPFM and the 2015 Scheme, following the Transfer while the Reinsurance Agreement is in place
 - SWE's Board will have principal oversight on discretionary decisions of the SWL Board to ensure compliance with the relevant Luxembourg regulatory requirements. The governance of the CM WPF will include the reinsured Transferring UWP Business. So oversight of the Transferring UWP Business will remain as strong as it was pre-Transfer

- the SWE Chief Actuary will have access to appropriate information regarding bonus distribution when advising the SWE Board
- in the unlikely event of termination of the Reinsurance Agreement, a termination amount will be determined taking into account a fair distribution of the estate; and the process used will involve an independent actuary and require no objection from both the UK and Luxembourg Regulators. If the Reinsurance Agreement is terminated with a mutual agreement, the independent actuary will also consider the ongoing protections and governance provided to the Transferring UWP Policyholders before and after the Transfer. These processes will ensure a fair outcome to all policyholders, including the Transferring Policyholders.

External bodies providing further policyholder protection

FSCS

- 11.42 The Transferring UWP Business is currently covered by the FSCS, which is a compensation scheme of last resort in the UK and protects policyholders if a financial services company were to fail. Following the Transfer, the Transferring UWP Policyholders will hold policies with a Luxembourg based insurance entity and will lose entitlement to this form of protection (although if the claim results from an event which occurs prior to the transfer it will continue to be covered by the FSCS). A policyholder protection scheme equivalent to the FSCS does not exist in Luxembourg. The question that I must therefore address is whether or not this is a material loss in the context of the Transfer.
- 11.43 An alternative to the proposed Scheme structure could have been for SWL to apply for UK authorisation of SWE, which could have meant that Transferring Policies currently benefiting from FSCS protection would not lose that protection if they were transferred to a UK branch of SWE. This alternative strategy would not have been viable for the following reasons:
- the tight timescales associated with Brexit not allowing enough time to fully explore this option
 - the uncertainty over whether the FSCS rules would stay unchanged post-Brexit
 - the reluctance of the PRA (as expressed in supervisory statement SS2/18) to allow EU insurers to have UK branches larger than £500m, a figure exceeded by the Transferring Business.
- 11.44 The purpose of the Scheme is to effect the transfer of the Transferring Business from SWL to SWE in order to enable the continued servicing (eg receiving premiums and paying claims) of the Transferring Business, regardless of the outcome of the Brexit negotiations. In my opinion, having certainty about how the policies in the Transferring Business will be serviced after Brexit is very important. The loss of the FSCS protection is a consequence of achieving this certainty. In addition, I have considered that the FSCS provides protection to covered policyholders following an insolvency or default event. Given that SWE will be well capitalised and will be required to comply with Solvency II in EU law, the likelihood of default or insolvency of SWE is, in my opinion, remote. Therefore the likelihood of FSCS being required is remote and so I do not consider the loss of FSCS protection to have a material adverse effect on the Transferring UWP Policyholders.
- 11.45 The Transferring UWP Policyholders will not be compensated for the loss of FSCS protection and I consider that this is reasonable, given my comments above.
- 11.46 It is possible that the outcome of Brexit negotiations results in a deal with the EU which means SWL would have been able to continue to service contracts sold under EU passporting rights either for a transitional period, or until the end of the policy term. If this were to be the result of Brexit negotiations, then the Transferring Policyholders will have lost their FSCS protection that they would have retained had the Transfer not taken place. However, as stated above, I consider that having certainty about how the policies will be serviced after Brexit is very important. Additionally, it is my view that there is insufficient time to wait for the results of such negotiations, and that action is required ahead of Brexit to ensure servicing of the Transferring Policies can continue post-Brexit. I will provide an update in my Supplementary Report on the latest relevant Brexit negotiations and I will also continue to monitor developments in the legal and regulatory position around Brexit and consider, in discussion with SWL

and SWE, whether any such developments could affect the Transferring Policyholders' loss of FSCS cover. I will comment in my Supplementary Report on any changes in the position described above.

Ombudsman

- 11.47 Prior to the Transfer, where activities have been carried out on a Freedom of Establishment basis, any complaints that could not be resolved between SWL and the policyholder would need to be dealt with by the local system of complaints handling (which would primarily involve the local regulator in the territory where the policy was sold). For activities carried out on a Freedom of Services basis, as well as being able to use the local system of complaints handling, policyholders would also be entitled to refer their complaint to the UK FOS.
- 11.48 The only change to the above position as a result of the Transfer is for the activities carried out on a Freedom of Services basis. Following the Transfer, this business will continue to have access to their local system of complaints handling, but will not have access to the UK FOS for complaints that arise on activities after the Transfer. However, they will be able to direct such complaints to the CAA and LOS. I describe the LOS in more detail in Section 3. The Transferring UWP Policyholders will still be able to bring complaints to the UK FOS for any activities carried out on a Freedom of Services basis by SWL that occurred prior to the Transfer.
- 11.49 I have compared the services and powers of both the UK FOS and CAA and LOS and can confirm that both offer a free service in a timely fashion with the LOS offering services in a range of languages. While the decisions of the UK FOS are legally binding, the decisions of LOS and the CAA are not legally binding which is a lack of power when compared to the UK FOS.
- 11.50 However, if following a complaint to the CAA, an insurer does not agree to follow the CAA's opinion or recommendation, the CAA informs the policyholder and provides them with a copy of its opinion or recommendation. A policyholder can then take the matter to the court and use the CAA's assessment which will be considered persuasive. As such, the CAA supports the policyholder in reaching a mediated solution. Therefore, even though the regimes are not identical they are designed to channel complaints and resolve disputes in practice.
- 11.51 In addition, I have been informed that in practice the Transferring UWP Policyholders always raised their disputes through their local system of complaints handling rather than the UK FOS. This indicates that they might not look to use the UK FOS in the future and, as such, are unlikely to suffer detriment from the withdrawal of this service.
- 11.52 Therefore, in my opinion policyholders will not be adversely affected by any loss of policyholder protection with respect to the UK FOS as a result of the Transfer.

Conduct of business

- 11.53 Before the Transfer, the Transferring UWP Business is subject to the UK COBS. After the Transfer, the Transferring UWP Business will be subject to Luxembourg regulations, which include the CAA's conduct related mission statements as set out in the Luxembourg Insurance Act. However, these are not as detailed as the UK COBS and do not include any specific requirements for with-profits business. Therefore, for example, a PPFM, WPA or WPC are not required in Luxembourg.
- 11.54 As the Transferring UWP Business will be reinsured to SWL it will continue to participate in the CM WPF which is operated in line with the UK COBS and will therefore indirectly benefit from the UK COBS. The Transferring UWP Business will also be subject to the requirements of the CM WPF PPFM and the UK WPC albeit indirectly.
- 11.55 LBG also has Group level Customer Treatment Policy. As a subsidiary company of the Group, SWE is expected to comply with this policy.
- 11.56 Therefore, in my opinion policyholders will not be materially adversely affected by any loss of policyholder protection with respect to the prevailing the UK COBS regulation as a result of the Transfer.

Conclusion for External bodies providing further policyholder protection

11.57 It is my opinion that the Transferring Policyholders will not be materially adversely affected by the Transfer in relation to the policyholder protection because:

- the certainty of being able to service a policy is, in my view, more important and more valuable than the FSCS cover that will be lost
- the value of the FSCS cover is low since the likelihood of the protection provided by the FSCS being required is remote. As SWL and SWE both have, or will have, appropriate capital and risk management policies, they are expected to be capitalised within the range of their target SCR Cover Ratio and compliant with Solvency II rules, and consequently, the likelihood of becoming insolvent is remote
- although the ombudsman services in Luxembourg and the other EU countries, from which the policies were purchased, are not binding in the same way as in the UK, there are complaints mechanisms available for the policyholders
- although the equivalent of the UK COBS does not exist in Luxembourg, the policyholders will continue to indirectly benefit from the key aspects of the UK COBS by means of the Reinsurance Agreement
- the provisions and governance arrangements that SWL and SWE will put in place as part of the termination process of the Reinsurance Agreement (when the termination is mutually agreed) provide protection for the Transferring Policyholders.

Governance arrangements

11.58 I describe the governance structures of SWL and SWE in detail in Sections 4 and 6. The governance arrangements for both companies are in line with Group governance frameworks; governance of SWE will also comply with the Luxembourg regulations.

11.59 With respect to the composition of the proposed Board of SWE:

- SWE's proposed Board will consist of competent directors, one of which is independent, to promote a high standard of corporate governance
- although SWE's proposed Board has a smaller number of directors compared to the SWL Board, this is, in my view, reasonable given the relative scale and complexity of the two companies
- I have considered industry best practice for the Board composition of subsidiary companies of a similar size to the proposed features in SWE's plan and I am satisfied that the level of competence and independence will be comparable to its peer group
- the Board and senior management of SWE will be approved by the CAA and their competence and experience is considered in their approval
- the composition of the Board of SWE will comply with Luxembourg regulations.

11.60 SWE will have representation within SWG's and SWL's committees where areas relevant to SWE are discussed. SWE will also have access to LB's services for support on functions such as internal audit, actuarial and finance services. I am satisfied that this will ensure that a similar level of governance will apply to the Transferring UWP Business before and after the Transfer.

11.61 Paragraphs 6.44 to 6.47 describe the governance that will apply to WP business within SWE. I am satisfied that this is appropriate.

Conclusion

11.62 Overall I am satisfied that there are no material differences in the company governance arrangements of SWE and SWL that adversely affect the Transferring UWP Policyholders as:

- SWE's proposed Board will consist of appropriate competencies and an independent director approved by the CAA

- SWE will have representation on SWG's Insurance Group level committees and SWL's committees when relevant areas for SWE are discussed
- the composition of SWE's proposed Board will comply with Luxembourg regulations
- the senior management roles will be approved by the CAA
- SWE will also have access to LB's services for support on certain functions such as internal audit, actuarial and finance services
- the governance around WP business in SWE is appropriate.

Associated Arrangements

- 11.63 In Section 9, I considered the Reinsurance Agreement and Charge Agreement and I concluded that the Reinsurance Agreement results in no change to the management of the Transferring UWP Policies before and immediately after the Transfer. I also concluded that the provisions governing the termination of the Reinsurance Agreement provide suitable protection for the Transferring UWP Business. In addition, I concluded that the Charge Agreement is an appropriate mechanism to help mitigate the risk of SWL failing to honour its obligations under the Reinsurance Agreement.
- 11.64 In Sections 4 and 5, I described the German litigation claims in relation to the Transferring Business. In Section 9, I considered the Indemnity Agreement and Charge Agreement and I concluded that the Indemnity Agreement limits SWE and the Transferring Policyholders' exposure to these claims. I also concluded that the governance surrounding the termination of the Indemnity Agreement provides suitable protection for the Transferring Policyholders. In addition, I concluded that the Charge Agreement is an appropriate mechanism to help mitigate the risk of SWL failing to honour its obligations under the Indemnity Agreement.
- 11.65 Overall, I am satisfied that the relevant Associated Arrangements will not have a material adverse effect on the interests of the Transferring UWP Policyholders and will provide the same level of protection in relation to litigation claims before and after the Transfer.

Vesting annuities

- 11.66 As summarised in Section 4, the Transferring UWP Policies include pensions and deferred annuity business whose benefits will convert to with-profits annuities at vesting (this is compulsory for some UWP pensions policies, those which have an annuity feature but optional for deferred annuity policies).
- 11.67 As part of the Reinsurance Agreement, these annuities will be reinsured to SWL at vesting. This will ensure the management of this business and payment of the with-profits annuities continue to be the same as they would have been had they vested in SWL before the Transfer. There will be no change to the way the annuities are priced after the Transfer.
- 11.68 Any GAOs on Transferring Policies will be reinsured from SWE into the Combined Fund within SWL. Should the price of an annuity exceed the accumulated policy proceeds as a result of there being a biting GAO on the policy, then the Combined Fund will pay the difference between the policy proceeds and the price of the annuity into the CM WPF.
- 11.69 Annuities will be paid by SWE, but in effect will continue to be paid by SWL by means of the Reinsurance Agreement. SWE will be meeting the administration expenses for this business and the Reinsurance Agreement includes the requirement for SWL to pay an expense charge to SWE.
- 11.70 For the bonus distribution, the with-profits governance applied will be the same as the governance for the Transferring UWP Business as described in Section 6. This applies post-vesting as well as pre-vesting.

Conclusion

- 11.71 I am of the opinion that the vesting annuitants would not be materially adversely affected by the Transfer because :

- the with-profits annuity benefits will be reinsured back to SWL; they will be maintained in the same way as they would have been had they vested in SWL before the Transfer
- the pricing of the annuities will not change after the Transfer
- the governance around the bonus distribution will be the same as the Transferring UWP Business.

