The proposed Insurance Business Transfer Scheme relating to the transfer of business from The Royal London Mutual Insurance Society Limited to Royal London DAC

Report by the With Profits Actuary of The Royal London Mutual Insurance Society Limited

3 October 2018

Contents

1. INTRODUCTION AND SUMMARY

1.1 Purpose

The purpose of this report is to consider the likely effect of a scheme of transfer (the "**Scheme**") of part of the long-term business of The Royal London Mutual Insurance Society Limited ("**RLMIS**") to Royal London DAC ("**Royal London DAC**") under an insurance business transfer scheme under Part VII of the Financial Services and Markets Act 2000 ("**Part VII Transfer**") on:

(a) the holders of the RLMIS with-profits policies proposed to be transferred under the Scheme; and
(b) the non-transferring with-profits policyholders of RLMIS at the time of transfer,

in each case with particular reference to their benefit expectations, the future security of those benefits, their contractual rights, policyholder protection, service levels, with-profits governance and the general requirement to treat customers fairly. This transfer effected by the Scheme is known as the "**Royal London Ireland transfer**" or the "**Transfer**".

The business proposed to be transferred from RLMIS to Royal London DAC (the "**Transferring business**") comprises:

(i) Protection business written in Ireland by RLMIS through its local branch since 1 July 2011 ("**RL Ireland Protection business**").
(ii) Business originally written in Ireland by:
   a. Royal Liver Assurance Limited, Caledonian Insurance Company and Irish Life Assurance plc, subsequently transferred to RLMIS on 1 July 2011 by way of a scheme of transfer under Section 86 of the Friendly Societies Act 1992, and
   b. GRE Life Ireland Limited, which became a subsidiary of Royal Liver Assurance Limited following its acquisition, and subsequently transferred to RLMIS on 1 July 2012 by way of a scheme of transfer under the Assurance Act 1909 and European Communities (Life Assurance) Framework Regulations 1994.

   (together, the "**Ireland Liver business**")
(iii) Business written in Germany by RLMIS ("**German Bond business**").

The report has been prepared for the Directors of RLMIS in order to assist them in deciding whether to proceed with the Transfer.

It is intended that the High Court will be asked to approve the Transfer at a hearing on 31 January 2019. It is proposed that the Transfer will have an effective date of 7 February 2019 (the "**Effective Date**"), except for accounting purposes where it will be assumed that the transfer took place on 1 January 2019. This will not impact policyholder benefits. The PRA and FCA, as regulators, are entitled to be heard in proceedings and they have been informed of the proposed terms.

The report is based on the draft core documents sent to the PRA and FCA with this report on 28 September 2018.

1.2 Background

RLMIS is a long-term insurance company authorised in the UK. Once authorised, Royal London DAC will be a long-term insurance company authorised in Ireland by the Central Bank of Ireland ("**CBI**"). It is expected that Royal London DAC will be authorised by the end of 2018. Authorisation must be obtained before the Transfer can take place. RLMIS is a large mutual insurance company and owns 100% of Royal London DAC. RLMIS will provide Royal London DAC with a €40m (£36m) capital injection prior to the authorisation by the CBI. The amount of the capital injection was calculated taking into account the proposed Transfer.

Royal London DAC has been established to enable the life insurance business previously written by RLMIS through a branch in Ireland to be written directly through a life insurer authorised in Ireland. This will allow the Royal London Group to continue to sell new life insurance business in Ireland once the UK has left the European Union ("**EU**"), assuming that the passporting rights will be lost at the point of exit. In addition, the Transfer will allow the existing RLMIS business written in Ireland and Germany to continue to be serviced without reliance on EU passporting rights. This is because the Transfer will move the business from RLMIS, a UK regulated company, to Royal London DAC that will be authorised in Ireland.

If the Transfer was not carried out then, without agreement between the EU and the UK as to how existing cross-border business can continue to be serviced, RLMIS would not be authorised to service its business written in the EU. This would include paying claims to policyholders. There remains considerable uncertainty on whether such an agreement will be reached between the EU and the UK, and on the timing and terms of any such agreement. The Transfer is being carried out to mitigate the risk that no workable agreement is reached. Accepting the risk (and therefore taking no action) was not considered a valid option because of the potential consequences for RLMIS and the affected policyholders if RLMIS could not service its business written in the EU.

It would have been possible to include a provision within the Scheme to allow parts of the Transfer, for example the transfer of the Liver Ireland business and the German Bond business, not to be transferred in the event an agreement is reached between the EU and the UK. Such a provision has not been included because of the complex messaging it would require and the increased uncertainty it would bring for policyholders. The approach being taken gives clarity and allows clear messaging to those affected.

The Ireland Liver business is currently held in a ring-fenced fund (the "**Royal Liver Sub-Fund**") within RLMIS together with business written in the UK by Royal Liver Assurance Limited and the businesses that Royal Liver Assurance Limited acquired prior to transferring its business to RLMIS, including Friends Provident (including its London and Manchester business) business (the "**Non-transferring Liver business**"). As at 31 December 2017 the Royal Liver Sub-Fund had best estimate liabilities (BEL) of £1.7bn, of which £755m relates to the policies comprising the Ireland Liver business (the "**Ireland Liver Policies**"). The Ireland Liver business is therefore a material proportion of the Royal Liver Sub-Fund.

The Royal Liver Sub-Fund is currently in a stable financial position. As at 31 December 2017 it had own funds of £499m and an SCR of £181m giving a coverage ratio of 275%.

The business in the Royal Liver Sub-Fund includes a significant proportion of with-profits business which is subject to its own Principles and Practices of Financial Management (the "**PPFM**"). The Royal Liver Sub-Fund is managed uniformly, for example by spreading investment returns and tax across the non-transferring policies in the Royal Liver Sub-Fund (the "**Non-Transferring Liver Policies**") and the Ireland Liver Policies. The holders of with-profits Ireland Liver Policies and Non-transferring Liver Policies are both equivalently entitled to share in the estate of the Royal Liver Sub-Fund. The estate is the amount by which the realistic value of the assets exceeds the realistic value of the liabilities in the Royal Liver Sub-Fund.

To broadly maintain the economic position of the Royal Liver Sub-Fund, continue current practice and cause minimum disruption across all policyholders, the Ireland Liver Policies will be 100% reinsured back to the Royal Liver Sub-Fund in RLMIS under a reinsurance agreement (the "**Liver Reinsurance Agreement**") on the Effective Date. If the reinsurance was not in place, it would be necessary to split the Royal Liver Sub-Fund. Splitting the Royal Liver Sub-Fund would mean the need for a once and for all allocation of all the assets in that fund between the holders of Ireland Liver Policies and Non-transferring Liver Policies. This would change the economic position of the Liver Sub-Fund.

The Royal Liver Sub-Fund is managed according to the Royal Liver Instrument of Transfer ("**Royal Liver IoT"**) that was established when RLMIS acquired Royal Liver Assurance Limited's business in July 2011. The Royal Liver IoT includes a set of Core Principles of Financial Management. The Liver Supervisory Committee (established under the Royal Liver IoT) is responsible for ensuring RLMIS manage the business in line with the Royal Liver IoT (including the Core Principles of Financial Management). Some of the key provisions of the Royal Liver IoT are around estate distribution methodology, expenses, capital support and the cessation point of the Royal Liver Sub-Fund.

The Royal Liver IoT sets out fees that are charged by the RLMIS Main Fund (the "**RL Main Fund**") to the Royal Liver Sub-Fund in exchange for policy administration and investment management services. The RL Main Fund retains any profits or losses that arise from the actual expenses being different to the fees. The fees for policy administration are fixed (besides allowance for inflation) until December 2021 when they will revert to actual expenses plus a margin, subject to a comparison against the costs of managing the business through outsourcing. The investment management fees remain fixed for the lifetime of the Royal Liver Sub-Fund.

The German Bond business was sold to German residents through RL360^0 and its predecessor Scottish Life International. RL360^0 was a subsidiary of RLMIS at the time the business was sold, located in the Isle of Man. The German Bond business continues to be administered in the Isle of Man by RL360^0 Management Services Limited under the terms of an outsourced administration services agreement.

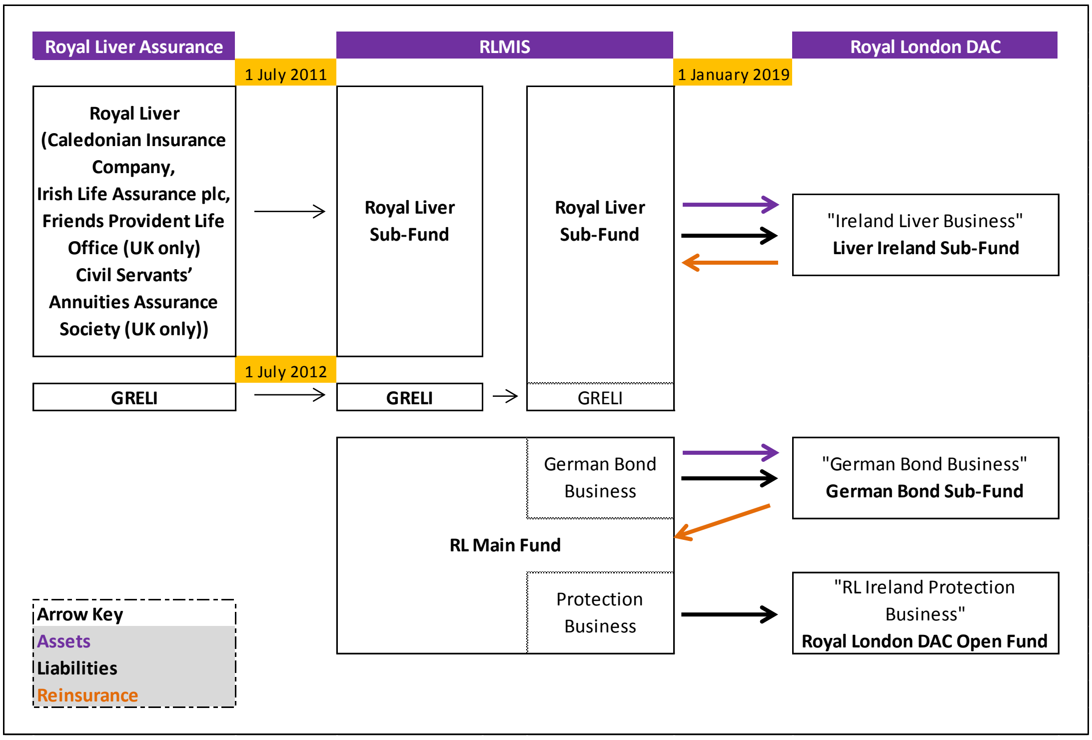
In a similar way to the Ireland Liver business, the policies comprising the German Bond business (the "**German Bond Policies**") will be 100% reinsured back to the RL Main Fund in RLMIS under a reinsurance agreement (the "**German Bond Reinsurance Agreement**") on the Effective Date. The German Bond business is a relatively small block of mainly unitised with-profits business which shares in the profits and losses of the RL Main Fund. The reinsurance will allow this to continue. The unitised with-profits German Bond Policies are eligible for ProfitShare, Royal London's mechanism for sharing profits in the RL Main Fund with eligible policyholders. There are also a small number, around 35, of unit-linked German Bond Policies.

As at 31 December 2017 the RL Main Fund had £44.7bn of BEL, of which £0.12bn relates to the German Bond business. The German Bond business is currently covered by the RL Main Fund PPFM.

The Ireland Liver business and German Bond business will be transferred to separate ring-fenced funds in Royal London DAC, the '**Liver Ireland Fund'** and '**German Bond Fund**' respectively and together the "**Royal London DAC Closed Funds**". The RL Ireland Protection business will be transferred to Royal London DAC's Open Fund (the "**Royal London DAC Open Fund**").

The RLMIS With Profits Committee (the "**RLMIS WPC**") currently provides oversight to all with-profits policies in RLMIS which includes with-profits Ireland Liver Policies and with-profits German Bond Policies. The terms of the Liver Reinsurance Agreement and German Bond Reinsurance Agreement will allow the Ireland Liver Policies and German Bond Policies to continue to benefit from a level of oversight from the RLMIS WPC.

The diagram below summarises the development of the business to be transferred and the policies which are to be reinsured back to RLMIS.



