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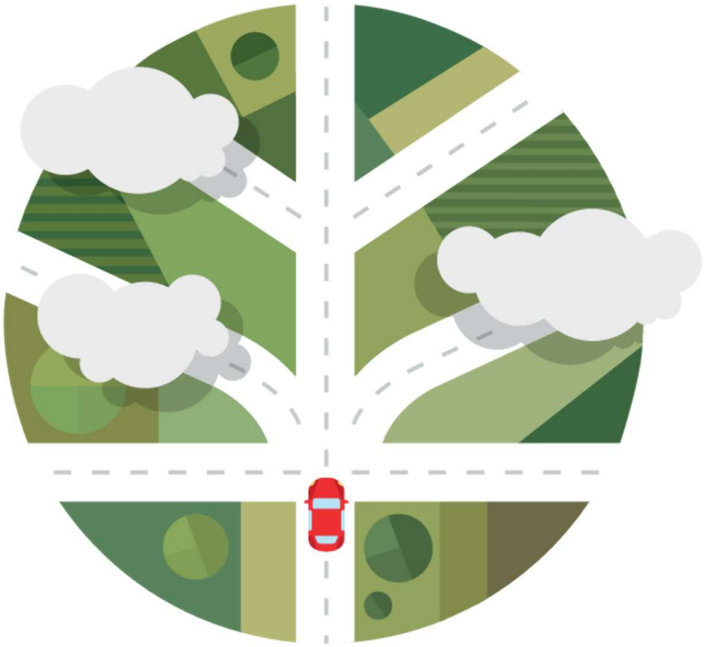

# Royal London DAC

## Report on the proposed transfer of business from The Royal London Mutual Insurance Society Limited to Royal London Insurance DAC

Report prepared by Ciara Regan, Head of Actuarial Function for Royal London Insurance DAC

21 January 2019

# Contents

# 1. Introduction

## 1.1 Purpose of Report

The purpose of this report is to consider the likely impact of a proposed transfer of part of the long-term insurance business of The Royal London Mutual Insurance Society Limited (**"RLMIS"**) to Royal London Insurance DAC (**"Royal London DAC"**) under Part VII of the Financial Services and Markets Act 2000 as at 7 February 2019 (**"Effective Date"**).

While the transfer will occur on the Effective Date, for the purposes of any accounting requirements (including the accounting of benefits and the allocation of premiums), it will be treated as if it had become effective on 1 January 2019.

In preparing this report, I have assessed the impact of the proposed transfer on:

- the policyholders of Royal London DAC at the Effective Date. This comprises policyholders that purchased their policies between the date that Royal London DAC commenced selling new business (7 January 2019) and the Effective Date. Such policyholders are collectively referred to throughout this report as "**existing policyholders**"; and
- the policyholders of RLMIS that are proposed to be transferred into Royal London DAC. This comprises policyholders of all policies written in the Republic of Ireland ("**ROI**") or Germany up to the date RLMIS ceased writing polices in the ROI (6 January 2019[1]). Such policyholders are collectively referred to throughout this report as "**transferring policyholders**".

In each case, I have considered the potential impact on policyholders with particular reference to:

- their benefit expectations;
- the future security of those benefits;
- their contractual rights;
- policyholder protection;
- service levels; and
- with-profits governance.

This transfer is known as the "**Royal London Ireland transfer**" or the "**Transfer**". The terms of the Transfer have been set out in the "**Scheme of Transfer**".

This report has been prepared solely for the use of Royal London DAC in connection with the Scheme of Transfer. It is also expected that this report will be provided to the UK High Court and to the CBI.

It is intended that the UK High Court will be asked to approve the Transfer at a hearing on 31 January 2019. If approved, the Transfer will take effect on the Effective Date (although it will be treated for accounting purposes as though it took effect from the retrospective date of 1 January 2019). The CBI, as the regulator of Royal London DAC, has been informed of the proposed terms of the Transfer.

