Royal London (Scottish Life) GAR Compromise Scheme

With Profits Actuary's Report

June 2018

Contents

1 EXECUTIVE SUMMARY

1.1 CONTEXT FOR THIS REPORT

Royal London is proposing to make an offer to certain former-Scottish Life pension customers (the "Eligible Planholders"). In return for giving up an annuity guarantee, known as a guaranteed annuity rate or GAR, they will receive an increase to their current plan value and corresponding increases to eligible contributions made in future. If approved, this change will be achieved through a legal process known as a Part 26 Scheme of Arrangement. Such a Scheme has been used in the past for the restructuring of life insurance businesses and is subject to strict legal requirements and regulatory oversight. This report gives my views on the Scheme as Royal London's With Profits Actuary. It will be made available to the Court and to planholders who may be affected by this change, alongside reports from Royal London's Chief Actuary and an Independent Actuary.

The reports from the Chief Actuary (CA) and Independent Actuary (IA) are written in formal language and cover some of the legal aspects in depth, as is typical of such reports. In this report I have tried to focus on conveying the essential elements of the Scheme in language that should be more accessible to a lay audience, particularly for those planholders whose rights and interests would be materially affected if the Scheme proceeds. Where I have described some of the more technical aspects in simpler language than the CA and IA reports this is deliberate and does not indicate any difference of view on the underlying process of the Scheme. I have read the CA and IA reports and I am supportive of their conclusions and rationale. There is nothing in their reports that represents a difference of substance from the views I express in this report.

1.2 EFFECT OF THE SCHEME ON GUARANTEED ANNUITY RATE PLANHOLDERS

There are around 33,000 planholders who benefit from Guaranteed Annuity Rates (GARs) in the Scottish Life Fund who will be given the opportunity to exchange the GARs for an increased plan value, and an increase to the value of eligible contributions made in future. Individuals will be asked to vote 'for' or 'against' the Scheme and will have an opportunity to opt out of the Scheme and retain the GAR regardless of the result of the overall 'for' and 'against' vote. In order to opt out, individuals will have to take positive action to notify Royal London that they wish to opt out. Otherwise, if the Scheme is implemented, all of those who have not opted out will lose the benefit of the GAR in exchange for increased values.

Critical in this process is the recognition that those who do not engage will follow the decision of those that vote on the Scheme. It is therefore essential that individuals have sufficient information, and in a sufficiently engaging format, to understand the consequences and be encouraged to participate actively. I have reviewed the communications materials and I believe they strike a good balance, between enough information and too much, to achieve this aim.

Despite these efforts our expectation is that a substantial number of individuals will be passive and will therefore end up following the decision of those who vote on the Scheme. Given this, it is important that the terms of the Scheme, in particular the increases to plan values that will be offered in return for planholders giving up the value of the GARs, are fair to planholders as a whole. The valuation of the GARs uses genuine best-estimates for the key assumptions on future interest rates and future longevity trends. By genuine best-estimates I mean assumptions that do not have any explicit or implicit margin for prudence. This approach avoids bias in the offer in favour of either GAR or non-GAR policyholders. The level of the offer has been set assuming that individuals use 75% of their eligible fund value to purchase an annuity on guaranteed terms. This is at or above the rate observed in practice for the majority of planholders. Since the introduction of Pension Freedoms, experience indicates that planholders with similar plans use around 66% of their fund on average to buy an annuity, and best-estimate reserves have been established on that basis. The remainder is taken as cash, or transferred into another arrangement.

As a result I believe the uplifts to retirement savings are fair to the Included Planholders when looked at on average. It is important that those for whom the Scheme may represent less than the actuarial value they expect to obtain from the GAR can appreciate the consequence of remaining passive. Those intending to use more than 75% of their eligible fund to purchase an annuity on guaranteed terms are more likely to fall into this category. The latest experience indicates that a small proportion of policyholders, around 14% by number, take more than 75% of their fund as an annuity. These policyholders tend to have larger than average pot sizes and will appreciate the magnitude of the decision from the individual illustrations. The communication materials, and access to guidance and advice, are an important protection for planholders who may be better off opting out. I also regard the availability of the opt-out as a critical component of the Scheme as this allows planholders to take account of their personal circumstances and retain the benefit of the GAR even if the Scheme is implemented.

Royal London has a choice about the approach to non-responders. They could be opted-out of the scheme and keep what they have or, the route being followed in practice, they could be included in the group of policyholders having their GAR exchanged for a higher policy value. This point has been considered carefully and I am happy with the approach being taken for the following reason. Those who do not engage with the process are likely to have smaller pots in the main, and based on our experience of comparable plans, are more likely to cash-in their policy and hence lose the value of their GAR altogether. By including them in the Scheme these policyholders will have a value for the GAR forced into their plan. This will result in better policyholder outcomes for the 60% of policyholders by number, who are likely to cash-in.

It is the case that disengaged policyholders who would ultimately have taken their entire pot as an annuity will receive an uplift that does not fully reflect that choice. This does not mean that they necessarily 'lose out' – particularly if interest rates rise from the calculation date to the date they take their retirement proceeds. They also have more flexibility, which has an intrinsic value.

We cannot tell in advance which category each policyholder will fall into. Given that, I think it is better to take the approach that benefits the many, giving them the value of the GAR on a 75% take-up rate, rather than leave them with no value for their GAR. The clear protection for those who would take more than 75% of their fund as an annuity is the quality of the communication materials.

Two groups that are in a different position are the small group of policyholders for whom Royal London has no address details and the group of policyholders for whom the address Royal London holds is incorrect, but no mail has been returned as ‘goneaway’. These policyholders will, in the main, still be better off having their GAR exchanged, if they ultimately cash in their plans. However, they will not receive the communication materials and will not see the factors that would indicate whether they should opt out, if that is the best course of action for them. As a result, any policyholder who is able to demonstrate that they were not living at any address to which Royal London sent the communication materials will be given the opportunity to reinstate their GAR and have the uplift removed. Should any such policyholder re-connect with Royal London, they will be provided with the communication materials and will then have 3 months in which to decide whether to have their GAR reinstated and the uplift removed.

1.3 EFFECT OF THE SCHEME ON WITH PROFIT PLANHOLDERS IN THE SCOTTISH LIFE FUND

If the Scheme proceeds it will reduce the risks within the Scottish Life Fund materially. This will allow a more equitable and more certain distribution of the ‘Inherited Estate’. The ‘Inherited Estate’ is the excess of assets in the fund over a realistic assessment of the liabilities attributed to the fund.

The with profit planholders in the Scottish Life Fund are, collectively, entitled to the Inherited Estate as it becomes available. It only becomes available for distribution when the fund can exceed its capital requirements sufficiently to protect planholders who are due to claim in future against the effects of reasonably foreseeable adverse events. At present, the level of capital requirements in respect of longevity increases and potential interest rate reductions are very high, which is slowing the rate at which and certainty with which the Inherited Estate can be distributed.

The basis used for calculating the offer to Eligible Planholders, assuming that they will use 75% of their fund to purchase an annuity on guaranteed terms, is more than the current best estimate reserve held for GARs in the fund. In effect, the with profits planholders will be giving up some of the Inherited Estate in order for the Scheme to be proposed and implemented. This can only be fair to the with profits planholders if it improves the equity of treatment between generations of with profits planholders and/or reduces the risks associated with future Inherited Estate distributions.

The analysis of these fairness aspects is complex and is set out later in my report. In summary, I am content that the Scheme, if it applies to a sufficient majority of Eligible Planholders, will produce a more stable distribution of the Inherited Estate and will remove much of the risk associated with the future distributions. If a large number of planholders opt out of the Scheme then the benefits are reduced. The implementation of the Scheme is subject to a condition that the Independent Actuary confirms, after the Court has approved the Scheme at the Sanction Hearing scheduled for Monday, 12 November 2018, that the Scheme continues to produce fair outcomes overall. In considering whether to provide that confirmation, the Independent Actuary will consider, amongst other factors, whether the level of opt-outs is so high that the impact of the Scheme on with profits planholders would be expected to be detrimental.

1.4 OVERALL CONCLUSIONS

I cover a number of more detailed points in the body of my report. However, my conclusions on the Scheme and the way in which the Scheme is being put forward are as follows:

- The Scheme provides a genuine best estimate of the value of the GAR based on available information and reasonable assumptions, including Royal London's experience since the introduction of Pension Freedoms of what planholders use their retirement savings for.
- The value offered for the GAR is fair and capable of being understood by planholders. In particular, the calculation of the uplifts to plan value based on 75% of the value of the GAR is reasonable, given that the vast majority of planholders take at least 25% of their fund as cash. The communications to planholders are fair and balanced.
- The impact of the Scheme on the with profits planholders in the Scottish Life Fund should be positive.
- The process being followed is fair to those who participate and those that do not. The Scheme has been reviewed by the Independent Actuary, it has also been subject to rigorous internal review, and planholders may opt out of the Scheme and thereby take account of their own personal circumstances and views on the benefits of the Scheme.
- There should be no material consequences to planholders outside the Scottish Life Fund, either positive or negative.

Accordingly, I am supportive of the Scheme being put to planholders in its current form.

2 ROLE OF THE WPA

2.1 DUTY TO THE WITH PROFIT PLANHOLDERS

In my role as With Profits Actuary I have a professional and regulatory duty to protect the interests of with profits planholders in Royal London. This duty extends to the interests of with profits planholders outside the Scottish Life Fund. In particular there is a reputational risk associated with the Scheme, should its effect be misconstrued in the financial press for example, or if the Scheme fails to proceed after planholders' expectations have been raised. The direct financial effect of the Scheme on with profits planholders outside the Scottish Life Fund is fairly limited except in extreme stress conditions where the Scottish Life Fund 'burns through' its available capital and has to rely on support from Royal London's Main Fund for example. This remote risk should be reduced by the Scheme.

I have a clear role in protecting the interests of with profits planholders in the Scottish Life Fund through the development of the Scheme. I have worked closely with the project team developing the Scheme and have had discussions on a number of topics with the Chief Actuary and the Independent Actuary. I am satisfied that the Scheme will result in improved outcomes for with profits planholders in the Scottish Life Fund.