1.3 Supporting documents and information

In considering the likely impact of the Transfer I have taken account of:

- The latest draft of the Scheme
- The RLMIS PPFMs
- The draft amended RLMIS PPFMs (for the Transfer)
- The draft Royal London DAC PPFM Guides
- The RLMIS and draft Royal London DAC capital management plans
- The latest draft RLMIS Chief Actuary's Report on the Transfer ("the **Chief Actuary's Report**")
- The latest draft of the Liver Reinsurance Agreement
- The latest draft of the German Bond Reinsurance Agreement
- The latest drafts of the Collateral Framework Agreements and Deeds of Charge
- The Royal Liver IoT
- The proposed amendments to the Royal Liver IoT (which are subject to approval of the PRA)
- Pillar 1 capital balance sheets

This report includes financial information at 31 December 2017. I will prepare a supplementary report at a later date (but prior to the final court hearing) based on more up-to-date financial information.

In my judgement the movements in the figures from the date as at which they were calculated up to the date of this report are not sufficiently material to affect my conclusions.

1.4 Credentials and declaration of interest

I am a Fellow of the Institute and Faculty of Actuaries and the With Profits Actuary ("**WPA**") for all with-profits funds in RLMIS. I have been WPA for RLMIS since 1 January 2016. Given the nature of the proposed Transfer I am content that it is appropriate for me to report as WPA on the impact of the Transfer on both transferring and non-transferring policyholders in a single document.

My role in RLMIS is unaffected by the proposed Transfer. I am a member of the RLMIS Group Personal Pension Plan and as a result a member of RLMIS, eligible for ProfitShare, but otherwise have no policies with RLMIS. I have no policies with Royal London DAC. I confirm that I have taken no account of my personal interest in reaching any of the conclusions detailed in this report.

2 OUTLINE OF THE PROPOSED TRANSFER

2.1 Background information on Royal London and Royal London DAC

Appendix A gives background information about RLMIS, Royal London DAC, the background to and rationale for the Transfer and information about the business that is proposed to be transferred. It also highlights some of the more important aspects of the Transfer.

2.2 Summary of proposed Transfer

(i) RL Ireland Protection business.

This is RLMIS's existing protection business liabilities which have been written in Ireland through a local branch into the RL Main Fund since 1 July 2011. This business will be transferred to the Royal London DAC Open Fund. The BEL for this business has a negative value (-£62.5m at 31 December 2017) as is often the case with protection business and, as a result, there will be no asset transferred alongside the liabilities under the Scheme.

There will be no payment by Royal London DAC to RLMIS in connection with the Transfer. RLMIS is providing initial funding of €40m for Royal London DAC, as described in section 1.2. The transfer of a more mature block of protection business of this nature reduces the amount of capital needed as it lessens the impact of new business strain. The initial funding of €40m is calculated assuming that the Transfer takes place and therefore takes this into account.

The RL Ireland Protection business is currently reinsured. The reinsurance contracts held by RLMIS in respect of this business will be novated to Royal London DAC on the Effective Date. These reinsurance contracts are valued at £28m as at 31 December 2017.

Under the Scheme Royal London DAC will take on all existing rights and obligations of RLMIS in relation to the transferring RL Ireland Protection business.

(ii) Ireland Liver business.

This is the Ireland Liver business in the Royal Liver Sub-Fund which will be transferred to the Liver Ireland Sub-Fund established under the Scheme. This will be a ring-fenced fund under Solvency II. Assets sufficient to match the following will be transferred:

(i) BEL,
(ii) risk margin,
(iii) solvency capital requirement (SCR), and
(iv) the capital buffer required under the internal capital management framework,

in respect of Ireland Liver business, all calculated on the basis that the reinsurance to RLMIS and any third party reinsurance agreements are not in place. Under the terms of the Scheme Royal London DAC will take on all existing rights and obligations of RLMIS in relation to the transferring Ireland Liver business.

From the Effective Date, the Ireland Liver Policies will be 100% reinsured back to the Royal Liver Sub-Fund under a quota share arrangement as described in section 2.3. The initial reinsurance premium will be equal to:

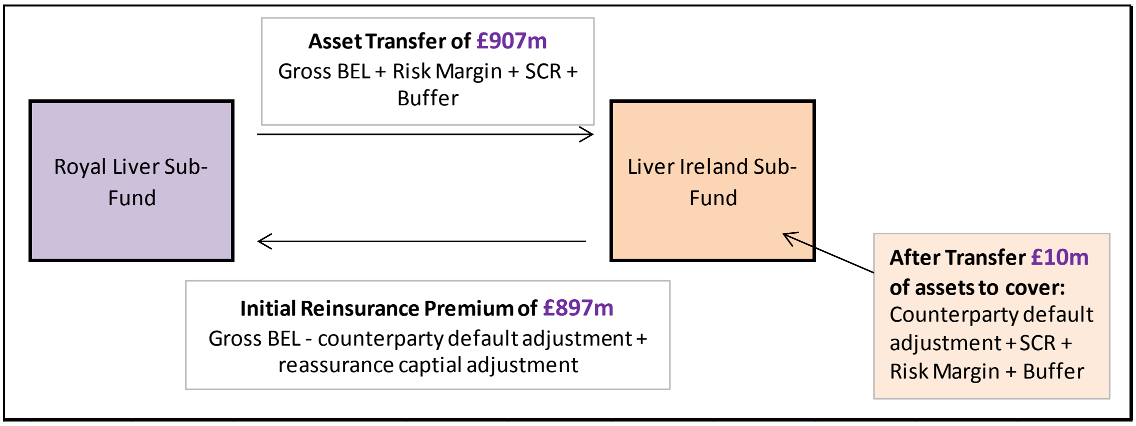
(i) the gross value of the BEL, less an adjustment to BEL to take account of expected losses due to default of the counterparty (i.e. RLMIS) after the reinsurance (the "**BEL Counterparty Default Adjustment**"), plus
(ii) the difference between
    - the risk margin, SCR and capital buffer calculated gross of the reinsurance and
    - the risk margin, SCR and capital buffer calculated net of the reinsurance

    (the "**Reinsurance Capital Requirements Adjustment**")

in respect of the Ireland Liver business.

The initial reinsurance premium will be paid as at the Effective Date, but for timing reasons it will be calculated as an estimate based on the valuation data from the previous quarter. The position will be corrected through an additional payment once the data on the actual position is available.

The assets remaining in the Liver Ireland Sub-Fund will then be sufficient to cover the risk margin, BEL counterparty default adjustment, SCR and the capital buffer required under the Royal London DAC internal capital management framework (after allowing for reinsurance). The cashflows are shown in the diagram below, including figures as at 31 December 2017 in pounds (note the actual cashflows will be in Euros and be based on the exchange rate at the Effective Date where applicable):



The rationale for the reinsurance of the Ireland Liver Policies back to the Royal Liver Sub-Fund is to keep the Royal Liver Sub-Fund economically intact and enable RLMIS to maintain the expectations of policyholders under the Royal Liver PPFM. This includes the expectations of holders of Liver Ireland Policies for whom the Royal Liver PPFM will not directly apply after the Effective Date. It will allow the use of uniform rates of return and consistent distribution rates to continue for Non-transferring Liver Policies and Ireland Liver Policies. The level of currency risk in the Royal Liver Sub-Fund is not expected to change as a result of the Transfer. RLMIS currently actively manages the level of currency risk through hedging arrangements which will remain in place after the Transfer.

If the reinsurance was not in place, it would be necessary to split the Royal Liver Sub-Fund. Splitting the Royal Liver Sub-Fund would mean the need for a once and for all allocation of all the assets in that fund between the holders of Ireland Liver Policies and Non-transferring Liver Policies. This would be a complex task which would involve detailed consideration around the fairness to different groups and generations of policyholders. It would not be possible to complete this process in a fair and controlled manner ahead of the deadline of 29 March 2019 imposed by Brexit.

In addition, the reinsurance will allow past management practices, which have worked well, to continue, for example the continued use of uniform rates of return, consistent distribution rates and consistent surrender value methodologies. Such practices have allowed policies to share in the profits of the Liver Sub-Fund in a consistent manner, as could be expected when investing in a with-profits fund. It will also mean there will no material consequences on the covenant available to the pension funds currently supported by the Royal Liver Sub-Fund.

The reinsurance will include both with-profits and non-profit and unit linked policies. The non-profit and unit-linked policies contribute towards the profits in the Royal Liver Sub-Fund and therefore form a key component of the sub-fund. Reinsuring these policies as well as the with-profits policies therefore contributes towards keeping the fund economically intact.

The Scheme, Liver Reinsurance Agreement and the amended Royal Liver IoT all recognise that, if the Liver Reinsurance Agreement was to be terminated, an exercise to allocate the assets of the Royal Liver Sub-Fund, in particular the estate, between the holders of Non-transferring Liver Policies and Ireland Liver Policies would be required. A robust governance process has been set out in the legal documentation to ensure the amount allocated to Non-transferring Liver Policies and Liver Ireland Policies is fair and equitable.

Under the Scheme Royal London DAC will take on all existing rights and obligations of RLMIS in relation to the Ireland Liver business. This includes any mis-selling liabilities. There are no known current mis-selling issues, and given no new business has been sold since 2011 the risk of new mis-selling issues arising is small. In addition, whilst the Liver Reinsurance Agreement is in place any additional capital required in respect of mis-selling claims would be provided by the Royal Liver Sub-Fund estate.

The Royal Liver PPFM will be amended on the Effective Date to reflect the proposed reinsurance of the Ireland Liver Policies. From the Effective Date the Royal Liver PPFM will cease to apply directly to Liver Ireland Policies. It will continue to apply to Non-transferring Liver Policies.

Royal London DAC has produced and will maintain from the Effective Date a PPFM guide document in respect of the business in the Liver Ireland Sub-Fund (the "**Liver Ireland PPFM Guide**"). This short guide will explain the key principles of how the Liver Ireland Sub-Fund is managed. There is a requirement in the Scheme for Royal London DAC to maintain such a guide.

Whilst the Liver Reinsurance Agreement is in place the Liver Ireland PPFM Guide will refer back to the Royal Liver PPFM for the technical detail where relevant. It will explain that policies in the Liver Ireland Sub-Fund are reinsured by RLMIS and that this means the Royal Liver PPFM remains indirectly relevant. It will continue to cover the key principles of how the business is managed in customer friendly language meaning it will remain a stand-alone document despite any reference to the Royal Liver PPFM.

The Royal Liver PPFM and Liver PPFM Guide will need to remain consistent whilst the Liver Reinsurance Agreement is in place. I will work closely with Royal London DAC's Head of Actuarial Function (HoAF) to ensure this consistency remains.The Royal Liver IoT will be amended as a result of the Transfer from the Effective Date. This is covered in section 2.6.

Currently, the Royal Liver IoT sets out the fees that are charged to the Royal Liver Sub-Fund in exchange for policy administration and investment management services in relation to the Ireland Liver Policies and the Non-transferring Liver Policies. The Scheme sets out the fees to be charged by Royal London DAC to the Liver Ireland Sub-Fund for such services in respect of the Ireland Liver Policies. There are no differences between the fees specified in the Royal Liver IoT and the Scheme. This means that from the Effective Date any profits of losses from the fees being different to actual expenses will emerge in the Royal London DAC Open Fund.

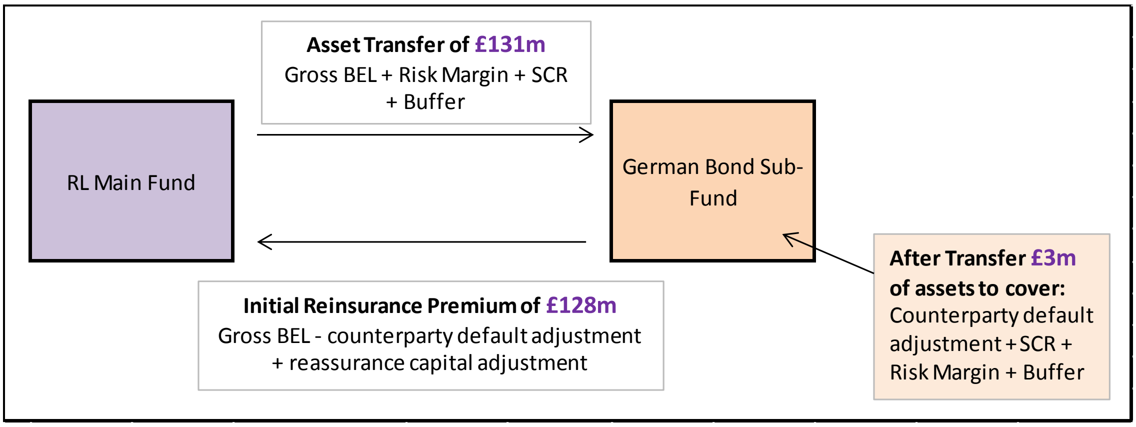
From December 2021 the fees for policy administration revert to actual expenses plus a margin, subject to a comparison against the costs of managing the business through outsourcing. This is included in the Liver IoT and the Scheme. The actual expenses charged to the Royal Liver Sub-Fund will be based on Non-transferring Liver policies only and the actual costs charged to the Liver Ireland Sub-Fund will be based on Ireland Liver policies only.