[1] There may be some pipeline policies, whereby a proposal for a policy has been received or issued by, or on behalf of, RLMIS to a prospective customer in ROI, before authorisation of Royal London DAC, but has not become a policy in force by the date Royal London DAC commences selling new business. These 'pipeline policies' will be written by RLMIS after the date that Royal London DAC commences selling new business and will be transferred to Royal London DAC on the Effective Date.

The report is based on the draft core documents sent to the CBI on the 28 September 2018, and the supplementary reports and other documents sent to the UK's Prudential Regulation Authority ("**PRA**") and Financial Conduct Authority ("**FCA**") on the 19 November 2018. These documents have been specified in section 1.4 below.

## 1.2 Authorisation, capitalisation and existing business of Royal London DAC

Royal London DAC is fully authorised by the CBI to write life insurance business with effect from 1 January 2019. From 7 January 2019, Royal London DAC commenced writing the business previously written by the Irish Branch of RLMIS.

Before authorisation of Royal London DAC as a regulated entity by the CBI, RLMIS provided Royal London DAC with capital of €40m comprising €1m share capital and a €39m capital contribution. The size of the capital contribution was determined based on the risk and liquidity profile of both the new business expected to be written into Royal London DAC and the open book of business expected to be transferred into Royal London DAC on the Effective Date.

Royal London DAC is a wholly-owned subsidiary of RLMIS. It will be valued as an asset within the Royal London Main Fund of RLMIS and is expected to ultimately pay dividends to the Royal London Main Fund.

As noted in section 1.1, one of the purposes of this report is to consider the likely impact of the Transfer on the existing policyholders of Royal London DAC. For the sake of clarity, the existing policyholders are those whose policies have been and will continue to be written into a new fund, the ("**Royal London DAC Open Fund**") between 7 January 2019 and the Effective Date.

## 1.3 Background on reasons for the transfer

RLMIS is a long-term insurance, mutual company, established and regulated in the United Kingdom ("**UK**") and which currently services business written in the UK, Ireland and Germany. European Union ("**EU**") passporting arrangements allow RLMIS to sell and to service business written elsewhere in the EU (i.e. outside of the UK).

In the event of the UK leaving the EU without any arrangements that replace passporting, or otherwise allow passporting to continue, there is a risk that it will become illegal for RLMIS to service its existing business written in Ireland and Germany and to sell new business in the EU. It is possible that the outcome of the EU exit negotiations will result in an agreement with the EU, which means that RLMIS would have been able to continue to service policies sold under EU passporting rights either for a transitional period, or until the end of the policy term. RLMIS is of the opinion that there is not sufficient time to wait for the results of EU exit negotiations. The Transfer will provide certainty that the transferring policyholders can continue to be serviced once the UK has left the EU, regardless of the outcome of EU exit negotiations.

Royal London DAC has been established in the ROI to enable the life insurance business previously written by RLMIS, through the ROI branch, to be written through an authorised life insurer in the ROI. In addition, two closed books of business, which were not previously written through the ROI branch will be transferred into Royal London DAC; one book of ROI business will be transferred from the Royal Liver Sub-Fund, and a closed book of German bond business will be transferred from the Royal London Main Fund within RLMIS.

The Transfer will improve economies of scale for Royal London DAC as the fixed costs associated with running the business will be spread over a larger number of policies compared to the pre-Transfer position.