Tax implications

Policyholder Tax

- 11.72 I am not an expert in tax matters and, therefore, in forming my opinion on the impact of policyholder tax, I have relied upon documents produced by SWL's in-house tax experts, and summary papers produced based on the tax advice SWL has received from its tax advisors. I have reviewed this information to ensure it is in line with my understanding and consistent with what I have seen in similar restructures. Grant Thornton's tax specialists have also reviewed this information, with no areas of disagreement being identified.
- 11.73 I do not anticipate that there will be a change in policyholder taxation for the Transferring UWP Policyholders who are tax residents in Austria, Italy or Luxembourg, as the Transfer does not result in a material change to the terms and conditions of the Transferring UWP Business. In particular, I understand SWL currently withholds tax on policy payments to Italian resident policyholders, with the process managed on its behalf by its Italian outsource provider; following the Transfer, this will be managed by SWE and the Italian outsource provider; an identical amount of tax will be withheld.
- 11.74 There will, however be a change in the timing of the payment of the policyholder tax in Germany. This is a result of SWE setting up a branch with a representative to comply with CAA data protection and control requirements. In Germany, that branch will withhold the tax due to the German government on claim payments to comply with German taxation law (rather than SWL paying claims gross of tax, with the policyholder paying the tax at a later date via his tax return). 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. There is therefore no material adverse impact to the policyholders.
- 11.75 Therefore, based on the information provided to me by both SWL and its tax advisors, I do not expect there to be any change to any policyholder's tax liability as a result of the Transfer (albeit that there will be a change in the timing due to the withholding tax of the policyholders in Germany).

Taxation of the CM WPF

- 11.76 The CM WPF makes a contribution towards SWL's corporation tax. The tax charged to the CM WPF is calculated by treating the CM WPF as if it were a standalone UK mutual insurance company. The transfer of the Transferring Policies out of the CM WPF and their reinsurance back into it will have no impact on the tax charged to the CM WPF. SWL's in-house tax experts have investigated and concluded that withholding tax rules would not have an impact on the tax on with-profits funds as a result of holding the FWH in SWE rather than in SWL after the Transfer.

Corporation tax

- 11.77 There would potentially be tax relief for SWE (subject to analysis from Luxembourg tax authorities) due to a Transfer pricing adjustment as described in Section 7. This will be confirmed following the completion of the Transfer pricing valuation closer to the effective Date and I will provide an update on this in my Supplementary Report.
- 11.78 No further trading profits or losses are expected on the Transferring UWP Business in SWE as a result of the Transfer because of the Reinsurance Agreement. There will be no direct Luxembourg corporation tax impact on the Transferring UWP Policyholders in SWE.
- 11.79 There will be no Luxembourg corporation tax impact arising from the Indemnity Agreement.
- 11.80 SWL's in-house tax experts have investigated and concluded that holding the FWH in SWE rather than in SWL after the Transfer would not have an impact on SWL and SWE's corporation tax.

11.81 The corporation tax position of SWL and SWE does not affect the Transferring Policyholders.

VAT

11.82 The Transfer will qualify as a transfer of going concern for VAT purposes. Luxembourg VAT will be charged on policy administration services provided to SWE, including those provided by SWL. These costs will be met by the shareholders of SWE, and therefore do not directly affect the Transferring Policyholders.

11.83 There will be no Luxembourg VAT arising from the Reinsurance Agreement or the Indemnity Agreement.

Tax clearances

11.84 Pre-clearance will be obtained from HMRC and the Luxembourg tax authorities. I will provide an update on these in my Supplementary Report.

Conclusion

11.85 It is my opinion that there will be no material adverse tax implications for the Transferring UWP Business as a result of the Transfer because:

- there is no material change to policyholder tax impact as a result of the Transfer
- there is no net corporation tax impact on the Transferring UWP Policyholders
- additional VAT costs will be met by SWE shareholders, therefore there is no direct VAT impact on the Transferring UWP Policyholders.

Costs of the Transfer and incremental ongoing expenses

11.86 As described in Section 7, the one-off costs of implementing the Transfer will be met by SWL shareholders through the Combined Fund. There will be an increase in the ongoing costs as a result of the Transfer and these will be met by the shareholders of SWE. The costs related to the Italian surrender option will be borne by the shareholders of SWL.

11.87 I can confirm that any exceptional expenses that result from the Transfer will not be charged to the estate of the CM WPF as discussed in Section 7.

11.88 There is limited scope to increase policy charges in the event that there is an increase in ongoing expenses after the Transfer. Any change in charges would be in line with the terms and conditions of the policies, as set out in product literature and therefore in line with policyholders' reasonable expectations. Any changes to charges will need the approval of the SWE Board after taking into account appropriate actuarial advice and unit pricing implications.

Conclusion

11.89 Overall, it is my opinion that the expenses due to the Transfer will not materially adversely impact the Transferring UWP Policyholders because:

- all one-off costs as a result of the Transfer are met by SWL shareholders and the increase in ongoing costs will be met by the SWE shareholders
- any exceptional expenses that arise as a result of the Transfer will not be charged to the estate of the CM WPF
- there is limited scope for charges to policyholders to change and this could only happen with sufficient governance.

Administration and service standards

11.90 Policy administration and investment management for the Transferring UWP Policies are currently outsourced to different external providers as outlined in Section 6. There will be no change to either the service standards agreements or the terms upon which the administrative and investment management arrangements are provided as a result of the Transfer. The outsourcing agreements will

be novated to SWE. The same teams will continue to carry out the administration of the Transferring UWP Policies. SWE will have the same service standards as previously applied in SWL.

- 11.91 In line with the requirements of Luxembourg regulations, branch offices will also be set up in Germany and Italy where the outsourcing companies are based to ensure that SWE has control over data protection. The branch office in Germany will only have a representative for data protection however rather than operating as a full branch.
- 11.92 Therefore, there is no reason to expect that the quality and level of service provided to the Transferring UWP Policyholders will deteriorate as a consequence of the Transfer.

Conclusion

- 11.93 Overall, it is my view that the Transferring UWP Policyholders will not experience any material adverse changes to the administration of their policies as a result of the Transfer. I have reached this conclusion because:
- the Transferring UWP Policies will continue to be serviced under the same outsourcing arrangements by the same teams as they were prior to the Transfer
 - SWE will adopt the same service standards as previously applied in SWL.

Conclusion for Transferring UWP Policyholders

- 11.94 Overall, I am satisfied that the Transferring UWP Policyholders will not suffer any material adverse effect as a result of the Transfer.

Transferring UL Policyholders

- 11.95 The Transferring Business includes UL policies currently invested in unit-linked funds in the Combined Fund. The funds in which the policies are invested are exclusively for this business. As a result of the Transfer, these policies will be transferred from the Combined Fund to the UL funds in SWE. To ensure that the operation of these policies remains unchanged SWE will enter into the Unit Linked Service Agreement as discussed in Section 9.

Policyholder benefit expectations and contractual rights

Terms and conditions

- 11.96 Under the Transfer, SWE will take on all existing rights and obligations of SWL in relation to the Transferring UL Business. While the Transferring UL Policyholders will become direct policyholders of SWE rather than SWL there will be no material changes to the terms and conditions of their policies as a result of the Transfer, and therefore no impact on the contractual rights of these policyholders.

Unit-linked governance

- 11.97 The Unit Linked Service Agreement described in Section 9, will ensure that the operation of the unit-linked funds remain the same before and after the Transfer, albeit under the control of SWE rather than SWL.
- 11.98 After the Transfer, the UK COBS requirements in relation to unit-linked business will no longer apply to the Transferring UL Business retained by SWE. Luxembourg regulations do not include provisions equivalent to the UK COBS requirements but the CAA's mission statement does include conduct related statements. Unit-linked business is a common life insurance business line in Luxembourg. As mentioned in Section 3, the Luxembourg regulations have investment rules and restrictions with respect to unit-linked business. In my opinion, these rules and restrictions provide appropriate protections for the Transferring UL Policyholders with respect to management of their unit-linked policies.
- 11.99 The benefits for unit-linked policies are determined in relation to the value of units, therefore there will be limited scope for exercising discretion on the Transferring UL Business. However, as mentioned in

Section 6, I considered a number of areas where the benefits of the Transferring UL Policyholders may be subject to the discretion of SWE (in particular, the charges applied to unit-linked policies).

- 11.100 LBG also has Group level policies, including the Customer Treatment Policy. As a subsidiary of SWL, SWE is expected to comply with this policy for managing the Transferring UL Business.
- 11.101 Following the Transfer, the SWE Chief Actuary will advise the SWE Board on the management of the Transferring UL Business for actuarial matters, under the Luxembourg regulations.
- 11.102 Based on all of the above, I am satisfied that the governance around the use of discretion for the Transferring UL business will be similar to that under SWL and that the benefit expectations of Transferring UL Policyholders will suffer no detriment as a result of the Transfer.

Conclusion

- 11.103 Based on the above comments, I am satisfied that the Transfer will not have any material adverse effect on the benefit expectations and contractual rights of the Transferring UL Policyholders because:
- there are no material changes to the policy terms and conditions
 - the Unit Linked Service Agreement will ensure that the operation of the Transferring UL Policies is unchanged before and after the Transfer
 - following the Transfer, although the UK COBS will no longer apply to the Transferring UL Business, the Luxembourg rules and restrictions in relation to management of unit-linked business provide investment rules and restrictions
 - the governance around the use of discretion for the Transferring UL Business in SWE will be similar to that in SWL
 - after the Transfer, the SWE Chief Actuary will advise the SWE Board on the management of the Transferring UL Policies for actuarial matters, under Luxembourg regulations
 - the Transferring UL Business will continue to be subject to LBG's group-level policy Customer Treatment Policy.

External bodies providing further policyholder protection

FSCS

- 11.104 The Transferring UL Business is currently covered by the FSCS, which is a compensation scheme of last resort in the UK and protects policyholders if a financial services company were to fail. Following the Transfer, the Transferring UL Policyholders will hold policies with a Luxembourg based insurance entity and will lose entitlement to this form of protection (although if the claim results from an event which occurs prior to the transfer it will continue to be covered by the FSCS). A policyholder protection scheme equivalent to the FSCS does not exist in Luxembourg. The question that I must therefore address is whether or not this is a material loss in the context of the Transfer.
- 11.105 The purpose of the Scheme is to effect the transfer of the Transferring Business from SWL to SWE in order to enable the continued servicing (eg receiving premiums and paying claims) of the Transferring Business, regardless of the outcome of the Brexit negotiations. In my opinion, having certainty about how the policies in the Transferring Business will be serviced after Brexit is very important. The loss of the FSCS protection is a consequence of achieving this certainty. In addition, I have considered that the FSCS provides protection to covered policyholders following an insolvency or default event. Given that SWE will be well capitalised and will be required to comply with Solvency II in EU law, the likelihood of default or insolvency of SWE is, in my opinion, remote. Therefore, in my opinion, the likelihood of FSCS being required is remote and so I do not consider the loss of FSCS protection to have a material adverse effect on the Transferring UL Policyholders.
- 11.106 The Transferring UL Policyholders will not be compensated for the loss of FSCS protection and I consider that this is reasonable, given my comments above.
- 11.107 It is possible that the outcome of Brexit negotiations results in a deal with the EU which means SWL would have been able to continue to service contracts sold under EU passporting rights either for a

transitional period, or until the end of the policy term. If this were to be the result of Brexit negotiations, then the Transferring Policyholders will have lost their FSCS protection that they would have retained had the Transfer not taken place. However, as stated above, I consider that having certainty about how the policies will be serviced after Brexit is very important. Additionally, it is my view that there is insufficient time to wait for the results of such negotiations, and that action is required ahead of Brexit to ensure servicing of the Transferring Policies can continue post-Brexit. I will provide an update in my Supplementary Report on the latest relevant Brexit negotiations and I will also continue to monitor developments in the legal and regulatory position around Brexit and consider, in discussion with SWL and SWE, whether any such developments could affect the Transferring Policyholders' loss of FSCS cover. I will comment in my Supplementary Report on any changes in the position described above.

Ombudsman

- 11.108 Prior to the Transfer, where activities have been carried out on a Freedom of Establishment basis, any complaints that could not be resolved between SWL and the policyholder would need to be dealt with by the local system of complaints handling (which would primarily involve the local regulator in the territory where the policy was sold). For activities carried out on a Freedom of Services basis, as well as being able to use the local system of complaints handling, policyholders would also be entitled to refer their complaint to the UK FOS.
- 11.109 The only change to the above position as a result of the Transfer is for the business carried out on a Freedom of Services basis. Following the Transfer, this business will continue to have access to their local system of complaints handling, but will not have access to the UK FOS for complaints that arise on activities after the Transfer. However, they will be able to direct such complaints to the CAA or LOS. I describe the LOS in more detail in Section 3. The Transferring UL Policyholders will still be able to bring complaints to the UK FOS for any activities carried out on Freedom of Services basis by SWL that occurred prior to the Transfer.
- 11.110 I have compared the services and powers of both the UK FOS and CAA and LOS and can confirm that both offer a free service in a timely fashion with the LOS offering services in a range of languages. While the decisions of the UK FOS are legally binding, the decisions of the CAA and the LOS are not legally binding which is a lack of power when compared to the UK FOS.
- 11.111 However, if following a complaint to the CAA, an insurer does not agree to follow the CAA's opinion or recommendation, the CAA informs the policyholder and provides them with a copy of its opinion or recommendation. A policyholder can then take the matter to the court and use the CAA's assessment, which will be considered persuasive. As such, the CAA supports the policyholder in reaching a mediated solution. Therefore, even though the regimes are not identical they are designed to channel complaints and resolve disputes in practice.
- 11.112 In addition, I have been informed that in practice the Transferring UL Policyholders always raised their disputes through their local system of complaints handling rather than the UK FOS. This indicates that they might not look to use the UK FOS in the future and as such are unlikely to suffer detriment from the withdrawal of this service.
- 11.113 Therefore, in my opinion policyholders will not be adversely affected by any loss of policyholder protection with respect to UK FOS as a result of the Transfer.