2.2 DUTY TO THE ELIGIBLE PLANHOLDERS

Royal London is a mutual and as such, any material transaction can have an effect on Royal London's members and with profits planholders. As a result, my role as With Profits Actuary extends to advising the Board on matters of fairness to planholders more generally. I am a member of Royal London's Customer Standards Committee (CSC). I have raised a number of points on the Scheme and the treatment of Eligible Planholders at CSC and these have been properly debated and resolved. I am satisfied that the Scheme represents a good offer to Eligible Planholders and that the communications are effective in setting out the risks associated with the Scheme to Eligible Planholders.

2.3 CREDENTIALS

I am a Fellow of the Institute and Faculty of Actuaries. I have been Royal London's With Profits Actuary since 1 January 2016. I was involved in the acquisition of Scottish Life in 2001 and have been involved in managing the Scottish Life Fund since then. I hold one plan with Royal London, namely a staff pension plan. Accordingly, I have no financial interest in the Scheme, holding neither an Eligible Plan under the scheme nor any other plans that are directly impacted by the scheme.

2.4 LINK TO THE WITH PROFITS COMMITTEE AND THEIR VIEWS

The With Profits Committee (WPC) has been supportive of the Scheme since it was first mooted in 2016. I am the chief adviser to the WPC and aim to ensure effective lines of communication between the WPC and the Royal London Executive Team. I am satisfied that the WPC has been provided with all necessary information to form a view on the fairness of the Scheme. In particular the WPC has had the opportunity to question me, the Chief Actuary and the Independent Actuary on a number of occasions prior to the Scheme being put to planholders.

2.5 LINK TO THE REGULATORS AND THEIR VIEWS

Both the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) have been keen to understand the effect of the Scheme and have been involved in discussions since 2016. The Scheme is primarily a financial transaction between Royal London and Included Planholders in the Scottish Life Fund, which requires careful consideration of its fairness to all stakeholders. As a result the FCA has taken the lead on supervisory oversight with the PRA keen to ensure that the overall strength of the Scottish Life Fund, and of Royal London more generally, is not adversely affected by the Scheme.

I have been involved in all of the substantial discussions with the FCA and PRA on the Scheme. As an individual subject to the Senior Insurance Managers Regime (SIMR) I have a duty to keep the regulators informed of any material items.

3 THE FAIRNESS ISSUES RELATING TO ELIGIBLE PLANHOLDERS

3.1 WHAT THE ELIGIBLE PLANHOLDERS HAVE

Several types of pension savings plans sold by The Scottish Life Assurance Company in the 1970s, 1980s and early 1990s contained an annuity guarantee. This was an explicit provision allowing the plan proceeds to be converted to an annuity on guaranteed terms at retirement. At the start of 2018 the remaining population of plans with these guarantees was around 34,000.

The rates for conversion were based on what were thought to be prudent assessments of interest rates and longevity assumptions at the time. The guarantees were included in plan terms primarily for marketing purposes, with no real expectation at the time that that they would obtain any significant intrinsic value.

The proposed scheme (the Scheme) covers the majority of the remaining Scottish Life plans with Guaranteed Annuity Rates (GARs). Some plan types (the Versatile Retirement Benefit Plan, Personal Growth Individual Allocation Plan, Sovereign Plan and various Personal Pension Plans and Bonds) are excluded from the Scheme, for a number of practical reasons. Royal London will investigate the feasibility of making individual offers to these planholders on an individual basis at a future date.

The vast majority of GAR policyholders in the Scottish Life Fund will be covered. The Scheme could be delayed to carry out the necessary systems work to include more plan types but in the mean-time more policyholders will give up their GARs for no value and any delay increases the risk that the uplifts need to be reduced to reflect market changes. As a result I am content that it is fair to proceed with the Scheme as it stands, with the population of plans proposed to be covered.

The plans covered by the Scheme are as follows:

- Executive Personal Pensions branded as Talisman or Hallmark taken out before 1 November 1989 ("Talisman Executive Pension Plans"),
- Talisman Personal Pension Plans taken out on or after 1 June 1985 and before 1 July 1988, which are also known as Retirement Annuity Contracts ("Talisman Retirement Annuity Contracts"),
- Talisman Personal Pension Plans,
- Talisman Group Personal Pension Plans ("Talisman Group Personal Pension Plans").

In addition to accepting normal contributions, the Talisman Personal Pension Plans and the Talisman Group Personal Pension Plans could 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’ and were subject to statutory requirements (for example, the annuity purchased using Protected Rights benefits needed to increase in line with inflation and needed to provide a widow's pension 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. The GAR on any Protected Rights benefits under the Talisman Personal Pension Plans and the Talisman Group Personal Pension Plans is also only available from age 60, whereas the GAR which applies to Additional Rights benefits can be taken from normal retirement date.

The form of guaranteed annuity used for the tables of GAR rates set out in the plan terms and conditions are:

Product Type	Escalation	Spouse's Benefit	Payment Frequency	Minimum period for annuity
Talisman Executive Pension Plans	None	None	Monthly in Advance	5 years
Talisman Retirement Annuity Contracts	None	None	Annually in Arrears	None
Talisman Personal Pension Plans / Talisman Group Personal Pension Plans Additional Rights	None	None	Annually in Arrears	None
Talisman Personal Pension Plans / Talisman Group Personal Pension Plans Protected Rights	3%	50%	Annually in Arrears	None

In practice Royal London has permitted planholders to take benefits in the form of an annuity with a different shape (with/without spouse's benefit, level/escalating) on a basis determined by the company to be of equivalent value to that set out in the terms and conditions. The GARs are not limited to the originally selected retirement date, and can be applied at any age from 55 for Additional Rights and 60 for other benefits.

All contributions on eligible plans paid prior to 31/12/1994 attracted GARs. On-going contracting out monies attracted GARs until contracting out on a money-purchase basis ceased in 2012. In December 1994, Scottish Life sent a notice to planholders which had the effect of limiting the future accrual of GAR benefits. As a result since 31/12/1994 only benefits secured by regular contributions payable at the level then in force, plus any contractual increases already in place, attract GARs. Single contributions and transfers-in after 31/12/1994 do not attract GARs, nor do non-contractual increases in regular contributions after that date.

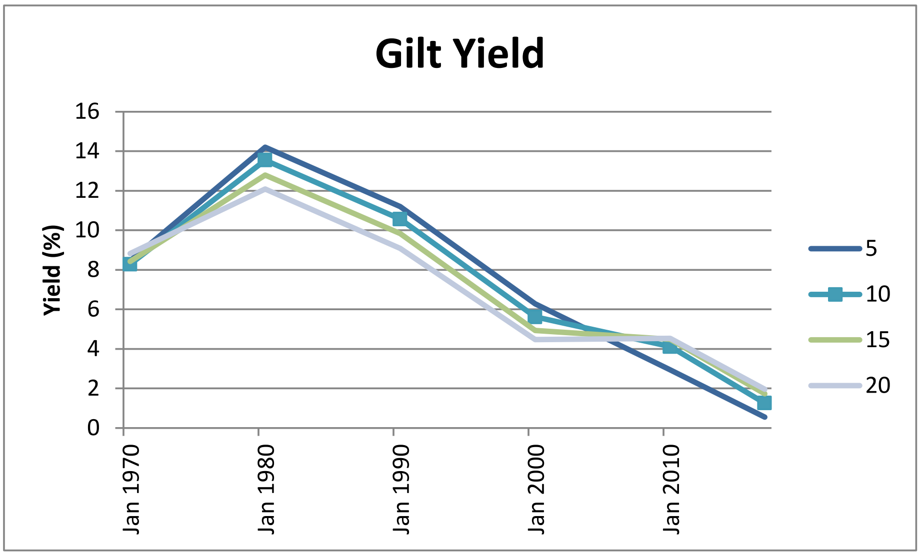
In 2008 the on-going entitlement to GARs on regular contributions was further restricted, using the powers within the original terms and conditions. Broadly, non-payment of contributions for a year now results in the loss of future accrual of GAR benefits. Planholders are warned if their actions risk losing future entitlement to GARs.

GARs apply to the funds built up by eligible contributions and these can be invested in Unit-Linked Funds, in With Profits or in a Secure Account (which is a form of deposit administration). With profits benefits can be in either the Scottish Life Fund (for benefits accrued up to 30 June 2001 plus on-going regular contributions at the level in-force at the time) or the Royal London Main Fund (for other contributions or switches into with profits after 30 June 2001). Scottish Life Fund with profit benefits for plans taken out prior to 1998 (including all of the Eligible Plans covered by the Scheme) have their benefits disinvested from with profits at the selected retirement age and accrue 'Late Vesting' interest thereafter. Funds retain their eligibility to GARs even if switched from one investment medium to another, or between Unit-Linked Funds.

The value of the GAR is only currently realised if a planholder chooses to take an annuity through Royal London. Since 2016 Royal London has fulfilled these annuity requests through an annuity bureau. No value is given for the GAR on monies taken as cash, transferred to another provider or used for income drawdown.

3.2 THE CURRENT ECONOMIC ENVIRONMENT

After 8 years of the Bank of England Base Rate being less than 1% it is easy to forget how different the economic environment was ten, twenty or thirty years ago. The following graph shows gilt yields at 5, 10, 15 and 20 years duration for each decade from the 1970s to mid-2017.

