Royal London (Scottish Life) GAR Compromise Scheme

Report of the Chief Actuary

May 2018

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1 Introduction

Purpose of report

1.1 The purpose of this report is to consider the impact of a proposed Scheme of Arrangement under the terms of Part 26 of the Companies Act 2006 (the Scheme). Under this Scheme, certain planholders with guaranteed annuity rates (GARs) (the Eligible Planholders) within the Scottish Life Fund will be made an offer to exchange their GAR for an immediate increase to their current plan value (the Uplift).

1.2 This report describes the Scheme and the impacts of the Scheme, including the financial impacts on solvency and security, and the impacts on the various planholder groups within The Royal London Mutual Insurance Society Limited (Royal London, the Company, or we). In this report, I give my opinion on the effects of the Scheme in relation to the above and my overall opinion on the Scheme.

1.3 The report is written for the Royal London Board in my capacity as Chief Actuary for Royal London. This report may also be used by the Independent Actuary, the With-Profits Actuary, the Scottish Life Supervisory Committee, the High Court, the Prudential Regulation Authority (PRA) and the Financial Conduct Authority (FCA).

1.4 The Financial Reporting Council has issued standards which 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 does so in all material respects.

1.5 During the preparation of this report, I have considered the content of the Independent Actuary report and the With-Profits Actuary report which have been prepared in relation to the Scheme.

1.6 I will also prepare a Supplementary Report ahead of the Court Sanction Hearing, which is scheduled for 12 November 2018.

Scope of report

1.7 The key focus of this report is the impact of the Scheme on planholders within the Scottish Life Fund and the financial impact on the Scottish Life Fund. However, where relevant this report also considers any impacts that the Scheme may have on the wider business, including planholders within and the financial position of the Royal London Main Fund and all other funds within Royal London.

Introduction to the Chief Actuary

Background

1.8 I am a Fellow of the Institute and Faculty of Actuaries and I have been the Chief Actuary of Royal London since 2013. Prior to this, I held the position of With-Profits Actuary of the Co-operative Insurance Society Limited (CIS) from 2007 to 2010 and Chief Actuary from 2010 to 2013. CIS was acquired by Royal London in 2013.

1.9 I have held a Life Insurance (including with-profits) practising certificate for over 10 years and have over 20 years of post-qualification experience.

1.10 I am an employee of Royal London. I hold staff pension plans with Royal London and a critical illness plan but I am not a planholder of any of the Eligible Plans and confirm that I have not considered my personal interest in reaching any of the conclusions detailed in this report.

Responsibilities

1.11 I am a member of several internal committees at Royal London, including:

- Internal Model Change Committee;
- Stress and Scenario Testing Forum; and
- Insurance Risk Committee.

1.12 In addition I am the Chairperson of the following committees at Royal London:

- Capital Management Committee;
- Product Pricing Approval Committee; and
- Group Assumptions Governance Committee.

Regulatory and professional guidance

1.13 To help ensure fairness, an Independent Actuary has been appointed to provide an independent report to the High Court on the fairness of our offer. We are also in contact with HMRC regarding any potential tax consequences of the Scheme.

1.14 The Scheme will only proceed if:

i. a majority by number representing 75% by value of the Eligible Planholders voting on the Scheme, vote in favour of the Scheme;
ii. the Scheme is sanctioned by the Court; and
iii. the Independent Actuary confirms that the Scheme continues to satisfy his Fairness Criteria allowing for any necessary adjustments made to uplifts after the Sanction Hearing, for example to take account of any changes in economic or other factors.

1.15 If the Scheme is approved, the Scheme Implementation Date is expected to be 7 December 2018 with all Uplifts being applied with effect from this date.

Definition of terms

Materiality

1.16 In considering the effect of the Scheme on different groups of planholders, I occasionally apply a concept of materiality and consider whether the position of any group is, in the round, "materially adversely affected". 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.

Economic Value

1.17 The Economic Value of the GAR is a measure of the expected future value of the plan benefits to the planholder based on a number of actuarial assumptions about future economic and demographic experience, including future interest rates, longevity and GAR take-up rates. The assumptions used to determine Economic Value are described in section 5 of this report. A key assumption that drives the offer is the assumption that planholders take 75% of their plan as an annuity and 25% as a tax-free lump sum.

Other terms used within the report

1.18 I have included within Appendix A a glossary of all capitalised terms used within this report.

2 Executive Summary

Background

2.1 The Scottish Life Fund was formed in 2001 following the acquisition of The Scottish Life Assurance Company (Scottish Life) by Royal London. As at 31 December 2017 there were c.107,000 plans within the Scottish Life Fund, including with-profits, unitised with-profits, deposit administration and non-profit plans.

2.2 As at 31 December 2017, c.34,000 of the plans within the Scottish Life Fund had a GAR attached to them, and c.33,000 of these (the Eligible Plans) are to be offered the GAR compromise. These GARs were originally written in the 1980s and 1990s, and given the higher interest rates and shorter life expectancies at the time, the terms underlying their calculation were relatively generous compared to the calculation basis employed today. As a consequence, the GARs are now very valuable and provide planholders with an income in retirement that is often materially greater than the equivalent open market rate that could be purchased with the plan fund value. However, these planholders will only benefit from their GAR if they buy an annuity through Royal London.

2.3 Pension Freedoms were introduced by the UK Government in April 2015. Prior to this, most pension savers would use the bulk of their defined contribution pension savings to purchase an annuity, since fully flexible drawdown products were only accessible to those who could demonstrate a minimum level of income from other sources and any cash taken in excess of an initial tax-free "pension commencement lump sum" (which could be up to 25% of an individual's pension savings under the lifetime allowance) would be subject to penal tax rates. The changes introduced in April 2015 allow individuals over the age of 55 much more flexibility over how they draw their pension savings, subject to the marginal rate of income tax. This was achieved by removing restrictions on drawdown products, to enable all pension savers to draw down income after minimum pension age without any restrictions on the amount or timing of such drawdown income or any requirements to demonstrate they had another form of income; and by introducing a new type of lump sum, called an "uncrystallised funds pension lump sum", which allows pension savers to take all of their retirement savings in cash (either as one lump sum or in multiple lump sums, and subject to the lifetime allowance) without incurring penal tax charges. These changes mean that there is now a genuine alternative to buying an annuity available to all pension savers.

2.4 Since the introduction of Pension Freedoms, more people choose to access their retirement fund by taking out a drawdown plan or taking cash than by buying an annuity. However, any Royal London planholder with a GAR will forgo the value of their GAR on any part of their retirement fund that they don't use to purchase an annuity. The Scheme enables planholders to take better advantage of Pension Freedoms, as the full value of their pensions savings, including the value of the Uplift applied under the Scheme, is accessible upon retirement regardless of how they choose to access their savings.

2.5 GARs are the core issue for the Scottish Life Fund and increase the risk profile of the fund. There are significant risks associated with GARs, which include exposure to increasing longevity, falling interest rates and increasing GAR take-up rates. Exposure to these risks requires Royal London to retain more of the Scottish Life Fund Estate, restricting distributions to with-profits planholders within the Scottish Life Fund. In addition, the Capital Coverage Ratio (CCR) as at 31 December 2017 was 169%, which is below the internal target of 211% that Royal London aim to hold.

2.6 The proposed Scheme would enable planholders to take better advantage of Pension Freedoms, whilst also addressing some of the issues faced by the Scottish Life Fund.

The Scheme

2.7 Royal London is proposing to offer c.33,000 plans in the Scottish Life Fund the opportunity to exchange their GAR for an Uplift to their plan value. The Uplift will be calculated as the expected Economic Value of the GAR attached to their plan.

2.8 The process for implementing the Scheme is summarised as follows:

- An initial mailing, referred to as the appetite mailing was sent to all Eligible Planholders to provide an outline of the Scheme and to seek feedback on whether they are likely to support the Scheme. This mailing included notice of the date of the initial Court hearing (the "Convening Hearing") so that Eligible Planholders can attend and give their views to the Court in person or through a representative. As a result of the interest expressed following the appetite mailing by Eligible Planholders in the Scheme, Royal London has decided to put a formal offer to Eligible Planholders.
- The Convening Hearing will be held on 25 June 2018 and at the hearing the Court will consider the terms of the Scheme and be asked to approve the convening of a meeting (the "Planholder Meeting"). Subject to the Court approving the convening of the Planholder Meeting, a further mailing will be sent to Eligible Planholders with details of the potential Uplift available to each planholder and detailed information on the Scheme.
- Eligible Planholders will be able to opt out of the Scheme by post or online until 19 October 2018 at 12 noon or in person at the planholder meeting, and if they do, their GAR will remain unchanged. This is an important right as the Scheme will be binding on all Eligible Planholders who do not opt out, irrespective of whether they vote for or against the Scheme, or do not vote at all.
- Any planholders who opt out of the Scheme will not be permitted to vote. Planholders who had previously submitted an opt-out but then wish to participate in the vote can do so by notifying us by post or online before 19 October 2018. Alternatively planholders who had submitted an opt-out can withdraw their opt-out in person at the planholder meeting on 23 October 2018.
- Planholders will have a period of three months before the Planholder Meeting to decide what to do – whether to opt out and, if they decide not to opt out, whether to vote for or against the Scheme.
- A three-step process will be available to aid Eligible Planholders in coming to a decision, which includes:
    - a detailed information pack including personalised illustration;
    - a freephone guidance service; and
    - access to subsidised independent advice.
- The Scheme will go ahead if:
    - of the Eligible Planholders voting in person or by proxy (including postal and online votes) at the Planholder Meeting a majority by number, who together represent 75% by value (where value is based on the Uplift applied to plan values), vote in favour of the Scheme;
    - the Scheme is subsequently sanctioned by the Court;
    - and the Independent Actuary confirms that the Scheme continues to satisfy his Fairness Criteria allowing for any necessary adjustments made to uplifts, for example in order to allow for changes in economic conditions or longevity assumption changes that occur between the formal mailing and 14 November 2018.
- If the Scheme goes ahead, those who did not opt-out of the Scheme will have their GAR removed from their plan in exchange for an Uplift applied to their current plan value, any guaranteed benefits and any eligible future premiums.
- If the Scheme goes ahead, planholders who opted-out will retain their GAR but will not have their plan value increased by the Uplift.

- If the overall vote is not in favour of the Scheme then it will not proceed and the Eligible Plans will be unchanged.
- Royal London may withdraw the Scheme at any time prior to the Sanction Hearing.

Consequences of the Scheme

2.9 For Included Plans (Eligible Plans that do not opt-out of the Scheme), their GAR will be removed and an Uplift, calculated in line with the Scheme will be applied to their current plan value, as well as any guaranteed benefits and eligible future premiums regardless of how the individual planholder voted.

2.10 For all other plans, including Opted-Out Plans, any GARs that apply will remain unchanged and no Uplift will be applied. The only way for Eligible planholders to be certain that their GAR will be unchanged is therefore to opt-out.

2.11 It has been decided that any potential impacts of the Scheme on the Royal London Main Fund should be neutralised. As discussed in more detail in paragraph 6.58, an inter-fund transfer will be effected between the Scottish Life Fund and the Royal London Main Fund with the aim of achieving this.

2.12 As at 31 December 2017 the Royal London Main Fund bore a burn-through cost in relation to the Scottish Life Fund, which was calculated as £2.6m on an Embedded Value basis and also resulted in an increase in the SCR of the Royal London Main Fund on a Solvency II basis. As detailed in paragraphs 6.2 to 6.9, the risks associated with the Scottish Life Fund are expected to reduce, therefore it is expected that the burn-through cost will significantly reduce. However, given the relative size of the Royal London Main Fund compared to the burn-through cost, this impact is immaterial.

2.13 In addition to the above, the benefits of the Scheme are as follows:

- for Eligible Planholders, they will have the opportunity to take better advantage of Pension Freedoms, as the full value of their pension savings, including the value of the Uplift applied under the Scheme, is accessible upon retirement regardless of how they choose to access their savings;
- the Scheme is expected to result in a more stable, less risky Scottish Life Fund, which would lead to lower capital requirements;
- this should enable an earlier and fairer distribution of the Scottish Life Fund Estate to Scottish Life Fund with-profits planholders; in addition
- although there are no immediate plans to alter the investments backing asset shares and the Scottish Life Fund Estate, the Scheme is expected to enable greater investment freedom of the Scottish Life Fund Estate. Whilst the Scheme will result in an initial fall in the value of the Scottish Life Fund Estate, the greater investment freedom may enable higher distribution of the Scottish Life Fund Estate to Scottish Life Fund with-profits planholders.

2.14 There are also some potential disadvantages of the Scheme:

- Included Planholders will no longer have a GAR, therefore, should interest rates reduce or life expectancy increase beyond that assumed in the offer at the point of retirement, Included Planholders may find that they cannot replicate the benefits they would have otherwise been entitled to if they had opted out of the Scheme. Conversely, an increase in interest rates or reduction in life expectancy would mean that Included Planholders should be able to secure a higher level of income than they would have been entitled to under the GAR; and

- the overall size of the Scottish Life Fund Estate will be reduced (as a result of the costs of the Scheme being charged to the Scottish Life Fund and the use of an adjusted GAR take-up rate in the Offer Basis) therefore, all else being equal, total payouts to with-profit planholders over the lifetime of the fund will be lower as a result. In particular, with-profit planholders retiring in the long term will receive a lower distribution from the Scottish Life Fund Estate than if the Scheme did not go ahead. This however, has to be balanced against the current restricted distribution to planholders retiring in the short term, the fairer and more secure distribution of the Scottish Life Fund Estate which results from the Scheme and the greater stability of the Scottish Life Fund as a result of the Scheme.

Chief Actuary's opinion

2.15 The focus of my report is to assess the financial impacts of the Scheme on the Scottish Life Fund, and also the impacts on the various planholder groups within Royal London. I also consider the financial impacts of the Scheme on the wider business including the Royal London Main Fund.

2.16 Overall, it is my opinion that the Scheme represents the most appropriate approach to addressing the most significant issues affecting the Scottish Life Fund, and it aligns with the company aim of managing the business in a way that benefits Royal London planholders.