Conduct of business

- 11.114 Before the Transfer, the Transferring UL Business is subject to the UK COBS. After the Transfer, the Transferring UL Business will be subject to Luxembourg regulations which include the CAA's conduct related mission statements as set out in the Luxembourg Insurance Act and the investment rules and restrictions related to unit-linked products. However, these are not as detailed as the UK COBS.
- 11.115 SWE will manage the Transferring UL Business similarly to how the business was managed within SWL before the Transfer. The unit-linked governance structure for SWE will be similar to that of SWL. All major decisions around discretion will be taken by the senior leadership team and submitted to IIGC for comment which is again similar to the SWL process. The Unit Linked Service Agreement will enable the current service providers to carry out box management and unit pricing activities in the

same manner before and after the Transfer. SWE will follow the Group's Treating Customers Fairly policy.

- 11.116 Therefore, in my opinion the Transferring UL Policyholders will not be adversely affected by any loss of policyholder protection with respect to the prevailing conduct of business regulation as a result of the Transfer.

Conclusion for External bodies providing further policyholder protection

- 11.117 It is my opinion that the Transferring Policyholders will not be materially adversely affected by the Transfer in relation to the policyholder protection because:
- the certainty of being able to service a policy is, in my view, more important and more valuable than the FSCS cover that will be lost
 - the value of the FSCS cover is low since the likelihood of the protection provided by the FSCS being required is remote, as SWL and SWE both have or will have appropriate capital and risk management policies, they are expected to be capitalised within the range of their target SCR Cover and compliant with Solvency II rules, and consequently, the likelihood of becoming insolvent is remote
 - although the ombudsman services in Luxembourg and the other EU countries, from which the policies were purchased, are not binding in the same way as in the UK, there are complaints mechanisms available for the policyholders
 - although the equivalent of the UK COBS does not exist in Luxembourg the same committee will consider the changes to unit-linked discretion in SWE as in SWL to ensure that the policyholder is treated fairly. Also, the Unit Linked Service Agreement ensures there is no change to the operation of the Transferring UL Policies.

Governance arrangements

- 11.118 I describe the governance structures of SWL and SWE in detail in Sections 4 and 6. The governance arrangements for both the companies are in line with LBG governance frameworks, however governance of SWE will also comply with the Luxembourg regulations.
- 11.119 With respect to the composition of the proposed Board of SWE:
- SWE's proposed Board will consist of competent directors, one of which is independent to promote a high standard of corporate governance
 - although SWE's proposed Board has a smaller number of directors compared to the SWL Board, this is, in my view, reasonable given the relative scale and complexity of the two companies
 - I have considered industry best practice for the Board composition of subsidiary companies of a similar size to the proposed features in SWE's plan and I am satisfied that the level of competence and independence will be comparable to its peer group
 - the Board and senior management of SWE will be approved by the relevant regulators and their competence and experience is considered in their approval
 - the composition of the Board of SWE will comply with Luxembourg regulations.
- 11.120 SWE will have representation in SWG's and SWL's committees where areas relevant to SWE are discussed. SWE will also have access to LB's services for support on functions such as internal audit, actuarial and finance services. I am satisfied that this will ensure that a similar level of governance will apply to the Transferring UL Business before and after the Transfer.

Conclusion

- 11.121 Overall I am satisfied that there are no material differences in the company governance arrangements of SWE and SWL that adversely affect the Transferring UL Policyholders as:

- SWEs proposed Board will consist of appropriate competencies and an independent director approved by the CAA
- SWE will have representation on SWG's Insurance Group level committees and SWL's committees when relevant areas for SWE are discussed
- the composition of SWEs proposed Board will comply with Luxembourg regulations
- the senior management roles will be approved by the CAA
- SWE will also have access to LB services for support on certain functions such as internal audit, actuarial and finance services.

Associated Arrangements

- 11.122 In Section 9, I also considered the Unit Linked Service Agreement and I concluded that it ensures that the operations of the Transferring UL Business remain the same, before and immediately after the Transfer.
- 11.123 In Sections 4 and 5, I described the German litigation claims in relation to the Transferring Business. In Section 9, I considered the Indemnity Agreement and Charge Agreement and I concluded that the Indemnity Agreement limits SWE and the Transferring Policyholders' exposure to these claims. I also concluded that the governance surrounding the termination of the Indemnity Agreement provides suitable protection for the Transferring Policyholders. In addition, I concluded that the Charge Agreement is an appropriate mechanism to help mitigate the risk of SWL failing to honour its obligations under the Indemnity Agreement.
- 11.124 Overall, I am satisfied that the relevant Associated Arrangements will not have a material adverse effect on the interests of the Transferring UL Policyholders and will provide the same level of protection in relation to litigation claims before and after the Transfer.

Vesting annuities

- 11.125 As summarised in Section 4, the Transferring UL Policies include pensions and deferred annuity business whose benefits will convert to with-profits annuities at vesting (this is compulsory for all UL pensions policies but optional for deferred annuity policies).
- 11.126 As part of the Reinsurance Agreement, these annuities will be reinsured to SWL at vesting. This will ensure the management of this business and payment of the with-profits annuities continue to be the same as they would have been had they vested in SWL before the Transfer. There will be no change to the way the annuities are priced after the Transfer.
- 11.127 Any GAOs on Transferring Policies will be reinsured from SWE into the Combined Fund within SWL. Should the price of an annuity exceed the accumulated policy proceeds as a result of there being a biting GAO on the policy, then the Combined Fund will pay the difference between the policy proceeds and the price of the annuity into the CM WPF.
- 11.128 Annuities will be paid by SWE, but in effect will continue to be paid by SWL by means of the Reinsurance Agreement. SWE will be meeting the administration expenses for this business and the Reinsurance Agreement includes the requirement for SWL to pay an expense charge to SWE.
- 11.129 For the bonus distribution, the with-profits governance applied will be the same as the governance for the Transferring UWP Business as described in Section 6. This applies post-vesting as well as pre-vesting.

Conclusion

- 11.130 I am of the opinion that the vesting annuitants would not be materially adversely affected by the Transfer because:
- the with-profits annuity benefits will be reinsured back to SWL; they will be maintained in the same way as they would have been had they vested in SWL before the Transfer
 - the pricing of the annuities will not change after the Transfer

- the governance around the bonus distribution will be the same as the Transferring UWP Business.

Tax implications

Policyholder Tax

- 11.131 I am not an expert in tax matters and, therefore, in forming my opinion on the impact of policyholder tax, I have relied upon documents produced by SWL's in-house tax experts, and summary papers produced based on the tax advice SWL has received from its tax advisors. I have reviewed this information to ensure it is in line with my understanding and consistent with what I have seen in similar restructures. Grant Thornton's tax specialists have also reviewed this information, with no areas of disagreement being identified.
- 11.132 I do not anticipate that there will be a change in policyholder taxation for the Transferring UL Policyholders who are tax residents in Austria, Italy or Luxembourg, as the Transfer does not result in a material change to the terms and conditions of the Transferring UL Business. In particular, I understand SWL currently withholds tax on policy payments to Italian resident policyholders, with the process managed on its behalf by its Italian outsource provider; following the Transfer, this will be managed by SWE and the Italian outsource provider; an identical amount of tax will be withheld.
- 11.133 There will, however be a change in the timing of the payment of the policyholder tax in Germany. This is a result of SWE setting up a branch with a representative to comply with CAA data protection and control requirements. In Germany, that branch will withhold the tax due to the German government on claim payments to comply with German taxation law (rather than SWL paying claims gross of tax, with the policyholder paying the tax at a later date via his tax return). 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.
- 11.134 Therefore, based on the information provided to me by SWL and its tax advisors, I do not expect there to be any change to any policyholder's tax liability as a result of the Transfer (albeit that there will be a change in the timing due to the withholding tax of the policyholders in Germany).

Tax charges

- 11.135 The unit-linked funds backing the Transferring UL Policies are not charged any tax on income or gains. Following the transfer, they will not be charged any tax. Because the funds will continue to be managed within Luxembourg, there will be no changes to how taxes are withheld on dividends received by the funds.

Corporation tax

- 11.136 There would potentially be a tax relief for SWE (subject to analysis from Luxembourg tax authorities) due to a Transfer pricing adjustment as described in Section 7. This will be confirmed following the completion of the Transfer pricing valuation closer to the effective Date and I will provide an update on this in my Supplementary Report.
- 11.137 No further trading profits or losses are expected for the Transferring UL Business in SWE as a result of the Transfer. Therefore there will be no direct Luxembourg corporation tax impact on the Transferring UL Policyholders.
- 11.138 There will be no Luxembourg corporation tax impact arising from the Indemnity Agreement.

VAT

- 11.139 The Transfer will qualify as a transfer of going concern for VAT purposes. Luxembourg VAT will be charged on policy administration services provided to SWE, including those provided by SWL. These costs will be met by the SWE shareholders, and therefore do not directly affect the Transferring UL Policyholders.
- 11.140 There will be no Luxembourg VAT arising from the Indemnity Agreement.

Tax clearances

- 11.141 Pre-clearance will be obtained from HMRC and the Luxembourg tax authorities. I will provide an update on these in my Supplementary Report.

Conclusion

- 11.142 It is my opinion that there will be no material adverse tax implications for the Transferring UL business as a result of the Transfer because:
- there are no material policyholder tax impacts as a result of the Transfer
 - there are no net corporation tax impacts on the Transferring UL Policyholders
 - additional VAT costs will be met by SWE shareholders, therefore there is no direct VAT impact on the Transferring UL Policyholders.

Costs of the Transfer and incremental ongoing expenses

- 11.143 As described in Section 7, the one-off costs of implementing the Transfer will be met by the shareholders of SWL through the Combined Fund. There will be an increase in the ongoing costs as a result of the Transfer and these will be met by the shareholders of SWE. The costs related to the Italian surrender option will be borne by the shareholders of SWL.
- 11.144 There is limited scope to increase policy charges in the event that there is an increase in ongoing expenses following the Transfer. Any change in charges would be in line with the terms and conditions of the policies, as set out in product literature and therefore in line with policyholders' reasonable expectations. Any changes to charges will need the approval of the SWE Board after taking in to account appropriate actuarial advice and unit pricing implications.

Conclusion

- 11.145 Overall, it is my opinion that the expenses due to the Transfer will not materially adversely impact the Transferring UL Policyholders because:
- all one-off costs as a result of the Transfer are met by SWL Shareholders and the increase in ongoing costs will be met by the SWE Shareholders
 - there is limited scope for charges to policyholders to change and this could only happen with sufficient governance.

Administration and service standards

- 11.146 Policy administration and investment management for the Transferring UL Policies are currently outsourced to different providers as outlined in Section 6. There will be no change to either the service standards agreement or the terms upon which the administrative and investment management arrangements are provided as a result of the Transfer. The outsourcing agreements will be novated to SWE. The same teams will continue to carry out the administration of the Transferring Policies. SWE will have the same service standards as previously applied in SWL.
- 11.147 The Unit Linked Service Agreement enables LB to provide support to SWE in relation to the operations of the Transferring UL Business. This means that the same teams, systems and processes will be used to carry out the operation of the UL policies before and after the Transfer. Therefore, the Transferring UL Policyholders will not experience any change in service standards in relation to the unit-linked funds management as a result the Transfer.
- 11.148 In line with the requirements of Luxembourg regulations, branch offices will also be set up in Germany and Italy, where the outsourcing companies are based to ensure that SWE has control over data protection.
- 11.149 Therefore, there is no reason to expect that the quality and level of service provided to the Transferring UL Policyholders will deteriorate as a consequence of the Transfer.

Conclusion

11.150 Overall, it is my view that the Transferring UL Policyholders will not experience any material adverse changes to the administration of their policies as a result of the Transfer. I have reached this conclusion because:

- the Transferring UL Policies will continue to be serviced under the same outsourcing arrangements as they were prior to the Transfer
- the Unit Linked Service Agreement ensures that the operation of the Transferring UL Business will be unchanged and the same teams, systems and processes will be used
- SWE will adopt the same service standards as previously applied in SWL.

Conclusion for Transferring UL Policyholders

11.151 Overall, I am satisfied that the Transferring UL Policyholders will not suffer a material adverse effect as a result of the Transfer.