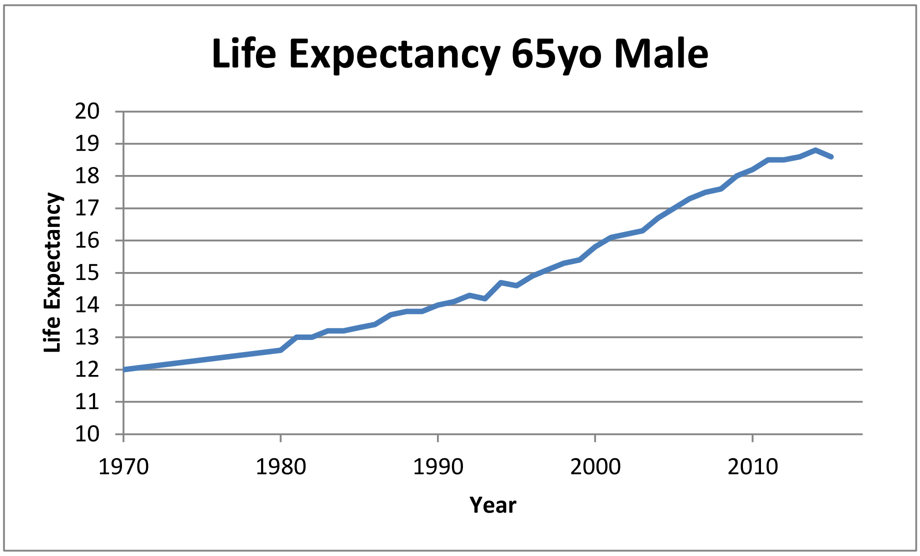


When assessing the value of annuity liabilities coming into payment in future, the medium to long durations are most important. Taking 10 years as a reference point, the yields from 1970 onwards were 8.3%, 13.5%, 10.6%, 5.6%, 4.1% and currently stand at around 1.4%.

In the 1980s a 65 year old male would be expected to live a further 13 years on average. At these rates of interest, providing an income of £100pa for 13 years would require an initial fund of £778, £597, £690, £906, £992 and currently £1,190. From a purely economic perspective the income stream produced by an annuity requires a bigger initial fund, or in other words the annuity income stream is more valuable, than at any time in the past. Looking from 1980 to now, the value has broadly doubled through economic factors alone.

3.3 TRENDS IN LONGEVITY

At the same time as yields have been falling, life expectancy has been increasing. Except for the most recent couple of years, the trend has been fairly steady. The following graph shows the experience for 65 year old males in the UK.



From a figure of around 13 years in the 1980s, life expectancy for a 65 year old male has increased to almost 19 years. If we combine this increase in life expectancy with the fall in yields, the combined effect on the value of annuities is even more pronounced. An income of £100pa, allowing for both factors, would require a fund of £743, £597, £715, £1,038, £1,206 and currently £1,680.

This demonstrates how dramatically the value of an annuity has increased, with the combined effect being almost a tripling of value from the 1980s to now.

Assessing the future trend in longevity is a significant challenge. There are a large number of known factors that will affect future longevity whose future values are difficult to predict. Indeed, there may be further factors that we do not know about at this point. Developments in medicine, social trends in respect of exercise and diet, government spending on the NHS and the economic climate more generally will all have an effect. There are wider socio-political factors that could also have a dramatic effect through changes to working patterns, potential civil unrest, war, terrorism and so on.

The actuarial profession established and continues to support the Continuous Mortality Investigation (CMI) to help provide an objective assessment of mortality experience. The CMI's mission statement is:

> *To produce high-quality impartial analysis, standard tables and models of mortality and morbidity for long-term insurance products and pension scheme liabilities on behalf of subscribers and, in doing so, to further actuarial understanding*

In recent times the CMI has produced a revised mortality model each year. These models are used by the life insurance industry for a number of purposes, including to establish reserves for annuities and to price new annuities. The models for 2015 and 2016 indicated a potential slowing of future longevity improvements, reversing the long-term trend to that point. The industry was reluctant to accept the 2015 model at face value, particularly for prudential reserving purposes. The continuation of this trend into the 2016 model is an indication that 2015 wasn't just a blip.

I expect the industry to move towards the 2016 longevity model when producing end-2017 financial results. This will have a relatively modest effect on the value of annuities already in payment but will materially reduce the expected cost for those annuities coming into payment a number of years from now. It should represent a move towards a more realistic view, rather than one with implicit margins for prudence. The latest views of longevity will be factored into the comparators used to show individuals the value of their own offer. The risk that longevity increases more quickly than assumed is highlighted as one of the key factors policyholders should take into account.

The uncertainty over future longevity is more than just a practical inconvenience though. The uncertainty has a direct consequence on the capital that Royal London is required to hold in respect of the GAR liabilities. Broadly speaking the approach to assessing capital requirements is to determine how much the critical assumptions could change in a 1-in-200 year adverse event. The level of uncertainty over future longevity assumptions results in a 1-in-200 year movement being very significant. With the value of GARs being very sensitive to changes in longevity assumption, this uncertainty has materially increased the capital required in the Scottish Life Fund. This in turn delays the distribution of the Inherited Estate in the Scottish Life Fund to eligible with profits planholders.

3.4 PENSION FREEDOMS AND ADVICE REQUIREMENTS

In 2015, wide-ranging changes were introduced to the pension landscape. Prior to that point, 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 so-called 'Pension Freedoms' reforms in 2015 put much more control in the hands of individuals, most crucially by giving all defined contribution pension savers who have reached the minimum retirement age the ability to access their retirement savings under the lifetime allowance as cash, without incurring penal tax charges.

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.

The 'Pension Freedoms' reforms also simplified the regime for annuities, allowing greater flexibility in their structure, and included changes to the taxation of death benefits, including making it more tax efficient to pass on drawdown pension funds on death.

At the same time, in order to ensure that individuals do not give up valuable pension benefits, for example rights under defined benefit schemes or guarantees, without their understanding the potential consequences of doing so, the government introduced a mandatory advice regime for certain planholders who have a subsisting right to "safeguarded benefits". This regime requires that anyone who proposes to give up such benefits must obtain appropriate independent advice where the value of their safeguarded benefits is more than £30,000. In the context of a GAR, this regime will apply to individual planholders (excluding trustees), where they have a direct contractual right to a GAR, and to members of a trust-based pension scheme, where the rules of that scheme entitle them to a GAR. In the context of the Scheme, this means that planholders with Talisman Retirement Annuity Contracts and individual planholders to whom a Talisman Executive Pension Plan has been assigned, and who in each case have GAR benefits valued at more than £30,000, will be subject to the mandatory advice requirement. I discuss the application of the mandatory advice requirement to the Scheme and Royal London's approach further in section 3.9 below.

In addition, new statutory risk warning requirements will be implemented from April 2018. These will apply in respect of all planholders with subsisting rights to safeguarded flexible benefits. The £30,000 threshold which applies to the mandatory advice requirement will not apply in relation to these statutory risk warnings.

In addition to mandatory advice for those with bigger pots, Royal London, along with the rest of the industry, has sought to improve knowledge and understanding of the value of GARs. Telephone call-scripts, plan statements and projections have been revised in an effort to make the value of GARs explicit. This is to ensure that individuals, particularly those not subject to the mandatory advice requirement, can make informed decisions where these could result in the loss of such a valuable benefit.

3.5 THE NATURE OF THE SCHEME

The preceding sections indicate one of the key drivers for Royal London promoting the Scheme. The value of GARs has increased dramatically in the last decade and individuals have the freedom not to annuitise but instead to be more flexible with how they access pension savings. Individuals either give up GARs for flexibility or give up flexibility for GARs. Rather than being stuck with this difficult choice, the Scheme aims to give those individuals who want it, the benefits of both.

It is worth pointing out at this stage that the Scheme is open to most of the 34,000 planholders who benefit from GARs in the Scottish Life Fund. However, those who do not want to be bound by the Scheme can opt out and retain their existing entitlement to benefit from a GAR.

If the Scheme is implemented, planholders who are not opted out will have the benefit of the GAR exchanged for an immediate uplift to their plan benefits. Planholders, regardless of whether they voted 'for', voted 'against' or did not vote at all, will all be bound by the Scheme. They will lose all entitlement to benefit from a GAR and will have their plan values increased. This will be an irrevocable change for each planholder, unless they can demonstrate that they were not living at any address mailed, and hence did not receive the communication materials.

The Scheme aims to reflect the value of the GAR on a reasonable set of assumptions. The GARs, and hence the uplift to benefits, will depend on the plan type, current age and gender. The Scheme is different to the one put forward by Phoenix in a similar Scheme in 2009. There, a key part of the Phoenix Scheme was the chance to have increased growth potential from a change to the investments backing the plans. Here, planholders are free to switch between funds while still retaining the benefit of the GAR. As a result the Scheme can apply to all planholders in scope, not just those with more than (say) 10 years from retirement as was the case in the Phoenix Scheme.

For those planholders entitled to benefit from GARs on on-going premiums, in addition to the uplift to their current plan value, each future premium that would have been eligible to benefit from the GAR will also be uplifted by the same amount when it is paid. The planholder is required to pay the future premiums in order to benefit from this uplift.

Plans subject to the Scheme that are invested in either of the With Profits Funds (Scottish Life or Royal London) will have both guaranteed benefits and underlying asset shares uplifted. This will ensure that the With Profit guarantees are not diluted, as they would be if just the asset share was uplifted. This approach also mirrors, as far as possible, the interaction of the GAR and the With Profit guarantee when benefits are currently taken. The same approach applies to investments in the Secure Account.

More generally, the uplifts will be applied to the funds currently chosen by each planholder. The rights to switch between investment types and between unit-linked funds will remain unaffected. It is important to bear in mind that the increase in plan value in itself does not produce any increase in the risk associated with the investment choice (although clearly the uplift in retirement savings does increase the amount exposed to investment risk generally). Clearly, what would be changed by the Scheme is the link to the potential value of the GAR in future, in the economic conditions prevailing at that time. The Scheme removes the potential benefit of the GAR increasing in value and removes the potential risk of the GAR decreasing in value.

3.6 THE BASIS FOR CALCULATING THE VALUE OF THE GAR

The value of the GAR for the purposes of the Scheme has been calculated using Royal London's best estimate of a number of assumptions. The most important of these are:

- The interest rates used to value future payments,
- The trends in future longevity, and
- Planholder behaviour over retirement age.

The Solvency II rules that European insurers now use to set prudential reserves require assumptions to be best estimates. Typically this leads to assumptions that are equally likely to be a little too high or a little too low in practice. This contrasts with the pre-Solvency II basis where assumptions were made with implicit margins for prudence, thereby not achieving a genuine best estimate. The assumptions for interest rates and longevity used for the Scheme reflect the bases that will be used for Royal London's Solvency II reporting and are best estimates. Assumed planholder behaviour over when retirement benefits are taken has been simplified for the Scheme and, importantly, does not allow for any surrender of GAR benefits prior to retirement. This assumption helps to preserve value for those who are intending to realise the plan benefits some years hence.