2.17 I believe that the planholder communications provide sufficient information to allow Eligible Planholders, including Verified Gone-Away Included Planholders who subsequently reengage with Royal London and can evidence that they were not living at any address to which Royal London sent the mailings, to make an informed decision as to whether they opt-out, or vote for or against the Scheme.

2.18 In an environment where pensions legislation enables significantly greater flexibility in how pension benefits can be taken, the Scheme allows Eligible Planholders to benefit from the value of their GAR regardless of how they choose to access their pensions savings.

2.19 In addition, I believe the Scheme is structured in such a way that it is fair to the various planholder groups.

2.20 It is my opinion that the Scheme does not have a materially adverse impact on the financial position of either the Scottish Life Fund or the Royal London Main Fund and does not threaten the solvency or security of either of these funds. In fact, the solvency and security of the SL Fund should improve as a result of the Scheme.

2.21 I have read both the With-Profit Actuary's and Independent Actuary's reports and there is nothing contained within the respective reports that represents a substantial difference to the views I express in this report.

3 Background

3.1 Within this section I provide background information, including how the business within the Scottish Life Fund was acquired, the products within the Scottish Life Fund, the Scottish Life Fund's current financial position and interactions with the wider Company.

History of the Scottish Life Fund

3.2 The Scottish Life Fund was formed in 2001 pursuant to the terms of the Scottish Life Transfer Scheme, under which Royal London acquired the business of Scottish Life. The Scottish Life Fund is closed to new business except for very small volumes of increments to the level of premiums. The Eligible Plans were originally written by Scottish Life during the 1980s through to the early 1990s.

3.3 The Scottish Life Fund consists of conventional with-profits, unitised with-profits, deposit administration and non-profit business.

3.4 As at 31 December 2017 there were c.107,000 planholders in the Scottish Life Fund. Of these, c.34,000 plans have GARs attached to them, of which c.33,000 are Eligible Plans that will be able to participate in the Scheme (see paragraph 6.111 for the rationale behind excluding certain planholders from the Scheme). The Scottish Life Fund is responsible for meeting the costs associated with the GARs.

Products within the Scottish Life Fund

3.5 The Eligible Plans below have GARs and are in-scope of the Scheme. These are pension products, all of which are available as conventional with-profits, unitised with-profit, deposit administration and unit-linked investment options. The unitised with-profit and unit-linked investment options sit within the Royal London Main Fund.

- Talisman Executive Pension Plan and Talisman Hallmark Executive Pension Plan;
- Talisman Retirement Annuity Contract;
- Talisman Personal Pension Plan; and
- Talisman Group Personal Pension Plan.

3.6 The products below have GARs but are not included within the Scheme.

- Personal Pension, Pre-Talisman (PPPOL);
- Versatile Retirement Benefit Plan (VRBP);
- Personal Pension Bonus Bond (PP Bonus Bond);
- Personal Pension Bond (PP Bond);
- Sovereign Plan; and
- Protected Growth Individual Allocation (PGIA).

3.7 These products represent c.3% of the GAR book of business by plan count and by plan value as at 31 December 2017.

Products without GARs

3.8 The Scottish Life Fund also consists of non-GAR with-profits, deferred annuities and Guaranteed Minimum Pension (GMP) products, as well as legacy with-profits and non-profit protection products.

Further details of Eligible Plans

Talisman Executive Pension Plan and Talisman Hallmark Executive Pension Plan

3.9 Both of the above products were originally issued to the trustees of occupational pension schemes, typically schemes which had been established by small to medium sized companies specifically for the purpose of taking out such plans with Royal London to secure retirement benefits for a small number of executives. Therefore, the planholder is the trustee of the occupational pension scheme, rather than the underlying members, and the trustee has the contractual rights to the GAR.

3.10 These plans permitted the member to choose between with-profits and unit-linked investments, and it was also possible to switch between such investments.

3.11 The terms and conditions of these plans do not contain a clear contractual GAR. However, for plans issued prior to 1 November 1989, Royal London has administered them on the basis that they contain a tabular GAR. Talisman Executive Pension Plans and Talisman Hallmark Executive Pension Plans written on or after 1 November 1989 are not treated as providing a GAR.

3.12 Similarly, the contractual terms of Talisman Executive Pension Plans and Talisman Hallmark Executive Pension Plans suggest that if the planholder wishes to take their benefits on a date other than their nominated retirement date, the value of the benefits to which they are entitled would be determined by Royal London. However, Royal London has always administered these plans on the basis that the planholders can use the GAR to purchase an annuity if their scheme member wishes to retire at any age between 60 and 75.

3.13 Protected Rights benefits (see paragraph 3.20 below) could not be accrued in Talisman Executive Pension Plans or Talisman Hallmark Executive Pension Plans.

3.14 Some Talisman Executive Pension Plans and Talisman Hallmark Executive Pension Plans have been assigned (or are treated as having been assigned) to an individual member of the occupational pension scheme, for example upon the winding up of the occupational pension scheme or when the scheme member left that company's employment. In these circumstances, the former member will be the planholder rather than the trustee of the occupational pension scheme. If a plan has been assigned to an individual member, rather than being held by the trustees, and has a GAR value in excess of £30,000 prior to the Uplift being applied, the planholder will be required to take appropriate advice if they wish to participate in the Scheme.

Talisman Retirement Annuity Contracts

3.15 These plans, which were sold by Royal London as "Talisman Personal Pension Plans" from 1 June 1985 to 30 June 1988, were designed to provide retirement savings for self-employed individuals or workers not offered access to an occupational pension scheme. They offered the ability to invest in either with-profits or unit-linked investments, and to switch between the two.

3.16 The GAR is detailed in the plan terms and conditions, by reference to a table describing the guaranteed minimum annuity available per £1,000 of accrued investments at the vesting date. The tables detailed the GAR available at ages 60 to 75 for males and females.

3.17 Planholders of Talisman Retirement Annuity Contracts with a GAR value in excess of £30,000 prior to the Uplift being applied will be required to take appropriate advice if they wish to participate in the Scheme.

Talisman Personal Pension Plan

3.18 These are a type of post-1988 personal pension plan issued under trust which was capable of approval as an appropriate personal pension scheme within the meaning of Section 2 of the Social Security Act 1986. They were also sold by Royal London as "Talisman Personal Pension Plans", but only plans taken out on or after 1 July 1988 and before 1 February 1992 contained a GAR. Individuals who wished to take out a plan would become a member of The Royal London Personal Pension Scheme (No. 2), formerly known as The Scottish Life Personal Pension Scheme (the Royal London Personal Pension Scheme). The trustee of the Royal London Personal Pension Scheme, which is currently Royal London itself, would then take out a plan on behalf of the scheme member.

3.19 As with Talisman Retirement Annuity Contracts, Talisman Executive Pension Plans and Talisman Hallmark Executive Pension Plans, these plans enabled the individual members to invest in a mixture of with-profits and unit-linked investments, and to switch between them.

3.20 These plans could also be used as a vehicle for contracting out of the Second State Pension (originally called the State Earnings-Related Pension Scheme). Money purchase contracted out benefits are known as Protected Rights benefits and were subject to various statutory requirements (for example, the annuity purchased using Protected Rights benefits needed to increase in line with inflation and needed to provide an annuity for a surviving spouse or civil partner). In addition, the earliest date on which the Protected Rights benefits (including any applicable GAR) could be taken was age 60, rather than normal retirement age (which is currently age 55). The statutory regime for Protected Rights was revoked with retrospective effect on 6 April 2012 and there is now no statutory requirement for those benefits to be separately identifiable from non-Protected Rights benefits – referred to as 'Additional Rights' benefits. However, because of the statutory requirements which formerly applied to Protected Rights benefits, they benefitted from a different GAR and Royal London therefore continues to maintain them as separately identifiable funds.

3.21 As with Talisman Retirement Annuity Contracts, the terms and conditions of Talisman Personal Pension Plans include a table of GAR rates. This specifies the value of the GAR that applies to Additional Rights vesting at between ages 50 and 75 (although plan terms only permit vesting from "normal retirement age" which is currently 55) for both male and female planholders. The terms and conditions also include a second table of GAR rates that specifies the value of the GAR that applies to Protected Rights vesting between 60 and 75 (without differentiation between males and females).

Talisman Group Personal Pension Plan

3.22 These plans were issued under the same terms and conditions as Talisman Personal Pension Plans, with the only difference being that they were sold to employees of a specific employer on a group basis. Therefore, the description of Talisman Personal Pension Plans also applies here.

Current position of the Scottish Life Fund

Planholder statistics

3.23 The table below sets out the number of plans, fund value and base GAR reserve at 31 December 2017 for all products within the Scottish Life Fund.

Product	Plan count	Fund value (£m)	GAR reserve (£m)
Plans with GARs and included within the Scheme			
Talisman Executive Pension Plan	624	25	12
Talisman Retirement Annuity Contract	3,757	111	66
Talisman Personal Pension Plan	28,633	907	500
Talisman Group Personal Pension Plan	209	10	5
Talisman Hallmark Executive Pension Plan	13	0.4	0.2
Sub-total	*33,236*	*1,053*	*584*
Plans with GARs but excluded from the Scheme			
PPPOL	521	25	17
VRBP	391	6	4
PP Bonus Bond	16	1	1
PP Bond	38	1	1
Sovereign Plan	32	1	1
PGIA	29	1	1
Sub-total	*1,027*	*35*	*25*
Plans without GARs			
Non-GAR	72,916	1,164	-
Total	**107,179**	**2,252**	**609**

3.24 The future premiums relating to Eligible Plans that would be eligible for an Uplift are c.£3.1m p.a. Total future premiums within the Scottish Life Fund are c.£12.1m p.a.

Capital and Solvency II position of the Scottish Life Fund

3.25 The table below sets out the financial position of the Scottish Life Fund as at 31 December 2017 on an Internal Model basis. Please note that Royal London's Internal Model has not yet been approved by the regulator. (Standard Formula results can be found in Appendix B).

Scottish Life Fund	31 December 2017 (£m)
Assets	3,151
Liabilities	2,873
BEL	*2,561*
Risk Margin	*312*
TMTP	477
Own Funds	754
SCR	446
Excess Capital	308
CCR	169%

3.26 The Capital Coverage Ratio (CCR) as at 31 December 2017 was 169%, which is below the internal target of 211% that Royal London aims to hold for the Scottish Life Fund.

3.27 Currently, when calculating the capital requirements of the Scottish Life Fund, credit has been taken for the most severe management action, which involves the cutting of pay-outs to planholders to the minimum allowable amount (the "Ultimate Management Action"). This provides a mechanism for keeping pay-outs above asset share when the capital strength of the Scottish Life Fund would otherwise not have been able to support pay-outs at that level.

3.28 As at 31 December 2017 the Scottish Life Fund had an asset value of £3.2bn, and the reserve for plans with GARs was £1.0bn of the total fund consisting of £390m in base reserves and £609m of GAR reserves. Some of the £609m of GAR reserves are in respect of plans which have investments in the Royal London Main Fund, as the GAR reserve for these plans remains in the Scottish Life Fund. The cost of supporting the GARs has significantly increased over time due to improving longevity, low interest rates and the introduction of Solvency II capital requirements.

3.29 The Scottish Life Fund currently has significant exposure to longevity and interest rate risk, as well as the risk of increasing GAR take-up rates. As a result, GARs are now the core issue for the Scottish Life Fund and are increasing the risk profile of the fund, leading to constraints on the distribution of the Scottish Life Fund Estate and the investment strategy of the fund.

3.30 Removing the GARs would reduce the level of longevity and interest rate risk in the Scottish Life Fund, thereby reducing the amount of capital which needs to be held under Solvency II.

3.31 In addition, the low CCR in relation to Royal London's internal target places constraints on the investment strategy, as a low equity backing ratio (EBR) (21% as at 31 December 2017) is required to support the capital position. The low CCR also places constraints on the distribution of the Estate. These constraints cannot be eased whilst the majority of GARs remain in place.

Solvency II Applications

Internal Model

3.32 Royal London is currently applying for the use of an Internal Model for Solvency II purposes. The Internal Model Approval Process (IMAP) is running in parallel to the Scheme during 2018, with our pre-application having been submitted in March 2018.

3.33 A decision on the Internal Model application is expected to take place in September 2019. The Internal Model application will contain the post-Scheme balance sheet, with an addendum setting out the incremental impact of the Scheme.

3.34 The timelines for the successful implementation of the Internal Model could potentially be impacted by the Scheme. The IMAP will therefore require timely provision of information to support the approval process.

3.35 As set out in paragraph 4.26, there are costs associated with the Scheme's impact on IMAP, and these costs have been shared equally between the Scottish Life Fund and the Royal London Main Fund, as agreed between the Group Finance Director and the With-Profits Actuary for Royal London. I consider this cost allocation appropriate.

Matching Adjustment

3.36 Royal London does not make use of the Matching Adjustment due to low volumes of annuity business.

Volatility Adjustment

3.37 Royal London uses the Volatility Adjustment. The Scheme is not expected to have an impact on the use of the volatility adjustment; however, this will continue to be monitored as part of the annual review process.

Nature of the GAR

3.38 The plan terms for Eligible Plans vary by product. The plan terms typically include a table setting out the minimum annuity that will be payable per £1,000 of accrued investments depending on retirement age, gender and product, or are operated by Royal London on the basis that they do contain such a table.

3.39 For certain Eligible Plans, their plan terms allow planholders to choose an alternative annuity structure, for example an escalating annuity or an annuity that includes a spouse or dependant benefit. The plan terms for some Eligible Plans suggest the GAR must be taken into account when determining annuity rates for alternative annuity structures. For other plans, there is no contractual obligation for the GAR to be considered. In practice, Royal London take the GAR into consideration for all Eligible Plans.