## 1.4 Supporting documents and information

In considering the likely implications of the Transfer, I have reviewed the applicable sections of the following documents:

- The latest draft of the Scheme of Transfer.
- The RLMIS Principles and Practices of Financial Management ("PPFM") and draft Royal London DAC PPFM Guides. I note that the Royal London DAC PPFM Guides will be updated before the effective date to comply with the CBI's With-Profits Operating Principles ("**WPOP**") requirements.
- The RLMIS With-Profits Actuary's ("**WPA**") Report on the Transfer ("the With-Profits Actuary Report") and the latest draft of the WPA Supplementary Report on the Transfer.
- The RLMIS Chief Actuary's Report and the latest draft of the RLMIS Chief Actuary's Supplementary Report.
- The Independent Expert's Report and the latest draft of the Independent Expert's Supplementary Report.
- The amendments to the Instrument of Transfer (**"IoT"**) which governs the operation of the Royal Liver Fund within RLMIS. The amendments reflect the change in status of the Irish policyholders from direct to reinsured and have been approved by the PRA, the FCA and the Liver Supervisory Committee[2].
- The latest draft of the Liver Reinsurance Agreement.
- The latest draft of the German Bond Reinsurance Agreement.
- The Collateral Framework Agreements and the Deeds of Charge.

This report includes financial information as at 30 June 2018, which illustrates the expected financial impact of the Transfer as if it had occurred at that date.

Figures relating to RLMIS are based on published returns as at 30 June 2018 and assume no change between 30 June 2018 and the Effective Date. The same approach has been used to produce figures to represent the financial impact of the Transfer for Royal London DAC. In my judgement, the movements in the figures from the date as at which they were calculated up to the date of this report would not be sufficiently material to affect my conclusions.

[2] The Liver Supervisory Committee was established pursuant to the IoT to provide oversight on the operation of the Royal Liver Sub-Fund within RLMIS. The committee has the right to independent actuarial advice on any proposed amendments to the IoT and I understand it has exercised this right in respect of the proposed changes to reflect the Transfer.

## 1.5 Credentials and declaration of interest

I am a Fellow of the Institute and Faculty of Actuaries (UK) and a Fellow of the Society of Actuaries in Ireland. I have more than 25 years' experience in the Irish insurance and reinsurance industry and I am a Partner in Deloitte Ireland LLP ("Deloitte").

I am the Head of Actuarial Function ("**HoAF**") for Royal London DAC. Given the nature of the proposed Transfer, I am satisfied that it is appropriate for me to report as HoAF on the likely impact of the Scheme of Transfer on Royal London DAC's policyholders, both existing and those transferring into Royal London DAC, in a single document. I am not aware of any conflict of interest that would affect my professional judgement in reaching any of the conclusions detailed in this report.

## 1.6 Reliances and limitations

To the best of my knowledge, I have taken account of all material facts in assessing the likely impact of the Scheme of Transfer on Royal London DAC's existing and transferring policyholders and in preparing this report.

This report is based on information made available to me by RLMIS and Royal London DAC on or prior to 9 January 2019. It takes no account of information provided after that date.

In performing my review and preparing this report, I have relied without independent verification on the accuracy and completeness of data and information provided to me, both written and oral, by the main UK business of RLMIS and the Irish branch of RLMIS. I have reviewed the information for consistency and reasonableness but I have not audited or otherwise validated it. I have reviewed the 30 June 2018 financial information supplied for RLMIS. The written information and data, upon which I have relied, including financial information, are summarised in Appendix 6.1.

In arriving at my conclusions, in particular with respect to the security of policyholders' benefits, I have reviewed the various items of financial data provided and I have also considered the differences in the regulatory regimes between the UK and ROI as they pertain to RLMIS and Royal London DAC. I have also relied on the information and opinions provided by tax specialists within RLMIS.

There is no professional guidance specifically covering the work of the HoAF in respect of a Part VII transfer. However, ASP LA-6[3] provides guidance in respect of the role of the Independent Actuary in the context of a Section 13 transfer (the Irish equivalent of a UK Part VII transfer) which is a similar role. I have, therefore, considered ASP LA-6 in preparing this report and have complied with it in all material respects. Although not directly applicable, I have considered ASP-LA4[4], which provides guidance to Appointed Actuaries in considering and interpreting policyholders' reasonable expectations for the purpose of making a valuation of a company's life assurance liabilities. I have considered the CBI's guidance for Head of Actuarial Function[5], the general requirements of ASP PA-2[6] and APS X2[7] and I have complied with them in all applicable aspects.