Together these assumptions dictate the *shape* of the valuation of the GAR, that is, how the valuation of the GAR varies between product types (reflecting the GAR rates for each product type), between males and females (reflecting the underlying differences in longevity by gender) and between older and younger planholders. The *level* of the valuation of the GAR is dictated by a parameter that represents the extent to which planholders use their pension savings to buy an annuity. Since the introduction of Pension Freedoms, experience indicates that planholders with plans similar to those subject to the Scheme use around 66% of their funds on average to buy an annuity. The remainder is taken as cash, or transferred into another arrangement such as drawdown.

This average figure reflects three popular choices, other than a small minority that fall somewhere in between:

Form of Benefits	Proportion of Eligible Plans		Comment
	By Value	By Number	
0% Cash	24%	14%	Fully annuitised – maximising the value of the GAR.
25% Cash	45%	25%	Taking advantage of the maximum amount tax-free.
100% Cash	28%	60%	Fully encashed – losing all benefit from the GAR.
Other	3%	1%	

The valuation of the GAR has been calculated on the basis that planholders will use 75% of their fund to buy an annuity and benefit from the GAR. This mirrors the most popular choice, by value, shown in the table above. There is no unique answer that is right for all planholders, though. The Scheme reflects a compromise and planholders need to judge for themselves whether this represents sufficient value for them not to opt out.

There will be planholders who choose not to engage in this process. There may be some for whom engagement is more difficult through some form of educational or emotional vulnerability. There will also be some whom Royal London cannot reach as a result of not having up-to-date address details. The Scheme binds all of those who don't opt out so it is important that the valuation is fair.

There is a range of values that could be judged to be fair. I am satisfied that 75% lies within the range of fair valuations in light of our experience of how planholders use their retirement savings. A higher figure would be more generous to Included Planholders, at the expense of with-profits planholders in the Scottish Life Fund. A lower figure would be beneficial to the with-profits planholders in the Scottish Life Fund at the expense of Included Planholders. The figure itself is a subjective one, determining the balance between the two groups of policyholders.

Planholders with smaller pots are more likely to give up the benefit of the GAR to access their plan proceeds in cash. Looking at plan count, rather than plan value, around 85% of planholders with plans similar to those subject to the Scheme have taken at least 25% in cash since the introduction of pension freedoms. The Scheme will represent fair or good value to them, based on the assumptions used, ignoring for the moment the benefit of additional flexibility itself. For those who would take less than 25% in cash, the opt-out route gives the ability to maintain the GAR, and its value, as it is.

For the population of planholders who have not kept Royal London informed of changes to their address details, Royal London has undertaken tracing activity in conjunction with Capita and the Department for Work and Pensions (DWP) to re-engage with these planholders. This activity is proving worthwhile and the initial 20% of 'gone-aways' has been reduced to around 8%, with tracing activity continuing.

For the majority of the remaining 8% Royal London has a high degree of confidence about the planholders' up to date address details, but it has not had this verified by positive re-engagement. The appetite mailing will be sent to all such planholders in an effort to reach as many planholders as possible.

One of the difficulties here is that data protection restrictions prevent DWP from supplying address details directly to Royal London. Instead planholders have to choose to re-engage, on receipt of a letter issued by DWP on Royal London's behalf. Many of those for whom DWP have found an address choose not to re-engage, potentially through fear that the contact is a scam.

I am satisfied that Royal London has taken all reasonable steps within the constraints of the data protection laws to maximise the population it can send details of the Scheme to. Although there is a reasonable level of variation, the plans without verified addresses are on average smaller than those with verified addresses. Planholders with small pots have a high propensity to take their benefits in cash. Not opting out and therefore being subject to the Scheme is likely to be positive for those who will realise their pension savings in cash, rather than as an annuity. As a result, I am satisfied that it is consistent with the fair treatment of planholders for the Scheme to apply to the cases where current address details have not been verified by positive re-engagement.

There is a small proportion of the overall population, around 2% of the total number of plans in scope, for whom no address details have been obtained, despite extensive tracing. For these planholders the widespread advertising that is planned is one way of helping to raise awareness and encourage re-engagement. The question of opting these planholders out of the Scheme by default has been considered. On balance the better option is to have these planholders included in the Scheme, given that the valuation of the GAR that we have used, promotes pension freedoms and crystallises the value of the GAR when interest rates are very low. Around 16 of these planholders must receive financial advice before they can participate in the Scheme. If they do not re-connect before the Scheme is implemented and take financial advice then they will be opted out. As this small number of policyholders will not have received the communications materials they will be given these materials when they do re-engage and they will be offered the opportunity to have their GARs restored and the uplift removed. Likewise, any other planholder who can demonstrate that they were not living at any address mailed, and hence did not receive the communication materials, will be given a similar opportunity to have their GAR restored and the uplift removed. In each case this decision must be made within 3 months of being sent the communication materials after they re-connect.

I consider this approach to be the most appropriate way forward for these planholders for whom we have no address details.

The valuation of the GAR is heavily influenced by long-term interest rates. There is a risk that the valuation which was made at the start of the voting period, and which is set out in the personalised illustration sent to Eligible Planholders, is no longer appropriate at the end of the voting period, in particular if interest rates move materially. To ensure that the Included Planholders receive an uplift that reflects the economic circumstances at the date the Scheme is implemented (which is expected to be 7 December 2018), the uplifts will be recalculated as at 14 November 2018, as close to the implementation date as is practically possible.

This approach not only protects the Included Planholders, in the event of a material fall in interest rates, it also protects the with profits planholders in the fund from a material increase in interest rates. Such an increase in interest rates could make the original valuation of the GAR unreasonably generous, relative to an objective assessment, to the detriment of the with profits planholders in the fund.

It is recognised that the potential for uplifts to change in this way may be unsettling for the Included Planholders. In recognition of this, a minimum uplift has been set for each planholder, details of which are included in their personalised illustration. The minimum uplift provides that, so long as the scheme can be implemented fairly at an overall level, their uplifted fund value will never be less than 90% of the expected value.

There are other factors that could change the fairness of the valuation of the GAR and these will also be taken into account when recalculating the value of the GAR. The ultimate aim is to ensure that the Independent Actuary can confirm that the final offer is fair.

While this recalculation process adds a layer of complexity to the process I am satisfied that it brings with it additional protections for both the Included Planholders and the with profits planholders in the fund, should economic or demographic circumstances change while planholders are considering the Scheme. On balance I am content that the benefits of a recalculation outweigh the additional complexity that it brings.

3.7 FACTORS TO BE CONSIDERED BY PLANHOLDERS

Whether the Scheme is a good choice for an individual will depend on a number of factors. Primarily these factors will reflect the extent to which the assumptions used to arrive at the valuation of the GAR apply in practice for an individual. There are other aspects, such as attitude to risk that should also factor into the decision process. The proximity of retirement is one such factor as it will affect the certainty with which an individual can assess their future needs for cash rather than a regular income.

The interest rates used in the assessment of the offer will reflect the term-structure of interest rates at the point of calculation. If interest rates are lower than this in future then it will be more difficult for planholders to replace the income the GAR would have provided either through drawdown or by taking out an annuity.

If planholders are intending to use their increased fund value to buy an annuity then they need to bear in mind that EU legislation that currently applies in the UK prohibits annuity providers from differentiating on the basis of gender. The value of the GAR has been calculated taking gender into account. As a result, males will find it more difficult to replicate the GAR benefits from their uplifted fund value for as long as a gender-neutral annuity market persists in the UK. I am satisfied that it is fair to take gender into account in the valuation of the GAR, as this represents the true actuarial value of the benefit being given up. It is important that planholders, male planholders in particular, are made aware that a gender neutral annuity market means that replicating the GAR income by purchasing an annuity from the increased fund may not be possible. Males intending to use an annuity for their retirement income should consider opting out of the Scheme.

If longevity improves more quickly than assumed then planholders will also find it difficult to replace the income the GAR would have provided either through drawdown or by taking out an annuity. This risk may be mitigated to a certain extent where planholders are in poor health compared to the average. There is now a well-established impaired life annuity market. Conversely, this risk may be exacerbated for planholders who are healthier than the norm and expect to live longer than average.

If a planholder is intending to take their entire GAR fund as an annuity then the Scheme, based on an assumed split of 75% annuity 25% cash, will provide less value in pure actuarial terms. This may be mitigated by the extra utility from having the choice over how and when to access the benefits.

A related risk concerns the continuation of the current tax regime that allows 25% of a pension pot to be taken tax-free. Removal of that benefit may reduce the attractiveness of taking 25% up front. A planholder who judges that the ability to access a larger amount tax-free is a key factor for them in deciding not to opt out should bear in mind that the tax rules could be changed in future to reduce or remove this benefit.

The original idea behind the GAR was to provide a safety net for planholders, guaranteeing them a minimum retirement income for a given level of fund. The Scheme will remove that guarantee, exposing planholders to the risks referred to above. Those who are risk-averse may value the certainty of a GAR over the flexibility provided by the Scheme, even where the actuarial value on offer is greater.

It is important to bear in mind that most of these risks have a corresponding opposite that is a potential benefit of the scheme. If interest rates rise then the Scheme will have locked-in the current high value of annuities. Similarly, if longevity improves more slowly or deteriorates then again planholders will have locked in the value of current assumptions. Planholders who intend to take more than 25% of their retirement fund in cash are likely to be better off not opting out of the Scheme. Those in ill health may also be better off not opting out of the Scheme, even if they intend to take an annuity, as a result of being able to access the impaired life annuity market, with their uplifted fund value.

3.8 PLANHOLDER COMMUNICATION

The quality and effectiveness of the communication with planholders is an extremely important aspect of the Scheme. Prior to the Scheme being proposed to planholders, an 'appetite mailing' has been sent to all planholders in scope for whom Royal London, or DWP, have address details. This first mailing introduced the form of the Scheme and gave non-personalised illustrations to make the proposal more tangible.

The appetite mailing had an essential role in informing and educating planholders about the nature of the plan they have and the nature of the GAR in particular. We should be mindful that for many of the 33,000 this would have been the first time they had to think seriously about their retirement plans. In many cases retirement may be a decade or more in the future.