(iii) However, the expenses charged to the asset shares of both Non-transferring Liver policies and Liver Ireland policies will be the average of the actual expenses across both groups for each business class. The Core Principles of Financial Management in the Liver IoT have been amended to include this requirement. This means that, whilst the Liver Reinsurance Agreement remains in place, the allocation of expenses between different policyholder groups will continue to be carried out in the same way as intended before the Transfer. **German bond business.**

This is the German Bond business in the RL Main Fund. It is proposed to be transferred to the German Bond Sub-Fund in Royal London DAC which will be established under the Scheme. This will be a ring-fenced fund under Solvency II.

The German Bond Policies will be 100% reinsured back to the RL Main Fund as described in section 2.3. The assets transferred and the initial reinsurance premium will be calculated on the same basis as described in section 2.2 (ii) for the Ireland Liver business.

The cashflows are shown in the diagram below, including figures as at 31 December 2017 in pounds (note the actual cashflows will be in Euros):



There is £120m BEL of German Bond business, of which £118m relates to with-profits business. It would not be economically viable to manage this block of with-profits business in Royal London DAC in isolation as the business runs off. In addition, without the reinsurance it is likely the investment strategy would need to change to reflect the reduced size of the fund. The German Bond Reinsurance Agreement allows continuity of the investment strategy for this business. This is the rationale behind reinsuring the business under the German Bond Reinsurance Agreement. There are only 35 unit-linked German Bond policies. These policies are included within the reinsurance, largely for practical reasons and to avoid having such a small number of policies in a stand alone sub-fund.

Under the Scheme Royal London DAC will take on all existing rights and obligations of RLMIS in relation to the German Bond business. However, RLMIS will continue to meet any mis-selling liabilities that pre-date the Transfer through an indemnity.

The RL Main Fund PPFM will be amended on the Effective Date to reflect the proposed reinsurance of the German Bond Policies. From the Effective Date the RL Main Fund PPFM will cease to apply directly to German Bond Policies. It will continue to apply to relevant non-transferring policies in the RL Main Fund (the "**Non-transferring RL Main Fund Policies**").

Royal London DAC has produced and will maintain from the Effective Date a PPFM guide document in respect of the business in the German Bond Sub-Fund (the "**German Bond PPFM Guide").** This short guide will explain the key principles of how the German Bond Sub-Fund is managed. There is a requirement in the Scheme for Royal London DAC to maintain such a guide.

Whilst the German Bond Reinsurance Agreement is in place the German Bond PPFM Guide will refer back to the RL Main Fund PPFM for the technical detail where relevant. It will explain that policies in the German Bond Sub-Fund are reinsured by RLMIS and that this means the RL Main Fund PPFM remains indirectly relevant. It will continue to cover the key principles of how the business is managed in customer friendly language meaning it will remain a stand-alone document despite any reference to the RL Main Fund PPFM.

The RL Main Fund PPFM and German Bond PPFM Guide will need to remain consistent whilst the German Bond Reinsurance Agreement is in place. I will work closely with Royal London DAC's HoAF to ensure this consistency remains.

The Scheme includes provisions that expense fees can be charged by the Royal London DAC Open Fund to the German Bond Sub-Fund. These fees will be in line with actual expenses incurred in respect of the German Bond business. This includes any exceptional expenses. This is described in more detail in section 3.5.

2.3 Summary of proposed reinsurance agreements

From the Effective Date, the liabilities under the Ireland Liver Policies in the Liver Ireland Sub-Fund and German Bond Policies in the German Bond Sub-Fund are to be reinsured fully to the Royal Liver Sub-Fund and RL Main Fund respectively.

The initial reinsurance premium is described in section 2.2. The ongoing reinsurance premiums will be equal to;

- the annual policy premiums payable under the business in the relevant Royal London DAC Closed Fund (zero for the German Bond Sub-Fund as this is all single premium business)
- less the expense fees incurred in respect of the reinsured business as described in section 2.2
- less any exceptional expenses incurred
- less the actual tax paid in Ireland in the relevant Royal London DAC Closed Fund

- less the claims paid in respect of the reinsured business
- less any amounts paid to the National Treasury Management Agency (NTMA) in respect of unclaimed funds on the reinsured business as described in section A8 in appendix A.
- plus, on a quarterly basis, an experience adjustment (positive or negative) to keep the capital coverage ratio for the relevant Royal London DAC Closed Fund in line with the Royal London DAC capital management framework.

The capital being transferred to each of the Royal London DAC Closed Funds will come from the respective RLMIS Funds. This means that any surplus in the Royal London DAC Closed Funds, in particular as the business and capital requirements run off, will need to be distributed to both eligible Transferring Policies and those remaining in the relevant RLMIS Funds. The experience adjustments under each of the Liver Reinsurance Agreement and the German Bond Reinsurance Agreement (together the **"Reinsurance Agreements"**) will ensure that any surplus finds its way back to the respective RLMIS Funds. From here it will be distributed through the usual mechanisms to eligible policyholders, UK, Ireland and Germany. Details about the bonus setting process after the Effective Date, which includes the process to distribute such surplus, is set out in section 3.11.

The experience adjustment will be calculated in line with the Royal London DAC capital management framework, which at outset will be aligned with the RLMIS capital management framework. The expectation is that this consistency will remain but if Royal London DAC does propose any changes to the framework, in particular in relation to the Royal London DAC Closed Funds, then they will notify RLMIS.

The Reinsurance Agreements include an allowance for expense cashflows. To consider the impact of this the full set of expense cashflows is outlined below for the Liver Ireland Business:

a. Actual expenses will be incurred by the Royal London DAC Open Fund
b. The Royal London DAC Open Fund will charge the Ireland Liver Sub-Fund the fees for policy administration and investment management services as set out in the Scheme, including any exceptional costs
c. The ongoing reinsurance premium paid from the Royal Liver Sub-Fund to the Liver Ireland Sub-Fund will include the amount specified in (b)

The net effect of these cashflows is:

- The Royal Liver Sub-Fund incurs a cost equal to the fees for policy administration and investment management services and any exceptional costs (as it does currently in respect of this business). These expenses will be passed on to policyholders in an appropriate manner in line with the Liver IoT and Royal Liver PPFM. This is discussed further in section 3.5.
- The Royal London DAC Open Fund makes a profit or loss depending on the difference between the actual costs of administering the Ireland Liver business and the amount described above. Note this is expected to make a profit. Prior to the Transfer this profit or loss would have emerged in the RL Main Fund.

A similar arrangement will be in place for the German Bond Business except that all the cashflows will relate to actual expenses. This will give a net effect of the RL Main Fund incurring the actual expenses in respect of the German Bond business with no profits or losses arising in the Royal London DAC Open Fund. The impact on policyholders is covered in section 3.5.

On the Effective Date RLMIS and Royal London DAC will enter into deeds of charge which will provide collateral to support each Reinsurance Agreement in the event of a material breach of the terms of the Reinsurance Agreement by RLMIS. There will be 2 deeds of charge for each Reinsurance Agreement, a first tier and second tier. Each deed of charge will provide a fixed charge over sufficient assets of the RLMIS Fund which provides the reinsurance cover (i.e. the Royal Liver Sub-Fund or the RL Main Fund) to enable 50% of the reinsured BEL to be met.

The charges will mean that in the event that a material breach of either the German Bond Reinsurance Agreement or the Liver Reinsurance Agreement occurs, Royal London DAC can take control of sufficient assets to meet the reinsured BEL.

The difference between the first tier and second tier deeds of charge is that the second tier deeds of charge, in relation to each Reinsurance Agreement, will contain an equalisation provision. The equalisation provision will ensure that the interests of Royal London DAC will be considered on a consistent basis with the interests of direct policyholders of RLMIS. The first tier deeds of charge will not contain equalisation provisions to ensure that Royal London DAC has sufficient assets to meet any claims arising on the Ireland Liver Policies and German Bond Policies, up to 50% of BEL, whilst insolvency proceedings are progressed.

There is a possibility that Transferring Policies could receive more than direct policies of RLMIS under this arrangement, but this would require RLMIS to go insolvent and only be able to meet 50% of policyholders claim values. This is an extremely remote possibility.

The assets subject to each deed of charge will be taken from the assets of the relevant RLMIS Fund and will be allocated to a separate collateral account held with the custodian, HSBC. No changes are expected to be required to the assets in the relevant RLMIS Funds to accommodate this requirement. The assets will continue to be managed by Royal London Asset Management ("**RLAM**") to the relevant investment benchmarks. Monthly settlement arrangements will make the assets available to meet claims arising under the Reinsurance Agreements. The value of the collateral relative to the reinsured liabilities will be reassessed on, at least, a quarterly basis based on regulatory reporting figures and there will be a top up and release of collateral held as appropriate.

In addition, Royal London DAC will have a separate floating charge over the assets of RLMIS, up to the value of the aggregate BEL of the reinsured policies under the Reinsurance Agreements. This will contain an equalisation provision, meaning that Royal London DAC will rank pari passu with the direct policyholders of RLMIS in the event that RLMIS becomes insolvent. Without such a charge, Royal London DAC, and therefore reinsured policyholders, would rank behind direct policyholders of

RLMIS in the event of RLMIS being wound up. The floating charge contains an equalisation provision that ensures Royal London DAC ranks pari passu, and not above, direct policyholders of RLMIS.

The above fixed and floating charges will not impact the investment strategy of either the RL Main Fund or the Royal Liver Sub-Fund.

2.4 Summary of reinsurance termination protections

The Reinsurance Agreements are a key component of the Transfer. Several provisions have been included in the Scheme and Reinsurance Agreements to protect policyholders in the unlikely event that the Reinsurance Agreements are terminated.

If RLMIS or Royal London DAC proposes to terminate the Reinsurance Agreements, then prior to taking action, the Scheme requires:

- RLMIS to consult the With Profits Actuary, Chief Actuary, With Profits Committee, Liver Supervisory Committee (Liver Reinsurance Agreement only) and notify the FCA and PRA and
- Royal London DAC to consult the Head of Actuarial Function and notify the CBI.

(i) Ireland Liver business

If the Liver Reinsurance Agreement was terminated then the Royal Liver Sub-Fund would need to be split and the assets of the Royal Liver Sub-Fund and Liver Ireland Sub-Fund allocated between the Ireland Liver Policies and the Non-transferring Liver Policies. This would include the allocation of the Royal Liver Sub-Fund estate between eligible Ireland Liver Policies and Non-transferring Liver Policies.

The Scheme requires RLMIS to consider the opinions of the Royal London With-Profits Actuary, Royal London Chief Actuary, Royal London DAC HoAF, Liver Supervisory Committee, RLMIS WPC and Royal London DAC Board when completing this process. In addition an independent expert must be appointed to opine on the fairness of the fund split amounts, including the allocation of the estate of the Royal Liver Sub-Fund between holders of Ireland Liver Policies and Non-transferring Liver Policies.

The Scheme requires the following additional governance around this process:

- The Royal London Chief Actuary and Royal London With Profits Actuary to each provide a report to the Royal London Board and the Royal London DAC Head of Actuarial Function to provide a report to the Royal London DAC Board confirming that the allocation of the assets between the Ireland Liver Policies and Non-transferring Liver Policies represents a fair proportion.
- The independent expert to provide a certificate confirming that the assets between the Ireland Liver Policies and Non-transferring Liver Policies represents a fair proportion.

- The above reports and certificate are to be provided to the PRA and FCA by RLMIS and the CBI by Royal London DAC.

Following termination of the Liver Reinsurance Agreement the Liver Ireland Sub-Fund may continue to operate as a ring-fenced fund without the link to the Royal Liver Sub-Fund. Relevant provisions, including a requirement to maintain a PPFM Guide, capital support provisions and a set of Core Principles of Financial Management have been included in the Scheme to ensure the Liver Ireland Sub-Fund will be managed in a similar manner to how the Royal Liver Sub-Fund is managed now.

(ii) German Bond business

In the event of termination of the German Bond Reinsurance Agreement the German Bond Sub-Fund will cease to exist. This is because the fund would be so small it is unlikely it would be viable to run it as its own ring-fenced with-profits fund. The Scheme contains provisions for closing the German Bond Sub-Fund. There is a requirement in the German Bond Reinsurance Agreement that an independent expert considers the termination amount, and in particular if any additional payments should be made for the loss of eligibility to future ProfitShare amounts. The expert has a duty to consult the Royal London With-Profits Actuary in coming to their conclusion.

The Scheme contains provisions to ensure that on termination of the German Bond Reinsurance Agreement Royal London DAC are provided with enough assets to meet the capital requirements in relation to the German Bond business. Any additional assets required by Royal London DAC will be provided by the Royal London Main Fund. This amount will reflect the capital requirements required by the Royal London DAC Open Fund after the collapse of the German Bond Sub-Fund.