3.40 All contributions paid prior to 31 December 1994 attract GARs, and in addition on-going contracting out monies attracted GARs until contracting out on a money purchase basis ceased in 2012. In December 1994, Scottish Life gave notice to Eligible Planholders that it was exercising its right to amend the terms of the plans so that future accrual of GAR benefits would be limited. The effect of this variation was that only future regular contributions payable at the level in force as at 31 December 1994 or in accordance with any contractual increases agreed at that date benefit from the GAR. Any single premiums or increases in regular premiums after that date will not benefit from the GAR.

3.41 In 2008, Royal London exercised its rights to make a further variation of the terms and conditions of Talisman Executive Pensions Plans, Talisman Retirement Annuity Contracts, Talisman Personal Pension Plans and Talisman Group Personal Pension Plans by issuing a further notice to planholders. The effect of this variation was that, if a planholder failed to pay contributions at the agreed level (in whole or in part) for a year, any premiums paid after the planholder restarted contributions would not attract GAR benefits.

3.42 Royal London has also taken further steps to reduce its GAR liability in respect of Talisman Personal Pension Plans and Talisman Group Personal Pension Plans. These have the effect that, with effect from 10 January 2014, if a planholder delays their retirement beyond the original nominated retirement date, any regular contributions made after that date will not benefit from the GAR.

3.43 To cover the costs of providing the GAR, all with-profits plans within the Scottish Life Fund (regardless of whether the plan has an attaching GAR) are subject to a GAR charge of either 0.16% or 0.49% p.a., depending on when the product was sold.

3.44 The value of the GAR is not reflected in transfer values. The value of the GAR can only be realised at retirement if planholders choose to take an annuity with Royal London (in practice, Royal London satisfies this obligation by arranging for the purchase of an annuity through its Annuity Bureau).

Any previous compromises or similar actions

3.45 The Scottish Life Fund has not been subject to any compromises or actions, similar to the Scheme, since the Scottish Life Fund was established in 2001 at the time the business of Scottish Life was transferred to Royal London.

Overall Royal London fund structure

3.46 The structure of Royal London's long-term insurance business can be summarised as follows (values shown are total assets within each fund as at 31 December 2017):

Royal London (CIS) Sub-Fund (£31bn)	Royal London Main Fund (£49bn)	Scottish Life Closed Fund (£3.2bn)	PLAL With-Profits Fund (£1bn)	Royal Liver Sub-Fund (£2bn)
RLCIS Estate	*RL Estate*	*Scottish Life Fund Estate*	*PLAL Estate*	*Royal Liver Estate*
	Royal London IB & OB Sub-Fund			
	Refuge Assurance IB Sub-Fund			
	United Friendly IB Sub-Fund			
	United Friendly OB Sub-Fund			

Royal London Main Fund

3.47 There are c.3.6m planholders within the Royal London Main Fund. The table below sets out the financial position of the Royal London Main Fund as at 31 December 2017 on an Internal Model basis. Please note that Royal London's Internal Model has not yet been approved by the regulator.

Royal London Main Fund	31 December 2017 (£m)
Assets	48,768
Liabilities	45,291
BEL	*44,660*
Risk Margin	*631*
Own Funds	3,476
SCR	1,692
Excess Capital	1,784
CCR	205%

3.48 The Royal London Main Fund planholders are considered within this report as there are various interactions between the Scottish Life Fund and Royal London Main Fund, as specified in the following section.

Interactions of Scottish Life Fund with the Royal London Main Fund

Scottish Life Fund VIF

3.49 In accordance with the terms of the Scottish Life Transfer Scheme, the value-in-force (VIF) associated with Eligible Plans within the Scottish Life Fund accrues in the Royal London Main Fund Estate, specified as charges less expenses incurred on all products written by Scottish Life, regardless of whether they now sit within the Scottish Life Fund or Royal London Main Fund.

Switches

3.50 There are plans within the Scottish Life Fund which permit switching from with-profits to unit-linked investments. Switches into unit-linked investments will sit within the Royal London Main Fund. Any subsequent switches from unit-linked investments to with-profit investments will also remain within the Royal London Main Fund.

Burn-through risk

3.51 In accordance with the terms of the Scottish Life Transfer Scheme, the Royal London Main Fund is required to provide financial support to the Scottish Life Fund when necessary. As at 31 December 2017, the Royal London Main Fund therefore bore burn-through risk in relation to the Scottish Life Fund, which was calculated as c.£2.6m on an Embedded Value basis, this also results in an increase in the SCR for the Royal London Main Fund.

Merger of the Scottish Life Fund into the Royal London Main Fund

3.52 Within the Scottish Life Transfer Scheme, allowance was made for the Scottish Life Fund to be merged with the Royal London Main Fund once the value of the assets falls below a specified value. The option to merge the funds is available when the value of the assets falls below an amount equal to £500m increased annually with inflation from 1 July 2001, and the merging of funds becomes compulsory when the value of the assets falls below £50m increased annually with inflation from 1 July 2001.

4 The Scheme

4.1 Within this section I consider the details of the Scheme, including the general process to implement the Scheme, the methodology and assumptions used to derive the offer and the costs associated with the Scheme.

Overview of the Scheme

4.2 As outlined in the previous section, there were c.34,000 plans with attaching GARs in the Scottish Life Fund as at 31 December 2017. These GARs were written in the 1980s and 1990s, and given the higher interest rates and shorter life expectancies at the time, the terms underlying their calculation were relatively generous compared to the calculation basis employed today. As a consequence, the GARs are now very valuable and can provide planholders who use the GAR to buy an annuity with an income in retirement that is often materially greater than they could purchase if they bought an annuity at an open market rate. However, those planholders will only benefit from their GAR if they buy an annuity through Royal London.

4.3 In April 2015, the government made some important changes to pensions, which gave people more freedom and choice in accessing their retirement savings. As a result, more people now choose to access their retirement fund by taking out a drawdown plan or taking cash than by buying an annuity.

4.4 Royal London proposes to offer c.33,000 former Scottish Life pension planholders (the Eligible Planholders) the opportunity to exchange a valuable GAR option in exchange for an Uplift to their existing plan value equivalent to the Economic Value of their GAR. This proposal is referred to as the 'Scheme' in this report.

4.5 The process for implementing the Scheme is summarised as follows:

- An initial mailing, referred to as the appetite mailing, was sent to all Eligible Planholders to provide an outline of the Scheme and to seek feedback on whether they are likely to support the Scheme. This mailing included notice of the date of the initial Court hearing (the "Convening Hearing") so that Eligible Planholders can attend and give their views to the Court in person or through a representative. As a result of the interest expressed following the appetite mailing by Eligible Planholders in the Scheme, Royal London has decided to put a formal offer to Eligible Planholders.
- The Convening Hearing will be held on 25 June 2018, and at the hearing the Court will consider the terms of the Scheme and be asked to approve the convening of a meeting (the "Planholder Meeting") at which Eligible Planholders will be able to vote on the Scheme. The Planholder Meeting is planned to be held on 23 October 2018.
- Subject to the Court approving the convening of the Planholder Meeting, a further mailing will be sent to Eligible Planholders with details of the Uplift available to each planholder and information on the Scheme. Eligible Planholders will be able to opt out of the Scheme by post or online until 19 October 2018 at 12 noon or in person at the Planholder Meeting, and if they do, their GAR will remain unchanged. This is an important right as the Scheme will be binding on all Eligible Planholders who do not opt out, irrespective of whether they vote for or against the Scheme, or do not vote at all. The exception to this is for Verified Gone-Away Included Planholders, for whom the vote is not a binding decision, as outlined in paragraph 6.101 onwards.
- Any planholders who opt out of the Scheme will not be permitted to vote. Planholders who had previously opted-out but then wish to withdraw their opt-out can do so by notifying us by post or online before 19 October 2018. Alternatively planholders who had previously submitted an opt-out can withdraw their opt-out in person at the planholder meeting on 23 October 2018.

- Planholders will have a period of three months before the Planholder Meeting to decide what to do – whether to opt out and, if they decide not to opt out, whether to vote for or against the Scheme.
- Before the voting deadline, a three-step advice process will be available to Eligible Planholders, which includes:
    - information to aid the voting decision, including a personalised illustration;
    - a freephone guidance service to provide further clarity; and
    - access to an independent advice service, which will either be free for planholders that are required by legislation to take advice prior to voting or otherwise materially subsidised. If a planholder wishes to seek financial advice from his or her own advisor, Royal London will also subsidise this planholder in meeting this cost to an equivalent level.
- The Scheme will go ahead if, of Eligible Planholders voting in person or by proxy (including postal and online votes) at the Planholder Meeting in favour of the scheme:
    - a majority by number, who together represent 75% by value (where value is based on the Uplift applied to plan values), vote in favour of the Scheme;
    - the Scheme is subsequently sanctioned by the Court;
    - and the Independent Actuary confirms that the Scheme continues to satisfy his Fairness Criteria allowing for any necessary adjustments made to uplifts in order to allow for changes in economic conditions or longevity assumption changes that occur between the formal mailing and 14 November 2018.
- If the Scheme goes ahead, those who did not opt-out of the Scheme will have their GAR removed from their plan in exchange for an Uplift applied to their current plan value, any guaranteed benefits, and any future eligible premiums.
- If the Scheme goes ahead, planholders who opted-out will retain their GAR but will not have their plan value increased by the Uplift.
- If the overall vote is not in favour of the Scheme then it will not proceed and the Eligible Plans will be unchanged.
- Royal London may withdraw the Scheme at any time prior to the Sanction Hearing.

4.6 Royal London sought legal advice from Hogan Lovells who performed legal due diligence regarding the need for separate voting classes under the Scheme. The legal opinion from Hogan Lovells was that plan terms and conditions were not so dissimilar as to make it impossible for Eligible Planholders to consult together with a view to their common interest. Therefore there will be a single meeting at which all Eligible Planholders will vote. However, the appropriateness of using a single voting class remains subject to consideration by the Court.

The Scheme methodology

4.7 The offer under the Scheme is expressed in terms of an Uplift to plan value and is set depending on:

- the current age of the planholder (in complete years) as at the Scheme Implementation Date;
- the gender of the planholder (see paragraphs 5.34 to 5.35 for detail on how this relates to the EU Gender Directive);
- a GAR take-up rate of 75% (i.e. 25% of plan value is taken as a tax-free lump sum at retirement); and
- the GAR terms (expressed as a rate p.a. per £1,000 of plan value), which vary by:
    - contract;
    - gender; and;
    - and in the case of Talisman Personal Pension Plan, also by rights type (i.e. Protected Rights and Additional Rights).

4.8 The full table of offer Uplifts as at 31 December 2017 is set out below. This table will be subject to review and adjustment prior to the Scheme Implementation Date.

Age	Talisman Executive Pension Plan	Talisman Retirement Annuity Contract	86 AR	86 PR	Talisman Executive Pension Plan	Talisman Retirement Annuity Contract	86 AR	86 PR
	F	F	F	F	M	M	M	M
40								
41			63%	89%			74%	74%
42			62%	88%			73%	74%
43			62%	88%			72%	73%
44			61%	87%			72%	72%
45		72%	60%	86%			71%	72%
46		72%	59%	85%		85%	70%	71%
47	63%	71%	59%	84%	70%	84%	69%	70%
48	62%	70%	58%	82%	69%	83%	68%	69%
49	62%	69%	57%	81%	68%	82%	67%	68%
50	61%	68%	56%	80%	67%	81%	67%	67%
51	60%	67%	55%	79%	67%	80%	66%	66%
52	59%	67%	55%	78%	66%	79%	65%	65%
53	59%	66%	54%	77%	65%	79%	64%	64%
54	58%	65%	54%	76%	64%	78%	63%	63%
55	58%	65%	53%	75%	63%	77%	62%	62%
56	57%	65%	53%	75%	63%	76%	62%	62%
57	57%	65%	53%	74%	62%	75%	60%	62%
58	57%	65%	53%	74%	61%	75%	60%	62%
59	57%	65%	53%	74%	61%	75%	60%	62%
60	57%	65%	53%	73%	61%	75%	60%	62%
61	57%	65%	53%	73%	61%	75%	60%	61%
62	57%	65%	53%	73%	61%	75%	60%	59%
63	57%	65%	53%	73%	61%	75%	60%	58%
64	57%	65%	53%	73%	61%	75%	60%	58%
65	57%	65%	53%	73%	61%	75%	60%	58%
66	57%	65%	53%	73%	61%	75%	60%	58%
67	57%	65%	53%	73%	61%	75%	60%	58%
68	57%	65%	53%	73%	61%	75%	60%	58%
69	57%	65%	53%	73%	61%	75%	60%	58%
70	57%	65%	53%	73%	61%	75%	60%	58%
71	57%	65%	53%	73%	61%	75%	60%	58%
72	57%	65%	53%	73%	61%	75%	60%	58%
73	57%	65%	53%	73%	61%	75%	60%	58%
74	57%	65%	53%	73%	61%	75%	60%	58%
75	57%	65%	53%	73%	61%	75%	60%	58%

4.9 The Uplifts are intended to represent the Economic Value of the GAR income benefit applying at the planholders' assumed retirement age (62 for females and 67 for males), using assumptions detailed in 4.14, including the GAR take-up rate assumption of 75%. Where planholders are currently older than the retirement ages assumed above they are assumed to retire immediately.

4.10 As an example, a planholder currently aged 60 who was expected to retire at 67 would have the buy-out cost of the GAR calculated using annuity rates based on expected interest rates 7 years from now and 7 years of accumulated longevity improvements in the mortality basis.

Scope of the Uplift

4.11 There are certain cases whereby the full plan value will not be eligible for the Uplift, and there are rules around how future premiums will be treated. The scope of the Uplift is as follows:

- some plans are only entitled to a GAR on a portion of their plan, due to differing GAR entitlement rules towards different premiums (see paragraphs 3.40 to 3.42). For such plans, only the proportion of the plan that is eligible for the GAR will be subject to an Uplift;
- only regular contributions in force at 31 December 1994 and contractual increases to premiums are eligible for the GAR and therefore such premiums paid in the future will be subject to an Uplift. Any non-contractual premiums or increases to premiums in the future will not be subject to an Uplift; and
- paid-up plans will receive an Uplift on the GAR-eligible portion of their plan value. If a paid-up plan reinstates premiums in the future then these premiums would not be eligible for the GAR, and would therefore not be subject to an Uplift.