Communications with Transferring Policyholders

11.152 I have set out a summary of SWL's communication strategy in Section 7. The communications have been tailored to different groups of Transferring Policyholders. The Policyholder Pack will be sent to Transferring Policyholders, except those subject to waivers, and will be translated into local languages that are relevant to these policyholders.

11.153 I have reviewed SWL's communications strategy and the information that will be provided to policyholders to inform them of the Transfer. I have reviewed the English version of the communications and the process SWL has utilised to translate these communications and I am satisfied that it ensures the documents are fit for purpose and not misleading. I am satisfied that the communications are appropriate, clearly worded and not misleading. In addition, the communications include the key information that I would expect to see, based on my experience of other schemes, including a brief, easy to understand overview of the Scheme, the options available to policyholders, responses to frequently asked questions, a means for seeking further information if required and the policyholders' right to object to the Scheme.

Dispensation and waivers

Paragraph 3(2)(a)

11.154 As outlined in paragraph 7.77, SWL has sought dispensations from the Court with regards to the requirement contained in FSMA to publish the legal notice in two national newspapers in each EEA country where a Transferring Policyholder is resident.

11.155 I understand that, as at 31 December 2017, there were 80 Transferring Policyholders having a current residential address in an EEA Member State other than the United Kingdom, Austria, Germany or Italy. In total 0.3% of the Transferring Policyholders reside across 47 jurisdictions other than United Kingdom, Austria, Germany or Italy. Given the low volume of Transferring Policyholders known to be living outside of the United Kingdom, Austria, Germany or Italy, and the fact that these policyholders will be sent the communications pack by post, the benefit of publishing the notice in two national newspapers for each of the countries where these policyholders are currently living would be disproportionate to the costs involved. In addition, it is noted that SWL has never purposefully or directly sold business in most of these jurisdictions.

11.156 Therefore, I agree with SWL's decision to seek specific dispensations from the requirement to publish the notice in two national newspapers within the EEA which is the state of the commitment in relation to any Transferring Policies.

Paragraph 3(2)(b)

11.157 As outlined in paragraph 7.80 SWL is to seek a waiver from the requirement to notify certain Transferring Policyholders of SWL of the Transfer. Appendix G provides an assessment of each of the

groups of policyholders identified against the factors outlined in paragraph 7.79, providing rationale for excluding each of these groups of policyholders from the mailing.

- 11.158 I have reviewed the reasons that these dispensations and waivers have been sought in relation to all policyholders of SWL, including the Transferring Policyholders. It is my opinion that, in each case, it is appropriate to not send the communications pack to these policyholders. In addition, the transfer website contains the information detailed within each variant of the communications pack, enabling these policyholders to access the same level of information as they would have had if they were included in the mailing. Further, I am satisfied that full compliance with this regulation is both unnecessary and disproportionately costly.

Rights of Transferring Policyholders to object to the Scheme

- 11.159 Any policyholder who feels they may be adversely affected by the Scheme may put their objections to SWL, Herbert Smith Freehills (solicitors to SWL) or the High Court. I will be provided with copies of any such objections, and they will also be shared with the PRA and the FCA. I will consider any such objections when concluding on the appropriateness of the Scheme in the Supplementary Report.

Overall conclusion

- 11.160 Overall, I have concluded that there will be no material adverse impact on the Transferring Policyholders as a result of the Transfer.

12 The impact of the Transfer on the Non-transferring Policyholders of SWL

Introduction

- 12.1 The Scheme and the Associated Arrangements are designed to minimise disruption to the general operation and security of Non-transferring Business.
- 12.2 I note that the Transferring Business represents approximately 1.5% of the total number of policies of SWL and 2.4% of the total BEL of SWL. Transferring UWP Business represents 34% of the BEL of CM WPF. Transferring UL Business represents approximately 0.4% of the BEL of SWL's total unit-linked business.
- 12.3 Within this Section, I consider the analysis performed in earlier Sections of the Report in relation to the Non-transferring Policyholders. In order to understand whether the Transfer will have any material adverse effect on Non-transferring Policyholders, it is necessary to consider various possible areas which could be affected, including:
- policyholder benefit expectations and contractual rights
 - the security of Non-transferring Policyholders benefits, utilising the analysis performed in Section 10
 - litigation claims and the Indemnity Agreement
 - the policyholder protection in terms of the UK COBS and access to external bodies, such as FSCS and ombudsman services
 - the company governance
 - tax implications
 - expenses and charges
 - administration and service standards.

Policyholder benefit expectations and contractual rights

- 12.4 Within this Section I have considered separately two distinct groups of Non-transferring Policyholders:
- Non-transferring Policyholders in CM WPF
 - Other Non-transferring Policyholders.

Non-transferring Policyholders in the CM WPF

- 12.5 The Transfer will not result in any changes to the policy terms and conditions for the Non-transferring Policyholders in the CM WPF. There will be no change to the governance or operation of the Non-transferring policies especially around discretion within SWL: the roles of the SWL Board, the WPC and the WPA in the management of the Non-transferring Policies in the CM WPF will not change.
- 12.6 The 2015 Scheme will be amended to enable payments to be made from the CM WPF to SWE in respect of the FWH. My certification for these changes to the 2015 Scheme is in Appendix F. Together, the Reinsurance Agreement and the update to the 2015 Scheme ensure that the CM WPF will continue to be managed as a whole fund without having to be split between the Transferring Business and Non-transferring Business.

Consequences of future termination of the Reinsurance Agreement

- 12.7 If the Reinsurance Agreement were ever to be terminated, the CM WPF would need to be split between SWL and SWE. A termination amount would be determined considering the fair distribution of the estate within the CM WPF with oversight of an independent actuary and no objection from the Luxembourg and UK Regulators.

- 12.8 Because the Non-transferring Business in the CM WPF runs off more quickly than the Transferring UWP Business, a Fund Split could shorten the run-off of the remaining CM WPF. The 2015 Scheme allows the CM WPF to be merged into the SW WPF when it falls below a specified size and as a result of the Transfer, the CM WPF would potentially need to be merged with the SW WPF earlier than might have been the case if the Reinsurance Agreement had stayed in place. A merger of the WP funds would need to be in line with the provisions defined in the 2015 Scheme.

Conclusion for Non-transferring Policyholders in CM WPF

- 12.9 Provided the Reinsurance Agreement stays in place, I am satisfied that the Transfer will have no material effect on either the policyholder benefits or contractual rights for the Non-transferring Policyholders in the CM WPF, because:
- there is no change to the policy terms and conditions
 - the discretion policies and the governance around these will be unchanged by the Transfer
 - the investment policies of the funds will not be amended as a result of the Transfer
 - with the FWH in place, interests of the Non-transferring Policyholders in the CM WPF will be managed in materially the same way after the Transfer as they were before
 - If the Reinsurance Agreement were ever to be terminated, I am still satisfied that the Transfer will have no material effect on the policyholder benefits or contractual rights for the Non-transferring Policyholders in the CM WPF. This is because, the termination's main impact on the CM WPF would be to accelerate its run-off and its possible closure or merger with the SW WPF and the 2015 Scheme includes provisions to protect the CM WPF policyholders when this happens. In addition, a termination amount would be determined with oversight of an independent actuary and no objection from the Luxembourg and UK Regulators. The termination process is designed to ensure a fair outcome to all policyholders, including the Non-transferring Policyholders.

Other Non-transferring Policyholders

- 12.10 There will be no changes to the terms and conditions of the Other Non-transferring Policyholders as a result of the Transfer.
- 12.11 For Non-transferring UL Policies:
- the unit-linked funds that the Transferring UL Policies are investing in will remain unchanged
 - the governance structures that are in place for unit-linked policies will be unchanged
 - there will be no changes to discretionary charges on UL policies.
- 12.12 The Other Non-transferring Policies would not be impacted by a future termination of the Reinsurance Agreement.

Conclusion for Other Non-transferring Policyholders

- 12.13 Overall, I am satisfied that the Transfer will have no material effect on either the policyholder benefits or contractual rights for the Other Non-transferring Policyholders.

Conclusion for all Non-transferring policies

- 12.14 Having considered separately the Non-transferring policies within and outside the CM WPF, I have concluded that the Transfer will have no material adverse effect on the policyholder benefits or contractual rights for either class of the Non-transferring Policyholders.

Security of policyholder benefits for non-transferring policies

- 12.15 In this Section, I consider the security of the benefits of the Non-transferring Policyholders, and whether this is adversely affected by the Transfer. To do this, I consider the financial strength of SWL before and after the Transfer, and any changes to the risks that SWL is exposed to as a result of the Transfer.

- 12.16 I also consider the implications of the Associated Arrangements on the security of the benefits of the Non-transferring Policyholders. A more detailed analysis of these considerations is in Sections 9 and 10, I refer to these Sections where appropriate.

Risk profile

- 12.17 In Section 10, I considered the risk profiles of SWL before and after the Transfer and found there to be no significant impact on the risks that SWL is exposed to as a result of the Transfer.
- 12.18 Any future changes to SWL's risk profile would be identified and addressed by SWL in line with its Risk Management Framework and these processes will not change as a result of the Transfer.

Capital position

- 12.19 Changes in the security of policyholder benefits for the Non-transferring Policyholders can be measured by comparing the levels of SWL's SCR Cover Ratio before and after the Transfer.
- 12.20 My analysis in Section 10 concluded that SWL will be well capitalised (ie will have a suitably high SCR Cover Ratio) immediately after the Transfer, and is expected to remain appropriately capitalised over the five-year planning horizon following the Transfer.
- 12.21 My analysis of the stress and scenario tests within SWL's ORSA in Section 10 gave me comfort that SWL has a number of potential management actions available to control its solvency in adverse economic conditions, giving me no cause for concern over SWL's future solvency.
- 12.22 Section 10 describes what the impact of the Transfer would have been on SWL's Solvency II Pillar I capital position if the Transfer had taken effect on 31 December 2017 and shows that the SCR Cover Ratio would have fallen slightly from a position in the Green zone to one in the Amber zone. My analysis also suggests that the profitability of SWL will have strengthened its Solvency II Pillar I capital position enough by the effective date of the Transfer for it to still be in the Green zone following the Transfer.

Solvency risk appetite

- 12.23 There will be no change to SWL's CMP and SRA as a result of the Transfer.

Litigation claims and indemnity agreement

- 12.24 After the Transfer, SWL will continue to be liable for the majority of the German business litigation claims, with SWE meeting part of the cost under the Indemnity Agreement. Although SWL's direct exposure to the claims will be slightly smaller, it will still have indirect exposure to SWE's share due to the Indemnity Agreement and because SWE is a subsidiary of SWL.
- 12.25 Overall, I am satisfied that the treatment under the Transfer of the litigation claims will have no impact on the security of benefits of Non-transferring Policyholders because SWL's exposure to these claims will not increase as a result of the Transfer.

Reinsurance Agreement and Charge Agreement

- 12.26 In Section 9 I considered the Reinsurance Agreement and Charge Agreement and I concluded that the FWH provisions within the Reinsurance Agreement had the effect of ranking SWE higher than the direct policyholders in the unlikely event of SWL becoming insolvent.
- 12.27 This feature is due to regulatory requirements in Luxembourg and is an unavoidable consequence of the arrangements that are required so that the Transferring Policies can continue to be serviced after Brexit.
- 12.28 I am satisfied that this feature of the Reinsurance Agreement is not materially onerous to the security of benefits for the Non-transferring Policyholders because:
- the transferring policyholders only represent 2% of SWL's business before the Transfer
 - the likelihood of SWL becoming insolvent is extremely remote

Conclusion

- 12.29 Overall, I am satisfied that the Transfer does not cause a material adverse effect on the security of benefits of the Non-transferring Policyholders, because:
- the CMP and Solvency Risk Appetite for SWL will be unaltered as a result of the Transfer
 - although the SCR Cover Ratio will decrease as a result of the Transfer, it will reside within the Green zone and remain well above the minimum regulatory level
 - going forward, SWL will take the necessary management actions in line with its CMP to keep the SCR Cover Ratio within the Green zone after the Transfer
 - the ranking of SWE policyholders ahead of SWL policyholders in the event of SWL insolvency is (a) an unavoidable consequence of Brexit arrangements, and (b) not materially onerous to SWL policyholders.

Access to independent bodies providing further policyholder protection

COBS rules

- 12.30 The policies of the Non-transferring Policyholders will continue to be managed in line with the UK COBS rules.

FSCS

- 12.31 There is no change to the level of protection under the FSCS for the Non-transferring Policyholders as a result of the Transfer.

Ombudsman

- 12.32 The Non-transferring Policyholders would continue to have access to the ombudsman service, to help with any disputes regarding their policies.

Conclusion

- 12.33 Overall, since these policyholders will continue to be covered by the same protection standards as they are prior to the Transfer, I am satisfied that the Transfer will have no impact on the protection of Non-transferring Policyholders.

Governance

Company level governance arrangements

- 12.34 The Boards and committees of SWL and SWG will be unchanged by the Transfer and there will be no material change in the responsibilities of these Boards and committees. The terms of reference of the relevant committees will be amended to include SWEs representation.