2.5 Financial Impact

Section 2.3 of the Chief Actuary's report provides detailed figures on the financial impacts for RLMIS and Royal London DAC. This section focuses on the figures that will directly affect with-profits policies, which are the figures showing the impact on the Royal Liver Sub-Fund and RL Main Fund.

The figures are based on the provisional Pillar 1 calculations as at 31 December 2017 and assume the Transfer takes place on 1 January 2019. I have taken these figures into account when assessing the likely effect of the Transfer on the relevant policyholders.

Royal Liver Sub-Fund

£m	Royal Liver Sub-Fund Pre Transfer	Project Costs	Transfer from Royal Liver Sub-Fund	Reinsurance from RL DAC to Royal Liver Sub-Fund	Royal Liver Sub-Fund Post Transfer
Assets	2,311	-10	-907	897	2,291
BEL	1,713		-755	755	1,713
Risk Margin	44		-20	20	44
TMTP	-46		0	0	-46
Current Liabilities	100		0	0	100
Subordinated debt	0		0	0	0
Own funds	499	-10	-131	121	479
Capital requirement	181		-80	80	181
Excess capital	318				298
Own Funds (% of capital requirement)	275%				264%

The key cashflows impacting the position of the Royal Liver Sub-Fund is the net impact of the asset transfer and initial reinsurance premium, (£10m), as explained in Section 2.2 (ii) and the project costs that are being charged to the fund, (£10m), as described in Section 3.5.

RL Main Fund

£m	RL Main Fund Pre Transfer	Project Costs	Transfer Protection Business from RL Main Fund (inc. Seed Capital)	Transfer German Business to German Bond Sub-Fund	Reinsurance from RL DAC to RL Main Fund	RL Main Fund Post Transfer
Assets	49,749	-11	-64	-131	128	49,672
BEL	44,660		70	-121	121	44,730
Risk Margin	732		-7	-2	2	725
TMTP	-729		0	0	0	-729
Current Liabilities	1,667		0	0		1,667
Subordinated debt	883		0	0		883
Own funds	4,303	-11	-126	-9	6	4,163
Capital requirement	1,933		-17	-5	5	1,917
Excess capital	2,370					2,247
Own Funds (% of capital requirement)	223%					217%

The key cashflows impacting the RL Main Fund are the initial capital transfer to Royal London DAC as described in Section 1.2 (£36m in the table above which is equivalent to €40m), the net impact of the asset transfer and initial reinsurance premium for the German Bond business as explained in Section 2.2 (iii) (£3m) and the project costs that are being charged to the fund, as described in Section 3.5 (£11m).

In addition there is a £62m increase in BEL from the transfer of the Post 2011 Protection business as explained in Section 2.2 (i), a transfer of £28m reflecting the novated reinsurance arrangements in respect of the RL Ireland Protection business as explained in section 2.2 (i) and a £7.5m increase in BEL from the reduction in future expense profits described in Section 3.5.

My analysis in sections 3 and 4, which considers the likely impact of the Transfer on with-profits policyholders, should be considered in relation to these figures which show that the capital impact on the Royal Liver Sub-Fund and RL Main Fund is relatively small.

2.6 Proposed amendments to the Royal Liver Instrument of Transfer

It is proposed that the Royal Liver IoT is amended on the Effective Date as a consequence of the Transfer. The key amendments that are proposed are:

- Relevant provisions, for example estate distribution methodology, are proposed to be extended to cover the Ireland Liver Policies as well as the Non-transferring Liver Policies.
- The Core Principles of Financial Management are proposed to be amended to include the reinsured Ireland Liver Policies. The Scheme requires the Royal London DAC Board to consider these principles when managing the Liver Ireland Sub-Fund whilst the Liver Reinsurance Agreement is in place.
- The terms of reference of the Liver Supervisory Committee are proposed to be amended to ensure they can continue to offer a level of protection to the Ireland Liver Policies. This includes giving them the right to raise any concerns that relate to Ireland Liver Policies with the Royal London DAC Board.

I am comfortable that the proposed amendments do not have a material adverse affect on any policyholders. The amendments have been certified by myself, the Chief Actuary and an Independent Expert, at the request of the Liver Supervisory Committee, and are required to be approved by the PRA. My certification is in Appendix B.

3 IMPACT OF THE TRANSFER ON THE TRANSFERRING POLICYHOLDERS

3.1 Factors considered

The likely impact of the Transfer on the policyholders of RLMIS transferring to Royal London DAC is considered against the headings of:

(a) Security of benefits (Section 3.2).
(b) Benefits payable under participating policies (Section 3.3).
(c) Application of discretionary management actions (Section 3.4).
(d) Expenses (Section 3.5).
(e) Service standards/standards of administration (Section 3.6).
(f) Investment strategy (Section 3.7).
(g) Tax (Section 3.8).
(h) Membership rights (Section 3.9).
(i) Policyholder communications (Section 3.10).

(j) Governance (Section 3.11).

When doing so, I consider and take into account more generally the requirement to treat customers fairly.

I consider the impact on the policies comprising the RL Ireland Protection business (the "**RL Ireland Protection Policies**"), Ireland Liver Policies and German bond Policies separately where appropriate.

3.2 Security of benefit

RL Ireland Protection Business

The Royal London DAC Open Fund will accept the transferring RL Ireland Protection Policies and accept any new business sold from, it is anticipated, December 2018. There will be a small amount of pipeline business that will be written by RLMIS after this date from application forms that have already been issued. This business will be transferred to Royal London DAC under the Scheme and is included in the RL Ireland Protection Business for the purpose of this report.

An initial capital injection of €40m will be provided from the RL Main Fund prior to the authorisation by the CBI. Royal London DAC will align the capital management framework of the Royal London DAC Open Fund with the capital framework of Royal London Group. This means it will target being able to withstand a 1-in-20 year event and still be able to meet the capital requirements. The bounds of when management actions may be taken will also remain consistent. This includes dividends paid to and capital injections from the RL Main Fund. There will be a loss of diversification benefits as a result of the Transfer, but this has been taken into account by RLMIS when calculating the initial capital injection of €40m to ensure the Royal London DAC Open Fund will be well capitalised when the Transfer takes effect.

It is not anticipated that RLMIS would need to provide additional capital as Royal London DAC is expected to be self-supporting from its own business. That said, while RLMIS remains the sole shareholder it will need to consider its ability to subscribe further capital as required. RLMIS will be under no greater obligation to subscribe further capital than any other shareholder in similar conditions.

I am satisfied that because Royal London DAC will be well capitalised when the Transfer takes effect there is no material adverse effect on the security of benefits for RL Ireland Protection Policies.

Ireland Liver and German Bond Business

The Liver Ireland Sub-Fund and German Bond Sub-Fund will be ring-fenced-funds under Solvency II and closed to new business. The capital framework for the ring-fenced funds will be aligned with Royal London Group's capital framework. The ring-fencing will segregate the assets backing the policies in these funds. This will allow any surplus in each fund to be distributed to the relevant eligible policyholders over time. While the Reinsurance Agreements are in place only a small amount of risk will remain in the Royal London DAC Closed Funds, in relation to operational risk and the risk of counterparty default of RLMIS, which is mitigated by the collateral described in section 2.3.

The Royal London DAC Open Fund will not be able to access the assets in the Liver Ireland Sub-Fund and German Bond Sub-Fund, except in very extreme scenarios such as insolvency. The Liver Ireland Sub-Fund and German Bond Sub-Fund policies will not be eligible to share in any surplus in the Royal London DAC Open Fund. This will preserve the interests of all policyholders, Ireland, Germany and UK.

The Reinsurance Agreements contain an experience adjustment provision that keeps the capital position of each of the Royal London DAC Closed Funds at the target level. This means that the capital position of the Royal London DAC Closed Funds cannot reach an unacceptable level unless RLMIS fails to meet its obligations under the Reinsurance Agreements. This means no capital support mechanism is required whilst the Reinsurance Agreements remain in place (and being complied with). If RLMIS fails to meet its obligations under the Reinsurance Agreements then, under the Scheme, the Royal London DAC Open Fund can provide capital support to the Royal London DAC Closed Funds. The collateral described in section 2.3 also provides protection in this scenario.

The Liver Ireland Policies currently benefit from the capital support arrangement that the Royal Liver Sub-Fund has with the RL Main Fund under the Royal Liver IoT. The German Bond Policies are currently invested in the RL Main Fund for which there are some capital support arrangements in place with the RLMIS closed funds. I am satisfied that the Reinsurance Agreements have been set up in a manner such that there will be no material adverse affect on the security of benefits for Ireland Liver Policies or German Bond Ireland Policies.

In the unlikely event that the German Bond Reinsurance Agreement is terminated then the German Bond Sub-Fund would collapse into the Royal London DAC Open Fund and cease to exist. This means there would be no requirement for capital support.

In the unlikely event that the Liver Reinsurance Agreement is terminated and the Liver Ireland Sub-Fund continues to exist, the Royal London DAC Open Fund would, as long as it was able, provide any capital support that may be required by the Liver Ireland Sub-Fund. This provision has been included in the Scheme.

In order to ensure that Royal London DAC and the policies of RLMIS that are not transferring under the Scheme (the "**Non-transferring Policies**") rank equally in the event of insolvency of RLMIS, Royal London DAC will benefit from a floating charge over the assets of RLMIS. This charge contains an equalisation provision.

There will also be dedicated collateral for the cover provided in respect of each of the Reinsurance Agreements which is described in section 2.3. The first tier deed of charge, in respect of 50% of the reinsured BEL, will not contain an equalisation provision. It is expected that this will give Royal London DAC sufficient assets (50% of the reinsured BEL) to enable them to pay claims to the Ireland Liver Policies while insolvency proceedings are completed. The second tier collateral and the insolvency floating charge is subject to an equalisation provision. This structure ensures that holders of Ireland Liver Policies and German Bond Policies will not be materially adversely affected by the Transfer in the event of insolvency of RLMIS.

It is proposed that the Royal Liver IoT is amended, as described in section 2.6 to ensure adequate protection for the holders of Liver Ireland Policies and continued protection for the holders of Non-transferring Liver Policies. This includes oversight of the Liver Supervisory Committee who is responsible for overseeing that RLMIS adheres to the Royal Liver IoT.

In addition certain provisions from the Royal Liver IoT have been carried over into the Scheme to put direct obligations on the Royal London DAC Board where required. The Royal London DAC Board is required to consider the Core Principles of Financial Management in the Royal Liver IoT when managing the Liver Ireland Sub-Fund whilst the Liver Reinsurance Agreement is in place.

If the Liver Reinsurance Agreement is terminated Royal London DAC is required to manage the Liver Ireland Sub-Fund in accordance with separate Core Principles of Financial Management that have been included in the Scheme. These provide protection for holders of Liver Ireland Policies in the unlikely event that the Liver Reinsurance Agreement is terminated and the Liver Ireland Sub-Fund remains a separate ring-fenced fund.

I am satisfied that the provisions included in the Royal Liver IoT (Liver Ireland Policies only) and Scheme and the security agreements associated with the Reinsurance Agreements give sufficient protection to the holders of Ireland Liver Policies and German Bond Policies.

Financial Services Compensation Scheme

The holders of the following Transferring business policies (the "**Transferring Policies**") are currently covered by the UK Financial Services Compensation Scheme ("**FSCS**"):

(a) holders of Ireland Liver Policies, where the relevant policy was written after 1 December 2001 and originally written by Royal Liver Assurance Limited or Caledonian Insurance Company Limited;
(b) holders of German Bond Policies and
(c) holders of RL Ireland Protection Policies.

Holders of Ireland Liver policies originally written by Irish Life Assurance plc or GRE Life Ireland Limited are not currently covered by FSCS.

The FSCS protects policyholders when financial services firms (including insurers) default or become insolvent. FSCS protection will not extend to Royal London DAC following the Transfer. Those policyholders who are currently covered by FSCS will no longer be covered by FSCS. There is no equivalent scheme in Ireland.

The protection provided by the FSCS for long-term insurance (e.g. pensions and life assurance) claims against firms declared in default on or after 3 July 2015 is 100% of the claim with no upper limit.

It is highly unlikely that the FSCS cover will ever be called upon. Royal London DAC will be appropriately capitalised at the Effective Date and has a robust proposed capital management plan in place. On the Effective Date, the RL Ireland Protection business will be supported by the material capital injection made by RLMIS to the Royal London DAC Open Fund described in section 1.2.