The Scheme assumptions

4.12 An Offer Basis has been established in order to determine the offers made under the Scheme to individual planholders.

4.13 The most material assumptions under the Offer Basis are longevity, GAR take-up rate and discount rate.

4.14 The table below summarises the assumptions used in deriving the Offer Basis.

Assumption	Offer Basis	
Longevity	**Males:** 89% of the Male Pension Annuities in Payment 08 tables (PML08) CMI_2016 [1.5% p.a.] **Females:** 86% of the Female Pension Annuities in Payment 08 tables (PFL08) CMI_2016 [1.5%]	
Transfer	0% p.a.	
GAR Take-up	75%	
Retirement Age	Males retire at age 67 and Females at age 62 (or immediately if current age is greater)	
Spouse (Talisman Personal Pension Plan PR only)	Gender: male Age: three years older than main planholder	Gender: female Age: three years younger than main planholder
Discount rate	EIOPA UK GBP Swap Curve with volatility adjustment	

Longevity

4.15 Longevity is calculated using the male and female Pensions Annuities in Payment 08 (PML08/PFL08) mortality base tables and some long-term improvement factors. These base tables are derived using annuitant mortality data collected from UK life insurance offices between 2007 and 2010. As these base tables are based on data that is not directly reflective of the Scottish Life Fund Scheme members being modelled percentage factors have been applied (89% for males and 86% for females) to calibrate the tables to the annuitant experience of Royal London, and in particular the Scottish Life Fund.

4.16 It is widely accepted from historic mortality experience that over time, longevity is improving. Therefore it is necessary to apply some long-term improvement factors to the base table detailed above. Royal London have chosen to use the Continuous Mortality Investigation

(CMI) 2016 improvement model as the best estimate of longevity improvements, with a long-term improvement rate of 1.5% p.a. The CMI 2016 improvement model is designed by the Continuous Mortality Investigation (an establishment set up and supported by the actuarial profession) which carries out the research required to produce high-quality impartial materials for the insurance and pension industry.

Transfer

4.17 This is the percentage of individuals transferring their plan values to another provider. For the purposes of the Scheme, this has been assumed to be 0% i.e. no transfers.

GAR take-up

4.18 This is the proportion of retirement benefits taken as an annuity rather than cash upon retirement.

Spouse

4.19 The GAR which applies to Protected Rights benefits under the terms of the Talisman Personal Pension Plans is in respect of an annuity with an attaching spouse's annuity (this reflects the statutory requirements which formerly applied to Protected Rights). For the purposes of determining the value of this spouse's annuity, the spouse is assumed to be of the opposite sex, and if male three years older than the main planholder, and if female three years younger than the main planholder.

Discount rate

4.20 The discount rate is necessary to consider the time-value of money. The discount rate used is the EIOPA UK GBP Swap Curve with Volatility Adjustment as at December 2017 consistent with the valuation of Best Estimate Liabilities under Solvency II for the Eligible Plans at 31 December 2017.

4.21 I set out the rationale for these assumptions in section 5.

Worked example

4.22 Below is a table detailing a typical plan for each of the product types included within the Scheme, and the associated plan size before and after the Scheme.

Plan type	Current Age	Sex	Eligible rate*	Uplift	Plan value (before)	Plan value (after)
Talisman Executive Pension Plan	60	M	0.94	61%	£57,000	£89,684
Talisman Executive Pension Plan	57	F	0.95	57%	£37,000	£57,036
Talisman Retirement Annuity Contract	59	M	0.95	75%	£37,000	£63,363
Talisman Retirement Annuity Contract	58	F	0.96	65%	£27,000	£43,848
Talisman Personal Pension Plan AR	54	M	0.98	63%	£40,000	£64,696
Talisman Personal Pension Plan PR	54	M	0.98	63%	£40,000	£64,696
Talisman Personal Pension Plan AR	52	F	0.98	55%	£24,000	£36,936
Talisman Personal Pension Plan PR	52	F	0.98	78%	£24,000	£42,346

* this is the percentage of the plan value which could be used to purchase a GAR at retirement, and is therefore eligible for the Uplift.

4.23 The Plan Value (after) column shown in the above table has been calculated as follows:

Plan Value (after) = Plan Value (before) x (1 + Uplift x Eligible Rate)

Taking Male Talisman Executive Pension Plan as an example:

Plan Value (after) = £57,000 x (1+ 61% * 0.94)
= £57,000 x (1.5734)
= £89,684

4.24 For the plans shown, the Uplift is between 55% and 78%. Across all Eligible Plans the range of Uplifts is between 53% and 89%.

4.25 For these typical plans, we have not considered future premiums, and depending on the plan conditions, these may also be eligible for the Uplift.

Costs of the Scheme

4.26 The large majority of costs attributed to the Scheme will be met by the Scottish Life Fund Estate. Some of the costs attributed to the Scheme are in relation to the impact of the Scheme on the IMAP, half of which will be met by the Royal London Main Fund.

Governance

4.27 We have a formal approval process for the terms of the Scheme and the planholder offers to be made.

4.28 Internally within Royal London, the Group Board will be the final formal approval point. Our interim approval process will include agreement to the terms and the impact of the Scheme, through various groups and bodies.

4.29 In addition to my approval of the terms of the Scheme and its financial impacts as Chief Actuary, it will also be approved internally by:

- the Project Steering Group;
- the With-Profits Committee and the Scottish Life Fund Supervisory Committee; and
- the Group Executive Committee.

4.30 The process also includes external review and comment by various bodies:

- our external legal advisors, Hogan Lovells, and our appointed QC, Martin Moore, have provided external independent legal opinion and support with the Scheme documents and the structuring of the offer;
- the Independent Actuary, Paul Coulthard of Deloitte LLP, has reviewed the terms and the fairness of the Scheme, in making his own report to the Court; and
- ultimately, the High Court will consider whether all of the statutory requirements have been satisfied in relation to the Scheme and whether it is appropriate for it to sanction the Scheme. In making that decision, the Court will assess whether an intelligent and honest person, acting in his own interest, might reasonably approve the proposal.

Other Royal London funds

4.31 The Scottish Life Fund is a ring-fenced fund for regulatory purposes. The operation of the Scottish Life Fund is subject to the terms of the Scottish Life Transfer Scheme under which the entire business of Scottish Life was transferred to Royal London in 2001. There are various interactions between the Scottish Life Fund and the Royal London Main Fund as a result of the Scottish Life Transfer Scheme, for example the establishment of linked funds for Scottish Life Fund plans in the Royal London Main Fund, in relation to switches and the transfer of charges from the Scottish Life Fund to the Royal London Main Fund. No such interactions arise in relation to other funds established by Royal London. Therefore, within this report, I do not consider the impacts of any other planholders aside from those in the Scottish Life Fund and the Royal London Main Fund. The Scottish Life Transfer Scheme allows for the funds of the Scottish Life Fund to be merged with the Royal London Main Fund when the asset value of the Scottish Life Fund falls below a pre-defined threshold, this is expected to occur in the next 5 to 10 years.

Alternatives considered

4.32 In order to address the issues around the risk profile of the Scottish Life Fund, a merger of the Scottish Life Fund into the Royal London Main Fund was also considered, either in conjunction with or instead of the Scheme outlined in this report. However, the decision was made that the GARs should first be bought-out in order to minimise the burden on the Royal London Main Fund when the two funds are merged. Therefore, the merging of the Scottish Life Fund and the Royal London Main Fund has not been incorporated within the Scheme and will instead be considered separately at a later date.

4.33 Another alternative considered was the potential to buyout another guarantee within the Scottish Life Fund relating to GMPs (the "GMP Guarantee"). As the value of the GMP Guarantees is c£0.2bn, which is smaller than the value of the GARs (c.£0.6bn), it was decided that any buyout of GMP Guarantees would be considered at a later date. Given the legislation governing GMPs, and the outcome of our legal analysis, any buyout would likely have to be done on an individual basis rather than via a formal Scheme of Arrangement.

4.34 Finally, longevity reinsurance was also considered to reduce the capital requirements of the Scottish Life Fund. However, this was prohibitively expensive and was therefore not pursued.

5 Rationale for assumption setting

5.1 Within this section, I consider the assumptions used in deriving the Offer Basis, which are then used to calculate the offer Uplifts, the rationale behind them and I give my opinion on whether I believe these assumptions are reasonable.

5.2 The assumptions used in calculating the Uplift applied to plans are chosen to be equal to best estimate, unless such a choice would cause the Scheme to breach the fairness tests set by the Independent Actuary.

5.3 As covered in section 4, the table below summarises the assumptions used in deriving the Offer Basis.

<table>
<tr><th>Assumption</th><th colspan="2">Offer Basis</th></tr>
<tr><td>Longevity</td><td colspan="2">Males: 89% of the Male Pension Annuities in Payment 08 tables (PML08)
CMI_2016 [1.5% p.a.]

Females: 86% of the Female Pension Annuities in Payment 08 tables (PFL08)
CMI_2016 [1.5%]</td></tr>
<tr><td>Transfer</td><td colspan="2">0% p.a.</td></tr>
<tr><td>GAR Take-up</td><td colspan="2">75%</td></tr>
<tr><td>Retirement Age</td><td colspan="2">Males retire at age 67 and Females at age 62 (or immediately if current age is greater)</td></tr>
<tr><td>Spouse
(Talisman Personal Pension Plan PR only)</td><td>Gender: male
Age: three years older than main planholder</td><td>Gender: female
Age: three years younger than main planholder</td></tr>
<tr><td>Discount rate</td><td colspan="2">EIOPA UK GBP Swap Curve with volatility adjustment</td></tr>
</table>

5.4 Each assumption is discussed in turn in the sections below.

Longevity

5.5 The longevity assumption has a material impact on the offer made under the Scheme. The 2017 best estimate assumption will be used for the Offer Basis in order to represent fair value. This includes use of the CMI 2016 model and the external views of longevity experts, both of which recognise the recent slowdown in mortality improvements. Since plans within the Scottish Life Fund were not medically underwritten at the point of sale, the average longevity experience is used when setting the assumption.

Transfer

5.6 Plans lose their GAR upon transferring to another provider, and therefore it is important to distinguish between exits resulting from transfers and exits resulting from retirement.

5.7 For valuation purposes, we use our average transfer experience when setting the transfer assumption. However, it would not be fair on planholders to reflect this average experience in the Offer Basis, since on an individual basis the average experience may not be an accurate portrayal of the planholder's intentions, and the inclusion of a transfer assumption would result in a reduced Uplift. Therefore, the fairest approach is to assume nil transfers in the Offer Basis.

GAR take-up rate

5.8 The GAR take-up rate assumption is the proportion of retirement benefits taken as an annuity rather than cash upon retirement. Since Pension Freedoms, planholders have been taking increased proportions as cash, reducing the GAR take-up rate.

5.9 To form the Offer Basis an upward adjustment has been made to the year-end 2017 best estimate assumption, taking the assumption from 66.3% to 75%.

5.10 Whilst the best estimate represents average experience, the majority of Scottish Life Fund plans by plan value take 75% of their plan as an annuity. It has been decided in this instance that reflecting this in the Offer Basis represents current planholder behaviour and will minimise the likely opt-out rate for this particular Scheme.

5.11 For planholders who would take less than 75% of their plan as an annuity, this assumption therefore results in an offer that is higher than the Economic Value of their plan and these planholders therefore benefit from this assumption.

5.12 For planholders who would take more than 75% of their plan as an annuity, it may be better to opt out of the Scheme. However, increasing the assumption above 75% in the Offer Basis would be to the detriment of other plans in the Scottish Life Fund that either opt-out or are not included within the Scheme. Therefore, an assumption of greater than 75% would be inappropriate. It will be made clear to planholders in the formal offer written communication that if they intend to take more than 75% of their plan value as an annuity then it may be more appropriate to opt-out of the Scheme (although this decision is also dependent on the individual planholder's other circumstances).

5.13 This adjustment to the year-end 2017 best estimate assumption will increase the overall value of the offer, which will be paid from the Scottish Life Fund Estate. However, setting the offer at this level is considered to strike a reasonable balance for all planholders.

Retirement age

5.14 Experience has shown that the Nominated Retirement Age (NRA) selected at outset has increasingly less influence on actual retirement ages. It is therefore deemed inappropriate to use the NRA for the retirement age assumption, as the offer made to planholders may not accurately reflect their intentions in terms of retirement age.

5.15 A liability weighted average retirement age was therefore derived from the average retirement experience for males and females. As a result, the Offer Basis assumes a retirement age of 67 for males and 62 for females.

5.16 I believe this assumption is appropriate as it more accurately reflects Royal London's experience compared to the NRA.

Spouse benefits

5.17 Talisman Personal Pension Plan PR are the only plans included within the Scheme which have a spouse's benefit entitlement. For these plans, if the annuitant dies before the spouse, the spouse will be entitled to 50% of the benefit payments for the remainder of their lifetime.

5.18 The offer for these plan types has been calculated using the assumptions detailed within this section, as well as two further assumptions about the spouse's age and gender. The offer assumes that where a spouse is female they are three years younger than the annuitant and where a spouse is male they are three years older than the annuitant. This is consistent with standard actuarial practice.

Discount rate

5.19 The use of the EIOPA UK GBP Swap Curve with volatility adjustment is appropriate for the discount rate assumption as it is objective, readily observable (being published regularly by EIOPA), and reflects both the term-structure of interest rates and the long-term nature of the products within the Scheme.

5.20 In addition this is in line with the assumption used for modelling and valuation purposes and is the market standard measure under Solvency II.

5.21 I therefore believe this assumption is appropriate for the Offer Basis.

PUP Rate

5.22 Under the Scheme, future premiums paid by Included Plans will only be uplifted when the premiums are paid, and therefore the offer Uplift is not influenced by the PUP rate.

5.23 Since PUP rates do not impact the value of the offer made to planholders, an assumption is not required for the Offer Basis.