Conclusion

- 12.35 Overall, because there will be no change to the arrangements, I am satisfied that there will be no material adverse effect on the company level governance arrangements for Non-transferring Policyholders as a result of the Transfer.

Tax

- 12.36 I am not an expert in tax matters and, therefore, in forming my opinion on the impact of policyholder tax, I have relied upon documents produced by SWL's in-house tax experts, and summary papers produced based on the tax advice SWL has received from its tax advisors. I have reviewed this information to ensure it is in line with my understanding and consistent with what I have seen in similar restructures. Grant Thornton's tax specialists have also reviewed this information, with no areas of disagreement being identified.

Policyholder tax

- 12.37 I do not anticipate that there will be a change in policyholder taxation for Non-transferring Policyholders as a result of the Transfer.

Corporation tax

- 12.38 There will be an accounting loss expected within SWL arising from the Transfer, related to the difference in the valuation of liabilities under IFRS and Luxembourg GAAP, the costs of setting-up and administering a new entity and increased capital requirements due to additional risks and loss of diversification. This loss will be subject to relief at the UK corporation tax at 19%. The impact is expected to be a tax saving in SWL. Just as the loss is borne by the shareholders of SWL, it is the shareholders of SWL that will benefit from the tax relief on the loss. Neither the loss nor associated the tax relief will impact the benefits of the Non-transferring Policyholders.
- 12.39 There would potentially be a tax charge for SWL due to a Transfer pricing adjustment as described in Section 7. This will be confirmed following the completion of the transfer pricing valuation closer to the effective Date and I will provide an update on this in my Supplementary Report. This tax charge would be borne by the shareholders of SWL.

Taxation of the CM WPF

- 12.40 For internal purposes, the CM WPF makes a contribution towards SWL's corporation tax. The tax charged to the CM WPF is calculated by treating the CM WPF as if it were a standalone UK insurance company. The transfer of the Transferring Policies out of the CM WPF and their reinsurance back into it will have no impact on the tax charged to the CM WPF.

Taxation of the unit-linked funds

- 12.41 There will be no change to how the internal unit-linked funds are taxed following the Transfer.

VAT

- 12.42 Luxembourg VAT will be charged on policy administration services provided to SWE, including those provided by LB. These costs will be met by the SWE shareholders, and therefore do not directly affect the Non-transferring Policyholders.
- 12.43 There will be no UK VAT arising from the Reinsurance Agreement or the Indemnity Agreement.

Tax clearances

- 12.44 Pre-clearance will be obtained from HMRC and the Luxembourg tax authorities: I will provide an update on this in my Supplementary Report.

Conclusion

- 12.45 It is my opinion that there will be no material adverse tax implications for the Non-transferring Business as a result of the Transfer because:
- there is no change anticipated in policyholder tax as a result of the Transfer
 - no changes will be made to how the CM WPF or the UL funds are taxed
 - any other tax costs will be met by the shareholders.

Expenses and charges

- 12.46 SWL shareholders will meet the one-off costs associated with the Transfer.
- 12.47 The current expense charging structure, and the governance around any changes to the charging structure will not change as a result of the Transfer. Therefore, for Non-transferring Policyholders, the Transfer will not result in a change to charges.
- 12.48 The CM WPF's PPFM mentions the possibility of exceptional costs being charged to the estate. Any exceptional costs arising from the Transfer will be met by shareholders rather than being charged to

the estate. Going forward, there will be no change in the way these exceptional costs are determined before and after the Transfer.

Conclusion

- 12.49 Overall, I am satisfied that the treatment of expenses and charges as a result of the Transfer will have no material impact on the Non-transferring Policyholders as:
- the one-off costs of the Transfer will be met by SWL shareholders
 - there will be no change in the expense charging structures
 - the treatment of future exceptional costs will remain unchanged.

Policy administration and service standards

- 12.50 After the Transfer, the administration of the Non-transferring Policyholders will remain unchanged. The Non-transferring Policies will continue to be administered by the same staff, in the same locations, adhering to the same service standards.

Conclusion

- 12.51 Overall, I am satisfied that there will be no material adverse effect on the administration and services standards of Non-transferring Policyholders as a result of the Transfer, as there are no anticipated changes to either of these.

Conclusion on the effect of the Transfer on the Non-transferring Policyholders

- 12.52 Overall, I am satisfied that there will be no material adverse effect on the Non-transferring Policyholders as a result of the Transfer.

Communications with Non-transferring Policyholders

- 12.53 SWL intends to seek waivers from the requirement to send written notices regarding the Transfer to the Non-transferring Policyholders, as it believes that the cost of mailings will be disproportionate relative to the benefits to the policyholders that would result from such mailing. SWL expects that the general communications will be more appropriate for this group of policyholders. The reasons behind seeking the waiver are:
- Transferring Policyholders make-up only 1.5% of the total number of policyholders
 - there will be no material adverse effect on the Non-transferring Policyholders as a result of the Transfer
 - individual communications regarding the Transfer may be unnecessarily confusing to Non-transferring Policyholders.
- 12.54 On the basis that I have concluded there is no material effect on the Non-transferring Policyholders, I have also concluded that there are no material issues that need to be brought directly to the attention of SWL's Non-transferring Policyholders before the Transfer proceeds. Therefore, I agree with SWL's decision to seek dispensation from the High Court with regard to the requirement contained in regulation 3(2)(b) of the Financial Services and Markets Act 2000 (Conduct of Business Transfers) (Requirements on Applicants) Regulations, 2001 (as amended) to notify all policyholders of SWL regarding the Transfer.

13 The Impact of the Transfer on the reinsurer of Transferring Business of SWL

Introduction

- 13.1 In this Section, I consider the external reinsurance arrangements in place in respect of the Transferring Business, how these arrangements are being dealt with under the Transfer and whether there will be any resulting material adverse effect on the reinsurers of Transferring Business of SWL.

External Reinsurance Arrangements

- 13.2 Two reinsurance contracts with Swiss Re for the Transferring Business will be transferred from SWL to SWE pursuant to the Transfer on the Effective Date. There will be no change to any of the terms and conditions of the reinsurance contracts as a result of the Transfer on the Effective Date.
- 13.3 SWL and SWE will engage with Swiss Re to provide it with the regulatory notification letters which will include the same content as will be included in the Policyholder Pack.

Conclusion

- 13.4 Given that there will be no change to the external reinsurance contracts besides the requirement to reflect the change of ownership following the Transfer, I am satisfied that there will be no material effect of the Transfer on the external reinsurers of the Transferring Policies.



Tim Roff FIA

Partner

Grant Thornton UK LLP

14 November 2018

A Summary CV for Tim Roff

Title

Partner

Experience

Tim is Partner and Head of Actuarial and Risk services at Grant Thornton. He has previously held roles as Head of Global Actuarial Services at KPMG and EY.

He is a senior actuary with 20 years of experience operating at partner level. He holds UK practising certificates to act in regulatory actuarial roles.

Tim has significant experience in all aspects of actuarial work – reserving, capital and pricing. He has acted as Chief Actuary for a number of major insurers.

He is an expert in financial reporting including various regulatory systems, IFRS and embedded value. He was senior actuary on the audit of a major insurance firm who report under all these bases.

Tim has worked on a range of transactions, restructuring and portfolio transfers, both sell side and buy side.

He has a range of expert experience including acting as expert on a scheme to release life company capital and arbitrator on a sale and purchase agreement dispute. He has acted as Skilled Person for the UK Regulators on a number of occasions.

Tim has a range of international experience and has carried out assignments in Belgium, France, Ireland, Morocco, Netherlands, Switzerland and US.

Professional qualifications and membership

- Fellow of the Institute and Faculty of Actuaries

Career outline

- 2014 joined Grant Thornton UK LLP
- Partner, KPMG
- Partner, Ernst & Young

B Extract from work order

Terms of engagement between Scottish Widows Limited and Grant Thornton UK LLP

Independent Expert for Part VII Transfer

We write to acknowledge your instructions to act in the above matter and set out below our understanding of the work that you wish us to perform and the terms on which we shall undertake it.

The Agreement is subject to the approval of the Independent Expert by the Prudential Regulation Authority ("PRA") having consulted with the Financial Conduct Authority ("FCA").

Our instructions

You have asked us to provide an Independent Expert to report on the proposed scheme of transfer of a block of business from Scottish Widows Limited ("SWL") to New Co, a newly authorised entity to be set up and authorised in the EU (the "Scheme"). The Independent Expert's report ("Report") will be prepared in accordance with and for the purposes set out in Part VII of the Financial Services And Markets Act 2000 (as amended) ("FSMA") in relation to the Scheme which is to be submitted to the English High Court ("Court") for approval.

The Independent Expert's analysis and Report will follow the relevant FSMA requirements and associated supplemental guidance issued by the PRA and FCA. The Report will consider the Scheme as a whole and its effect on the transferring and non-transferring policyholders of SWL. In particular, it will include, but not be limited to, an opinion on:

- the impact of the Scheme on the different groups of policyholders affected by the Scheme, namely:
 - the transferring policyholders
 - the policyholders who will remain with SWL after the transfer.
- the adequacy of any safeguards in the Scheme intended to protect the interests of the affected policyholders
- any other information required to be included by the FSMA, the PRA and the FCA.

The Independent Expert will prepare the Report (for the directions hearing), a summary of the Report (for notification to all affected policyholders and other interested parties) and a supplementary report (for the sanction hearings containing updated information) (together the "Deliverables") which will be filed by the Addressees with the Court in connection with the Scheme. The Deliverables will note all information, advice, recommendations and other content of any reports, presentations or other communications provided by us to the Addressees.

Data reliance and limitations

In performing this assignment, the Independent Expert will rely on data and information provided by you, other third party experts such as actuaries and auditors, and industry sources of data. He will not audit or verify this data and information. If the underlying data or information is inaccurate or incomplete, the results of his analysis may likewise be inaccurate or incomplete.

In performing the services under this Agreement, we will use the skill, care, expertise and competence that could reasonably be expected from a highly reputable international consultancy firm or company providing to major multinational corporations the same or similar services to those provided under this Agreement.

The Independent Expert's ability to carry out this assignment will depend on a number of key factors:

- that the relevant and appropriate information is readily available, specifically:
 - financial data including projections
 - actuarial and audit reports
 - detailed information on reinsurance arrangements
 - detailed information on any guarantees
 - access to the personnel of both SWL and New Co.
- access to third party reports (subject to the provision of hold harmless letters as necessary) and access to their authors for the purposes of interview
- agreement of third parties of his reliance on their reports for the purpose of forming his independent expert opinion.

C PRA's approach to insurance business transfers

The tables below cross references Sections of the PRA's approach to business with the relevant Sections of this Report:

Reference to the PRA's approach to business transfers	Reference to relevant Section within the Report
2.30 The Scheme report should comply with the applicable rules on expert evidence and contain the following information:	
(1) who appointed the Independent Expert and who is bearing the costs of that appointment;	1.11/2.17
(2) confirmation that the Independent Expert has been approved or nominated by the PRA;	1.11/2.17
(3) a statement of the Independent Expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role;	2.24 and Appendix A
(4) whether the Independent Expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence and details of any such interest;	2.25 and 2.26
(5) the scope of the report;	Appendix B
(6) the purpose of the Scheme;	2.1 to 2.5
(7) a summary of the terms of the Scheme in so far as they are relevant to the report;	Section 7
(8) what documents, report and other material information the Independent Expert has considered in preparing the report and whether any information that they requested has not been provided;	Appendix E
(9) the extent to which the Independent Expert has relied on:	
(a) information provided by others; and	2.33
(b) the judgement of others;	2.33
(10) the people the Independent Expert has relied on and why, in their opinion, such reliance is reasonable;	2.33 and Appendix E
(11) Their opinion of the likely effects of the Scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between:	
(a) Transferring Policyholders;	Section 11
(b) policyholders of the transferor whose contracts will not be transferred; and	Section 12
(c) policyholders of the transferee;	N/A – the transferee is a new entity
(12) Their opinion on the likely effect of the Scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the Scheme;	Section 13
(13) what matters (if any) that the Independent Expert has not taken into account or evaluated in the report that might, in their opinion, be relevant to policyholders' considerations of the Scheme; and	No matters
(14) for each opinion that the Independent Expert expresses in the report, an outline of their reasons.	Demonstrated throughout the Report
2.32 The summary of the terms of the Scheme should include:	