[3] Actuarial Standard of Practice LA-6. Transfer of long-term business of an authorised insurance company – role of the independent actuary

[4] Actuarial Standard of Practice LA-4. Additional guidance for Appointed Actuaries on policyholders' reasonable expectations.

[5] https://www.centralbank.ie/docs/default-source/regulation/insurance-reinsurance/solvency-ii/requirements-and-guidance/guidance-for-(re)insurance-undertakings-on-head-of-actuarial-function-role.pdf?sfvrsn=4

[6] Actuarial Standard of Practice PA-2, General Actuarial Practice

[7] APS X2: Review of Actuarial Work (Version 1.0)

This report has been prepared solely for the use of Royal London DAC in connection with the Transfer, and must not be used for any other purpose. This report should be read in conjunction with the terms of the Scheme of Transfer and the associated reinsurance agreements.

Users of this report must not rely on it for any purpose other than in connection with the Scheme of Transfer. Neither Deloitte nor I owe or accept any duty to any party other than to Royal London DAC. Neither Deloitte nor I shall be liable for any loss, damage or expense (including interest) of whatever nature that is caused by any party's reliance on representations in this report.

This report has been prepared in accordance with agreed terms of reference and for a specific purpose. No liability will be accepted for the use of this report for a purpose for which it was not intended or for the results of any misunderstandings by any user of this report.

# 2. Outline of proposed transfer

RLMIS has two existing blocks of business written in the ROI, those being:

(a) a closed block, written originally by Royal Liver Assurance Limited and its predecessors, and held in the Royal Liver Sub-Fund ("**Ireland Liver Business**") and serviced on a freedom of services basis by RLMIS , a UK regulated entity; and

(b) an open block, written into the Royal London Main Fund ("**RL Post-2011 Business**") and serviced on a freedom of establishment basis through the Irish Branch of RLMIS.

RLMIS also has an existing block of business written in Germany on a freedom of services basis out of the UK, that being:

(c) a closed block of German bonds ("**German Bond Business**") written into the Royal London Main Fund within RLMIS.

As outlined in section 1.3, the rationale for effecting the Transfer for all three blocks (on a combined basis known as the **"transferring business"**) is to ensure that the business written in the ROI and Germany can continued to be serviced post Brexit in the event of passporting rights between the UK and those respective jurisdictions being discontinued. The Transfer is also expected to improve economies of scale for Royal London DAC, as the fixed costs associated with running the business will be spread over a much larger number of policies compared to the pre-Transfer position.

Under the Transfer, Royal London DAC will take on all existing rights and obligations applicable to RLMIS in relation to the transferring business. In the sections below, I consider the key current features of each block, the changes under the proposed Transfer, the proposed reinsurance, the associated security (collateral) arrangements and the expected financial impact of the Transfer.

## 2.1 Summary of business proposed to be transferred

### 2.1.1 Ireland Liver Business

The Ireland Liver Business proposed for transfer to Royal London DAC was written prior to July 2011 and is closed to new business other than new business generated as a result of honouring options available on existing policies. It comprises a mix of product types, all written in the ROI and acquired through a number of prior acquisitions, including:

- conventional life Ordinary Branch (OB) and Industrial Branch (IB) with profits and non-profit business;
- conventional pensions with profits and non-profit business;
- unitised with profits life and pensions business;
- unit-linked life and pensions business;
- protection and annuities business.