Partial withdrawals

5.24 Partial withdrawals are a relatively immaterial decrement. An aggregate assumption is currently used across all pension products, and the best estimate was 0.1% p.a. as at 31 December 2017.

5.25 Similar to PUPs, partial withdrawals do not impact the value of the offer and therefore an assumption is not required for the Offer Basis.

Review of interest rate and longevity rate changes

5.26 Between 30 April 2018 (the date at which the Uplifts have been calculated) and 14 November 2018 (the latest practical date prior to the Scheme Implementation Date in December 2018) longevity and interest rate movements need to be carefully monitored. Movements in either of these could necessitate a recalculation of the Uplift and extreme movements could result in the Scheme not being implemented.

5.27 If interest rates were to increase by 14 November 2018, and the Uplift were not to be recalculated, then the Included Planholders would receive more than the Economic Value and cause detriment to the other with-profits Excluded Planholders. Conversely, if interest rates were to decrease by 14 November, then the Included Planholders would receive less than the Economic Value of their plan, resulting in detriment to this planholder group, with the with-profits Excluded Planholders benefitting unfairly.

5.28 Therefore, in order to ensure that the Scheme remains fair to all planholder groups, a recalculation of the Uplift will be performed after the Sanction Hearing but prior to the Scheme Implementation Date. This recalculation will consider longevity and interest rate assumptions as at 14 November 2018, which will allow time for the recalculations to be completed ahead of the Scheme Implementation Date. Any changes to the Uplift factors will be subject to a maximum reduction of 10%. For example, an Uplift factor of 160% would not be reduced to lower than 90% of 160% (i.e. 144%).

5.29 As at 30 April 2018 we have seen a material increase in interest rates across all durations and the CMI have published an updated longevity improvements model (CMI 2017). Both of these changes act to reduce the value of the GAR and therefore the Uplifts. We have therefore recalculated the Uplifts as at 30 April 2018 reflecting both the increase in interest rates and CMI 2017 longevity improvements model and will base the information in the formal mailing pack on these recalculated uplifts. This ensures that Eligible Planholders can make a fully informed decision using our most up to date view of the Uplifts that will be applied and minimises the risk of further movement through to the Implementation Date.

5.30 The table below shows the Uplifts factors recalculated as at 30 April 2018 to be communicated to Eligible Planholders in the formal mailing pack:

Age	Talisman Executive Pension Plan	Talisman Retirement Annuity Contract	86 AR	86 PR	Talisman Executive Pension Plan	Talisman Retirement Annuity Contract	86 AR	86 PR
	F	F	F	F	M	M	M	M
40								
41			58%	81%			68%	68%
42			57%	81%			68%	67%
43			57%	80%			67%	67%
44			56%	79%			66%	66%
45		67%	56%	79%			66%	66%
46		67%	55%	78%		80%	65%	65%
47	59%	66%	54%	77%	65%	79%	64%	64%
48	58%	65%	53%	76%	65%	78%	64%	63%
49	57%	64%	53%	75%	64%	77%	63%	62%
50	57%	64%	52%	74%	63%	76%	62%	61%
51	56%	63%	51%	73%	62%	76%	61%	61%
52	55%	62%	51%	72%	61%	75%	60%	60%
53	55%	62%	50%	71%	61%	74%	60%	59%
54	54%	61%	50%	70%	60%	73%	59%	58%
55	54%	60%	49%	69%	59%	72%	58%	57%
56	53%	60%	49%	68%	59%	72%	58%	56%
57	53%	60%	48%	68%	58%	70%	56%	55%
58	53%	60%	48%	67%	57%	70%	56%	55%
59	53%	60%	48%	67%	57%	70%	56%	55%
60	53%	60%	48%	66%	56%	70%	56%	55%
61	53%	60%	48%	66%	56%	70%	56%	54%
62	53%	60%	48%	66%	56%	70%	56%	53%
63	53%	60%	48%	66%	56%	70%	56%	53%
64	53%	60%	48%	66%	56%	70%	56%	53%
65	53%	60%	48%	66%	56%	70%	56%	53%
66	53%	60%	48%	66%	56%	70%	56%	53%
67	53%	60%	48%	66%	56%	70%	56%	53%
68	53%	60%	48%	66%	56%	70%	56%	53%
69	53%	60%	48%	66%	56%	70%	56%	53%
70	53%	60%	48%	66%	56%	70%	56%	53%
71	53%	60%	48%	66%	56%	70%	56%	53%
72	53%	60%	48%	66%	56%	70%	56%	53%
73	53%	60%	48%	66%	56%	70%	56%	53%
74	53%	60%	48%	66%	56%	70%	56%	53%
75	53%	60%	48%	66%	56%	70%	56%	53%

5.31 The average uplift has reduced from 66% at 31 December 2017 to 61% as at 30 April 2018. The increase in interest rates accounts for 4% of this increase and the CMI 2017 model accounts for 1%.

5.32 If there were severe interest rate movements that would result in the Scheme causing material detriment to either Included Planholders or any other planholders then the Scheme would not be implemented.

5.33 I believe it is appropriate to base the information in the formal mailing packs on the recalculated uplifts as at 30 April and that is appropriate to recalculate the Uplift closer to the Scheme Implementation Date to ensure the Scheme continues to be fair to all planholder groups.

EU Gender Directive

5.34 The GAR terms were set prior to the introduction of the Gender Directive, and therefore the terms of the GAR, for most plans types, vary by gender. The assumptions underlying the calculation of the Uplift also consider the gender of the planholder.

5.35 The potential application of the Gender Directive on the offer was discussed with our legal advisers, Hogan Lovells, and our QC, Martin Moore, and the opinion was that the amendment to plan terms under the Scheme will not trigger the Gender Directive. Given the legal advice provided, Royal London considers the Gender Directive to be inapplicable to the Uplifts applied under the Scheme.

Chief Actuary opinion on assumptions

5.36 In my opinion, these assumptions result in an Uplift value which is fair not only to Included Plans, but also to all other groups of planholders. I note that these assumptions also result in a plan Uplift which satisfies all of the Independent Actuary's fairness tests.

6 Consequences of the Scheme

6.1 Within this section I consider the consequences of the Scheme. This includes the financial impacts of the Scheme and the subsequent consequences for the various groups of planholders.

Risk profile

6.2 Whilst the Scottish Life Fund does not sell annuities directly, the presence of GARs exposes the Scottish Life Fund to the risks typically linked to annuity business, in particular interest rate movements and changes in longevity trends, as well as increasing GAR take-up rates.

6.3 In terms of interest rate risk, the Scottish Life Fund is exposed to falling interest rates. Lower interest rates increase the value of the GAR in comparison to annuity rates that could be obtained on the open market. This results in both increased costs to the Scottish Life Fund of obtaining annuities at the guaranteed rates via the RL Annuity Bureau and increased numbers of planholders that choose to exercise their GAR. By removing the GAR, the exposure to interest risk is therefore substantially reduced.

6.4 Longevity risk is inherent in the Scottish Life Fund as a result of the GARs. Removing the GARs will significantly reduce the exposure to longevity risk.

6.5 The Scottish Life Fund is also exposed to increasing GAR take-up rates. This is partly linked to the risk of falling interest rates, as outlined above. However there are other factors that will influence the rate at which planholders choose to convert their fund to an annuity at retirement, mainly the introduction of Pension Freedoms which has led to lower GAR take-up rates. By removing the GAR for Eligible Plans which are subject to the Scheme, the Scottish Life Fund is less exposed to the risk of increased GAR take-up rates, which could occur in a number of scenarios such as a fall in interest rates or changes to pensions or tax legislation. However, the GAR take-up rate is expected to be high for Eligible Plans that opt-out of the Scheme, and therefore the extent to which this risk is reduced depends on the Scheme opt-out rate.

6.6 The number of planholders opting to exercise their GAR at retirement and purchase an annuity with Royal London has reduced following Pension Freedoms to historically low levels. Prior to Pension Freedoms, c.73% of planholders, by plan count, chose to exercise their GAR at retirement, falling to 38% as at 31 December 2016. Over recent years Royal London has taken a number of steps to improve communication with planholders about the value of their GAR, and all legislative requirements in this regard have been met. Irrespective of the steps taken, we have continued to see a significant and increasing proportion of people who give up their GAR in order to access the cash value of their plan. Whilst this may be an appropriate decision in some circumstances, there may be cases where planholders do not fully appreciate the value of their GAR, despite the communications received. The Scheme acts as an important step forward in giving these planholders the opportunity to monetise the value of their GAR and have the flexibility to use it how they choose without giving it up. This improves outcomes for planholders but also reduces any potential conduct risk that Royal London may be exposed to.

6.7 It is important to note that, whilst the risks outlined above are likely to be significantly reduced following the Scheme, they will not be removed entirely. This is due to the fact that GARs will still be present within the Scottish Life Fund, as not all products with GARs are included in the Scheme and inevitably, some plans will choose to opt-out of the Scheme and retain their GAR. In addition, other products within the Scottish Life Fund also have exposure to these risks.

6.8 The Scheme presents a risk that opt-out rates are higher than expected, leading to a higher proportion of planholders retaining their GARs than anticipated. This will result in the benefits of the Scheme being lower than anticipated. This risk has been partly mitigated by the appetite mailing that took place ahead of the formal voting period, which established the level of interest in the Scheme.

6.9 Overall, the removal of the GARs will result in a material reduction in the risk profile of the Scottish Life Fund. However, the various risks associated with running a fund that contains complex business, including with-profits and unit-linked business, will still be present.

6.10 The risk profile of the Royal London Main Fund is not expected to change following the Scheme.

Financial position

Scottish Life Fund

6.11 The table below shows the impact on the Scottish Life Fund's capital position pre-Scheme and post-Scheme based on a various opt-out scenarios. This is based on the 31 December 2017 Internal Model. Please note that Royal London's Internal Model has not yet been approved by the regulator. (Standard Formula results for pre-Scheme and 10% opt-out can be found in Appendix B).

Basis (£'000s)		Assets	Best Estimate Liability	Risk Margin	Technical Provisions	TMTP	Own Funds	SCR	Excess Capital	CCR
Pre-Scheme		3,151	*2,561*	*312*	2,873	477	754	446	308	169%
Post-Scheme	0% opt-out	2,611	*2,179*	*145*	2,324	216	503	110	393	457%
	10% opt-out	2,668	*2,263*	*162*	2,424	249	493	142	351	347%
	30% opt-out	2,772	*2,412*	*195*	2,607	310	475	210	265	226%

6.12 Assets within the Scottish Life Fund decrease as a result of the Scheme, as assets will be transferred to the Royal London Main Fund in order to apply the Uplift to unit-linked and unitised with-profits plan investments.

6.13 Technical Provisions also decrease as a result of the Scheme, which is caused by the following:

- asset shares and unit balances will be increased in accordance with the proposed offer in line with the proportion of plans subject to the Scheme;
- GAR costs will reduce as fewer plans will have a GAR available to exercise, with a larger reduction in scenarios with lower opt-out rates. Even in the 0% opt-out scenario a small amount of GAR reserve remains in respect of the Excluded Plans excluded from the Scheme; and
- the Risk Margin will reduce in line with the SCR, with a larger reduction in scenarios with lower opt-out rates.

6.14 Solvency II resulted in an increase in the Technical Provisions for the Scottish Life Fund, but the Transitional Measures on Technical Provisions (TMTP) under Solvency II allows the Scottish Life Fund a period of time to adapt before it has to fully comply with the new regulations. The TMTP is subject to approval by the PRA. The TMTP reduces under the Scheme, with a larger reduction in scenarios with lower opt-out rates. This reduction in TMTP follows the reduction in Risk Margin and Best Estimate Liabilities.

6.15 Own Funds decrease as a result of the Scheme. This is caused by a combination of two factors: the costs of the Scheme being charged to the Scottish Life Fund and the use of an adjusted GAR take-up rate in the Offer Basis. Both of these factors are considered later in this section of the report. The Own Funds are lower under scenarios with higher opt-out rates as those who opt-out are expected to take much more (95%) of their plan as GAR.

6.16 The SCR reduces under the Scheme, with a larger reduction in scenarios with lower opt-out rates. This is as a result of reduced longevity, interest rate and GAR take-up rate risk within the Scottish Life Fund.

6.17 Overall, the impact of the above results in increased excess capital and a strengthened CCR.

Royal London Main Fund

6.18 The table below shows the impact of the Scheme on the Royal London Main Fund for various opt-out rate scenarios. This is based on the 31 December 2017 Internal Model. Please note that Royal London's Internal Model has not yet been approved by the regulator.

Basis		Assets	Technical Provisions	Own Funds	SCR	Excess Capital	CCR
Pre-Scheme		48,768	45,291	3,476	1,692	1,784	205%
Post-Scheme	0% opt-out	49,115	45,648	3,468	1,712	1,756	203%
	10% opt-out	49,081	45,612	3,469	1,710	1,759	203%
	30% opt-out	49,011	45,541	3,470	1,706	1,765	203%

6.19 Assets within the Royal London Main Fund increase as a result of the Scheme, as assets will be transferred from the Scottish Life Fund in order to apply the Uplift to unit-linked and unitised with-profits plans.

6.20 The Scheme results in an increase in the Technical Provisions in the Royal London Main Fund. This increase is partly caused by the increased cost of guarantees. Royal London plans to eliminate the increased cost of guarantees by applying an adjustment to the inter-fund transfer described in paragraphs 6.57 to 6.62 below.

6.21 The SCR in the Royal London Main Fund is also increased as a result of the Scheme, and Royal London plan to compensate for the cost of holding increased capital by applying a further adjustment to the inter-fund transfer. This is also described further in paragraphs 6.57 to 6.62 below.