I reviewed the appetite mailing documents throughout their development. They were also subject to review by the Independent Actuary. In addition, and perhaps most importantly, they were subjected to one round of financial adviser testing and three rounds of Eligible Planholder, customer testing. The documents were refined between each round and the final round of customer testing was very positive.

The customer testing participants demonstrated that they understood what was being offered and what it meant for them. A majority indicated that they would be interested in the Scheme. Some indicated that they could see why the Scheme might be attractive for others, and so were supportive of it being made, but they would opt out of the Scheme themselves. This feedback gives comfort that the materials are well balanced and clear.

I am satisfied that the appetite mailing highlights the nature of the risks at an appropriate level and in terms that planholders will understand. Ultimately the question for planholders at the initial stage was whether they supported Royal London proceeding to make a formal offer. I believe the documents did a very good job of equipping planholders to answer that question, but more importantly, warmed them up to the thought processes required to respond to the planholder vote that follows.

The response to the appetite mailing was very positive and extremely encouraging. Around 30% of those mailed got in touch, an extremely high response for a direct mailing exercise. Of those 83% were in favour of Royal London proceeding to make an offer. Many planholders also provided comments on the proposed offer and the communications materials. The vast majority of these were extremely encouraging. Perhaps the most encouraging for me were the individuals who had clearly read and understood the materials and were happy to support the offer being made as it may benefit others, even though their own circumstances indicated that they should opt-out and that was their intention. Some negative comments have been received and these have been responded to by Royal London's customer relations team where appropriate.

The subsequent communications with planholders will include personalised illustrations showing the impact of the Scheme on their own plan. The communications will also include summaries of the terms of the Scheme and of the three actuarial reports. While necessarily more technical, the formal mailing documents do a similarly good job of conveying the nature of the offer for the individual.

The communication materials are the 'first line' in equipping planholders for this decision process. For some, the materials themselves will be sufficient to make a decision on the Scheme. For others, aspects of the Scheme may require explanation or even a professional recommendation. The second and third lines in equipping planholders for this decision, guidance and advice, are essential protections for such an important and irrevocable decision. Any Included Planholders who can demonstrate they were not living at any address to which the communication materials were sent will be provided with these materials and given equivalent support towards the cost of advice at the point they re-engage with Royal London. They will then be given 3 months to decide whether to have their GAR reinstated and the uplift removed.

3.9 THE GUIDANCE/ADVICE PROPOSAL

In order to participate in the Scheme, planholders with Talisman Retirement Annuity Contracts or with Talisman Executive Pension Plans that have been assigned to the individual, in each case with a GAR-eligible fund in excess of £30,000, need to take appropriate advice about giving up the benefit of the GAR. Royal London is providing access to appropriate advice for these planholders. Any such planholder in respect of whom Royal London does not receive confirmation that advice has been given will be opted out automatically and will retain the GAR.

There is no legal requirement for any other planholders to take advice before they can participate in the Scheme. However, Royal London has recognised that some planholders may want advice specific to their personal circumstances before making a decision.

Royal London will fund the cost of advice for planholders required to take advice in order to participate in the Scheme if that advice is provided by JLT Benefit Solutions Ltd (JLT) whom Royal London has contracted to provide independent financial advice for Eligible Planholders. Alternatively Royal London will provide up to £960 (including VAT) towards the costs of such individuals receiving advice from an appropriately qualified UK adviser of their choice, or if they are resident abroad and therefore not able to use JLT, up to £1,800 including VAT for receiving advice from an appropriately authorised adviser.

For those who are not required to take advice in order to participate in the Scheme, there will be a modest cost (£100) where advice is sought from the advisers selected by Royal London. Alternatively Royal London will provide up to £860 (including VAT) towards the costs of individuals receiving advice from an appropriately qualified UK adviser of their choice. In circumstances where an individual is resident abroad or is assessed by the experienced call-handling staff to be vulnerable, in need of a specific recommendation and unable to meet the £100 cost, Royal London will consider waiving the policyholder contribution. In order to protect the with profits policyholders who bear the expense risk, this discretion will be carefully monitored to ensure all policyholders are treated fairly and suitably protected.

The level of subsidy provided is ultimately a matter of judgement. In my view it is appropriate to subsidise the majority of the cost of advice for those who wish to take it. The level offered strikes an appropriate balance between affordability for individual planholders against the overall cost to the Scottish Life Fund. For the relative minority of policyholders who are required to take advice in order to participate in the Scheme, I believe it is right that a no-cost route to advice has been made available.

Royal London will also pay for telephone-based guidance for all planholders who want to understand the nature of the Scheme better by talking it through with an expert. This will be provided free of charge to the Eligible Planholders. Guidance differs from advice in that it is not specific to the circumstances of an individual planholder.

Royal London has selected JLT to provide both the advice referred to above (unless the planholder chooses to use their own adviser) and the telephone-based guidance service. JLT is authorised and regulated by the FCA and is a pension transfer specialist. Although Royal London will either pay for or subsidise JLT's advice, JLT will treat the planholder as its client and will act only in the planholder's interests when advising them. JLT will be paid by Royal London irrespective of whether it advises the planholder to accept the offer or not. JLT and Royal London do not have any other connections, other than those agreed on commercial bases. JLT was chosen in an open and fair selection process against comparable peers.

Planholders are being asked to make a very important decision that will have consequences for their entire time in retirement. I believe Royal London has recognised this and put in place support to ensure planholders can be as well-equipped as possible to make that choice. The level of financial subsidy towards that support from Royal London is very material, easily the single biggest operational cost of the entire project. I think this demonstrates Royal London’s commitment to treating customers fairly and giving them the required level of information.

I think their choice of guidance/advice partner is a good one, and that JLT will be able to provide sufficient capacity at a high quality. JLT has significant experience in similar large-scale exercises for defined benefit arrangements. Their ability to run both a guidance and advice process in a joined-up manner will help with the overall customer journey. JLT has been able to demonstrate that it has all of the necessary permissions and experience to carry out the task. I am also supportive of Royal London allowing planholders to use alternative advisers (whether existing or new) if they prefer, at the same cost to the fund. In addition, I consider the difference in subsidy for advice between planholders who are subject to the mandatory advice requirement and those that are not to be fair and appropriate.

3.10 THE LEGAL PROCESS

The Scheme of Arrangement that will put the proposal into effect requires approval by those Eligible Planholders to which it applies. In order for the Scheme to be approved, it must be approved by a majority of the Eligible Planholders who vote on it (which I refer to as the "vote by number"). That majority must also represent at least 75% of the total value of all the votes cast (which I refer to as the "vote by value"). The value of a vote cast will be based on the value of the GAR to be given up, measured by reference to the offer being made at the original offer stage. Any planholder who opts out of the Scheme will not vote on it.

Because the interests of all of those able to vote are broadly aligned, I believe it is possible for all the planholders to whom the Scheme applies to vote together as a single voting class or group. I am happy with the legal analysis that concludes that a single class is appropriate. Ultimately this will be a matter for the Court to decide though, taking account of all the circumstances.

In coming to this conclusion it is important to bear in mind that the benefits of the GAR, in respect of the future income stream it provides, are being valued on a consistent basis for all the Eligible Planholders. Where individuals have more valuable guarantees then the offer will be greater. From a broader fairness perspective I believe that this is the right approach too.

Detailed consideration has also been given to voting on the Scheme. Any person who is a creditor of Royal London in respect of a GAR under the terms and conditions of a plan which is subject to the Scheme is entitled to vote, but this is complicated by the fact that some of the GAR pension plans are held directly by planholders whereas others are held on trust for scheme members. Scheme members do not have direct rights against Royal London in relation to the GAR.

The Talisman Retirement Annuity Contract holders have a direct contractual relationship with Royal London. They are therefore all creditors in their own right in relation to the GAR and able to vote on the Scheme. Former members of Talisman Executive Pension Plans where the trust has been wound-up and plans assigned to individuals are in a similar position and are also creditors in their own right in relation to the GAR.

For employer sponsored trust-based arrangements, Talisman Executive Pension Plan schemes set up by employers for executives of the sponsoring company, the trustees are the legal creditors who are able to vote. Royal London will allow the trustees to opt out individual members of a Talisman Executive Pension Plan if they wish. Royal London will also allow the trustees to reflect the views of members on the vote by value by casting votes both for and against the Scheme. On the vote by number, trustees will be able to cast one vote except where there is disagreement between scheme members, when the trustees would be able to cast one vote in favour and one against. I consider that this is a fair approach as the will of the ultimate beneficiaries will be reflected as far as possible and 95% of Talisman Executive Pension Plan schemes have only one or two members.

For the remaining arrangements, the Talisman Personal Pension Plans and the Talisman Group Personal Pension Plans, Royal London is the planholder as trustee of The Royal London Personal Pension Scheme (No 2) and as such is entitled to vote on the Scheme. However, Royal London intends to abstain from voting because of its conflict of interest as both trustee of the plans and as insurer.

There are around 29,000 members of The Royal London Personal Pension Scheme (No 2) in respect of the Talisman Personal Pension Plans and Talisman Group Personal Pension Plans who benefit from GARs (out of a total of approximately 33,000 planholders to whom the Scheme applies) – taking account of the views of these scheme members on both the vote by value and the vote by number will therefore make a significant difference. To allow this to happen, each scheme member will be made a creditor of Royal London for the purposes of the vote through a Deed Poll. This additional step is not certain to be approved by the Court, although I would certainly encourage the Court to support the Deed Poll on the grounds of fairness. Should this route not prove possible then Royal London will act in the same way as the Talisman Executive Pension Plan trustees described above. Royal London will also consider convening a separate meeting of the scheme members at which they will be asked to approve the Scheme.

To be clear, those who opt out do not count at all in the voting process. Royal London will make arrangements for any comments that these planholders choose to make as part of the voting process to be passed on to the Court. This will ensure these planholders continue to have a voice, even if they do not have a vote.