The reinsurance of the Ireland Liver business and German Bond business back to RLMIS, and its collateralisation and associated floating charge, provides direct support from RLMIS for the Ireland Liver business and German Bond business. RLMIS is a large, well established and well-run company with a very small risk of overall failure. RLMIS has a robust and well established capital management plan and there is a comprehensive run off plan for the with-profits business in the Royal Liver Sub-Fund.

The probability of RLMIS not being able to meet its SCR within one year has been estimated as less than 1 in 15,000 and the probability of the deficit being as high as 10% is less than 1 in 33,000.

While the loss of FSCS coverage is unwelcome, it is an inevitable consequence of Brexit given the Irish regulatory regime does not have an equivalent. Bearing that in mind I am satisfied that policyholders will not experience any material loss in the security of their benefits as a result of the Transfer.

3.3 Benefits payable under participating policies

Ireland Liver Policies

The Ireland Liver business consists of a range of different types of business including with-profits, protection and unit linked. There will be no change to the contractual benefits for any policyholders as a result of the Transfer. This includes guaranteed benefits for with-profits policyholders.

The Liver Reinsurance Agreement will ensure that the economic position of the Royal Liver Sub-Fund remains intact. Estate distributions will continue to be based on the capital position of the Royal Liver Sub-Fund and shared equitably between the eligible Non-transferring Liver Policies and Ireland Liver Policies. This will help to allow policyholder’s reasonable expectations to be maintained after the Transfer.

Section 2.5 shows that a relatively small reduction to the capital coverage ratio of the Royal Liver Sub-Fund of c9% (from 275% to 266%) is expected at the Effective Date. This is not a material reduction. This may have a negative second order impact on with-profit policyholders, both in respect of Ireland Liver Policies and Non-transferring Liver Policies, through the estate distributions added to their policies. I do not believe these will be material as explained further below.

In addition to the impact at the Effective Date, there will be the following changes to the ongoing cashflows within the Royal Liver Sub-Fund:

- Additional ongoing expenses of around €2m per year (reducing over time as the business runs off) will be charged to the Royal Liver Sub-Fund. These are explained in section 3.5.
- The experience adjustment from the Liver Reinsurance Agreement as explained in section 2.3.

The impact of this reduction in cover ratio and expected change in ongoing cashflows has been assessed against the current run off plan for the Royal Liver Sub-Fund. This suggests it will cause an initial reduction in the estate distribution applied to each eligible policyholder’s asset share (and the sums assured of eligible contingent bonus policies) at year end 2018 of around 2%. Following this, the expected estate distributions will remain broadly unchanged from the current run-off plan.

Estate distributions have not been applied regularly for policies in the Royal Liver Sub-Fund in recent years. This means policyholder’s expectations have not been set at a certain level and I am satisfied that payouts can continue to meet their reasonable expectations after the Effective Date.

Although there may be a small reduction in the estate distribution portion of policyholder benefits from the Transfer it is important to note that the status quo is not an option. I am satisfied that this proposal, particularly with the reinsurance arrangement, minimises the affect on policyholder benefits. The other option would be to split the Royal Liver Sub-Fund, including allocation of the estate, which could not be done in a suitably fair and controlled manner ahead of Brexit.

German Bond Policies

The benefits for the German Bond Policies should be broadly unaltered by the proposed Transfer. With-profits German Bond Policies will continue to be eligible for ProfitShare allocations in the RL Main Fund at the Effective Date. Any such ProfitShare allocations will be applied through the German Bond Reinsurance Agreement and with-profits governance arrangements described in section 3.11. German Bond Policies will not be eligible for any ProfitShare if the German Bond Reinsurance Agreement is terminated.

The Transfer will not have a material affect on the capital position of the RL Main Fund and its ability to maintain ProfitShare at appropriate levels. The with-profits German Bond Policies currently confer membership rights, which will be lost on Transfer. This is covered in section 3.9 but I am satisfied it will not lead to policyholders being materially adversely affected.

3.4 Application of Discretionary Management Actions

There are a range of discretionary management actions that can be taken in respect of with-profits policies, for example bonus setting, surplus distribution, the determination of asset shares and more extreme actions such as removing past asset share enhancements in the event of a threat to solvency.

Following the Transfer there will be no material change to the actions that can be taken by RLMIS, and circumstances in which they will apply. Whilst the Reinsurance Agreements are in place any actions taken will be applied consistently to Ireland Liver Policies and Non-transferring Liver Policies and to German Bond Policies and Non-transferring RL Main Fund Policies. There are adequate provisions in the Scheme and Reinsurance Agreements to ensure this is applied in practice.

Section 3.3 explains the likely impact on policyholder benefits, including the discretionary elements. Section 3.11 explains the governance around with-profits policies after the Transfer. This includes explanation about how consistent treatment will be achieved whilst the Reinsurance Agreements are in place.

For Ireland Liver business the discretionary actions are currently governed by the Royal Liver IoT and in particular the Core Principles of Financial Management. Section 3.2 explains that these will continue to apply to Transferring Policies after the Effective Date through the Royal Liver IoT and the Scheme.

In addition the Ireland Liver business is managed in line with the Royal Liver PPFM and the German Bond business is managed in line with the RL Main Fund PPFM. This includes the approach to discretionary management actions. This will continue indirectly after the Transfer, as explained in section 2.2.

I am satisfied that there will not be a material change in the application of discretionary management actions for with-profits policies and that adequate protection and challenge will be provided through the governance structure outlined in section 3.11.

3.5 Expenses

<u>Ireland Liver Policies</u>

The Royal Liver IoT prescribes the expenses applied to policies in the Royal Liver Sub-Fund. These provisions will be replicated in the Scheme meaning the transferring Ireland Liver Policies will continue to be governed by these requirements. The administration expenses are fixed under a ‘rate card’ until December 2021 after which actual expenses plus a margin will apply (subject to a comparison against the costs of managing the business through outsourcing). There is also a defined basic service charge in respect of investment related expenses that is applied throughout the lifetime of the Royal Liver Ireland Sub-Fund.

Following the Transfer the ongoing cost of running the Ireland Liver business will increase. This is unavoidable as it will be less efficient to run two separate companies. As the Transfer is occurring due to regulatory change (i.e. Brexit) a fair proportion of the additional expenses from the inefficiencies will be charged to the Royal Liver Sub-Fund. This is in line with the Royal Liver IoT which allows the allocation of certain exceptional costs and expenses to the Royal Liver Sub-Fund.

The additional costs can be broken down as:

(i) a fair share of the costs of general management of Royal London DAC including Executive and Board Management and Risk and Compliance. This will be allocated to the Royal Liver Sub-Fund according to how much time is spent on the Ireland Liver business by each function, and

(ii) additional administration costs caused by moving the activity from the UK to Ireland, all of which will be allocated to the Royal Liver Sub-Fund.

Royal London's current best estimate is that these additional costs will amount to around €2m per year, reducing as the Ireland Liver Busienss runs off.

The costs of setting up Royal London DAC and completing the Transfer will all be borne by RLMIS and be shared between the Royal Liver Sub-Fund and RL Main Fund in a fair and appropriate manner. The allocation will be done on an activity basis and the Liver Supervisory Committee and RLMIS WPC are supportive of the principles proposed. The allocation has also been discussed with the Royal London DAC HoAF. Around £10m is expected to be allocated to the Royal Liver Sub-Fund, which in the context of the £2.3bn of assets is not material.

The costs will be spread across holders of Non-transferring Liver Policies and Ireland Liver Policies. The holders of Ireland Liver Policies have not had a choice in the Transfer happening, so I believe it is appropriate to share the costs across the entire Royal Liver Sub-Fund. This means the costs are shared by holders of both Liver Ireland Policies and Non-transferring Liver Policies in the existing Royal Liver Sub-Fund. This is part of the business risk that the fund is exposed to and it would not be fair to single out any group of policyholders to be solely exposed to this risk. Currently all policies in the Royal Liver Sub-Fund share in the risks and rewards, including investment returns and tax, so sharing these costs across the Royal Liver Sub-Fund is fair and consistent treatment.

Initially the additional costs will come out of the Royal Liver Sub-Fund estate as opposed to increasing the rate card payments. This means that the policyholder impact will only be through potential reduced estate distributions. The impact of this is covered in section 3.3 and deemed not material. When the rate card expires on 1 December 2021 the expenses will be spread across Non-transferring Liver Policies and Ireland Liver Policies. Considering the size of the additional expenses and the run off of business this will not materially affect policyholder benefits.

I am satisfied that a fair allocation of the costs is being charged to the different sets of Liver with-profit policyholders and there will be no material adverse affect on holders of Ireland Liver Policies.

<u>German Bond Policies</u>

The German Bond Policies have fixed charges that will remain unchanged. There will, therefore, be no impact on these policies from expenses.

The expenses in respect of the German Bond business will be incurred by Royal London DAC. Royal London DAC will charge any expenses in respect of the German Bond business, including exceptional expenses, to the German Bond Sub-Fund. Through the German Bond Reinsurance Agreement, RLMIS will then provide Royal London DAC with the money to meet any expenses charged to the German Bond Sub-Fund. This is described in Section 2.3.

There will be no change to the direct costs of administering the German Bond business as a result of the Transfer as the administration of this business will continue to be outsourced to RL360°. There will however be a small increase in the costs of administering the German Bond business as a result of the Transfer as they will share in the costs of the general management of Royal London DAC. Since the German Bond business is such as small proportion of Royal London DAC's business, these costs will be immaterial in the context of the RL Main Fund where they will ultimately be borne. They are expected to be less than £0.1m a year.

Royal London DAC may allocate any relevant exceptional costs to the German Bond Sub-Fund. The Royal London DAC Board is required to take into account the views of the HoAF when allocating any such expenses, who has explicit requirements to consider the fair treatment of with-profits policyholders in their regulatory role. In addition, while the reinsurance is in place the RLMIS Board, taking into considerations any views from the WPA, will approve any allocation of any such exceptional costs. I am satisfied that these protections will ensure a fair allocation to the German Bond Sub-Fund.

The costs of setting up Royal London DAC and completing the Transfer will be shared between the Royal Liver Sub-Fund and RL Main Fund, as described in the above Ireland Liver Policies section. Around £11m is expected to be allocated to the Royal London Main Fund, which in the context of the nearly £50bn of assets and £4bn of own funds is not material.

I am satisfied that there will be no material adverse affect on the expenses charged to German Bond business and no material adverse affect on the Royal London Main Fund or the policyholders within it.

3.6 Service standards/standards of administration

There will be no changes to the service provider or model for the RL Ireland Protection business or the German Bond business. The RL Ireland Protection business is currently administered in Ireland and the same arrangement will continue after the Transfer. Equally the German Bond business is currently administered in the Isle of Man by RL360° and the same arrangement will continue after the Transfer.

The Ireland Liver business originally sold by Caledonian Life Insurance and GRE Life is currently administered in Ireland. This will remain the same after the Transfer.

The other Ireland Liver business, which is the majority of the business, is currently administered in the UK. On Transfer the administration will be moved to Ireland, allowing Royal London DAC to provide closer oversight. This will avoid the costs and risks associated with dual regulation which would otherwise occur were the current administration model to remain in place. Royal London DAC will target the same level of service standards as currently maintained by Royal London. There is a risk of reduced service standards with the migration, particularly around loss of knowledge, but Royal London will be taking all reasonable steps to mitigate this risk. The Royal

London Group is committed to providing a good level of service and these standards will extend to Royal London DAC.

The Royal London Group is experienced at successfully migrating administration services through the numerous acquisitions it has completed. This experience puts the Group in a strong position to successfully migrate the relevant Ireland Liver business.

Royal London DAC will continue to have access to the expertise in Royal London, for example actuarial support, through outsourcing arrangements that are being put in place. This will give a level of continuity and reduce the risk associated with reduced knowledge.

I am satisfied that there will be no material adverse affect to policyholder service standards as a result of the Transfer.

3.7 Investment strategy

The investment strategy of the Royal London DAC Open Fund will not impact with-profits policies and is covered in the RLMIS Chief Actuary's report.

There will only be a small amount of assets left in the Liver Ireland Sub-Fund (c£10m) and German Bond Sub-Fund (c£3m) after the Reinsurance Agreements have been allowed for. A risk-averse investment strategy will be taken for these assets. This will not materially affect the overall investment strategy for policyholders and will reduce volatility in the Royal London DAC Closed Funds.

The investment strategy for the Royal Liver Sub-Fund and RL Main Fund will not be affected by the Transfer. This means that the investment strategy applied to policyholders' asset shares will remain unchanged.

Ireland Liver Policies will continue to benefit from the Uniform Return Method (URM) of allocating investment return. This allocates consistent returns to UK and Ireland policyholders and mitigates the currency risk. This methodology will continue to operate through the Liver Reinsurance Agreement. If the Liver Reinsurance Agreement was terminated this would cease to apply. Adequate protections have been put in place to consider the impact on policyholders on termination of the reinsurance.