6.22 As described in paragraph 3.51, as at 31 December 2017 the Royal London Main Fund bore a burn-through risk in relation to the Scottish Life Fund, this was calculated as c£2.6m on an Embedded Value basis, and also resulted in an increase in the SCR of the Royal London Main Fund. A reduced risk profile within the Scottish Life Fund will reduce the extent to which the Scottish Life Fund requires support from the Royal London Main Fund (although it will still be required to provide financial assistance to the Scottish Life fund should the need arise), therefore reducing burn-through risk in the Royal London Main Fund. It is expected that, following the Scheme, due to the expected reduction in the Scottish Life Fund SCR the probability that the Royal London Main Fund will be required to provide financial assistance to the Scottish Life Fund will be reduced. However, this position may change in line with any movements in the risks that will remain in the Scottish Life Fund following the Scheme.

Chief Actuary opinion on the financial impacts of the Scheme

6.23 As mentioned above, the Scheme would cause a reduction in the Own Funds of the Scottish Life Fund. However, the Scheme also results in a more stable and less risky fund, which is expected to lead to lower capital requirements and more freedom to distribute the Scottish Life

Fund Estate to planholders at maturity. Therefore, given that this results in a strengthened CCR and increased benefit security, the reduction in Own Funds is acceptable.

6.24 In my opinion, the aim of reducing any potential financial impact on the Royal London Main Fund has been achieved via the inter-fund transfer and there will be a small benefit to the Royal London Main Fund via the reduced burn-through risk.

Investment strategy

6.25 There are no immediate plans to alter the investments backing asset shares and the Scottish Life Fund Estate after the Scheme Effective Date. However, the EBR is relatively low for both assets backing asset shares and the Scottish Life Fund Estate due to capital constraints and the onerousness of the GARs. Following the Scheme there would be more freedom to make changes to the investment strategy. Derivatives are currently held within the Scottish Life Fund to back the GARs and to hedge against interest rate risk. Holdings in derivative investments will be unwound in proportion to the uptake of the offer, so that the remaining derivatives within the Scottish Life Fund are sufficient to cover the remaining plans with GARs within the fund. The proceeds from the derivative sales along with cash sitting in the Scottish Life Fund Estate will be used to purchase assets and apply the Uplifts to fund values for Included Plans. The assets purchased are expected to be in the same mix as those backing assets shares for with-profits plans and the underlying unit investments for unit-linked plans. As far as possible, the timing of derivative sales will coincide with the purchase of other assets in order to minimise the amount of time spent in cash.

6.26 Overall, the extent to which the investment strategy will be changed depends on the final outcome of the Scheme, which is mainly driven by the Scheme opt-out rate. The investment strategy of the Scottish Life Fund will therefore be reviewed after the Scheme has been implemented. However, the Scheme is expected to enable greater investment freedom which potentially allows for higher distributions of the Scottish Life Fund Estate, despite the initial fall in the value of the Scottish Life Fund Estate following the Scheme.

6.27 The investment strategy of the Royal London Main Fund will not be impacted by the Scheme.

The Scottish Life Fund Estate

6.28 The Scottish Life Fund Estate is taken to be the excess of assets over liabilities within the Scottish Life Fund, after allowing for the cost of meeting the GAR.

6.29 The table below shows the impact of the Scheme on the Scottish Life Fund Estate, based on the 31 December 2017 Internal Model results. Please note that Royal London's Internal Model has not yet been approved by the regulator.

(£'000s)	Pre-Scheme	Post-Scheme (10% opt-out)
Scottish Life Fund Estate	590	405

6.30 As can be seen from the table above, the overall value of the Scottish Life Fund Estate is reduced following the Scheme. The primary cause of the fall in the value of the Scottish Life Fund Estate is the use of an adjusted GAR take-up rate in the Offer Basis.

6.31 The rationale for the GAR take-up rate assumption used in the Offer Basis is set out in paragraphs 5.8 to 5.13. In summary, whilst the adjustment causes a fall in the value of the Scottish Life Fund Estate, it results in an offer that strikes an appropriate balance between ensuring Eligible Planholders are offered the Economic Value of their GAR and ensuring there is not a materially adverse impact for all other planholders.

6.32 The Uplift values, and therefore the impact on the Scottish Life Fund Estate shown above, are calculated using assumptions, including future longevity and interest rate assumptions. If, for example, longevity experience weakens or interest rates rise compared to those used in the Offer Basis, then the Uplift applied to Included Plans will be higher than the value of the GAR would have been at retirement. As a result, the Scottish Life Fund Estate would potentially be lower than if the Scheme had not occurred.

6.33 Conversely, if longevity experience strengthens or interest rates fall in the future, then the opposite of the above would occur, meaning the Scottish Life Fund Estate would potentially be higher than if the Scheme had not occurred.

6.34 The consequences of the above on planholders are discussed in the relevant sections below.

6.35 The Royal London Main Fund Estate is expected to benefit from the reduced risk of burn-through, reducing the costs on an Embedded Value basis and reducing the impact on the SCR of the Royal London Main Fund, as described in paragraph 6.22. However, given the size of the Royal London Main Fund Estate compared to the burn-through cost, this is not expected to be material.

Distribution of the Scottish Life Fund Estate

6.36 As at 31 December 2017, the Scottish Life Fund distributes the Scottish Life Fund Estate to with-profits planholders with with-profits investments in the Scottish Life Fund via an uplift to asset shares at maturity of 18.0% in anticipation of the Scheme improving the CCR in the short term. In the absence of the Scheme, the distribution of the Scottish Life Fund Estate would be reduced to 12.0% until the CCR is closer to Royal London's internal target range, at which point the uplifts will be allowed to increase.

6.37 Due to restricted distribution rates in the short term caused by the capital constraints, the Scottish Life Fund Estate would continue to grow, relative to the value of the asset shares. Over time, the risk in the Scottish Life Fund will decrease and therefore the capital requirements will reduce, resulting in more of the Scottish Life Fund Estate being available for distribution. The effect of this would be that medium to long-term planholders would benefit from significant uplifts to asset shares compared to planholders maturing in the short term.

6.38 Overall, the Scheme is expected to result in a more stable and less risky fund, which is expected to lead to lower capital requirements. This should enable an earlier and fairer distribution of the remaining Scottish Life Fund Estate across all generations of with-profits planholders, and remove the current requirement to pay uplifts at 12%. If the Scheme is implemented then it is anticipated that the initial uplift to asset shares could be increased to 40% by 2020.

6.39 There may be a small increase in the distribution of the Royal London Main Fund Estate as a result of the reduced burn-through costs described in paragraph 6.22. However, given the size of the Royal London Main Fund Estate compared to the burn-through cost, this is not expected to be material.

Principles and Practices of Financial Management

6.40 As covered in paragraph 6.51, the GAR charge applied to with-profits plans will be removed as a result of the Scheme. If the charge is removed then this will constitute a 'Practice' change within the Scottish Life Fund PPFM (Principles and Practices of Financial Management).

Scottish Life Fund with-profits planholders will be notified of this change to the Scottish Life Fund PPFM in early 2019.

6.41 There are no other changes to the Scottish Life Fund PPFM as a result of the Scheme.

6.42 The Royal London Main Fund PPFM will not change as a result of the Scheme.

Costs of the Scheme

6.43 As covered in section 4, the large majority of costs attributed to the Scheme will be met by the Scottish Life Fund Estate. Some of the costs attributed to the Scheme are in relation to the impact of the Scheme on the IMAP, half of which will be met by the Royal London Main Fund.

6.44 In calculating the estimated cost of the Scheme, it has been assumed that c.15% of Eligible Planholders will use the advice service offered. It is therefore possible that the costs of the Scheme are higher than estimated, if more than c.15% of Eligible Planholders opt to use this service. In deriving this assumption, we have taken advice from our appointed independent financial advisor on past experience under similar arrangements, doubled their suggested rate to ensure prudence and accounted for the planholders for which the provision of advice is mandatory.

Chief Actuary opinion on the costs of the Scheme

6.45 Costs associated with GARs are currently borne by the with-profits planholders within the Scottish Life Fund. Charging the costs of the Scheme to the Scottish Life Fund is justified by the significant benefits that will accrue to planholders in the Scottish Life Fund as outlined in the 'Planholder impacts' section below.

6.46 The overall level of costs is appropriate given the scale of the work involved in implementing the Scheme. The Scheme requires the appointment of various third parties to carry out specialist and independent tasks such as providing planholder advice, administering the voting process and the Independent Actuary. Where third parties have been used, a robust tender process was used to ensure the required services could be delivered both to a high standard and at a reasonable cost. In addition, there are cost implications of the Scheme internally, including updates to internal administration systems, impacts on Royal London's IMAP application, project management and integration costs.

6.47 It is my opinion that the costs associated with the Scheme have also been kept as low as is reasonably possible. There remains a residual risk that the costs of the Scheme are higher than estimated. However, I believe the assumptions used to estimate the level of costs is appropriate since they are based on past experience with additional prudence factored in.

6.48 Should Scheme expenses increase this would be met from the Scottish Life Fund Estate. If expenses were to increase by (say) 50% this would reduce Estate distributions to Scottish Life Fund with-profit planholders by 1% on average. The risk that expense increases have a material impact on Scottish Life Fund with-profit planholders is therefore relatively low.

6.49 Charging a small proportion of the IMAP costs to the Royal London Main Fund is a fair and sensible apportionment as it recognises the impact that the IMAP application has on the Scheme and vice versa.

Future expenses

6.50 If the Scheme is implemented, GARs will be removed from plans held by Eligible Planholders who do not opt out. In turn, the Scheme will remove an element of complexity from these plans and hence reduce the cost of administering these plans. The Scheme will therefore have no material adverse impact on expected future expenses within the Scottish Life Fund or the Royal London Main Fund.

Charges

6.51 The only plan charge that is expected to be impacted by the Scheme is the GAR charge, which is described in paragraph 3.43. This charge will be removed for all Scottish Life Fund with-profit planholders following the Scheme. This will result in a change to the Principles and Practices of Financial Management to be communicated to Scottish Life Fund with-profit planholders in early 2019.

6.52 There will continue to be GAR liabilities within the Scottish Life Fund after the Scheme due to out of scope GAR products and Opt-outs. Given that the majority of the GARs will be removed this is reasonable and the Scottish Life Fund Estate will bear the cost relating to these plans. Should there be a material reduction in the solvency of the Scottish Life Fund in future we will retain the right to reintroduce a charge for guarantees. Any reintroduction of a charge for guarantees will be subject to compliance with the relevant requirements, including the terms of the Scottish Life Fund Scheme, policy terms and conditions, and FCA and COBS rules around the treatment of with-profits policyholders.

6.53 As a result of plan values being increased by the Uplift amounts, annual management charges will increase in absolute terms, though the percentage charge will be unchanged.

6.54 All other charges will be unchanged following the Scheme.

Interactions between the Scottish Life Fund and the Royal London Main Fund

Scottish Life Transfer Scheme

6.55 The Scheme itself does not result in any changes to the Scottish Life Transfer Scheme. In addition, Royal London has sought external legal advice on the continued compliance with the Scottish Life Transfer Scheme and a high-level review has taken place. This concluded that the Scheme does not result in a breach to the terms of the Scottish Life Transfer Scheme.

6.56 In the sections below I highlight particular aspects of the Scottish Life Transfer Scheme that I have considered when reviewing the fairness of the Scheme.

Inter-fund transfer

6.57 As covered in paragraph 3.49, the VIF from Eligible Plans accrues within the Royal London Main Fund. As a result of the Scheme, the income from the annual management charge on Scottish Life Fund plans will be increased due to the Uplift applied to with-profits asset shares and unit-linked unit values. This additional income would accrue in the Royal London Main Fund.

6.58 In order to avoid this unintended effect, an inter-fund transfer has been agreed which will return any initial 'windfall' VIF arising in the Royal London Main Fund back to the Scottish Life Fund such that the Royal London Main Fund does not benefit or suffer any adverse effect from the Scheme.

6.59 The Scheme also results in a small reduction in the Royal London Main Fund Excess Capital, as the uplifts applied to unit funds and asset shares cause the cost of guarantees and SCR (mainly driven by market risk) for the Royal London Main Fund to increase. Therefore, the inter-fund transfer will also be reduced by the increase in guarantee costs and by a cost of capital charge on the increase in the SCR.

6.60 It is proposed that a one-off amount of c.£35.4m is transferred to the Scottish Life Fund from the Royal London Main Fund. This is calculated as the discounted value of the expected future increase in AMC cashflows (i.e. the excess VIF), incorporating the anticipated 10% mass lapse following the Scheme, which would act to reduce the VIF accruing to the Royal London Main Fund, and the adjustments detailed in 6.59 above.

6.61 After 12 months, a "true-up" exercise will be performed to allow for any variances against the assumed mass lapse rate assumption. Following this "true-up", no further transfers would take place.

6.62 An external legal view has been sought on whether the inter-fund transfer is in line with the Scottish Life Transfer Scheme. This concluded that the inter-fund transfer did not result in a breach of the terms of the Scottish Life Transfer Scheme.

Transfer of assets

6.63 As covered in paragraph 3.50, certain Eligible Plans have with-profits and unit-linked investments in the Royal London Main Fund. Therefore, applying the Uplift under the Scheme will require some assets to be transferred from the Scottish Life Fund to the Royal London Main Fund. However, this does not constitute a distribution from the Scottish Life Fund (which should be shared with all Scottish Life Fund planholders with with-profits investments in the Scottish Life Fund) and does not give rise to any issues under the terms of the Scottish Life Transfer Scheme, which restricts the transfer of assets into and out of the Scottish Life Fund.

Merger of the Scottish Life Fund with the Royal London Main Fund

6.64 As mentioned in 3.52, the Scottish Life Transfer Scheme allows for the Scottish Life Fund to be merged with the Royal London Main Fund once a certain threshold is reached.

6.65 The Scheme will result in the total assets within the Scottish Life Fund being reduced, as those used to back the GARs of Eligible Plans invested in the Royal London Main Fund will be transferred out of the Scottish Life Fund and into the Royal London Main Fund. This reduction in assets will accelerate the date on which the threshold for merging the Scottish Life Fund will be breached.

6.66 Any merger that does take place will be subject to controls and checks, and therefore, it is my opinion that the above does not cause a material adverse impact to any groups of planholders.