Reference to the PRA's approach to business transfers	Reference to relevant Section within the Report
(1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the Scheme; and	Section 13
(2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred.	Section 9
2.33 The Independent Expert's opinion of the likely effects of the Scheme on policyholders should:	
(1) include a comparison of the likely effects if it is or is not implemented;	2.6 to 2.7
(2) state whether they considered alternative arrangements and, if so, what;	2.19
(3) where different groups of policyholders are likely to be affected differently by the Scheme, include comment on those differences they consider may be material to the policyholders; and	Demonstrated throughout the Report
(4) include their views on:	
(a) the effect of the Scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;	Sections 10, 11 and 12
(b) the likely effects of the Scheme on matters such as investment management, new business strategy, administration, claims handling, expense levels and valuation bases in relation to how they may affect:	
(i) the security of policyholders' contractual rights;	Sections 11 and 12
(ii) levels of service provided to the policyholders; or	Sections 11 and 12
(iii) for the long-term insurance business, the reasonable expectations of policyholders; and	Sections 11 and 12
(c) the cost and tax effects of the Scheme, in relation to how they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations.	Sections 11 and 12
2.35 For any mutual company involved in the scheme, the report should:	
(1) describe the effect of the scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of these members to secure or prevent further changes which could affect their entitlement as policyholders;	N/A
(2) state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights; and	N/A
(3) comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without.	N/A
2.36 For a scheme involving long-term insurance business, the report should:	
(1) describe the effect of the Scheme on the nature and value of any rights of policyholders to participate in profits;	Sections 8, 9, 11 and 12
(2) if any such rights will be diluted by the Scheme, describe how any compensation offered to policyholders as a	N/A

Reference to the PRA's approach to business transfers	Reference to relevant Section within the Report
group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;	
(3) describe the likely effect of the Scheme on the approach used to determine:	
(a) the amount of any non-guaranteed benefits such as bonuses and surrender values; and	Sections 11 and 12
(b) the levels of any discretionary charges;	Sections 11 and 12
(4) describe what safeguards are provided by the Scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm;	Sections 9 and 11
(5) include the Independent Expert's overall assessment of the likely effects of the Scheme on the reasonable expectations of long-term insurance business policyholders;	Sections 11 and 12
(6) state whether the Independent Expert is satisfied that for each firm, the Scheme is equitable to all classes and generations of its policyholders; and	Sections 11 and 12
(7) state whether, in the Independent Expert's opinion, for each relevant firm the Scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holders) to ensure that the Scheme operates as presented.	Sections 9, 11 and 12
<i>2.37 Where the transfer forms part of a wider chain of events or corporate restructuring, it may not be appropriate to consider the transfer in isolation and the Independent Expert should seek sufficient explanations on corporate plans to enable them to understand the wider picture. Likewise, the Independent Expert will also need information on the operational plans of the transferee and, if only part of the business of the transferor is transferred, of the transferor. These will need to have sufficient detail to allow them to understand in broad terms how the business will be run.</i>	N/A
<i>2.38 A transfer may provide for benefits to be reduced for some or all of the policies being transferred. This might happen if the transferor is in financial difficulties. If there is such a proposal, the Independent Expert should report on what reductions they consider ought to be made, unless:</i>	
(1) the information required is not available and will not become available in time for his report, for instance it might depend on future events; or	N/A
(2) he is unable to report on this aspect in the time available.	N/A
Under such circumstances, the transfer might be urgent and it might be appropriate for the reduction in benefits to take place after the event, by means of an order under Section 112 of FSMA. The PRA considers any such reductions against its	N/A

Reference to the PRA's approach to business transfers	Reference to relevant Section within the Report
<p>statutory objectives. Section 113 of the FSMA allows the court, on application to the PRA, to appoint an independent actuary to report on any such post-transfer reduction in benefits.</p>	

D FCA’s Approach to insurance business transfers

The tables below cross references Sections of the FCA's approach to business with the relevant Sections of this report:

Reference to the CA's approach to business transfers	Reference to relevant Section within the report
Overarching guidance	
6.2 The FCA expect the report to have been constructed in such a way that it is easily readable and understandable by all its users and for the IE to pay attention to the following:	
6.2.1 Technical terms and acronyms should be defined on first use.	Demonstrated throughout the Report
6.2.2 There should be an executive summary that explains, at least in outline, the proposed transfer and the IE's conclusions.	Section 1
6.2.3 The business to be transferred should be described early in the report.	1.5 to 1.8
6.2.4 The detail given should be proportionate to the issues being discussed and the materiality of the transfer when seen as a whole. While all material issues must be discussed, IEs should try to avoid presenting reports that are disproportionately long.	Demonstrated throughout the Report
6.2.5 IEs should prepare their reports in a way that makes it possible for non-technically qualified readers to understand.	Not explicitly demonstrable but considered in the writing of the Report
6.3 IE reports should have detailed analysis, critical review and a conclusion. Plus, a sufficient consideration and comparison of:	
6.3.1 Reasonable benefit expectations (including impact of charges)	Sections 11 and 12
6.3.2 Type and level of service (including claims handling)	Sections 11 and 12
6.3.3 Management, administration and governance arrangements	Sections 11 and 12
6.4 IE reports should have good balance between factual description and supporting analysis. In many cases IE reports include a great deal of detail describing the transaction itself and the background but much less analysis of the effect on each Policyholder group’s reasonable expectations.	Demonstrated throughout the Report. Most of the analysis is included in Sections 11 and 12.
The level of reliance on the Applicants assessments and assertions	
6.6 In some instances, IEs will rely on assessments carried out by Applicants to reach their own conclusions. In these circumstances we expect the IE to demonstrate that they have questioned the adequacy of those assessments. We may also expect the IE to have urged the Applicants to undertake additional work or produce further evidence to support their assertions to ensure that the IE can be satisfied on a particular point.	2.46
6.7 & 6.8 We would also expect the IE to explain the nature of any challenges made to the Applicants and the outcome of these within their report, rather than just stating the final position. We will question and challenge the IE where we feel that an IE has relied on assertions made by the Applicants without sufficient challenge or request for supporting detail or evidence.	2.46

Reference to the CA's approach to business transfers	Reference to relevant Section within the report
<p>6.9 The IE should challenge calculations carried out by the Applicants if there is cause for doubt on review of the Scheme and supporting documents. As a minimum, we will expect the IE to:</p>	
<p>6.9.1 Review the methodology used and any assumptions made to satisfy themselves that the information is likely to be accurate and to challenge it where appropriate</p>	2.46
<p>6.9.2 Challenge the factual accuracy of matters that, on the face of the documents or considering the IE's knowledge and experience, appear inconsistent, confusing or incomplete</p>	2.46
<p>6.10 We would also expect the IE to challenge Applicants where the documents provided contain an insufficient level of detail or analysis.</p>	2.46
<p>6.11 Where the regulatory framework is different for the Transferor and Transferee, the IE should carry out sufficient analysis of the differences including, where appropriate, taking independent advice.</p>	Section 3
<p>6.12 In particular, with cross-border transfers we often see insufficiently detailed analysis of regulatory protections post-transfer. This can include:</p>	
<p>6.12.1 The extent to which existing regulatory requirements and protections continue, including whether there is continued access to the Financial Ombudsman Service and the Financial Services Compensation Scheme.</p>	Sections 3 and 11
<p>6.12.3 & 6.12.4 The comparative regulatory requirements and conduct protections across any relevant jurisdictions, including but not limited to complaints or compensation bodies compared to the UK</p>	Sections 3 and 11
<p>6.12.4 Analysis of the likely impacts. For example, the number of Policyholders affected, the size of possible claims and any potential mitigations.</p>	Sections 11, 12 and 13
<p>6.12.5 Post UK withdrawal, non-UK EEA customers may be subject to local conduct of business rules regime, which may not include FOS or FSCS. IN these cases, we are likely to accept firms taking proportionate approaches to compare regimes.</p>	Sections 3 and 11
<p>6.13 In these instances, we would expect to see a statement describing the two regimes as well as a considered comparison, highlighting points of significant difference that could adversely impact Policyholders. It is for the IE to use their judgement to decide on the level of detail to be included but it needs to be sufficient for the High Court to be in a position to be satisfied.</p>	Sections 3 and 11
<p>6.14 If the IE's analysis is inconclusive or there are potential conduct risks due to differences in the regulatory framework, there should be sufficient explanation of how Policyholders may be affected and the Applicant's proposals to mitigate these risks.</p>	Sections 3 and 11
<p>Balanced judgements and Sufficient Reasoning</p>	

Reference to the CA's approach to business transfers	Reference to relevant Section within the report
6.15 Where certain features of the Scheme are mentioned to demonstrate the IE's satisfaction with the Scheme we would expect to see evidence and reasoning behind the IE's conclusion.	Demonstrated throughout the Report
6.16 Where the IE states that there will be no material adverse impact the report should make clear whether the IE is certain that there will most likely not be an adverse impact or whether it is their best judgement, but lacks certainty. In these instances, we expect IEs to consider the following:	Demonstrated throughout the Report
6.16.1 Where the IE takes the view that there is probably no material adverse impact, we expect the IE to challenge the Applicants about further work the Applicants could undertake to enable the IE to be satisfied to a greater degree.	2.46
6.16.2 IEs should be able to challenge the Applicants to gain the necessary level of confidence that their report's conclusions are robust. In addition, they will need to consider how any proposed changes/mitigations will impact all Policyholder groups.	Demonstrated throughout the Report
6.17 We expect the IE to have checked that the documents they are relying, and forming judgements, on are the most up-to-date available when finalising their report.	Appendix E
6.18 If market conditions have changed significantly since the IE's analysis was carried out and they formed their judgement, we would expect the Applicants to discuss any changes with the IE and for the IE to update their report as necessary. If the Scheme document has been finalised, the IE should comment in more detail in their Supplementary Report or by issuing supplementary letters to the High Court to confirm whether their judgement is unchanged.	I am not aware of any significant changes in market conditions since carrying out the analysis detailed in the Report. I will issue a Supplementary Report based on the most up to date information available to me prior to the second Court hearing.
Sufficient regard to relevant considerations affecting Policyholders	
6.19 We would expect to see IE consideration of all relevant issues for each individual group of Policyholders in both firms, as well as how an issue may impact each group. Our expectations include:	
6.19.1 Current and proposed future position of each Policyholder group	Sections 11 and 12
6.19.2 Potential effects of the transfer on each of the different Policyholder groups	Sections 11 and 12
6.19.3 Potential material adverse impacts that may affect each group of Policyholders, how these impacts are inter-related and how they will be mitigated	The potential material adverse effects of the Scheme are explained in detail throughout the Report.
6.20 To support this, we expect the IE to consider whether the groups of affected Policyholders have been identified appropriately.	When considering the issues covered in my Report I have given thought to the impact the issues may have on a range of policyholder groups.
6.21 We would also expect the IE to review and give their opinion on administrative changes affecting Policyholders and claimants. Here we would expect the IE to include:	

Reference to the CA's approach to business transfers	Reference to relevant Section within the report
<p>6.21.1 Consideration of the impact of an outsourcing agreement entered into by the parties before the Part VII process began, where the administration duty 'moved' from the Transferor to the Transferee in preparation for the Transfer. Here, we would expect to see a comparison of the pre and post-outsourced administration arrangements so the IE can clearly review and compare any changes to Policyholder positions and service expectations.</p>	<p>Sections 7 and 9</p>
<p>6.21.2 The IE should consider what might happen if the transfer does not proceed and the possibility that the outsourcing agreement could be cancelled, returning the administrative arrangements to the original state.</p>	<p>Sections 7 and 9</p>
<p>6.22 IEs should also review and give their opinion on all relevant issues for all Policyholder groups where reinsurance was entered into in anticipation of a transfer:</p>	
<p>6.22.1 Some firms pre-empt regulatory scrutiny by buying reinsurance against risks before they begin the transfer process. In these instances, the IE should consider if it is appropriate to compare the proposed Scheme with the position the Transferor would be in if they did not benefit from the reinsurance contract.</p>	<p>N/A – There are no such reinsurance arrangements in relation to the Scheme.</p>
<p>6.22.2 If the transfer is not sanctioned and the reinsurance either terminates automatically or can be terminated by the Transferee, we believe the IE should consider the Scheme as if the reinsurance was not in place.</p>	<p>N/A – There are no such reinsurance arrangements in relation to the Scheme.</p>
<p>6.23 The IE may identify particular sub-groups of Policyholders whose benefits, without other compensating factors, are likely to be adversely affected.</p>	<p>Explained in detail throughout the Report</p>
<p>6.24 & 6.25 We would expect to see IE consideration and analysis of alternatives when a loss is expected for a particular subgroup of Policyholders, even if the IE does not consider this loss to be material. In these circumstances we may request that the IE and/or Applicants consider other ways of mitigating the adverse impacts on the affected Policyholders, should they happen, including providing compensation. We would expect to see this analysis even if the IE is able to conclude that the Policyholder group as a whole is not likely to suffer material adverse impact, even if a minority may.</p>	<p>Section 11</p>
<p>6.26 & 6.27 When an IE is assessing the potential material adverse impacts on various groups of Policyholders, we may feel they have reached their conclusion based on the balance of probabilities and without adequately considering the possible impact on all affected Policyholder groups. As a specific example, we might consider the right of Policyholders to make a claim on the FSCS following a cross-border general insurance transfer: The IE may say they are satisfied that there is no material adverse impact on Policyholders because the Transferee's capital position, and the short term nature of the liabilities, means that it is unlikely the Scheme will fail and Policyholders need recourse to the</p>	<p>Section 10</p>