RLAM, a member of the Royal London Group, is the investment manager for RLMIS Funds. RLAM will also be the investment manager for Royal London DAC. Royal London DAC will provide suitable oversight to RLAM to ensure good investment decisions are made for policyholders.

3.8 Tax

There are a number of areas of potential change in taxation which are explained below. These are subject to clearances that are being sought from the tax authorities.

(i) Policyholder Tax

No changes are anticipated in respect of direct policyholder taxation for the:

- RL Ireland Protection business and the Ireland Liver business as the funds are expected to continue to be taxed on the same bases when they move from the Irish branch in RLMIS to Royal London DAC and, in particular for the Ireland Liver business, no change arose when it was transferred into RLMIS in 2011
- the German Bond business given no policyholders have become resident in Ireland

There are 2 tax bases in operation for Ireland Liver Policies, an old basis which uses an Investment minus Expenses (I-E) approach, similar to the UK, and a new basis which calculates individual policyholder tax on a separate basis.

For those on an I-E basis, which is the majority of policies, the tax liability is spread across both Non-transferring Liver Policies and Ireland Liver Policies. This is done through reducing the investment returns applied to policyholder's asset shares. This pooling will continue to apply after the Transfer whilst the Liver Reinsurance Agreement is in place. If the Liver Reinsurance Agreement was terminated this would cease to apply. Adequate protections have been put in place to consider the impact on policyholders if the Liver Reinsurance Agreement is terminated.

(ii) Capital Gains Tax

Any business assets (including intangible assets) being transferred from RLMIS to Royal London DAC will fall within the group relief exemptions, and therefore be exempt from any capital gains taxation at the time of the Transfer. Tax would arise if Royal London DAC, whilst retaining ownership of these assets, left the Royal London Group within 10 years of the Transfer. No such departure from the Group is envisaged.

(iii) Value Added Tax

No additional VAT is expected from the Transfer of assets because all of the Irish companies and branches transferring assets that are providing services to each other will be registered in the same Irish VAT group.

An immaterial amount of VAT may arise if certain services are provided between the UK and Ireland and vice versa. The proposed commercial structure of the business including the movement of any UK based policy administration in respect of the Ireland Liver business to Dublin should mitigate this risk.

(iv) Corporation Tax

No trading profits, and therefore corporation tax, is expected to arise in the Liver Ireland Sub-Fund and German Bond Sub-Fund which will be run along mutual lines due to the Reinsurance Agreements. The assets being transferred into the Royal London DAC Closed Funds are expected to be matched by corresponding policyholder liabilities and so will have no impact on the income statement, and hence no tax will be payable.

Trading profits are expected to arise in the Royal London DAC Open Fund and corporation tax will be applied at 12.5%. Currently the profits from the RL Ireland Protection Policies have concessionary treatment because they are in a mutual with-profit fund. This will no longer be applied, which will lead to an increase in tax payable. The Royal London DAC Open Fund does not include any with-profits business so there will be no direct impact on policyholder benefits, the only impact would come through is any impact on ProfitShare. However, the impact will be immaterial in the context of the RL Main Fund and therefore have no impact on ProfitShare.

There will be a small change to the tax computation for the Ireland former Liver Business. The amount and type of assets being matched to the Irish business is expected to change for tax purposes. This could result in an additional cost or benefit depending upon the amount of assets required to support the Irish business. However, there will be a corresponding adjustment to the amount and type of assets matched to the UK business for tax purposes which will mitigate the impact (see section 4.7(iii)). The total tax charge is pooled and spread across both Non-transferring Liver Policies and Ireland Liver Policies and so I am satisfied this is not expected to have a material affect.

The capital contributions into the Royal London DAC Open Fund (value of in force business) are expected to be accounted for as a capital contribution with no impact on the income statement (subject to confirmation from the tax authorities). Consequently no tax is expected to arise in Royal London DAC in respect of the Transfer.

(v) Transfer Pricing

Given the mutual nature of the Liver Ireland business and German Bond business and the relatively small sums involved it is expected that a simple cost recharge or a modest cost plus approach may be appropriate.

Overall there will be some additional taxation arising as a result of the Transfer, although not directly on the holders of Transferring Policies. That arising from the transfer of the Ireland Liver business and the German Bond business will be charged, via the Reinsurance Agreements, to the estates of the Royal Liver Sub-Fund and RL Main Fund respectively. That arising from the transfer of the RL Ireland Protection business will be funded from the share capital and profits arising in the Royal London DAC Open Fund and will not affect the benefits payable under those policies.

3.9 Membership rights

The only Transferring Policies that confer membership in RLMIS are the with-profits German Bond Policies. RLMIS's Articles of Association require that members continue to hold qualifying policies with RLMIS to maintain their membership. This will cease to be the case for with-profits German Bond Policies when they are transferred to Royal London DAC under the Scheme, meaning they will lose membership from the Effective Date.

The main benefits of membership of RLMIS are:

(i) The right to vote at the Annual General Meeting (”AGM”) or an Extraordinary General Meeting (”EGM”) of RLMIS.
(ii) The right to support a resolution to call an EGM of RLMIS which requires a minimum of 500 members to provide such support.
(iii) The right to include a resolution in the notice of the AGM which requires a minimum of 500 members to support such a resolution.
(iv) The potential for compensation in the event of a demutualisation of RLMIS.

The value of an individual right to vote at or include a resolution at an AGM or EGM or to call an EGM is seen to be small. The holders of the German Bond Policies represent c0.1% of the total membership of RLMIS so their power to have specific influence on the voting or decision making at any meeting is extremely small.

Demutualisations are less common in the UK market than they once were and RLMIS is committed to its mutual status such that it has no intention to demutualise in the foreseeable future. In the highly unlikely scenario that RLMIS does demutualise, the Scheme contains provisions which require RLMIS to treat the holders of with-profits German Bond policies as if they had continued to be members when calculating any compensation that may be due, providing that they continue to hold the policy. This means that the Transfer will have no impact on holders of with-profits German Bond policies in the event of demutualisation.
The main financial benefit which is associated with membership, but is not exclusive to members, is ProfitShare. The with-profits German Bond business received enhancements to asset shares of c£1.7m in respect of 2017. These policies will continue to be eligible for RLMIS's ProfitShare through the construction of the German Bond Reinsurance Agreement. The Scheme contains provisions to recognise that, while the German Bond Reinsurance Agreement is in place, the with-profits German Bond policies will retain eligibility to ProfitShare in line with that of direct policies of RLMIS.

RLMIS will not give any financial compensation for the loss of membership to the holders of with-profits German Bond Policies because of their continued entitlement to ProfitShare and the protection given in the Scheme in the event of demutualisation.

I am satisfied that these policyholders will not be materially adversely affected through the loss of membership. The main item they will lose is the ability to influence business decisions through their right to vote. To have this they must be qualifying policyholders of RLMIS which is not feasible following Brexit.

3.10 Policyholder Communications

A robust communications strategy has been produced which I have reviewed and is line with the principles of treating policyholders fairly.

Royal London will mail each group, subject to any waivers, of transferring policyholders with the following:

- an explanatory covering letter;
- a Policyholder booklet providing a summary of the Scheme, a summary of changes to the principles and practices of the PPFM for holders of Ireland Liver Policies and changes to the practices of the RL Main Fund PPFM for holders of German Bond Policies, a summary of the Independent Expert's report on the Transfer and a copy of the legal notice;

Royal London has produced tailored mailings for each group of Transferring Policies, the RL Ireland Protection business, Ireland Liver business and the German Bond business. The key points impacting policyholders are prominent in the letters. A separate tailored booklet has been produced for each main policyholder group with the appropriate information that is relevant to them. I have reviewed the policyholder letters and booklets and I'm satisfied that the key messages are clearly displayed.

Some customer testing has been completed on the communication materials. The focus of the testing was whether policyholders understand the key messages and their rights in relation to the Transfer. Different groups of policyholders were considered within the testing including holders of Ireland Liver Policies, Liver Non-transferring Policies and RL Ireland Protection Policies. No testing has been completed for German Bond Business as the sample size is too small. Action has been taken following the small amounts of minor feedback to address the points raised. This gives additional comfort that the messages are clear to policyholders.

Following the mailing, any new Royal London DAC policyholders will receive details of the proposed Transfer within the new business process.

Supplementing the written communications, information will be posted on the royallondon.com and royallondon.ie websites and legal notices published in a variety of UK, Ireland and German newspapers. Dedicated telephone lines will also be established to handle customer responses. A full copy of the Scheme, the Independent Expert's report, the RLMIS Chief Actuary's report and this report will be available on-line or on request (in writing or by phone).

A number of waivers will be sought from the High Court where it is not practical, appropriate or possible to mail policyholders, which includes;

- transferring policyholders for whom Royal London does not hold a valid address
- transferring policyholders who are over age 100
- policyholders in the RL Main Fund who are not transferring
- policyholders in the other closed funds of RLMIS (excluding the Royal Liver Sub-Fund) who will not be transferring

There are a relatively large number, 59,006 as at 14 September 2018, of 'address unknowns' and 'goneaways' in the Ireland Liver population. This represents about 13% of the Liver Ireland population. RLMIS has been running a program to trace UK policyholders where it does not hold an address in recent years but it has not completed a similar tracing exercise in Ireland as there is no effective tracing available. The lack of available tracing options means there is little action that can be taken in respect of these policies ahead of the Transfer. Widespread advertising will help raise awareness of the Scheme amongst the population Royal London is unable to mail.

I believe the communications waivers that are proposed to be sought are reasonable and proportionate and I am satisfied the policyholder letters and booklet are appropriate.

3.11 Governance

In Ireland the regulatory requirements for with-profits governance are less extensive than in the UK. For example there is no requirement for a WPA, WPC or to maintain PPFMs which are all required in the UK through the FCA's Conduct of Business (COBS) rules. Steps have been taken to ensure that holders of with-profits Transferring Policies will not experience materially less oversight than they do currently.

Conduct of Business Rules

On Transfer, from a conduct of business perspective, the German Bond business will be managed in line with the German General Good Requirements, and to any extent where there is a material gap in these requirements the Ireland General Good Requirements. The Ireland Liver business will be managed in line with the Ireland General Good Requirements.

I am satisfied there will be no material adverse affect on policyholders from this change.

Ombudsman

Currently holders of Liver Ireland Policies have the right to complain to the Financial Services and Pensions Ombudsman Service (FSPO) in Ireland or the Financial Services Ombudsman (FOS) in the UK. In practice the majority of holders of Liver Ireland Policies use the FSPO. After the Transfer holders of Liver Ireland Policies should make complaints to the FSPO only, unless the complaint is in relation to something that occurred before the Effective Date in which case they can still complain to the FOS.

Holders of German Bond Policies currently have the right to complain to the FOS or BaFin. After the Transfer holders of German Bond Policies should complain to the FSPO or BaFin, unless the complaint is in relation to something that occurred before the Effective Date in which case they can still complain to the FOS.

There will be no change to the ombudsman for holders of RL Ireland Protection Policies who currently have the right to complain to the FSPO.

I am satisfied there will be no material adverse affect on any policyholders in their rights to make complaints to the relevant ombudsman.

PPFM

Royal London DAC is required by the Scheme to set up and maintain PPFM Guides for the Ireland Liver business and the German Bond business. These will look, in terms of content and coverage, similar to a customer friendly PPFM at outset and refer to the relevant RLMIS PPFMs for the detail while the Reinsurance Agreements are in place. The PPFM Guides will explain how Royal London DAC manages the business in the relevant Royal London DAC Closed Fund. Royal London DAC will be required to notify policyholders of any material changes to these PPFM Guides. Whilst the Reinsurance Agreements remains in place there is a requirement in the Scheme for the Royal London DAC PPFM Guides and the respective RLMIS PPFMs to remain consistent.

The Royal Liver PPFM and RL Main Fund PPFM will continue to apply indirectly to with-profits Liver Ireland Policies and German Bond Policies at the Effective Date. Amendments have been proposed for both of these PPFMs to appropriately reference the with-profits Liver Ireland Policies and German Bond Policies taking into account the Reinsurance Agreements.

Amendments will be made to the principles of the Royal Liver PPFM. All with-profits policyholders currently in the Royal Liver Sub-Fund, transferring and non-transferring, will be notified of these changes through the communications described in section 3.10. Royal London intends to seek a waiver from the guidance in COBS 20.4.2 which requires policyholders to be notified of any changes to the PPFM principles at least 3 months in advance. No amendments will be made to the principles of the RL Main Fund PPFM. Relevant policyholders will be notified of changes to those practices through the regular mailings.