Planholder communications

6.67 The key considerations for Eligible Planholders when determining how to vote and whether to opt out are as follows:

Life expectancy:

If a planholder expects to live longer than average, then opting out of the Scheme could provide them with more income in the long-term from the GAR than the Uplift amount offered under the Scheme.

Conversely, if a planholder believes they are to live a shorter than average life or are suffering from a life limiting illness, then opting out of the Scheme could provide them with less income in the long-term from the GAR than the Uplift amount offered under the Scheme.

Interest rates:

If a planholder believes that interest rates are likely to fall, leading to an increased GAR value in the future, then it may be appropriate to opt-out of the Scheme.

Conversely, if a planholder believes that interest rates are likely to rise, this would lead to decreased GAR values in the future, therefore it may be appropriate to participate in the Scheme, and receive a plan Uplift.

Tax-free cash:

If a planholder plans to take less than 25% of their plan as a tax-free cash lump sum then, due to the assumptions used in the Offer Basis, their GAR will be worth more if it is retained and therefore it may be appropriate to opt-out of the Scheme.
However, if a planholder plans to take more than 25% of their plan as cash, and purchase an annuity with the remainder, then they would potentially benefit from opting out of the Scheme as their uplift value may be higher than the value of their GAR if it were retained.

Guaranteed income:

If a planholder values a guaranteed lifetime income during retirement over the flexibility offered by compromising their GAR, it would be appropriate to opt-out of the Scheme.

Chief Actuary opinion on planholder communications

6.68 I believe these factors are clearly addressed in the planholder communications in a manner that is easy to understand. It is important that planholders consider the various factors in unison rather than consider each factor in isolation. The planholder communications provide a number of case studies to show how these factors may be considered in combination by individuals in various circumstances.

6.69 Therefore, I am comfortable that the planholder communications contain the key information required to enable Eligible Planholders, including Verified Gone-Away Included Planholders who subsequently reengage with Royal London and can evidence that they were not living at any address to which Royal London sent the mailings, to make a well-informed decision, and suitable additional advice is being made available either free of charge or at a heavily subsidised cost. I acknowledge that there will be Eligible Planholders that do not receive planholder communications, as a result of Royal London holding an incorrect address. However, reasonable efforts have been made to regain contact with these planholders and as detailed in paragraph 6.105, upon reengagement with Royal London, Verified Gone-Away Included Planholders will be provided with all communication materials.

Planholder advice

6.70 As outlined in paragraph 4.5, a three-step advice process will be available to Eligible Planholders prior to the voting deadline. This includes information to aid the voting decision being provided to all Eligible Planholders (including applicable information on the Lifetime Allowance), a freephone guidance service and access to an independent advice service. The independent advice service will either be free, if a planholder is required by legislation to take advice prior to voting, or materially subsidised.

Chief Actuary opinion on planholder advice

6.71 In my opinion, the arrangements for the provision of planholder advice under the Scheme are sufficient to ensure planholders have the support required to aid their decision. The three-step advice process allows planholders to seek the appropriate level of advice, and the provision of free and materially subsidised advice costs removes any barriers that planholders may have to seeking advice. Further, the planholder communications clearly indicate to planholders the advice services available and the process for obtaining advice. Finally, the independent advice service made available by Royal London will be provided by a qualified third party that has the appropriate experience and resource to ensure the adequate provision of advice.

Treating customers fairly

Chief Actuary opinion on treating customers fairly

6.72 I believe that the Scheme is consistent with the requirement to treat customers fairly with respect to both Eligible Planholders and all other planholders within Royal London. This is because Eligible Planholders have the opportunity to receive a significant Uplift to their plan value which is equivalent to the Economic Value of their GAR, and there are no material adverse changes to the benefits for other planholders as a consequence of the Scheme. Also, Eligible Planholders have the opportunity to opt-out of the Scheme.

6.73 For planholders not included in the Scheme, their plans will be unchanged, and there will be no adverse material impact to their plans.

6.74 In addition to the above, it is my opinion that the Scheme represents the most appropriate approach to addressing the most significant issues within the Scottish Life Fund in a way that is fair to all planholders, when compared to the alternative options considered in paragraph 4.32 to 4.34.

6.75 The Independent Actuary has specified four fairness tests that must be met by the Scheme. These tests and the conclusions concerning fairness are covered in the Independent Actuary report. I note that all of the tests set by the Independent Actuary have been met.

Planholder impacts

6.76 Within the following sections I consider the impact of the Scheme on the various groups of planholders, which are as follows:

- Included Plans – Eligible Plans that did not opt-out of the Scheme;
- Opted-Out Plans – Eligible Plans that opted-out of the Scheme;
- Gone-Aways – Eligible Plans for which Royal London has lost contact;
- Other plans with GARs within the Scottish Life Fund that are excluded from the Scheme;
- Other plans within the Scottish Life Fund that do not have GARs; and
- Royal London Main Fund Plans not in the scope of the Scheme – those that are not captured by the Scheme.

Included Plans

6.77 Paragraphs 6.78 to 6.96 set out the impacts that the Scheme will have on Eligible Planholders that do not opt-out of the Scheme.

Plan value

6.78 For Included Plans, an Uplift will be applied to plan values. For with-profits plans, this Uplift will be applied to both the asset share and the guaranteed benefits. For unit-linked plans, this Uplift will be applied to the unit fund by purchasing additional units equal to the value of the Uplift and will be split across funds in proportion to the existing investments.

Future premiums

6.79 As set out in section 4, for Included Plans, future contractual premiums and contractual increases to premiums will be uplifted by the same percentage as applied to plan values.

Future benefits

6.80 The Scheme will give Included Planholders the flexibility to take advantage of Pension Freedoms without losing the value of their GAR. GAR values are currently high, partly due to the low interest rate environment.

6.81 If interest rates fall, or longevity strengthens, then the value of the GAR at retirement will be higher than the Uplift applied under the Scheme, as described in paragraph 6.33. This results in the Estate being larger than it would have been, if the Scheme had not occurred. Therefore, whilst the planholders did not realise the full value of their GAR under the Scheme, with-profit planholders will benefit from an increased Scottish Life Fund Estate available for distribution.

6.82 Conversely, if interest rates rise then the value of the GAR will reduce. Therefore, by offering planholders the option to compromise their GAR now planholders have the option to crystallise the current high value of their GAR.

6.83 The Scheme is not expected to have any direct impact on future reversionary bonuses.

Options

6.84 The Scheme is not expected to impact any options available to planholders, other than the removal of their GAR.

Transfer values

6.85 The methodology used to calculate transfer values will not be impacted by the Scheme. Prior to the Scheme, if a planholder transferred their plan to another provider, they would not receive the benefit of the GAR, as this is only realised if they buy an annuity through Royal London's Annuity Bureau. However, following the Scheme, the value of the GAR will be reflected in the Uplift applied to the plan and is therefore beneficial for Included Plans who may choose to transfer their plan to another provider.

Tax

6.86 We have consulted with HMRC on the tax implications of the Scheme, and, although they are not able to provide a formal clearance (because there is not considered to be sufficient doubt about the analysis), the HMRC team has provided an informal confirmation that it agrees with Royal London's view that the Uplift being applied will not impact Included Planholders' Annual Allowance and will not cause any LTA protections to be lost.

6.87 The current tax rules impose the Lifetime Allowance, which results in additional tax charges if a planholder's total retirement fund, including within the Scottish Life Fund and any other arrangements, exceeds a certain limit in the year of their retirement. The standard Lifetime Allowance is £1,030,000 for the year 2018/2019.

6.88 It is possible that for some Eligible Planholders the proposed Scheme could result in their total retirement fund exceeding the Lifetime Allowance, resulting in additional tax charges. Within the planholder communications, this issue will be referred to and we will provide information as to where impacted planholders can obtain guidance and advice.

6.89 At the point of retirement, planholders are able to take 25% of the plan value as a tax-free lump sum. Following the Scheme, planholders' rights to do this will remain unchanged. However, for Included Plans, their plan value will be increased by the value of their Uplift, and thus the amount they can take tax-free will be increased as a result of the Scheme.

6.90 From a Corporation Tax perspective, Included Plans will continue to be categorised as pension business for the purposes of the Corporation Tax computation.

Loss of guaranteed income

6.91 Included Planholders will lose the guaranteed minimum retirement income for a given level of fund that they currently have access to. However, since the introduction of Pension Freedoms the loss of guaranteed minimum retirement income is not unique to this Scheme, and is becoming more common in the market, with individuals opting not to take an annuity at retirement.

If Included Planholders wish to purchase an annuity, they will be exposed to prevailing market conditions at their date of retirement. This could lead to their retirement income being more or less than what they would have received if they had chosen to opt out of the Scheme.

Benefits of the Scheme for Included Plans

6.92 The benefits of the Scheme for with-profits Included Planholders are as follows:

- the Scheme allows planholders to take advantage of Pension Freedoms whilst not losing all the value of the GAR (however, any annuity purchased through Royal London after the Scheme is implemented would be on the basis of market rates, not the GAR);
- the Scheme is expected to result in a more stable, and less risky Scottish Life Fund which would lead to lower capital requirements;
- this should enable an earlier and fairer distribution of the Scottish Life Fund Estate to Scottish Life Fund with-profits planholders;
- the Scheme also reduces the likelihood of the management actions being required; in addition
- the Scheme is expected to enable greater investment freedom of the Scottish Life Fund Estate. Whilst the Scheme will result in an initial fall in the value of the Scottish Life Fund Estate, the greater investment freedom may enable higher distribution of the Scottish Life Fund Estate to Scottish Life Fund with-profits planholders.

6.93 With-profits Included Planholders will also benefit from the expected removal of the GAR charge, as outlined in paragraph 6.51.

Chief Actuary opinion on Included Plans

6.94 In my opinion, the Scheme represents a fair deal to planholders who do not opt out and hence are subject to the removal of the GAR under the terms of the Scheme.

6.95 This is because the Uplift applied to their plans has been calculated to be equivalent to the Economic Value of the GAR associated with their plan and any eligible contractual premiums paid in future will also benefit from the Uplift. I believe it is reasonable for the Uplift to only apply to the proportion of the plan value that would have been eligible for the GAR as this best reflects the value of the GAR.

6.96 In the post-Pension Freedoms environment where individuals are no longer required to take an annuity or income drawdown at retirement, the Scheme allows these planholders to benefit from the value of the GAR regardless of what they choose to do at retirement.

Opted-Out Plans

6.97 For planholders that have opted out of the Scheme, their GAR will not be removed and no Uplift will be applied to their plan value.

Benefits of the Scheme for Opted-Out Plans

6.98 The benefits of the Scheme for with-profits Opted-Out Planholders are as follows:

- planholders would still have the opportunity to take advantage of Pension Freedoms but would lose the value of the GAR if they did not take an annuity through Royal London, even if ultimately they decide to opt-out;

- the Scheme is expected to result in a more stable, and less risky Scottish Life Fund, which would lead to lower capital requirements;
- this should enable an earlier and fairer distribution of the Scottish Life Fund Estate to with-profits planholders;
- the Scheme also reduces the likelihood of the management actions being required; in addition
- the Scheme is expected to enable greater investment freedom of the Scottish Life Fund Estate. Whilst the Scheme will result in an initial fall in the value of the Scottish Life Fund Estate, the greater investment freedom may enable higher distribution of the Scottish Life Fund Estate to Scottish Life Fund with-profits planholders.

6.99 With-profits Opted-Out Planholders will also benefit from the expected removal of the GAR charge, as outlined in paragraph 6.51.

Chief Actuary opinion on Opted-Out Plans

6.100 In my opinion the Scheme does not have any material adverse impact on planholders that have opted-out of the Scheme. The GAR benefit for these plans remains unchanged and these planholders will have been offered the benefits of the Scheme and chosen to opt-out based on their own preference.

Gone-Aways

6.101 In respect of 'Gone-Away' policyholders who have not kept Royal London informed of changes to their address details we have undertaken various tracing exercises using Capita and the Department for Work and Pensions (DWP) in order to re-establish contact and confirm current address details ahead of issuing mailing materials.

6.102 Following this exercise, the initial gone-away population of 20% has been materially reduced to 8%. For the majority of the remaining gone-away population, the tracing exercise has provided us with what are believed, on the basis of multiple sources of information, to be their current address details but the planholders have not positively responded to our tracing efforts to confirm these. We have sent the appetite mailing to these addresses in an attempt to reach as many planholders as possible. Further press advertising has been initiated to further increase re-engagement and reduce the remaining gone-away population.

6.103 For the remaining gone-away population, the average plan value is £21,000, with 75% of plans having a value below £30,000. For planholders with plans of a similar value, past experience suggests that there is a preference for taking their full plan value as a cash lump sum rather than exercising their GAR.

6.104 Gone-Away Planholders that must take advice prior to voting in the Scheme will automatically be considered to have opted-out of the Scheme. For all other Gone-Away Plans included in the Scheme, we have made the decision that their GARs will be included. On balance, this is considered a reasonable approach on the basis that the offer made to planholders is fair in the round and is particularly appropriate for the majority of customers who have small funds where experience suggests taking cash is by far the most popular choice of benefit.

6.105 Therefore Gone-Away Planholders will be considered as Included or Opted-Out planholders, as appropriate. However, should a Gone-Away Planholder subsequently reengage with Royal London, a retrospective opt-out option will be made available, provided the Gone-Away Planholder can demonstrate that they were not resident at the address to which the decision pack was sent. This option enables planholders to make a decision as to whether to retain their Uplift or reinstate their GAR. In order to aid this decision, the planholder would be provided with all communication material that was issued at the time of the scheme and access to the same subsidy support for any advice taken. They would then have a period of 3 months in which to confirm whether they wished to reinstate the GAR.

6.106 An additional retrospective opt-out reserve will be established in the Scottish Life Fund following the Scheme against both Best Estimate Liabilities and the Solvency Capital Requirement. The number of planholders qualifying for and subsequently exercising the retrospective opt-out is expected to be relatively limited and based on initial estimates the impact on the Scheme and on the financial position of the Scottish Life Fund is not expected to be material.