Those who do not engage with the voting process do not count for the voting tests. Only those who vote ‘for’ or ‘against’ the Scheme are counted in the simple majority by number and three quarters by value tests. There is no absolute number of votes required; only the proportions of those who vote are taken into account. In the extreme, if only one vote was received and this was in favour then the Scheme would take effect on the entire population that did not opt out.

Only plans that are potentially being compromised are included in the vote. Those with excluded contract types (such as Versatile Retirement Benefit Plans) and those who do not benefit from a GAR are excluded from the vote. In the case of with profits planholders, their interests are protected in a number of ways as set out later in this report.

3.11 TAX IMPLICATIONS OF THE SCHEME

Royal London has considered carefully with its external tax advisers whether the Scheme could have any adverse tax impact for the Included Planholders and has determined that it will not. It has also sought clearance from Her Majesty's Revenue and Customs (HMRC) that the Scheme will not adversely affect the tax status of pension plans. Although HMRC were not able to provide a formal clearance, on the basis that no area of uncertainty has been presented to it, HMRC did not identify any concerns with Royal London's analysis and the HMRC team also provided a personal confirmation that it agreed with Royal London's analysis.

The effect of the Scheme is to capitalise the benefit of the GAR on a realistic basis. This will give Included Plans a higher value for assessing against the Life-Time Allowance (LTA). For some planholders with the benefit of high value Included Plans or those with other pension savings that are already close to the LTA, the effect of the Scheme could be to push part of their retirement savings above the LTA, incurring a penal tax treatment. Royal London's communications will make this risk clear to all individuals and will make special mention of this risk for the highest value plans.

3.12 THE LINK BETWEEN THE INTERESTS OF SCHEME AND WITH PROFIT PLANHOLDERS

The costs of meeting GARs are borne by the Scottish Life Fund. Prudential reserves have been established within the fund to meet the best estimate costs of GARs. The uncertainty around the future cost of GARs, primarily in respect of changes in interest rates, longevity and GAR take-up rates gives rise to significant capital requirements over and above the best estimate.

The with profit planholders in the Scottish Life Fund expect to receive the 'Inherited Estate' of the fund over time. The Inherited Estate is the excess of assets in the fund over a realistic assessment of the liabilities attributed to the fund. The capital requirements in respect of GARs delay the distribution of the Inherited Estate as money has to be held back to mitigate the effect of an adverse event in the future. The extent of the capital requirements for GARs is such that a relatively small proportion of the total Inherited Estate is available to be distributed at the moment. In the absence of any material adverse experience, those with profit planholders who claim some years from now will receive a significantly larger proportion of the Inherited Estate than those claiming now. A more even sharing in the Inherited Estate between generations of planholder would represent a fairer outcome overall, more in line with planholder expectations, if it can be achieved at an acceptable cost.

If the Scheme is implemented it will materially reduce the capital requirements of the fund and allow the Inherited Estate to be distributed more quickly and in a fairer manner, provided the level of opt-outs is sufficiently low. The results from the Appetite Mailing are encouragingly positive and the Scheme will only proceed if the opt-out rate is sufficiently low that the Independent Actuary's fairness tests are met once the votes have been counted. The other related benefit of the Scheme is that it will materially reduce the risk in the fund and give greater certainty over the level of Inherited Estate distribution in future. In my view, the benefit of the Scheme to the with profits planholders through this capital unlock justifies spending part of the Inherited Estate on the Scheme (to the extent that it exceeds the current best estimate of the GAR liability), the cost of providing guidance and advice and the cost of the Scheme process.

It is important that these costs are managed effectively though in order to ensure appropriate value for money for the with profits planholders. I have oversight of the costs allocated to the Scottish Life Fund and I am content that the costs are being managed effectively, bearing in mind the significance of the project to Eligible Planholders, with profits planholders in the fund and Royal London's reputation more widely.

There are risks associated with the costs of the Scheme, most notably the potential costs from policyholders taking advice in larger numbers than originally forecast. Ultimately this is a balancing act. To ensure GAR policyholders have sufficient information and access to advice at a reasonable cost the offer includes material support and subsidies. The costs will be borne by the estate of the Scottish Life Fund. The level of capital released for the benefit of with profit policyholders is expected to be sufficient to justify the theoretical risk from expenses being more than forecast. I believe the correct balance has been struck, and asking GAR policyholders to contribute towards the cost of advice is a key part of the overall offer.

4 THE FAIRNESS ISSUES RELATING TO WITH PROFIT PLANHOLDERS

4.1 BACKGROUND TO THE SL FUND

Royal London acquired the business of The Scottish Life Assurance Company on 1 July 2001. The with profits business of Scottish Life was placed into a newly created, ring-fenced fund, the Scottish Life Fund. In addition to the with profits business, all plans with GARs were also placed into the Scottish Life Fund. This approach ensured, as far as possible, that the existing planholders of Royal London would be protected from the costs of the Scottish Life GARs, provided the Scottish Life Fund was solvent. The Royal London planholders committed to provide support to the with profits policyholders in the Scottish Life Fund only in respect of guaranteed benefits, i.e. the sums assured, not discretionary elements such as final bonus.

The Scottish Life Fund is currently able to meet its capital requirements without support from the rest of Royal London. This is the case even though the current Solvency II regime is significantly more onerous than the regime that was in place at the time that Royal London acquired Scottish Life.

4.2 OVERALL APPROACH TO WP MANAGEMENT IN THE SL FUND

The Scottish Life Fund is managed as far as possible as if it were a stand-alone fund. The original intention at the point Royal London acquired Scottish Life was that the Inherited Estate of Scottish Life would be distributed to eligible with profits planholders through an increase to the investment return credited to their asset shares. This increase to returns was intended to be kept relatively stable and applied from each plan's inception to eventual claim.

The initial estimate of enhancements set out in the planholder circular in April 2001 was 1.25%pa. This rate applied up to the start of 2006 at which point the reductions to interest rates and increases in longevity had increased the costs of GARs to the point at which the fund needed to reduce its overall liabilities to a level consistent with its capital resources. It achieved this through a retrospective reduction in the rate of enhancement from 1.25%pa to 0.75%pa. This reduced asset shares and the amounts payable to with profits planholders. The rate was changed again, but this time only prospectively, from the start of 2008 to 0.5%. In 2009 the rate applied was 0.7% and there was a change in practice to target in excess of 100% of asset share. In 2010 the enhancement was 2.4% and pay-outs continued to be targeted in excess of asset share. In 2011 the enhancement was 6.0% and pay-outs continued to be targeted in excess of asset share.

In 2012, the likely impact of the new Solvency II rules on the Scottish Life Fund started to become clearer. As a result the approach to managing the fund was changed. Rather than enhancing asset shares further, the Inherited Estate was distributed by increasing the pay-out ratio, that is, the extent to which pay-outs exceeded asset share. Amounts of 4.6%, 5.9% and 2.7% were built up in the pay-out ratio from 2012-2014.

For 2015 the pay-out ratio was set to be 120%. This was reduced at the start of 2016 to 118%, and reduced again from 1 July 2016 to 112% in light of the rapidly reducing interest rates. From the start of 2017 pay-out ratios were cut again to 106%.

The dominant factor affecting Inherited Estate distribution over the last decade and more has been the cost and capital requirements associated with the GARs.

Royal London has a capital framework that it applies to each of its with profits funds. The framework has been adjusted for the Scottish Life Fund in response to its relatively weak capital position. When calculating the capital requirements of the fund, credit has been taken for the most severe management action: cutting pay-outs to the minimum allowable amount. This approach gave a mechanism for keeping pay-outs above asset share when the capital strength of the fund in isolation may not have supported it. This modification has been accepted because the Scheme provides a way to tackle the relatively weak position of the fund directly.

The impact of revised longevity assumptions on with profit bonus setting was considered late in 2017. The slowing of longevity improvements, combined with recognition that the process to implement the GAR Compromise Scheme was progressing well, was sufficient to allow pay-out ratios from the start of 2018 to be targeted at 118% once again. If the Scheme is not implemented then I would expect this ratio to revert to around 112% in the short term.

4.3 LIKELY TREND IF THE SCHEME DOES NOT GO AHEAD

If the Scheme does not proceed then with profits planholders will remain exposed to significant risk in relation to the management of the Scottish Life Fund. The pay-out ratios are likely to remain highly volatile for some time. This cuts against the essence of a with profit plan, which is aimed at providing stable returns over time, smoothing out the market fluctuations.

Over time, as the capital requirements run off, the delayed distribution of Inherited Estate will flow to those who remain in the fund the longest. While a degree of reward for the risks being run over time is fair, our current projections indicate that pay-out ratios in future could rise rapidly giving windfall benefits to the few who are left when the majority of the risk has run off.

This extreme Tontine effect does not represent fair outcomes to the with profits planholders in the fund.

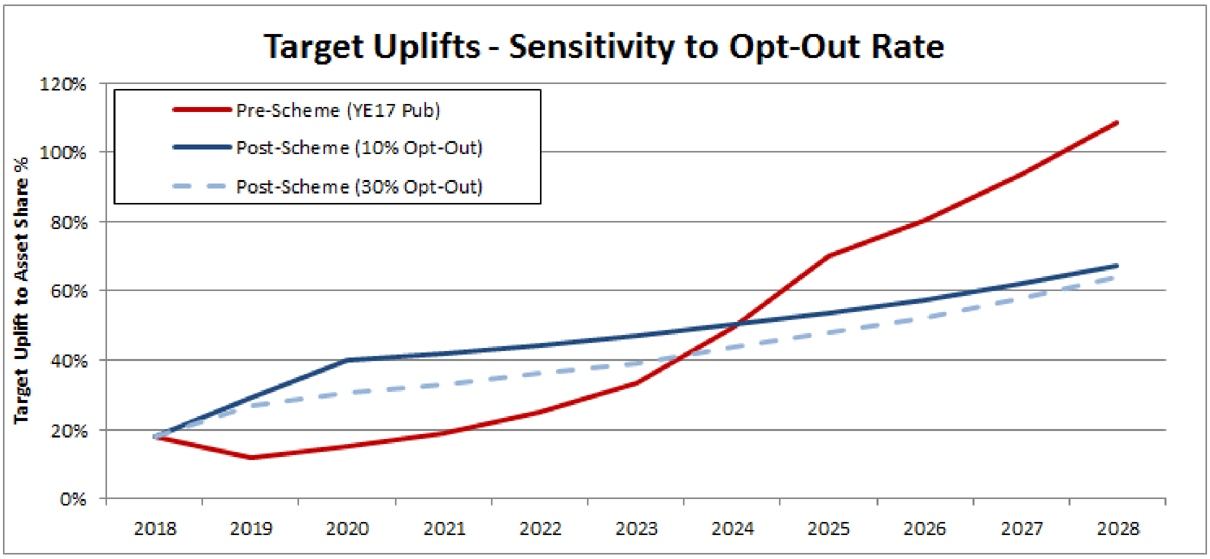
4.4 LIKELY TREND IF THE SCHEME DOES GO AHEAD

If the Scheme does proceed, then there are two key effects on with profits planholders. Firstly, the total value of the Inherited Estate will be reduced. This reflects the fact that the valuation of the GAR represents more than the current best estimate liability for the GARs. As described earlier, recent experience shows that around 66% of the value of Eligible Plans is used to purchase an annuity. The Scheme assumes 75% in order that those planholders expecting to take 25% in cash receive a fair value, it also assumes there are no surrenders prior to retirement benefits being taken. On this measure alone, the with profits planholders are losing some value relative to the pre-Scheme position. The Fund is also meeting the administrative costs of proposing and implementing the Scheme and providing guidance and advice to Eligible Planholders. The Fund will also share the cost of changes to actuarial models with the Royal London Main Fund. This also reduces the size of the Inherited Estate.