In the unlikely event that the Liver Reinsurance Agreement is terminated and the Liver Ireland Sub-Fund remains a ring-fenced fund, under the terms of the Scheme Royal London DAC would still be required to produce and maintain the PPFM Guide, although the requirement to do so may fall away if Irish regulatory requirements provide for alternative documents equivalent in content and purpose to the guides to be maintained by Royal London DAC. Both the holders of Ireland Liver Policies and Non-transferring Liver Policies have an interest in the estates of the Royal Liver Sub-Fund and Liver Ireland Sub-Fund and any deviation in management of the funds could lead to unequal treatment. Consistency between the Royal Liver PPFM and Liver Ireland PPFM guide will help to mitigate this risk. In addition RLMIS and Royal London DAC are required to manage the Royal Liver Sub-Fund and Liver Ireland Sub-Fund respectively in line with the same Core Principles of Financial Management which will further mitigate this risk.

I am satisfied the protections put in place for with-profits Transferring Policies are adequate in respect of PPFMs and there will be no material adverse affect on the protection such a document provides to policyholders.

Bonus Setting Process

Currently the RLMIS With-Profits team calculate the bonuses to be applied to all with-profits policies of RLMIS. This team will continue to calculate the bonuses in respect of the with-profits Liver Ireland Policies and German Bond Policies whilst the Reinsurance Agreements remain in place. It is expected that the Royal London DAC Board will declare bonuses that are consistent with those recommended by RLMIS, but it is recognised that there is a very remote possibility of a disagreement in views between the RLMIS Board and Royal London DAC Board following the Transfer.

The current with-profits bonus setting governance process will be adapted to include Royal London DAC’s HoAF and the Royal London DAC Board. Currently within Royal London’s regular process the principles of discretion, including estate distribution for the Royal Liver Sub-Fund, are presented to the RLMIS WPC and Liver Supervisory Committee ahead of recommendation to the RLMIS Board in September. Post Transfer, I will work closely with the HoAF when producing these principles. Following my recommendations, the HoAF will present the proposals to the Royal London DAC’s Board ahead of approval at the RLMIS Board.

If there is a disagreement between the RLMIS Board and Royal London DAC Board then the dispute resolution process written into each of the Reinsurance Agreements will be followed. The dispute resolution process will involve nominating an independent expert to opine on the fairness of the bonus declaration to different groups of policyholders, or on any regulatory reasons why the bonus declaration should differ. The outcome of this dispute resolution process will be binding on both RLMIS and Royal London DAC.

The main area of discretion in bonus setting is around estate distribution. This is very prescriptive in the Royal Liver IoT and leaves little room for disagreement between the two Boards. I believe using a collaborative approach with the HoAF means a disagreement is highly unlikely but I am comfortable that appropriate procedures are in place to protect all policyholders’ interests in the event this does happen.

Royal London DAC will not have any input or influence over any ProfitShare amount distributed by RLMIS and allocated to German Bond Policies.

Following the approval of the principles of discretion bonus rates are calculated and taken through the same approval process as for the principles of discretion (described above) in December. This approach to bonus setting should ensure that there are minimal changes to policyholders’ benefits as a result of the Transfer, and that they will continue to be in line with reasonable expectations.

Whilst the Liver Reinsurance Agreement is in place the Royal London DAC Board and Royal London DAC HoAF have a responsibility under the Scheme to consider the Non-transferring Liver business. Equally the Royal London Board, WPA and Chief Actuary will have a responsibility to consider the Ireland Liver business.

The general principles described above will be applied appropriately for any other areas where discretion may be exercised, for example changes to surrender values or the run off strategy of the Royal Liver Sub-Fund. In respect of the Liver Ireland

Policies Royal London DAC will have a relatively broad scope to dispute decisions made by RLMIS that impact the Royal Liver Sub-Fund. This is because of the interest the Liver Ireland Policies have in the estate of the Royal Liver Sub-Fund.

In respect of the German Bond Policies, Royal London DAC will only have the right to dispute areas that directly impact the German Bond Policies.

Liver Supervisory Committee and WPC

The Liver Supervisory Committee currently oversee that RLMIS manage the Liver Ireland business and the Non-transferring Liver business in line with the Royal Liver IoT. The terms of reference for the Liver Supervisory Committee have been expanded to give them continued responsibilities in respect of the Ireland Liver Policies, even though they will no longer be direct policies of RLMIS. This includes the ability to notify the Royal London DAC Board if in their opinion holders of Ireland Liver Policies are being adversely affected.

The RLMIS WPC will continue to consider issues on with profits Transferring Policies in relation to the Reinsurance Agreements. The Reinsurance Agreements are drafted in such a way that they can feed into areas of discretion.

Summary

I will not have direct responsibilities, as WPA, to Royal London DAC's Board, but the Royal London DAC's HoAF has explicit requirements to consider the fair treatment of with-profits policies in their regulatory role. I am committed to working closely with Royal London DAC's HoAF on any areas of discretion to ensure the actions taken by Royal London DAC and RLMIS are fair to all holders of with-profits Liver Ireland Policies, Non-transferring Liver Policies, German Bond Policies and Non-transferring RL Main Fund Policies. I am satisfied that this requirement and my oversight through the Reinsurance Agreements will ensure there is no material adverse affect in the level of protection holders of with-profits Ireland Liver Policies and with-profits German Bond Policies benefit from now.

In addition I am satisfied that adequate steps have been taken to ensure holders of with-profits Ireland Liver Policies and with-profits German Bond Policies will not be materially adversely effected by the change in regulatory regime effected by the Transfer.

4 IMPACT OF THE TRANSFER ON NON-TRANSFERRING POLICYHOLDERS OF ROYAL LONDON

4.1 Factors considered

The impact of the Transfer on the non-transferring policyholders of RLMIS, i.e. the policyholders of RLMIS immediately after the Effective Date, is considered against the headings of:

(a) Security of benefits (Section 4.2).

(b) Benefits payable under participating policies (Section 4.3).
(c) Expenses (Section 4.4).
(d) Service standards/standards of administration (Section 4.5).
(e) Investment strategy (Section 4.6).
(f) Tax (Section 4.7).
(g) Membership rights (Section 4.8).
(h) Policyholder communications (Section 4.9).
(i) Governance (Section 4.10)

There are subsets of RLMIS policyholders that will not be impacted by the Transfer because they are in separate closed funds within RLMIS that, except in extreme circumstances, are each managed independently from each other and the RL Main Fund. This includes all policyholders in the RL (CIS) Sub-Fund, PLAL Sub-Fund, Scottish Life Sub-Fund and ex-UAG (excluding Refuge Assurance OB) policyholders in the RL Main Fund.

The groups of non-transferring policyholders that will be impacted by the Transfer are those holding non-transferring:

- With-profits policies in the Royal Liver Sub-Fund
- With-profits policies in the RL Main Fund (excluding ex-UAG policies except Refuge Assurance OB policies)
- Other policies in the Royal Liver Sub-Fund and RL Main Fund (although to a lesser extent)

The next sections cover these subsets of impacted policies.

4.2 Security of benefits

<u>Insolvency of RLMIS</u>

In the event of default of RLMIS Non-transferring Liver Policies will rank equally with Royal London DAC through the floating charge and tier two deed of charge arrangements, subject to the minimum of 50% of the reinsured BEL which Royal London DAC would receive through the tier one deeds of charge described in section 2.3. The tier one deeds of charge do not contain equalisation provisions to give Royal London DAC what is expected to be sufficient assets (50% of the reinsured BEL) to meet claims on Ireland Liver Policies and German Bond policies whilst insolvency proceedings are being completed. I am satisfied that this will have no material adverse affect on holders of Non-Transferring Policies as the probability of RLMIS going insolvent and only being able to meet less than 50% of policyholders claim values is extremely remote.

<u>Non Transferring Liver Policies</u>

The holders of Non-transferring Liver Policies will be exposed to a small amount of additional risk following the Transfer as the Royal Liver Sub-Fund will be linked with Liver Ireland Sub-Fund through the Liver Reinsurance Agreement and certain provisions of the Scheme. The main extra risk is around divergence of the regulatory regimes in Ireland and the UK. Accepting this risk is unavoidable without permanently splitting the Royal Liver Sub-Fund which, as already discussed, could not be done in a suitably fair and controlled manner ahead of Brexit. I am satisfied accepting this risk is the best option and that it won't materially adversely affect holders of Non-Transferring Liver Policies.

In extreme scenarios the Royal Liver Sub-Fund will continue to benefit from capital support from the RL Main Fund.

Subject to the approval of the PRA, the Royal Liver IoT will be amended, amongst other things, to include the Ireland Liver Policies asset shares in the sunset clause. The sunset clause is the provision which sets out when the cessation of the Royal Liver Sub-Fund may take place. The inclusion of the Ireland Liver Policies in this clause means the mandatory and discretionary cessation thresholds of the Royal Liver Sub-Fund will remain unchanged.

The Transfer will reduce the capital cover ratio of the Royal Liver Sub-Fund by around 11%. This will not materially affect the solvency of the Fund or the security of benefits for Non-transferring Liver Policies.

<u>Non-Transferring RL Main Fund Policies</u>

The impact on the capital position of the RL Main Fund is shown in section 2.5. This shows the Transfer will not have a material affect on the security of the RL Main Fund.

The RL Main Fund will, if required, continue to provide capital support to the Royal Liver Sub-Fund in line with the Royal Liver IoT after the Transfer.

The German Bond business is subject to a potential ruling from the Federal Court of Justice that some of those bonds are deemed to have been mis-sold to investors in Germany by German financial intermediaries. Such a ruling may require compensation to be paid to customers. The potential for such a ruling arises because of similar rulings in respect of similar products sold in Germany by other insurers. RLMIS currently holds a reserve and Pillar 2 required capital for this risk.

The terms of the Scheme are such that such liabilities, i.e. mis-selling liabilities which pre date the Transfer in respect of the German Bond business, and those which arise in the future, are to be met in the first instance by Royal London DAC. Under a separate agreement between RLMIS and Royal London DAC, RLMIS will then cover any costs incurred by Royal London DAC in settling or defending any such claims.

I am satisfied there will be no material adverse affect on the security of benefits of the Non-transferring RL Main Fund Policies as a result of the Transfer.

4.3 Benefits payable under participating policies

<u>Non-transferring Liver Policies</u>

The impact on the benefits of the holders of Non-transferring Liver Policies will be very similar to the impact on holders of Ireland Liver Policies. This is because the Liver Reinsurance Agreement is being set up to broadly maintain the Royal Liver

Sub-Fund in its current economic state. In addition the costs of the Transfer will be shared between the holders of Non-transferring Liver Policies and the holders of Ireland Liver Policies equitably. This is in line with current practice and reflects both that there is no policyholder benefit from the process (for either UK or Ireland) and that it was not the choice of the Ireland policyholders.

There will be no change to policyholder's contractual benefits as a result of the Transfer. As described in Section 3.3 there may be an initial reduction to the expected discretionary estate distribution applied to the asset shares of eligible with-profits policies and sums assured of contingent bonus policies of around 2%. However, payouts will still be in line with policyholder's reasonable expectations and I am satisfied that holders of Non-transferring Liver Policies will not be materially adversely affected by the Transfer.

Non-transferring RL Main Fund Policies

Section 2.5 describes that the Transfer will have an initial marginal negative impact on the capital position of the RL Main Fund. However, it is expected that Royal London DAC will be profitable over the longer term. The shares for Royal London DAC will be allocated to the RL Main Fund meaning that future profits in Royal London DAC may benefit the policyholders in the RL Main Fund through future dividends paid. The dividend policy is briefly described in the proposed Royal London DAC capital management plan. Any dividends paid will flow through into the RL Main Fund, and may therefore contribute to future ProfitShare distributions.

The Transfer is not expected to impact the ProfitShare payable to eligible policyholders. I expect that Royal London will be able to maintain the appropriate levels of ProfitShare after the Effective Date and there will be no material adverse affect on the benefits for holders of Non-transferring RL Main Fund Policies.

4.4 Expenses

Non-transferring Liver Policies

The expenses applied to Non-transferring Liver Policies will continue to be in line with the Royal Liver IoT. The additional ongoing running costs will be shared between holders of Ireland Liver Policies and holders of Non-transferring Liver Policies. This means that the impact on expenses charged will be the same as for the Liver Ireland Policies which is described in Section 3.5.

I am satisfied there will be no material adverse affect to Non-Transferring Liver Policies in respect of expenses.

Non-transferring RL Main Fund Policies

The actual expenses charged to these policyholders will be unchanged.

The RL Main Fund currently holds the expense risk for the Royal Liver Sub-Fund. This will be the case until the rate card in the Royal Liver IoT expires at the end of 2021. The RL Main Fund receives the rate card payments and in return pays the actual expenses. Profits or losses are made accordingly. A similar arrangement is in place for the investment expenses, but this continues for the life of the Royal Liver Sub-Fund.