This business currently sits in the Royal Liver Sub-Fund within RLMIS and is serviced on a freedom of services basis by RLMIS, a UK regulated entity. The Royal Liver Sub-Fund within RLMIS arose from RLMIS's acquisition of Royal Liver Assurance Limited in 2011, with the business within this sub-fund comprising business written in both the UK and the ROI. At that time, this business was transferred from Royal Liver Assurance Limited to the Royal Liver Sub-Fund within RLMIS under an Instrument of Transfer (**"IoT"**). In 2012, the business of GRE Life Ireland Limited ("**GRELI**") was transferred into the Royal Liver Sub-Fund. GRELI was previously a subsidiary of Royal Liver Assurance Limited and was transferred to RLMIS as part of the transfer of the Royal Liver Business, becoming a subsidiary of RLMIS allocated to the Royal Liver Sub-Fund in 2011.

The IoT includes significant prescription on the management of the business within the Royal Liver Sub-Fund in RLMIS. It includes:

- Core Principles of Financial Management ("**CPFM**") which cover bonus and investment management principles that must be adhered to;
- ongoing and exceptional charges/fees permissible for deduction from the Royal Liver Sub-Fund for policy administration, investment management and other services. Any over/under payment of charges relative to actual expenses incurred is earned/paid by the Royal London Main Fund which takes the expense risk in relation to this business until December 2021. Thereafter, expense charges deducted from the Royal Liver Sub-Fund become actual expenses plus a margin, subject to a comparison against the costs of managing the business through outsourcing;
- roles and responsibilities of the Liver Supervisory Committee, which was established to provide independent oversight of policyholders' interests.

There are a number of existing reinsurance treaties in-force on this block of business.

As at 30 June 2018, the Ireland Liver Business comprised c. 445k policies, with a best-estimate liability, on a Solvency II basis, of c. £0.7 billion.

### 2.1.2 RL Post-2011 Business

The RL Post-2011 Business proposed for transfer to Royal London DAC was all written post June 2011 and is open to new business up to 6 January 2019 (pipeline policies may be written through the Irish Branch of RLMIS post 6 January 2019 as described in section 1.1). From 7 January 2019, any ROI new business that would have been written into this block has been and will continue to be written into the Royal London DAC Open Fund.

This block comprises the following types of business:

- Term Assurance (Life and Serious Illness) or 'TA' and Mortgage Protection (Life and Serious Illness) or 'MP' business written since 2011;
- Income Protection (IP) business written since 2015; and
- Whole of Life (WOL) product launched in 2016.

This business currently resides in the Royal London Main Fund within RLMIS and, from a ROI policyholder perspective, is serviced on a freedom of establishment basis through the Irish Branch of RLMIS.

There are six existing reinsurance treaties in-force on this block of business.

As at 30 June 2018, the RL Post-2011 Business comprised c. 55k policies, with a best-estimate liability, on a Solvency II basis, of negative c. £65m.

### 2.1.3 German Bond Business

The German Bond Business proposed for transfer to Royal London DAC is closed to new business and comprises the following types of business:

- German single premium unitised with profits bonds; and
- German single premium unit-linked bonds.

This business currently resides in the Royal London Main Fund within RLMIS and, from a German policyholder perspective, is serviced on a freedom of services basis from the UK through an Isle of Man outsourced services provider.

There are no reinsurance treaties in-force on this block of business.

As at 30 June 2018, the German Bond Business comprised c. 1.3k policies with a best estimate liability of c. £0.11 billion on a Solvency II basis.

## 2.2 Summary of the proposed transfer

### 2.2.1 Ireland Liver Business

Under the proposed Transfer, Royal London DAC will establish a separate ring-fenced fund, the **"Liver Ireland Sub-Fund"**. The Ireland Liver Business will transfer from the Royal Liver Sub-Fund within RLMIS into the Liver Ireland Sub-Fund within Royal London DAC on the Effective Date and Royal London DAC will take on all existing rights and obligations applicable to the transferring business from the Effective Date. The reinsurance arrangements already in place on the business within RLMIS will not transfer with the business to Royal London DAC.