The second effect is a significant reduction in the level of risk within the fund. Provided the number of opt-outs is relatively low, the Scheme will remove much of the risk associated with the GARs in the fund. This will reduce the volatility of the fund's capital position, allowing a more stable distribution of the Inherited Estate. It will reduce the likelihood of taking the most severe management action of cutting pay-outs to the minimum amount allowable. It will also allow a more equitable distribution of the Inherited Estate, with more available to those claiming in the near-term and removing the windfall effect of the Tontine from those who stay longest.

If the Scheme does proceed then the charges applied to asset shares in respect of GARs (0.49%pa in the majority of cases) will also be removed. Royal London will make this change to all with profits plans in the Scottish Life Fund, not just those directly affected by the Scheme. An improved capital position should, in time, allow for more investment freedom which may also benefit the remaining planholders in the fund.

The financial projections of the fund demonstrate the extent to which these two effects (reduced Inherited Estate and the reduced level of risk) balance off against one another. The following graph captures a number of these factors and is essential in understanding the projected net effect of the Scheme.



Firstly, consider the solid red line. This reflects the position at the end of 2017, in particular changes to longevity assumptions as mentioned earlier. It also reflects a new 'all risks' approach introduced by Royal London as part of its Solvency II development programme. 'All risks' is a more sophisticated and accurate approach to calculating how much capital the fund needs to hold to mitigate future risks, and how these risks are assumed to interact with one another. The combined effect of these changes, irrespective of the Scheme, is to increase the pay-out ratio to around 118% from 2018, with the ratio projected to rise over time. Royal London's Board approved this pay-out ratio target in December 2017. If we imagine that there was no uncertainty in the fund then the assets in the fund could support a pay-out ratio of 155%.

Next, we consider the dark blue line. This reflects the progress of the fund if the Scheme proceeds and those opting out represent 10% of the total value of the GAR liabilities. In this case, the pay-out ratio increases immediately post-Scheme and then increases more gradually than the position pre-Scheme. This in itself represents an intuitively fairer distribution of the Inherited Estate. While those who stay in the fund longest, and exposed to risk longest, should benefit most, on a traditional risk-reward basis, the pre-Scheme position feels too extreme.

This is only part of the picture though. As described above, the effect of the Scheme is to reduce the absolute size of the Inherited Estate. Where the assets pre-Scheme could support an ultimate pay-out ratio, in the absence of uncertainty, of 155%, the post-Scheme Inherited Estate supports 138%. In effect the potential for 17% pay-out uplifts has been forgone to achieve the Scheme. In my view it is the overall reduction in risk within the fund that justifies this cost.

Pre-Scheme the fund has a Solvency Capital Requirement (SCR) of £446m to protect against a 1-in-200 year adverse event. This figure is calculated on Royal London's 'Internal Model' of risks which best reflects the firm's view of reality. There are other measures of capital used for reporting under Solvency II, including the 'Standard Formula' result. I only consider here the 'Internal Model' results as these best reflect how the fund is managed day-to-day.

As mentioned earlier, holding back this capital delays the distribution of the Inherited Estate in the short-term. However, at its heart, this figure really represents the level of risk being run within the fund. Whereas the graph above shows our central projection on each set of assumptions, there are in reality a number of potential outcomes that will reflect the actual progress of future events. If we imagine the range of outcomes as lying above or below these central projections then the range before the Scheme is very wide. One measure of this is the risk that adverse events occur that require all discretionary benefits to be removed and only the bare minimum guaranteed benefits to be paid. Prior to the Scheme taking effect the risk of this occurring is around 40%. To be clear, this turn of events would represent not only removing the positive benefits of Inherited Estate distributions it would also result in pay-outs in many cases being below asset share.

Following the Scheme, on the basis of an assumed opt-out rate that represents 10% of the GAR liability, the level of the SCR is reduced significantly, from £446m to just £142m. This gives a sense of how much risk the Scheme removes from the fund. The likelihood of having to remove all discretionary benefits is reduced below 1%.

In my view this material increase in the certainty of future distributions justifies the modest reduction in their long-term central-estimate level. I also believe that this type of risk mitigation is in line with what the with profits planholders would expect from a management team looking after their best interests. There is no doubt that in certain situations the with profits planholders could be materially better off if the Scheme does not proceed. However there is also no doubt that they could be materially worse off if the Scheme does not proceed. In my view the 17% reduction in potential long-term pay-out ratio is justified by the £300m+ reduction in risk capital requirement.

The final line on this graph, the light blue one, shows the effect if more of the Eligible Planholders are opted out of the Scheme. In this case, less of the risk associated with GARs is removed from the fund. In addition we would expect that those who did opt out would be more inclined to exercise the GAR to its fullest extent. In combination the SCR would be £210m and the long-term pay-out ratio would be 133%. These are £68m more and 5% less respectively than in the scenario that assumes a 10% opt-out.

While this level of opt-out would still represent a material de-risking of the fund, for the benefit of the with profits planholders, the net benefits are more marginal. An overall reduction of 22% on the long-term pay-out ratio is a relatively high price to pay, but may still represent good value in the round.

My expectation is that the level of opt-outs will represent between 10% and 25% of the total GAR liability. In that case, I believe the Scheme represents a good outcome for the with profits planholders in the Scottish Life Fund.

4.5 RISKS TO THE WITH PROFIT PLANHOLDERS IN THE SCOTTISH LIFE FUND

There are a number of risks to with profit planholders through this process. Firstly, there is a risk that the Scheme does not proceed, having incurred all of the costs up to that point. This risk is being mitigated by the project team having a number of check-points throughout the process where it could be halted if the indications were not positive. All of the key stakeholders, including the Regulators are being kept up to date with progress in order to reduce the risk of surprises that stall progress late in the day.

There is a risk that interest rates increase rapidly or that longevity deteriorates materially, shortly after the Scheme is implemented. This would result in 'regret risk' where with profits planholders to whom the Scheme does not apply would, in hindsight, rather have held off and benefited from the experience being favourable. The obvious counter to this is that there is an equivalent risk that interest rates fall or that longevity improves after the Scheme is implemented, in which case the with profits planholders to whom the Scheme does not apply will be better off as a result of the Scheme.

The nature of those participating in the Scheme or opting out may be skewed so that the eventual benefits of the Scheme are lower than initially expected. The projections used to assess the Scheme allow for 'selection risk' whereby those who are in ill-health judge that the

Scheme represents more than fair value to them and that they are unlikely to opt out of the Scheme. Conversely, those in good health may judge that the Scheme does not represent fair value for them and they opt out. Similarly, those who opt out are assumed, for the purposes of calculating best estimate liabilities, to use the vast majority of their fund to buy an annuity in due course. The residual selection risk is not material.

4.6 RISK TO THE PLANHOLDERS OUTSIDE THE SCOTTISH LIFE FUND

The Scottish Life Fund can withstand a shock more severe than those judged to be 1-in-200 year events and still meet its commitments to guaranteed benefits. As a result the current risk to planholders outside the Scottish Life Fund from the GARs in the fund is small. The effect of the Scheme is to reduce the risk in the Scottish Life Fund and this will reduce the small risk to planholders outside the Scottish Life Fund even further. I am satisfied that the Scheme does not adversely affect those planholders outside the Scottish Life Fund, and that their interests do not need to be considered further here.

4.7 PROTECTIONS IN PLACE FOR THE WITH PROFITS PLANHOLDERS IN THE SCOTTISH LIFE FUND

The with profits planholders are not having their plan benefits compromised directly by the Scheme. However, they are indirectly affected, potentially to a material extent, depending on the long-term future progression of the fund. They are not being asked to vote on the Scheme, unless they are Eligible Planholders too in which case they have a vote in their capacity as Eligible Planholders.

Instead, I as With Profits Actuary, the Chief Actuary, the Independent Actuary, the Scottish Life Supervisory Committee, the With Profits Committee and the Board all have a role in protecting the interests of the Scottish Life Fund with profit planholders. I believe that the Scheme is likely to be beneficial to the interests of with profits planholders in the Scottish Life Fund. While some may end up with lower pay-outs, for example through the removal of the worst of the Tontine effect, the stability of those pay-outs will be much improved and the overall fairness of the distribution of the Inherited Estate will also be materially improved.

4.8 ALTERNATIVES CONSIDERED

A number of alternative options have been considered prior to embarking on the Scheme. Internal and external reinsurance has been explored. The interest rate hedging has been altered to be as effective as possible, bearing in mind that any such hedging is always a compromise given the different measures that can be hedged (best estimate liabilities, capital position etc.). A longevity hedge has been investigated a number of times but found to be prohibitively expensive. Reinsurance to remove or mitigate the extent of GAR take-up risk has also been explored.