Chief Actuary opinion on Gone-Away Plans

6.107 In my opinion, the decision to treat Gone-Away Plans that must take advice prior to voting in the Scheme as opt-outs is reasonable as it is a legal requirement that they take advice if they are to participate in the Scheme. These plans will not receive the required advice on how to vote in the Scheme and it is not appropriate for Royal London to make this decision on the planholder’s behalf.

6.108 The decision to treat all remaining Gone-Away Planholders as Included Planholders is reasonable as past experience suggests that these planholders would likely favour a policy Uplift, and opting these planholders into the Scheme crystallises the value of their GAR whilst interest rates are low.

6.109 In order for Gone-Away Planholders to realise the benefits of their plan, reengagement with Royal London is required. As outlined, Gone-Away Planholders that reengage with Royal London have the option to retrospectively reinstate their GAR, provided they can demonstrate that they were not resident at the address to which the decision pack was sent. Therefore, these planholders would not lose out on their ability to make a decision that is suitable to them. In addition, as detailed in the section on Included Plans the Scheme is not expected to have a material adverse impact on Included Plans, and we have taken steps to reduce the number of Gone-Away Planholders using the tracing exercise. Finally, the advertisement of the Scheme may also lead to Gone-Away Planholders making contact ahead of the Scheme, further reducing this population. Overall, it is therefore my opinion that the treatment of Gone-Away Planholders is appropriate.

6.110 I am satisfied that the increases in Best Estimate Liability and Solvency Capital Requirement in the Scottish Life Fund due to the retrospective opt-out do not adversely impact the benefits or the fairness of the Scheme for Scottish Life with-profit planholders.

Plans with GARs within the Scottish Life Fund that are excluded from the Scheme

6.111 As outlined in paragraph 3.6, certain products with GARs have been excluded from the Scheme. These products represent a very small volume of the overall GAR book of business and represent older contracts whose inclusion would drive a significant amount of work and potential costs in relation to the Scheme, particularly in relation to systems upgrades. This would put the ability to deliver the Scheme at risk, causing detriment to the wider GAR population.

6.112 For planholders with GARs within the Scottish Life Fund that have been excluded from the Scheme, their GAR will not be removed and no Uplift will be applied to their plan value.

Benefits of the Scheme for plans with GARs within the Scottish Life Fund that are excluded from the Scheme

6.113 The benefits of the Scheme for with-profits plans with GARs within the Scottish Life Fund that are excluded from the Scheme are as follows:

- the Scheme is expected to result in a more stable, and less risky Scottish Life Fund, which would lead to lower capital requirements;
- this should enable an earlier and fairer distribution of the Scottish Life Fund Estate to with-profits planholders;
- the Scheme also reduces the likelihood of the management actions being required; in addition
- the Scheme is expected to enable greater investment freedom of the Scottish Life Fund Estate. Whilst the Scheme will result in an initial fall in the value of the Scottish Life Fund Estate, the greater investment freedom may enable higher distribution of the Scottish Life Fund Estate to Scottish Life Fund with-profits planholders

6.114 For non-profit plans with GARs within the Scottish Life Fund that are excluded from the Scheme, the Scheme will not provide any additional benefits, nor will it cause any material adverse impact.

6.115 With-profits planholders with GARs within the Scottish Life Fund that are excluded from the Scheme will also benefit from the expected removal of the GAR charge, as outlined in paragraph 6.51.

Chief Actuary opinion on plans with GARs within the Scottish Life Fund that are excluded from the Scheme

6.116 For the reasons outlined above, I believe it is reasonable to exclude certain products from the Scheme. Excluded Plans will retain the benefit of their GAR. In my opinion the Scheme is not anticipated to have a material adverse impact on plans with GARs within the Scottish Life Fund that are excluded from the Scheme.

6.117 In addition Royal London will investigate the feasibility of making individual offers to these planholders that would have a similar effect to the Scheme, but this would be on an opt-in basis.

Other plans within the Scottish Life Fund

6.118 For other plans within the Scottish Life Fund, there will be no changes made as a result of the Scheme.

Benefits of the Scheme for other plans within the Scottish Life Fund

6.119 The benefits of the Scheme for other with-profits plans within the Scottish Life Fund are as follows:

- the Scheme is expected to result in a more stable, and less risky Scottish Life Fund, which would lead to lower capital requirements;
- this should enable an earlier and fairer distribution of the Scottish Life Fund Estate to with-profits planholders;
- the Scheme also reduces the likelihood of the management actions being required; in addition
- the Scheme is expected to enable greater investment freedom of the Scottish Life Fund Estate. Whilst the Scheme will result in an initial fall in the value of the Scottish Life Fund Estate, the greater investment freedom may enable higher distribution of the Scottish Life Fund Estate to Scottish Life Fund with-profits planholders.

6.120 Other with-profits planholders within the Scottish Life Fund will also benefit from the expected removal of the GAR charge, as outlined in paragraph 6.51.

6.121 For other non-profit plans, the Scheme will not provide any additional benefits, nor will it cause any material adverse impact.

Chief Actuary opinion on other plans within the Scottish Life Fund

6.122 In my opinion the Scheme is not anticipated to have a material adverse impact on the other plans within the Scottish Life Fund.

Royal London Main Fund plans not in the scope of the Scheme

With-profits plans

6.123 As outlined in paragraph 6.22, the burn-through risk currently borne by the Royal London Main Fund to support the Scottish Life Fund is expected to reduce as a result of the Scheme. This will benefit Royal London Main Fund with-profits planholders as this will be available for release into the Royal London Main Fund Estate. However, the requirement to provide financial assistance, as per the Scottish Life Transfer Scheme, remains in place and it is therefore possible that further support from the Royal London Main Fund will be required in future.

Other plans

6.124 The Scheme is not expected to have any material adverse impact on the other plans within the Royal London Main Fund.

Benefits of the Scheme for Royal London Main Fund plans not in the scope of the Scheme

6.125 As mentioned earlier, the Scheme is expected to result in a more stable, less risky Scottish Life Fund, which would lead to lower capital requirements. This is expected to significantly reduce or entirely remove the burn-through cost, although given the relative size of the Royal London Main Fund compared to the burn-through cost, this impact is not expected to be material.

Chief Actuary opinion on other plans within the Royal London Main Fund

6.126 It is my opinion that the Scheme will not have a material adverse impact on the other planholders of the Royal London Main Fund.

6.127 It has also been decided that the Royal London Main Fund will not benefit from the Scheme, as this fund does not bear the costs and risks arising from the existence of the GARs, aside from any secondary impacts which contribute to the burn-through costs, as discussed above. The inter-fund transfer described in paragraphs 6.60 to 6.62 will effectively remove the benefit of the additional income that the Royal London Main Fund will receive from annual management charges on Scottish Life Fund plans as a result of the Scheme.

Conclusions

6.128 In summary, I believe that no planholder group is materially adversely impacted by the Scheme, and for a number of the planholder groups the Scheme provides clear benefits.

11/6/2018

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A Glossary

Term	Glossary
Annual Allowance	This is a limit imposed by the Government on the amount that can be paid into a defined contribution pension scheme each year, for tax relief purposes.
Assets	An item or investment owned by a company regarded as having value and available to meet commitments.
Best Estimate Liability	The expected present value of future cash flows for current obligations, projected over a plan's run-off period, taking into account all up to date financial market and actuarial information.
Capital Coverage Ratio (CCR)	The capital coverage ratio is the eligible own funds divided by SCR and is a widely accepted measure of the financial strength of a fund.
Convening Hearing	The first Court hearing of the Scheme. This will consider the terms of the Scheme and the Court will be asked to approve the convening of a meeting.
Corporation Tax	A taxation which companies are subject to, which is levied on business profits and other forms of income, as well as on chargeable gains accruing to the company.
Department for Work and Pensions (DWP)	The government department responsible for welfare, pensions and child maintenance plans. It also administers the State Pension and a range of working age, disability and ill health benefits.
Eligible Plans/Planholders	Planholders that are eligible for the offer under the Scheme.
Embedded Value	The present value of future profits plus the adjusted net asset value.
Economic Value	A measure of the expected future value of the plan benefits to the planholder based on a number of actuarial assumptions about future economic and demographic experience, including future interest rates, longevity and GAR take-up rates.
Estate	The Estate is the working capital of a with-profits fund, and is used to support smoothing and guarantees. It is also used to meet solvency capital requirements.
Equity Backing Ratio (EBR)	The proportion of a fund that is invested in risky assets such as equities and property.
Excess Capital	The difference between the Own Funds and the SCR.
Gender Directive	A European Directive (Council Directive 2004/113/EC implementing the principle of equal treatment between men and women in the access to and supply of goods and services) which, amongst other things, prohibits the use of gender as a factor in the calculation of premiums and benefits.
Gone-Away Plans	These are plans for which Royal London does not hold up to date contact information.
Guaranteed Annuity Rate (GAR)	A type of guarantee offered on pension plans that provides a specified minimum income at retirement per £1,000 of maturity value.
Guaranteed Minimum Pension (GMP)	A type of guarantee offered on pension plans that provides a specified, fixed minimum income at retirement.
Independent Actuary	An independent actuary appointed to provide opinion and act as an adviser to the Scheme.

Term	Glossary
Included Plans/Planholders	Planholders that are included within the Scheme and do not opt-out.
Internal Model	Under Solvency II, firms can either use a standard formula to calculate their capital requirements, or build a bespoke model that more accurately reflects their risk profile, referred to as an Internal Model.
Internal Model Approval Process (IMAP)	The process for gaining approval for the Solvency II Internal Model from the Prudential Regulation Authority.
Lifetime Allowance	This is a limit imposed by the Government on the total value of an individual's pension arrangements before additional tax charges are triggered.
LTA protection	Allows some protection on defined contribution pension schemes in excess of £1 million.
Matching Adjustment	Under Solvency II, the matching adjustment gives insurers relief for holding certain long-term assets if they sufficiently match the cash flows of a portfolio of insurance liabilities.
Nominated Retirement Age	This is the date chosen at plan outset as the individual's retirement age.
Offer Basis	The collective name for the assumptions used to calculate the Uplift percentages.
Opted-Out Plans/Planholders	Planholders that are included within the Scheme and vote to opt-out.
Own Funds	Under Solvency II, the excess of assets above those which are used to cover the Technical Provisions.
Paid-up Plans	These are plans which have ceased making regular payments.
Pension Freedoms	The changes introduced by the UK government in April 2015 whereby individuals over the age of 55 were given more flexibility to access their entire pensions' savings as either a lump sum or income drawdown.
Planholder Meeting	A meeting where planholders can vote in person or by proxy for or against the Scheme.
Principles and Practices of Financial Management	These are the standards which are used in the management of the with-profits fund.
Protected Rights	Benefits accrued when an individual chose to contract out of the Second State Pension on a money purchase basis.
PUP Rates	This is the rate at which planholders cease regular payments on their plans and become paid-up planholders.
Risk Margin	The risk margin is in addition to the best estimate liabilities, that providers are required to hold under Solvency II.
Royal London Main Fund	The core business fund within Royal London, consisting of the Royal London IB & OB Sub-Fund, Refuge Assurance IB Sub-Fund, United Friendly IB Sub-Fund and United Friendly OB Sub-Fund.
Scheme Implementation Date	This is the date on which those plans which did not opt-out will have the plan Uplift applied and the GAR removed.
Scheme of Arrangement	Here, this is the court-approved process in which an agreement is reached between Royal London and planholders on the proposed Scheme.
Scottish Life	The Scottish Life Assurance Company.
Scottish Life Transfer Scheme	The insurance business transfer scheme made under Schedule 2C to the Insurance Companies Act 1982 under which the entire business

Term	Glossary
	of Scottish Life was transferred to Royal London.
Scottish Life Fund	A fund formed when Royal London acquired Scottish Life.
Solvency II	A European directive (Directive (2009/138/EC) on the taking-up and pursuit of the business of Insurance and Reinsurance) which codified and harmonised EU insurance regulation and, amongst other things, imposes requirements on the amount of capital insurance companies must hold to reduce the risk of insolvency.
Solvency Capital Requirement (SCR)	The amount of capital that is required to be held under Solvency II to ensure all quantifiable risks are taken into account.
Technical Provisions	Under Solvency II, technical provisions are intended to equal the amount that another insurer would require in order to take over the insurance obligations.
Transitional Measure on Technical Provisions (TMTP)	TMTP is an allowance for the increase in Technical Provisions as a result of Solvency II.
Ultimate Management Action	The most severe management action, which involves the cutting of pay-outs to planholders to the minimum allowable amount.
Uplift	The increase to plan value in exchange for the GAR under the Scheme.
Value-in-Force (VIF)	Represents the present value of the profits that will emerge on the current in-force business.
Verified Gone-Away Included Planholders	any Included Planholder who is able to provide evidence satisfactory to the Royal London Board to demonstrate that they were not living at any address to which Royal London sent the mailings relating to the Scheme.
Volatility Adjustment	Under Solvency II, in certain conditions, insurers can apply a volatility adjustment to the relevant risk-free rate they use.

B Standard Formula results

The table below shows the impact on the Scottish Life Fund's capital position pre-Scheme and post-Scheme based on various opt-out scenarios, using the 31 December 2017 Standard Formula results, which is the current reporting basis.

In each case it is assumed that Transitional Measures are recalculated due to the impact of the Scheme on the Group Solvency position.

Basis (£'000s)		Assets	Best Estimate Liability	Risk Margin	Technical Provisions	TMTP	Own Funds	SCR	Excess Capital	CCR
Pre-Scheme		3,151	*2,561*	*318*	2,880	483	754	414	340	182%
Post-Scheme	0% opt-out	2,611	*2,179*	*176*	2,355	245	501	191	311	263%
	10% opt-out	2,668	*2,263*	*191*	2,453	276	491	214	277	230%
	30% opt-out	2,772	*2,412*	*220*	2,633	333	472	260	212	182%

The rest of this report has been prepared using Internal Model results, as I believe these to be the most appropriate basis on which to assess the impact of the Scheme. We have included the Standard Formula results above for completeness.