Under the proposed Transfer, on the Effective Date, assets will be transferred from RLMIS to Royal London DAC. The value of these assets will be equal to the sum of the following, calculated gross of any reinsurance arrangements as at the Effective Date:

(i) the value of the Best Estimate Liability ("**BEL**"),

(ii) the Solvency Capital requirement ("**SCR**"),

(iii) the capital buffer required under Royal London DAC's internal capital management framework (the "**Capital Buffer**"), and

(iv) the risk margin.

As the Liver Ireland Sub-Fund will be ring-fenced, the SCR, Capital Buffer and risk margin will be calculated based on the fund in isolation with no allowance for diversification benefits with any other Royal London DAC business.

Simultaneous with the Transfer, a reinsurance quota-share arrangement (the "**Liver Reinsurance Agreement**") will be effected that will reinsure 100% of this business back into the Royal Liver Sub-Fund within RLMIS (this is described further in section 2.4). The rationale for effecting 100% reinsurance back to the Royal Liver Sub-Fund is to ensure that the fund remains economically intact, that the expectations of policyholders under their existing PPFM are maintained and that UK and ROI policyholders can continue to be treated consistently and as per the terms of the IoT.

Thus, under the proposed Liver Reinsurance Agreement, on the Effective Date, an initial reinsurance premium will be paid by Royal London DAC to RLMIS equal to:

(i) the BEL less the adjustment to the BEL to take account of expected losses due to default of the counterparty[8] (i.e. RLMIS) in Royal London DAC after the reinsurance is effected ("**BEL Counterparty Default Adjustment**"), plus

(ii) the SCR, the Capital Buffer and the risk margin (calculated as described above), less

(iii) the SCR, the Capital Buffer and the risk margin (calculated assuming the proposed reinsurance arrangement described above has been effected into the Royal Liver Sub-Fund within RLMIS).

The net effect of the proposed Transfer and proposed quota-share arrangements is that Royal London DAC's Liver Ireland Sub-Fund will have assets sufficient to cover the BEL Counterparty Default Adjustment and the risk margin, the SCR and the Capital Buffer (all after allowing for the reinsurance to RLMIS's Royal Liver Sub-Fund). That is, Royal London DAC will have sufficient assets to meet regulatory requirements in respect of the Liver Ireland Sub-Fund, plus a Capital Buffer. The Capital Buffer is calibrated such that there is a 1-in-20 probability of failing to cover the SCR, which itself is held to cover a 1-in-200 event over one-year. In addition, the risk margin is also held, which is a regulatory requirement.

Simultaneous with the reinsurance arrangement, fixed and floating charges supported by a collateral framework agreement will be entered into (collectively the "**Security Arrangements**").

The Security Arrangements will provide collateral to support RLMIS's obligations as reinsurer under the Liver Reinsurance Agreement. There will be one collateral framework agreement and two fixed charge deeds, a first tier and second tier. The fixed charges will be structured such that, in the event of a breach of the terms of the Liver Reinsurance Agreement by RLMIS, Royal London DAC could make a collateral call. This would provide Royal London DAC with access in short order to sufficient assets to enable Royal London DAC to continue to trade and meet its liabilities in respect of the Ireland Liver Business whilst RLMIS' insolvency proceedings (which could take a number of years) are being concluded. The collateral framework agreement also ensures equal claim priority with the direct UK policyholders in the majority of scenarios (i.e. the non-transferring RLMIS policies) and ensures equity and fair treatment between policyholders of RLMIS and Royal London DAC in the event of RLMIS becoming insolvent.

The Liver Reinsurance Agreement and associated Security Arrangements are described in further detail in sections 2.4 and 2.5 respectively.

[8] Under Article 81 of DIRECTIVE 2009/138/EC of the European Parliament and of the Council of 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II).