Following the Transfer the expense risk and associated profits or losses in relation to the administration of the Ireland Liver Policies will transfer to Royal London DAC. This will result in a £7.5m reduction to the expected future profits in the RL Main Fund which will be represented as a reduction to BEL. This will not have a material impact on the cover ratio of the RL Main Fund, as shown in section 2.5. In addition any profits that emerge in Royal London DAC will flow back to the RL Main Fund through the dividend policy set out in the Royal London DAC capital management plan.

The investment management expense risk and associated profits and losses will remain in the RL Main Fund whilst the reinsurance is in place because the assets backing the Ireland Liver Policies will be held in the Royal Liver Sub-Fund.

I am satisfied there will be no material adverse affect to Non-Transferring RL Main Fund Policies in respect of expenses.

4.5 Service standards/standards of administration

There will be no material changes to the administration as a result of the Transfer.

4.6 Investment strategy

The Transfer will have no direct impact on the investment strategy of the RL Main Fund or the Royal Liver Sub-Fund.

4.7 Tax

There are a number of areas of potential change resulting from the Transfer and they are subject to the clearances that are currently being sought from the tax authorities.

(i) Policyholder taxation

No changes are anticipated in respect of direct policyholder taxation for the business which is not being transferred.

(ii) Capital gains

Any business assets (including intangibles) passing from the Ireland Branch in RLMIS arise from business that is classified as non-BLAGAB[1] in the UK and so are expected to fall within the foreign branch exemption election that was made and confirmed with HMRC in 2017.

(iii) Corporation tax

It is expected that there will be a corresponding impact (to that noted in section 3.8(iv) in respect of Ireland) in the UK with the taxation of reinsured life business resulting in a change to the tax computation of the UK business.

[1] Basic life assurance and general annuity business.

This change is expected essentially to result in a change to the amount of assets being matched to the Ireland business and excluded from UK business for tax purposes. This in turn will affect the UK investment return and associated taxation. This could result in an additional cost or benefit depending upon the amount of assets required to support the Ireland business although it is not expected to have a material impact. As mentioned earlier the total tax charge is pooled and spread across both Non-transferring Liver Policies and Ireland Liver Policies and I am satisfied this is not expected to be material.

(iv) Transfer pricing

Given the mutual nature of the Ireland Liver business and the German Bond business and the relatively small sums involved, initial discussions with HMRC suggest that a simple cost recharge or a modest cost plus approach may be appropriate. Overall there will be some change to the taxation arising as a result of the Transfer, although not directly on the policyholders. These impacts are not expected to be material.

4.8 Membership Rights

There will be no impact on the membership rights of non-transferring policies.

4.9 Policyholder Communications

Royal London will mail all policyholders in the Royal Liver Sub-Fund, including holders of Non-transferring Liver Policies, subject to the waivers described in Section 3.10. This mailing will be tailored to these policyholders but include the same items as what is being provided to Transferring Policies; a covering letter and explanatory booklet.

Within this mailing policyholders will be notified of changes to the principles and practices of the Royal Liver PPFM. Royal London intend to seek a waiver from the guidance in COBS 20.4.2 which requires policyholders to be notified of any changes to the PPFM principles at least 3 months in advance.

Royal London have sought a waiver not to mail holders of Non-transferring RL Main Fund Policies or any policyholders of RLMIS's closed funds. These policyholders are not materially affected by the Transfer and I support this approach on these grounds.

There will be changes to the RL Main Fund PPFM practices. Relevant policyholders will be notified of these changes in their annual statements.

4.10 Governance

No changes will be made to the application of the Conduct of Business Rules for Non-Transferring Policies. Holders of Non-Transferring policies will retain the right to complain to the FOS in the UK after the Transfer.

Some of the principles and practices of the Royal Liver PPFM will be amended to reflect the Transfer. The proposed changes are required to reflect the Liver Ireland business whilst the Liver Reinsurance Agreement remains in place. Holders of Non-transferring Liver Policies will be notified of these changes as described in section 4.9.

Minor changes will be made to the RL Main Fund PPFM to reflect the German Bond business whilst the German Bond Reinsurance Agreement remains in place. Holders of Non-transferring RL Main Fund Policies will be notified of these changes as described in section 4.9.

The governance around the bonus setting process will change and is described in detail in section 3.11. This will only impact holders of with-profits Non-transferring Policies if there is a disagreement between Royal London and Royal London DAC. In this scenario an independent expert will resolve the dispute and I am satisfied non-transferring policies will not be materially adversely affected.

The Liver Supervisory Committee (Liver Non-transferring Policies only) and WPC will continue to consider the interests of holders of Non-transferring Policies after the Transfer.

I am satisfied that there will be no material adverse affect on the governance and protections for non-transferring policyholders.

5 CONCLUSIONS

In summary, I am of the opinion that:

(a) the Transfer will not adversely affect, to any material extent, the security of benefits or benefit expectations of the transferring with-profit policyholders; and

(b) the Transfer will not adversely affect, to any material extent, the security of benefits or benefit expectations of the non-transferring with-profit policyholders remaining in RLMIS; and

(c) carrying out the Transfer is not inconsistent with the requirement to treat customers fairly.

(d) the proposed amendments to the Instrument of Transfer will not materially adversely affect the reasonable expectations of, or materially reduce the protections conferred by the Instrument of Transfer, on the holders of Royal Liver policies. My certification is in Appendix B.

6 COMPLIANCE WITH ACTUARIAL STANDARDS

The actuarial elements of this report fall under the definition of technical actuarial work as defined by the Financial Reporting Council, and as such would be required to comply with Technical Actuarial Standards 100 (Principles for Technical Actuarial Work) and 200 (Insurance). This report complies with those standards.

The report has also been subject to peer review in line with the Actuarial Profession Standards document APS X2: Review of Actuarial Work.

Brian J Murray FFA

With Profits Actuary of Royal London

3 October 2018

APPENDIX A BACKGROUND TO AND OUTLINE OF THE TERMS OF THE TRANSFER

A.1 Introduction

This Appendix gives background information about RLMIS, Royal London DAC, the background to and rationale for the Transfer and about the business that is proposed to be transferred. It also highlights some of the more important terms of the Transfer. A summary of the terms of the Transfer will be included in the communications that will be issued to the transferring policyholders and, subject to the waivers referred to in section 3.10, those remaining with RLMIS.

A.2 Royal London

RLMIS is a mutual life insurance company and was established in the UK in 1861 as a friendly society. It was incorporated as a company limited by guarantee in 1908 and is governed by its own Memorandum and Articles of Association. It is registered in England, no. 99064.

Since 2000 RLMIS has acquired the long term business of several life companies, notably:

- The Co-operative Banking Group.
- The Scottish Life Assurance Company;
- Phoenix Life Assurance Limited.
- Certain protection business of Scottish Mutual Assurance Limited and Scottish Provident Limited.
- Royal Liver Assurance Limited
- Those in the United Assurance Group (‘UAG’) comprising Refuge Assurance plc, United Friendly Insurance plc, United Friendly Life Assurance Limited, Refuge Investments Limited and Canterbury Life Assurance Company Limited.

The long term businesses of these companies were subsequently transferred into RLMIS.

As a result RLMIS has a relatively complex fund structure including several distinct blocks of with profits business, a mixture of Ordinary Branch (‘OB’) and Industrial Branch (‘IB’) business, and a wide range of contract types. These transfers have given RLMIS valuable experience of effecting smooth and efficient transfers of business.

RLMIS now acquires most of its new business through independent financial advisers in the UK and specialises in writing pensions business (both unit linked and unitised with-profits) and non-profit protection business under the ‘Royal London’ brands.

RLMIS is in a healthy financial condition, as evidenced by the figures in its annual report and accounts, in its SFCR and relative to its Pillar 2 capital requirements. Some figures relating to its financial condition are provided in section 2.5.

A.3 Royal London DAC

The result of the UK public referendum of 23 June 2016 was that that the UK should leave the EU, with the planned exit on 29 March 2019. Currently the EU passporting system for banks and financial services companies enables firms that are authorised in any EU or EEA state to trade freely in any other with minimal additional authorisation. These passports are the foundation of the EU single market for financial services. Passporting may not be available to the UK after 29 March 2019 and UK firms could face significant regulatory barriers to providing cross-border banking and investment services to customers and counterparties in many EU Member States.

RLMIS has had a branch in Ireland since 2011 when RLMIS acquired the Royal Liver business. This branch sells protection business though an intermediated channel by way of such an EU passport.

To provide more certainty over the legal status of the business and the regulatory environment in which it operates, RLMIS decided to establish a subsidiary in Ireland and to seek to achieve this before the EU exit. This is also a mitigation to ensure that, regardless of the terms that the UK negotiates for its exit from the EU, the Royal London Group will continue to be able to operate in Ireland, and will also be able to maintain cross-border services passports in relation to other EEA states (or obtain equivalents). This subsidiary, Royal London DAC, is expected to be authorised in its own right by the Irish Regulator, the Central Bank of Ireland (CBI), by the end of 2018. The Transfer cannot go ahead until Royal London DAC is authorised.

A.4 Background to and business rationale for the Transfer

When the UK leaves the EU, unless there is a specific equivalent arrangement to passporting or grandfathering of existing terms for legacy business, it may not be possible to service business written in the UK into EU or EEA states. As a result it is planned to transfer all of the business written by RLMIS (or its predecessors) in the EU or EEA to Royal London DAC which will be able to benefit from the passporting arrangements. In practice this represents business written in Ireland and Germany.

A.5 The business proposed to be transferred

The business to be transferred from RLMIS to Royal London DAC comprises the RL Ireland Protection business, Ireland Liver business and German Bond business as referenced in Section 1.1.

A.6 Basic Transfer structure and terms of the Transfer

Please refer to Section 2.2 for the structure and terms of the Transfer.

All of the costs incurred in connection with the Transfer will be borne by RLMIS and shared between the RL Main Fund and the Royal Liver Sub-Fund. The Royal Liver Sub-Fund will bear its share of certain exceptional costs as described in the Transfer documentation, for example the additional costs of governance required for Royal London DAC. This is described in section 3.5.

A.7 Pension Fund covenant

The Royal Liver Sub-Fund has the liabilities for any losses under the former Royal Liver Assurance pension schemes, one each for the former UK and Ireland employees of Royal Liver Assurance. The Royal Liver Sub-Fund will maintain those liabilities after the Transfer. The Liver Reinsurance Agreement leaves the Royal Liver Sub-Fund in virtually the same position as it was before the Transfer of the Ireland Liver business, as described in sections 3.2 and 4.2 relating to the security of benefits for policies which are transferring and not transferring respectively. As a result the covenant of these two former Royal Liver Assurance pension funds is not materially affected by the Transfer.

The RL Main Fund has the liabilities for any losses under the Royal London Group Pension Scheme (“RLGPS”). As also described in sections 3.2 and 4.2 relating to the security of benefits for policies which are transferring and not transferring respectively, the transfer of the RL Ireland Protection business and German Bond business have an immaterial impact on the financial strength of the RLMIS RL Main Fund so the covenant of RLGPS is not materially affected by the Transfer.

A.8 Dormant Accounts

In Ireland, the Unclaimed Life Assurance Policies Act 2003 means that RLMIS is required to transfer funds in relation to policies that are deemed to be unclaimed (as determined by guidance issued by the CBI) to the National Treasury Management Agency (NTMA). This is an agency set up by the Irish Government to collect unclaimed funds from banks, building societies and life assurance companies and potentially use them for charitable and social purposes.

If a policyholder whose funds have been transferred to the NTMA claims in the future, their claim value remains the same as if the transfer to the NTMA had not taken place. RLMIS claims funds back from the NTMA in respect of such policies. After the Transfer Royal London DAC will complete this process in the same manner as RLMIS does currently.

A.9 Reinsurance agreements

Please refer to Section 2 for details of the Reinsurance Agreements.

APPENDIX B CERTIFICATION FOR PROPOSED CHANGES TO ROYAL LIVER INSTRUMENT OF TRANSFER

Certificate under Clause 36.2 of the Instrument of Transfer under which the long term business of Royal Liver Assurance Limited was transferred to The Royal London Mutual Insurance Society Limited ('Royal London') as sanctioned by the FSA with effect from 1 July 2011

I certify that, in my opinion the proposed amendments to the Instrument of Transfer will not materially adversely affect the reasonable expectations of, or materially reduce the protections conferred by the Instrument of Transfer, on the holders of Royal Liver policies. In coming to this opinion I have taken account of the proposals as a whole and their impact on holders of Royal Liver policies as a whole.

Brian Murray

With Profits Actuary of Royal London

3 October 2018