Reference to the CA's approach to business transfers	Reference to relevant Section within the report
<p>FSCS as a result. We would not be satisfied with this view without further evidence.</p>	
<p>Commercially sensitive or confidential information</p> <p>6.29 & 6.30 Often the IE will need to consider commercially sensitive or confidential information as part of their decision making process. In these circumstances, we remind IEs of their duty as an independent expert to consider Policyholder interests, particularly as this information will not be publicly available.</p> <p>In these situations we expect to see the analysis and the information relied upon. It is also possible that the High Court may wish to see that information without it being publicly disclosed. The IE may wish to consider sending a separate document with further details, solely for the High Court's use and not for public disclosure.</p>	<p>We have set out in Appendix E the key information we have relied upon in our report.</p>
<p>The level of reliance on the work of other experts</p>	
<p>6.31 For large scale and complex insurance business transfers we accept that the IE may rely on the analytical work of other qualified professionals, often to prevent their own work becoming disproportionately time consuming. However, we would still expect the IE to have carried out their own review of this analysis to ensure they have confidence in, and can place informed reliance on, the opinions they draw from another professional's work.</p>	<p>2.33</p>
<p>6.32 We expect the IE to have obtained a copy of any legal advice given to the Applicants. This should be in writing or transcribed, and approved by the advisor. It should also be in a sufficiently final form for the IE to be able to review and rely on it. The IE should reflect this review, and the opinions drawn from the advice, within their report.</p>	<p>2.33 and Appendix E</p>
<p>6.33, 6.34 and 6.35 Where the IE refers to factors that are outside their sphere of expertise and relies on advice received by the Applicants, the IE should consider whether or not to obtain their own independent advice on the relevant issue. In many cases, the IE's decision to obtain independent legal advice will depend on the significance and materiality of the issue.</p> <p>The IE's key consideration is whether it is reasonable for them to rely on the advice and whether their independence is compromised by doing so. Whether or not the legal advisor has acknowledged that it owes a duty of care to the IE will be relevant to this consideration. Depending on how complex the legal issue is, we may challenge IEs who rely on the Applicants' legal advice and merely state that they have no reason to doubt the advice and/or that it is consistent with their understanding of the position or experience of similar business transfers.</p>	<p>2.33 and Appendix E</p>
<p>6.36 In deciding whether to obtain independent legal advice, we would expect the IE to consider, amongst other things, the following:</p>	<p>Not explicitly demonstrable but considered in the undertaking of the work</p>

Reference to the CA's approach to business transfers	Reference to relevant Section within the report
<ul style="list-style-type: none"> • The significance of the issue and the degree of potential adverse impacts to Policyholders if the position turns out to be different from that considered likely in the legal advice. • How much the IE relies on the legal advice to reach their conclusions and, if they did not rely on the legal advice, would the report contain too little information to justify the view that there is no material adverse impact? • The difficulty, novelty or peculiarity of the issue to the Applicants' own circumstances. • Applicants' proposals to explain to Policyholders in communication documents the issues involved, any uncertainty, and any residual risks. • Whether the Applicants have obtained an adequate level of advice. Where relevant, whether the Applicants have engaged external advisors with the appropriate expertise and qualifications for the specific subject or jurisdiction. • Whether any advice already received is heavily caveated, qualified or there is a significant degree of uncertainty. 	
<p>6.37 Alternatively, the IE may need to explain why they consider that they do not need to get independent advice to be adequately satisfied on a point.</p>	<p>Throughout the Report I have explained how I have reached the conclusions I have drawn.</p>
<p>6.38 The IE should consider the Applicant's contingency plans if the risks identified in the legal advice occur and whether this may create negative consequences for Policyholders.</p>	<p>Considered throughout</p>
<p>Ambiguous language or a lack of clarity</p>	
<p>6.45 & 6.46 At the start of the document, the IE should provide a description of where they propose to rely on information provided by the Applicants. We will look for any overly general reliance, as it indicates a lack of critical assessment or challenge.</p>	<p>2.33</p>
<p>6.47 In summary, where the report does not seem to reach a clear conclusion, either generally or on a specific issue, the IE report should state clearly:</p>	
<p>6.47.1 That the IE has considered and is satisfied about the likely level of impact on a particular point. Where uncertainty remains, the IE report needs to include details of, and reasons for, this uncertainty as well as any further steps the IE has taken to get clarification, such as seeking further advice from a subject matter expert.</p>	<p>Demonstrated throughout the Report, including Sections 11 and 12</p>
<p>6.47.2 How has the IE satisfied him or herself about the identified uncertainty and formed an opinion on any potential impact.</p>	<p>N/A</p>
<p>Demonstrating challenge</p>	
<p>6.48 To ensure the IE report is complete and considered we expect to see challenge from all involved parties. This includes evidence that Applicants have made appropriate challenges, particularly where they believe the IE has not fully addressed issues.</p>	<p>SWL and their legal advisers have all had the opportunity to challenge all aspects of the Report. In order to arrive at my conclusions I have often discussed issues with the management teams of SWL</p>
<p>6.49 To ensure effective two-way challenge we would expect the IE to engage with FCA or PRA approved persons of</p>	<p>As discussed in 2.46, I have engaged with key subject matter</p>

Reference to the CA's approach to business transfers	Reference to relevant Section within the report
<p>sufficient seniority at the Applicant firm, such as senior actuaries, including possibly the Chief Actuary, the CFO, Senior Underwriters and so on.</p>	<p>experts from SWL, including senior actuaries, to gain comfort on the appropriateness of the methodology and conclusions for the most material quantitative aspects of the Scheme.</p>
<p>Technical actuarial guidance</p>	
<p>6.50 We expect IEs who are both qualified and unqualified members of the Institute & Faculty of Actuaries to pay proper regard to the Technical Actuarial Standards (TAS) published by the Financial Reporting Council, particularly those for compiling actuarial reports.</p>	<p>2.30</p>
<p>6.51 IEs should be particularly aware that the proposed new versions of the TAS due to come into force during 2017 specifically apply to technical actuarial work to support Part VII Transfers.</p>	<p>2.30</p>
<p>6.52 We draw specific attention to paragraph 5 of TAS 100 which states that actuarial communications should be 'clear, comprehensive and comprehensible so that users are able to make informed decisions understanding the matters relevant to the actuarial information'.</p>	<p>Not explicitly demonstrable but considered in the writing of the Report</p>
<p>6.53 Actuarially qualified IEs and peer reviewers should also bear in mind the Actuaries' Code and Actuarial Profession Standards documents APS X2: Review of Actuarial Work and APS L1: Duties and Responsibilities of Life Assurance Actuaries.</p>	<p>2.31</p>

E Information/Documents reviewed/relied on

The table below sets out the key documents I have relied on in preparing this Report. Some of this information is company confidential and is not publicly available. In addition to the listed documents, I have also relied on discussions (both orally and electronically) with Chief Actuary, With-Profits Actuary, Deputy Chief Actuary and Project Actuary at SWL and the Independent Counsel.

Document	Source
Scheme ([14] September 2018)	HSF
Reinsurance Agreement ([14] September 2018)	HSF
Deed of Charge ([14] September 2018)	HSF
Deed of Indemnity ([14] September 2018)	HSF
Unit Linked Service Agreement	LB
2015 Scheme (amended)	HSF
CAA Application Pack	SWL Deputy Chief Actuary
Report of the Chief Actuary	SWL Chief Actuary
Report of the With-Profits Actuary	SWL WPA
SWL Own Risk and Solvency Assessment (December 2017)	SWL Chief Actuary
SWG Solvency and Financial Condition Report (December 2017)	SWL Chief Actuary
Sensitivity Testing (September 2018)	SWL Deputy Chief Actuary
Communications Strategy ([28] September 2018)	SWL Deputy Chief Actuary
The Clerical Medical With-Profits Fund PPFM	SWL WPA
Capital Management Plan	SWL Chief Actuary
Witness Statement of Mike Harris	HSF
Independent Counsel Opinion ([September] 2018)	South Square

I have checked that the information listed above has been audited or supplied by an Approved Person or by a person appropriately qualified to provide such information and I am satisfied that it is reasonable for me to rely on this information.

F Certification for changes to the 2015 Scheme

Certificate for the amendments made to the 2015 Scheme under which all UK life insurance and pensions business of LBG including those from SW were consolidated into CMIG via a Part VII Transfer as sanctioned by the High Court with effect from 31 December 2015.

I certify that, in my opinion the proposed amendments to the 2015 Scheme will not materially adversely affect the reasonable expectations of, or materially reduce the protections conferred by the 2015 Scheme, on holders of policies of SWL (including those reinsured). In coming to this opinion I have taken account of the proposals as a whole and their impact on the Non-transferring Policies as a whole



Tim Roff

Independent Expert appointed by Scottish Widows Plc

14 November 2018

G Communication waivers

The table below outlines the reason SWL intends to seek waivers from the mailing for the following group of Transferring Policyholders.

Group of Transferring Policyholder	Reason for the waiver
Policyholders for whom there is insufficient or invalid address data	Impossibility
Assignees of Transferring Policies	Impossibility, practicality and availability of other information channels
Trustees in bankruptcy, bankruptcy lawyers, receivers and administrative receivers of Transferring Policyholders	Impossibility, practicality and availability of other information channels
Contingent annuitants	Impossibility, practicality, proportionality and availability of other information channels
Deceased Policyholders	Utility to the policyholder and the impact of the Transfer on the policyholder
Members of occupational pension schemes	Practicality and availability of other information channels
The second life on joint life policies, where the address held on the database is the same for both lives	Practicality
Beneficiaries of Transferring Policies	Impossibility, practicality and availability of other information channels
Beneficiaries resulting from court orders in relation to pension payments to former spouses	Impossibility, practicality and availability of other information channels
Transferring Policyholders whose policies have lapsed or expired	Utility to the policyholder and the impact of the Transfer on the policyholder

H Glossary

Term	Definition
2015 Scheme	The Part VII Transfer undertaken in 2015 by Lloyds Banking Group to consolidate all UK life insurance and pensions business into Clerical Medical Investment Group (which was then renamed Scottish Widows Limited)
ACA	Association of Insurers and Reinsurers. This is an industry body based in Luxembourg
Asset	Generally, any item of property whether tangible or intangible, that has financial or monetary value
Associated Arrangements	Together the Reinsurance Agreement, Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement.
AWE	UK Average Weekly Earnings Index
BEL	Best Estimate Liabilities
Board	The Board of Directors, which is a governing body of an entity.
Brexit	The term used to describe the UK's exit from the EU, following the vote taken in the EU referendum on 23 June 2016
CAA	Insurance Commission (Commissariat aux Assurances). The regulator responsible for the supervision of the insurance sector in Luxembourg.
CAA Circular Letter 15/03	The circular letter 15/03 of the CAA on investment rules for life insurance products linked to investment funds
Capital requirements	The level of funds that an insurance or reinsurance undertaking is required to hold in excess of its liabilities.
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CGF	Corporate Governance Framework. This framework outlines the governance of SWG, including the SWG Board and the relevant Board committees.
Charge Agreement	The floating charge agreement between SWL and SWE, to allow the Transferring Policyholders similar rights to Non-Transferring Policyholders upon the insolvency of SWL.
CM	Clerical Medical
CM WPF	CM With-Profits Fund. This is one of two ring-fenced funds for with-profits policies within SWL. See WPF for further details.
CM WPF PPFM	CM WPF Principles and Practices of Financial Management. The specific Principles and Practices of

	Financial Management for the CM WPF. See PPFM for further details.
CMIG	Clerical Medical Investment Group. In 2015, CMIG was renamed Scottish Widows Limited (SWL).
CMIG NPF	The CMIG Non-Profit Fund. This was combined with the CMIG SHF to form the Combined Fund. See Combined Fund for further details.
CMIG SHF	The CMIG Shareholder Fund. This was combined with the CMIG NPF to form the Combined Fund. See Combined Fund for further details.
CMIG WPF	CMIG With-Profits Fund. See WPF for further details.
CMILL	CMI Insurance (Luxembourg) S.A. A previous Luxembourg subsidiary of SWG. All of CMILL's policies were transferred to CMIG (now SWL) on 31 December 2015 by Ministerial Decree.
CMP	Capital Management Plan. The CMP sets out how the entity's capital level is monitored against the SRA and details the relevant courses of action the entity can take to restore its capital position should it fall to an unacceptable level.
COBS	Conduct of Business Sourcebook. This details the FCA's requirements with regard to the conduct of UK insurance companies (among other entities).
COO	Chief Operating Officer
Combined fund	That part of SWL's insurance funds not represented by the CM WPF and SW WPF. Whereas most of the profits made within the CM WPF and SW WPF are allocated to policyholders, all of the profits made within the Combined Fund belong to shareholders.
Credit rating	A measure of the financial security of a company provided by a third party agency
CRO	Chief Risk Officer
Customer Treatment Policy	This policy outlines the appropriate treatment of customers within all LBG operations.
EEA	European Economic Area
EIOPA	European Insurance and Occupational Pensions Authority
Estate	Difference between the value of the assets within a with-profits fund and the best estimate liabilities of the fund
EU	European Union
EU passporting rights	The collective term for Freedom of Establishment and Freedom of Services.