### 2.2.2 RL Post-2011 Business

The Irish branch of RLMIS has ceased writing business with effect from 6 January 2019. The business that would have been written through the Irish branch of RLMIS has been and will continue to be written by Royal London DAC with effect from 7 January 2019. The business written up to 7 January 2019 (including any pipeline policies written on or after 7 January 2019) into the Irish branch will be transferred from the Irish Branch of RLMIS into the Royal London DAC Open Fund under the proposed Transfer on the Effective Date. Royal London DAC will take on all existing rights and obligations applicable to the transferring business with effect from the Effective Date.

There are six existing reinsurance treaties in-force on this block of business. It is proposed that, if the proposed Transfer is approved by the UK High Court, all treaties will be amended and novated such that the cedant will change from RLMIS to Royal London DAC on the Effective Date. This has been agreed with the relevant reinsurers. New reinsurance agreements, with the same reinsurers, on substantially the same terms as those previously in place with RLMIS have been effected with effect from 7 January 2019. These new treaties cover any new business written by Royal London DAC after 7 January 2019.

As outlined in section 1.2, RLMIS has provided Royal London DAC with €40m of capital. There will be no explicit payment by Royal London DAC to RLMIS in connection with the transfer of this business. The capital contribution made into the Royal London DAC Open Fund was determined based on the value of the business transferred and the capital requirements of the Open Fund allowing for projected new business. The value of a more mature block of protection business of this nature reduces the overall level of funding required from RLMIS to Royal London DAC's Open Fund as it has a negative BEL and therefore reduces the impact of the new business strain, which arises from protection business. In other words, the mature part of the RL Post-2011 Business, together with the capital injection, is expected to generate sufficient cash flow to support the writing of new business into the fund.

### 2.2.3 German Bond Business

Under the proposed Transfer, Royal London DAC will establish a separate ring-fenced fund, the "**German Bond Sub-Fund**". The German Bond Business will transfer from the Royal London Main Fund within RLMIS into the German Bond Sub-Fund within Royal London DAC on the Effective Date and Royal London DAC will take on all existing rights and obligations applicable to the transferring business from the Effective Date.

Under the proposed Transfer, on the Effective Date, assets will be transferred from RLMIS to Royal London DAC. The value of these assets will be equal to the sum of the following, calculated gross of any reinsurance arrangements:

(i) the value of the BEL,

(ii) the SCR,

(iii) the Capital Buffer, and

(iv) the risk margin.

As the German Bond Sub-Fund will be ring-fenced, the SCR, Capital Buffer and risk margin will be calculated based on the fund in isolation with no allowance for diversification benefits with any other Royal London DAC business.

Simultaneous with the Transfer, a reinsurance quota-share arrangement (the "**German Bond Reinsurance Agreement**") will be effected, that will reinsure 100% of this business, back into the Royal London Main Fund within RLMIS. The rationale for effecting 100% reinsurance back to the Royal London Main Fund for this business is primarily because this is a small, closed, with-profits block of business which is in run-off and therefore would be difficult to manage on a stand-alone basis. The reinsurance will also ensure that the expectations of policyholders under their existing PPFM are maintained. German Bond with-profits policyholders within the Royal London Main Fund currently benefit from a "ProfitShare" arrangement, whereby eligible policies receive an allocation of part of the operating profits of RLMIS by means of a discretionary enhancement to asset shares and unit fund values. The overall effect of the German Bond Reinsurance agreement and the Scheme of Transfer means that the with-profits policyholders of the German Bond Business will continue to benefit from RLMIS's ProfitShare arrangement.

Thus, under the proposed quota-share reinsurance arrangement, on the Transfer, an initial reinsurance premium will be paid by Royal London DAC to RLMIS equal to:

(i) the BEL less the BEL Counterparty Default Adjustment, plus

(ii) the SCR, the Capital Buffer and the risk margin (calculated as described above), less

(iii) the SCR, the Capital Buffer and the risk margin (calculated assuming the proposed reinsurance arrangement described above has been effected into the Royal London Main Fund within RLMIS).