In each case the cost of the risk mitigation or the effect of shifting the risk to other Royal London planholders has stopped progress on those fronts, in favour of the Scheme. I am content that the Scheme represents the most suitable way to achieve the primary aim of improving flexibility for Included Planholders in light of pension freedoms at the same time as improving outcomes for with profits planholders through a more stable distribution of the Inherited Estate.

5 ASSESSING THE FAIRNESS OF THE SCHEME AND THE PROCESS

The Scheme offers the holders of certain pension plans allocated to the Scottish Life Fund the opportunity to exchange the substantial benefit of the GAR for a substantial and immediate increase in retirement savings. A key consideration in whether the Scheme should proceed or not, is the extent to which this exchange of value is fair to those affected.

5.1 FAIRNESS CRITERIA

There are a number of tests that the Scheme needs to pass for it to represent a fair offer from my perspective. Although derived separately these tests have significant parallels to the tests considered by the Independent Actuary in his analysis.

Firstly, I consider what I describe as the 'Offer Shape' test: the offer to Eligible Planholders should represent a genuine best estimate based on available information and reasonable assumptions.

The process used to assess the value of the GAR in essence looks at the projected income that will be produced from the GAR and values it using best estimate assumptions for interest rates and longevity. Key to this is the move to the CMI's 2016 longevity model and a long-term improvement rate of 1.5%pa. I am satisfied that this represents a reasonable assumption, as judged by a range of longevity experts and is consistent with the values chosen by other life offices. The value of the GAR itself will differ between males and females, between those with different product types (and hence GAR rates) and will depend on age at the Scheme Implementation Date. This ensures that the offer is at a level of granularity that captures the key known factors affecting value. There is a clear parallel here to the Independent Actuary's "Economic Value Test" when applied at Specimen plan level. I come to the same conclusion as the Independent Actuary, that the proposed offer passes this test.

I do note that it would be possible to refine the Scheme further by assessing likely individual longevity, for example, however this approach would be expensive and probably impractical to implement, intrusive, would introduce a degree of moral hazard and would be unlikely to find favour with the planholders themselves. There are areas where pooling of experience is a genuine positive and this is one of them in my opinion. I would find it difficult to support a Scheme where the offer to someone who was in extreme ill health was materially less than that for someone who is healthy, even if it reflected a cold hard actuarial reality. There are wider aspects of fairness and perceived fairness to be taken into consideration.

Secondly, I consider what I describe as the 'Offer Level' test: the level of the offer should be fair and capable of being understood by the Eligible Planholders.

The choice of 75% as the level of the offer is reasonable and will be conveyed to Eligible Planholders in order that they can judge for themselves whether they would be likely to take more or less of their plan proceeds than this as an annuity. Based on past experience the vast majority of Eligible Planholders, by number, take at least 25% of their fund as cash so the offer will have broad appeal, without being excessively generous. The communications around the Scheme do take proper account of the tendency for individuals to place an unreasonably high value on cash benefits now, compared to those in the future. The communications are in my opinion measured and balanced and protect the Eligible Planholders as far as possible from the effects of 'hyperbolic discounting' as it is known. There is a clear parallel here to the Independent Actuary's "Economic Value Test" when applied at Fund level. Again, I come to the same conclusion as the Independent Actuary, that the proposed offer passes this test.

Thirdly, the 'With Profit Fairness' test: the impact on the with profit planholders in the Scottish Life Fund should be positive, when taken in the round.

This is a subjective test in that it assesses the balance between giving up some of the Inherited Estate in exchange for a more equitable and more stable distribution of the residual Inherited Estate. It is assessed by looking at the range of outcomes for with profit planholders as a result of reasonable experience variances in future. This takes into account the extent to which the Scheme results in costs to the Scottish Life Fund that may be borne without the Scheme ever being implemented. I considered these factors at length in the preceding section of my report. I am content that the Scheme will result in a positive outcome for the with profits planholders in the Scottish Life Fund, when taken in the round.

Fourthly, I consider the 'Process' test: the process being followed must be fair to those that participate and those that do not.

The Scheme has been reviewed by the Independent Actuary and subject to rigorous internal governance by Royal London. The process being followed for the planholder vote is, as far as practically possible, that the wishes of each individual who engages with the process will be taken into account. Planholders may also opt out of the Scheme and thereby take account of their own personal circumstances and views on the benefits of the Scheme. For those who opt out, their views will be heard by the Court, even though they won't have a vote. The wishes of the majority should not be capable of being stymied by a small minority that do not want the Scheme for themselves. The Independent Actuary does not have an explicit test that mirrors this although I note that he has commented at length on the legal process being followed and concludes that it is sound. I concur with that conclusion. In particular I would urge the Court to look favourably on the application to use a Deed Poll to give creditor status to the Talisman Personal Pension Plan and Talisman Group Personal Pension Plan customers.

Finally, I consider a 'No Unintended Consequences' test: there should be no material unintended consequences to planholders outside the Scottish Life Fund.

The structure of the Scheme should be such that the planholders in the other Royal London funds should neither benefit materially from the Scheme nor should they be subject to any material detriment from the Scheme. In passing the preceding sections, the Scheme is well placed to avoid such unintended consequences. There is one particular aspect that is worth covering here for the sake of completeness. The original Scheme by which Royal London acquired the business of the former Scottish Life Assurance Company set out mechanisms for transferring value between the Scottish Life Fund and Royal London's Main Fund. One such mechanism related to an annual management charge applied to both with profits and unit-linked investments. The increase in fund values for Included Plans would by default result in more value being transferred from the Scottish Life Fund to the Royal London Main Fund.

In order to restore the pre-Scheme balance between the funds in the post-Scheme environment this additional value transfer has to be reversed. There are two clear ways to achieve this. Firstly, the additional amounts transferred each year could be refunded, allowing for the actual future experience of plan persistency and fund performance. Alternatively, the expected future amounts on a set of best-estimate assumptions could be transferred from the Royal London Main Fund to the Scottish Life Fund. This would be a 'once and done' approach.

The values concerned are not so material that they would affect how either fund is run. On balance I am content that the simplicity of the 'once and done' approach is preferable and that an amount, expected to be around £40m, should be passed from the Royal London Main Fund to the Scottish Life Fund as part of the Scheme. The Royal London Main Fund should acquire an asset of equal value in the form of Value of In-Force business (VIF). While this VIF will have different risk characteristics from the assets paid in return, the quantum involved means that this is not a material risk for the Main Fund and there is no overhead associated with on-going maintenance as there would be with the alternative approach. An allowance has been made in the amount for the cost of capital for the Main Fund on the risks that cannot be hedged.

This amount will allow for an expected level of plan exits, higher than the current rates experienced, as a result of the increased flexibility that the Scheme will allow planholders who currently benefit from the GAR. An assessment of the extent of this increase will be made twelve months after the Scheme has taken effect. If experience has been more or less affected than assumed then a further adjustment will be made between the funds to ensure that there is no net impact on the Main Fund. No further adjustments would be contemplated beyond this point.

5.2 NEGOTIATION SPACE AND DETERMINING THE RIGHT BALANCE

The 'Offer Level' test and the 'With Profit Fairness' test are necessarily in tension with each other. The results of the financial projections indicate that a suitable negotiation space exists that can satisfy both tests. In my view, the Scheme, based on calculating the value as if 75% of funds are used to buy an annuity, sits comfortably within that negotiation space. The majority of Eligible Planholders should find the Scheme attractive, not least because it locks in values that are high, relative to past experience, and the Scheme results in much more flexibility for those Eligible Planholders who want it.

5.3 SCRUTINY AND GOVERNANCE

The Scheme has been subject to significant levels of scrutiny within Royal London and from external agencies. The financial results have been subject to internal peer review, in line with the Actuarial Standard APS X2. A second line risk review has been carried out. The wider programme has been subject to on-going Quality Assurance reviews from KPMG. In addition the With Profits Committee and the Scottish Life Supervisory Committee have reviewed the Scheme, as well as the key communications documents. Their feedback has been taken into consideration in the final versions of the documents supplied to the Court.

The project has been running for the best part of two years and the Independent Actuary and his team have been heavily involved for the last year. They have provided robust challenge throughout the process and I believe the Scheme has benefited from their questions around adherence to their fairness tests. As noted above there is broad alignment between the IA's tests and those I have derived separately.

The IA has a broad range of responsibility in respect of the Scheme. He has considered the effect of the Scheme on those directly affected, the Included Planholders, and those indirectly affected, including the with profits planholders. The Chief Actuary has also produced a report in which he considers the effect of the Scheme on the capital position of the Scottish Life Fund and the Royal London Main Fund before and after the Scheme. He considers both the Internal Model results and the Standard Formula Results, noting as I do, that the Internal Model results reflect the way in which the business is run day to day.

In some respects the three roles (With Profits Actuary, the Chief Actuary and the Independent Actuary) are quite different. However, they are ultimately all concerned with the same outcome: that the Scheme should be fit for purpose and should represent a fair offer to the planholders who are subject to the Scheme and those that are not. The conclusions of all three reports are consistent.

6 CONCLUSION ON SCHEME

My conclusions on the Scheme and the way in which the Scheme is being put forward are as follows:

- The Scheme provides a genuine best estimate of the value of the GAR based on available information and reasonable assumptions, including Royal London's experience since the introduction of Pension Freedoms of what planholders use their retirement savings for.
- The level of the offer is fair and capable of being understood by planholders. In particular, the calculation of the uplifts to plan value based on 75% of the value of the GAR is reasonable, given that the vast majority of planholders take at least 25% of their fund as cash. The communications to planholders are fair and balanced.
- The impact of the Scheme on the with profits planholders in the Scottish Life Fund should be positive.
- The process being followed is fair to those who participate and those that do not. The Scheme has been reviewed by the Independent Actuary, it has also been subject to rigorous internal review, and planholders may opt out of the Scheme and thereby take account of their own personal circumstances and views on the benefits of the Scheme.
- There should be no material consequences to planholders outside the Scottish Life Fund, either positive or negative.

Accordingly, I am supportive of the Scheme being put to Eligible Planholders in its current form.

7/6/2018

BRIAN J MURRAY FFA