Excess Amount	The amount to be paid to the Transferring UWP Policyholders in excess of the FWH, such as estate distribution.
Existing Policyholders	The existing policyholders of SWL, prior to the Transfer.
FCA	Financial Conduct Authority. The FCA's responsibilities include the regulation of conduct of UK insurers.
FOS	Financial Ombudsman Service. An independent body set up to deal with individual complaints that consumers and financial businesses are not able to resolve themselves
FRC	Financial Reporting Council
Freedom of Establishment	The right of an insurer located in one EEA member state to underwrite a risk located in another EEA member state by establishing a permanent presence in that EEA member state. This permanent presence can be in the form of a local branch or agency. Freedom of Establishment business is business underwritten under a full binding authority where the policyholder and the risk are located in the same EEA member state outside the UK.
Freedom of Services	The right to provide business services on a cross-border basis within the EEA. For insurance contracts, this means that the contract can be underwritten in an EEA member state that is different from the member state where the risk is located. Freedom of Services business consists of open market business written from the UK (with or without the involvement of a local intermediary), business written under a full binding authority where the policyholder is located in a different member state from where the risk is located and business that is written under a prior submit binding authority agreement.
FSCS	Financial Services Compensation Scheme. FSCS is a statutory "fund of last resort" which provides compensation in the event of the insolvency of a financial services firm authorised by the PRA or FCA. Insurance protection exists for private policyholders and small businesses (those with an annual turnover of less than £1,000,000) in the situation when an insurer is unable to meet fully its liabilities. For long term insurance policies, the FSCS will pay 100% of any eligible claim. The FSCS is funded by levies on firms authorised by the PRA and FCA.
FSMA	Financial Services and Markets Act 2000 (as amended)
Fund Split	The process of identifying and transferring a fair share of assets to be transferred out of a with-profits fund when a group of policies is to be transferred out of the fund.
FWH	Funds Withheld. When SWE reinsures the investment element of the Transferring UWP Policies and with-

	profits annuities, it holds back the reinsurance premium as FWH. The FWH provides security for SWE against the possibility of SWL becoming insolvent and defaulting on reinsurance claims owed to SWE.
GAAP	Generally Accepted Account Principles. This is a collection of commonly-followed accounting rules and standards for financial reporting.
GAO	Guaranteed Annuity Option. An option attached to some pension accumulation policies giving the policyholder the option to purchase a with-profits annuity at a specified price. If the price of an annuity at retirement is higher than the guaranteed price, then the GAO is said to bite; otherwise the GAO expires worthless.
German business litigation claims	The outstanding and potential claims relating to certain (Transferring) policies sold by independent intermediaries in Germany prior to the Transfer.
GGF	Guaranteed Growth Funds. The funds that UWP Transferring Policyholders invested in: these funds currently form part of the CM WPF.
Grant Thornton	Grant Thornton UK LLP
Group	Lloyds Banking Group plc (LBG)
HLSM	Heidelberg Leben Services Management. One of the external providers used for servicing the German and Austrian policies.
IAC	Insurance Audit Committee. The committee responsible for the oversight of the quality and integrity of the Group's accounting and reporting practices.
IFRS	International Financial Reporting Standards
IGC	Insurance Independent Governance Committee. The committee responsible for the oversight of UK based workplace pension schemes of SWL.
Indemnity Agreement	The agreement entered into between SWE and SWL in relation to litigation claims against SWL prior to the Transfer.
Independent Counsel	Barry Isaacs QC, South Square
Independent Expert	Tim Roff FIA
Insurance Group	Scottish Widows Group (SWG)
Insurance	SWG's insurance Board, also known as SWG Board
IIGC	Insurance International Governance Committee
Internal Model	A bespoke model developed by an insurance or reinsurance undertaking to calculate its Solvency Capital Requirement under Solvency II. All insurers are required to calculate their Solvency Capital Requirement using

	either their own Internal Model or the Standard Formula
ITO	Information Technology Outsourcing S.R.L. One of the external providers used for servicing the Italian policies.
IWEC	Insurance and Wealth Executive Committee. The committee assists the Insurance and Wealth Group Director.
JDPO	Jurisdictional Data Privacy Officer
LBG	Lloyds Banking Group plc, also known as the Group
LB	Lloyds Bank plc
LOS	Luxembourg Ombudsman Service. A collective name (within this report) for NCOS, ACA and CAA mediation services.
Liability	A claim against the assets, or legal obligations of a person or organisation, arising out of past or current transactions or actions
MA	Matching adjustment. This is an adjustment to the risk-free interest rates used to discount insurance obligations, calculated by firms based on a specifically identified portfolio of assets and liabilities
Material adverse impact	A negative change that is considered to have a material impact on policyholders. For any group of policyholders, there may be some changes for the better and some for the worse. If there are some changes for the worse this does not necessarily mean that the Transfer is unfair or unreasonable, as they might be either outweighed by other benefits, or they might be extremely small. Where there are adverse changes this report attempts to give some context as to their size or likelihood of occurring. If a potential effect is very unlikely to happen and does not have a large impact, or if it is likely to happen but has a very small impact, it is not considered to be material.
Memorandum of Understanding	An agreement between two or more parties where they express a convergence of will, indicating a common line of action.
NCOS	National Consumer Ombudsman Service. An authority in charge of handling disputes relating to a sales or service agreement between professionals established in Luxembourg and consumers having their residence in Luxembourg or another EU Member State
Non-transferring Business/Policies/Policyholders	Business/policies/policyholders of SWL that will remain with SWL and not transfer to SWE as a result of the Scheme.
NPF	Non-Profit Fund. That part of a life insurer's insurance funds not represented by WPFs. SWL's NPF is known as the Combined Fund.

ORSA	Own Risk and Solvency Assessment. An internal risk management tool/process/report to assess the overall solvency needs of the firm taking into account the firm's own assessment of its specific risk profile. The ORSA is often referred to as Pillar 2 of the Solvency II regime.
Other Non-transferring Policyholders	The Non-transferring Policyholders are split into two groups: (i) those with WP policies in SWL's CM WPF and (ii) those with policies in the Combined Fund, and those in the SW WPF. The policyholders in group (ii) are the "Other Non-transferring Policyholders".
Own Funds	The excess of an insurer's admissible assets over its liabilities on a Solvency II basis
PAM	Pack Assurance Management. One of the external providers used for servicing the Luxembourg policies.
Parent	An enterprise that controls another through ownership of 50 percent or more of its voting stock.
PPFM	Principles and Practices of Financial Management. In managing with-profits business firms rely on their use of discretion. The PPFM explains the nature and extent of discretion available and how this discretion will be applied across different groups and generations of with-profits policyholders
PRA	Prudential Regulation Authority. The PRA's responsibilities include the prudential regulation of UK insurers, ie regulation relating to the ongoing solvency of UK insurers.
Prudent Person Principle	This principle is described in detail in paragraph 3.44. It is a part of the Luxembourg CAA Circular Letter 15/03 in relation to the investment of assets.
Reinsurance	An arrangement with another insurer or reinsurer whereby risks are shared (or passed on) to the reinsurer.
Reinsurance Agreement	The reinsurance agreement between SWL and SWE as a part of the transfer of business from SWL to SWE. The Reinsurance Agreement reinsures the investment element of the Transferring UWP Business from SWE back to SWL and with-profits annuities (both the small number of vested annuities as at 31 December 2017 and any future vesting with-profits annuities on the Transferring Business).
RAG	Red, Amber and Green. This is a traffic light system used to signal a company's capital position as bad, something in between and good.
RMF	Risk Management Framework. The procedures and policies within the entity for the identification, assessment, measurement and management of risks.

ROC	Insurance Risk Oversight Committee. The committee responsible for assisting the SWG Board in risk oversight, reviewing risk appetite and risk profile, reviewing the effectiveness of the Risk Management Framework, reviewing the methodology and assumptions used to determine capital requirements, reviewing stresses and scenarios for analysis.
Run-off	The remaining lifetime of a block of insurance business that still needs servicing despite gradually declining in size as a result of no new business being written.
SCR	Solvency Capital Requirement. The capital regulatory requirement under Pillar 1 of the Solvency II regime. The SCR can be calculated using the Standard Formula or using a firm's own Internal Model.
SCR Cover Ratio	The ratio of Own Funds to SCR.
SHF	Shareholder Fund
Solvency I	Solvency I was the regulatory regime for insurance companies in the UK that was superseded by Solvency II.
Solvency II	A new regulatory regime for insurers which came into force on 1 January 2016 aimed at harmonising regulation across all EU and EEA countries
SRA	Solvency Risk Appetite. A firm's internal view on how well capitalised it should be. This could be expressed, for example, in terms of a target SCR ratio or in terms of the severity of stress that it could survive while still keeping its SCR Ratio above 100%.
Standard Formula	A standardised calculation for the Solvency Capital Requirement of an insurance or reinsurance undertaking, as prescribed under Solvency II. All insurers are required to calculate their Solvency Capital Requirement using either the Standard Formula or an Internal Model
Subsidiary	An enterprise controlled by another (called the parent) through the ownership of greater than 50 percent of its voting stock
SUP 18	Chapter 18 of the Supervision Manual of the FCA's Handbook of Rules and Guidance
Supplementary Report	An additional report produced by the Independent Expert to reflect any updated financial information or any other matter which has come to light since the issue of the Report.
SW	Scottish Widows
SW NPF	Scottish Widows' Non-Profit Fund

SW WPF	Scottish Widows' With-Profits Fund
SWE	Scottish Widows Europe SA
SWG	Scottish Widows Group, also known as the Insurance Group
SWG Board	The Board of SWG, also known as Insurance Board
SWL	Scottish Widows Limited
Technical provisions	The insurance liabilities of an insurer, as determined for regulatory purposes. These are calculated as the provisions for the ultimate costs of settling all claims arising from events which have occurred up to the balance sheet date, including provision for claims incurred but not yet reported, less any amounts paid in respect of these claims; plus the provisions for claims arising on unexpired periods of exposure less any premium in respect of the business written that has not yet been received
Terms of Reference	Sets out the scope and limitations of an agreement.
The Effective Date	28 March 2019 or such other time and date as SWL and SWE may agree, being a date and time after the making of the Order sanctioning the Scheme
The High Court	The High Court of Justice of England and Wales
The Report	The report from the Independent Expert
The Scheme	The legal document that sets the terms of transfer of insurance business from SWL to SWE.
The Transfer	The Scheme, the Reinsurance Agreement, the Charge Agreement, the Unit Linked Service Agreement and the Indemnity Agreement.
Tied Assets	Tied Assets are a requirement under Luxembourg regulation. These assets are required to be deposited into a custodian bank following a tripartite custodian agreement with the CAA. The amount of assets deposited is equal to the greater of the Solvency II technical provisions and the reserves under Luxembourg GAAP.
TMTTP	Transitional measures on technical provisions. This is calculated as the difference between the technical provisions calculated under the previous regulatory regime (Solvency I) and the Solvency II technical provisions, and decreases linearly over a 16 year period
Transferor	Scottish Widows Limited
Transferring Business	Existing business originally written in EU countries that will be transferred to Scottish Widows Europe SA, a new subsidiary established by Scottish Widows Limited, once authorised.

Transferring Business/Policies/Policyholders	Business/Policies/Policyholders who will be transferred as a result of the Scheme.
Transferring UL Business/Policies/Policyholders	Unit-linked business within the Transferring Business/Policies/Policyholders
Transferring UWP Business/Policies/Policyholders	Unitised with-profits business within the Transferring Business/Policies/Policyholders. This includes Business/Policies/Policyholders currently invested in Guaranteed Growth Funds (GGFs) which reside in SWL's Clerical Medical with-profits fund (CM WPF). This group includes with-profits annuities (both the small number of vested annuities as at 31 December 2017 and any future vesting with-profits annuities on the Transferring Business).
UK	United Kingdom
The UK Regulators	The PRA and the FCA
UL	Unit-Linked.
ULC	Luxembourg Union of Customers (l'Union Luxembourgeoise des Consommateurs). This is an organisation based in Luxembourg.
Unit Linked Service Agreement	The agreements between SWE and LB to enable the operations of the Transferring UL Business to be managed in the same way before and after the Transfer.
UWP	Unitised With-Profits.
VA	Volatility Adjustment. Under Solvency II the volatility adjustment is an increase to the discount rate used in the calculation of the BEL which aims to prevent forced sale of assets in the event of extreme bond spread movements
VAT	Value Added Tax
WPA	With-profits actuary. The WPA is responsible for advising the firm's management, at the level of seniority that is reasonably appropriate, on key aspects of the discretion to be exercised affecting those classes of the with-profits insurance business of the firm in respect of which he or she has been appointed
WPC	With-profits committee. The committee is responsible for providing an independent view of the management and operations of the with-profits business of SWL.
WPF	With-profits Fund. A segregated fund within an entity's insurance fund and the fund within which most (or all) of the profits are distributed to with-profits policyholders



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