The net effect of the proposed Transfer and proposed quota-share arrangements outlined from a Royal London DAC perspective is that Royal London DAC's German Bond Sub-Fund will have assets sufficient to cover the BEL Counterparty Default Adjustment and the risk margin, SCR and the Capital Buffer (all after allowing for the reinsurance to RLMIS's Royal London Main Fund).

Simultaneous with the reinsurance arrangement, the Security Arrangements will be entered into, and will have the same structure, as described above for the Ireland Liver Business.

The German Bond Reinsurance Agreement and associated Security Arrangements are described in further detail in sections 2.4 and 2.5 respectively.

## 2.3 Summary of proposed external reinsurance arrangements

### 2.3.1 Ireland Liver Business

The Ireland Liver Business includes some protection business, which is subject to reinsurance of the mortality and/or morbidity risk with external reinsurers. Following the Transfer and the reinsurance of the business in the Royal London DAC Liver Ireland Sub-Fund back to the Royal Liver Sub-Fund within RLMIS, these external reinsurance contracts will be converted to retrocession contracts[9] between RLMIS and the external reinsurers, maintaining the equivalent reinsurance cover as applies immediately before the Transfer. This has been agreed with the relevant reinsurers.

[9] A retrocession is the process of ceding all or part of a reinsured risk to another reinsurer.

### 2.3.2 RL Post-2011 Business

The RL Post-2011 Business is subject to the reinsurance of the mortality and/or morbidity risk with external reinsurers. These treaties have been closed to new business, with the exception of pipeline policies as described in section 1.1, with effect from 6 January 2019 (i.e. the date at which the RLMIS Irish branch ceased writing new business). For the transferring business, the treaties will be novated to Royal London DAC from the Effective Date such that the same level of protection is provided after the Transfer. The novated treaties for transferring business will cover any pipeline business written through the Irish branch of RLMIS on or after 7 January 2019.

Royal London DAC has reinsurance arrangements in place in respect of the mortality and/or morbidity risk in respect of the policies sold from 7 January 2019. These new reinsurance agreements are with the same reinsurers and have been written on substantially the same terms as the previous reinsurance agreements that were in place with RLMIS in respect of this business.

### 2.3.3 German Bond Business

The German Bond Business is not subject to any external reinsurance arrangements either pre or post the Transfer.

## 2.4 Summary of proposed internal reinsurance arrangements

### 2.4.1 Ireland Liver Business

Description of the reinsurance agreement

The liabilities under the policies of the Royal London DAC Ireland Liver Business will be reinsured fully to the Royal Liver Sub-Fund within RLMIS. The relevant reinsurance agreement is the "**Liver Reinsurance Agreement"**.

The initial reinsurance premium will be as described above in section 2.2. Ongoing reinsurance premiums will be equal to the actual premiums payable in respect of the Ireland Liver Business' policies.

The net payment (which could be negative) from Royal London DAC to RLMIS under the agreement will be equal to:

(i) on a monthly basis, the ongoing reinsurance premiums, less

a) the expense fees charged to the Liver Ireland Sub-Fund, in accordance with the Scheme of Transfer, in respect of the reinsured business together with any relevant exceptional expenses, and

b) the actual tax paid in Ireland in the Royal London DAC Liver Ireland Sub-Fund, and

c) the claims paid in respect of the reinsured business including any payments made to the Ireland National Treasury Management Agency ("NTMA")[10], plus

(ii) on a quarterly basis, an experience adjustment to keep the Capital Buffer for the Liver Ireland Sub-Fund in line with the Royal London DAC internal capital management framework.

The diagram below shows how the experience adjustment will operate to maintain the target level of Capital Buffer in the Liver Ireland Sub-Fund within Royal London DAC. An assessment will be made of the Capital Buffer on a regular basis, generally quarterly with ongoing monitoring, and a payment will be made in the appropriate direction to maintain the Capital Buffer in line with the Royal London DAC internal capital management framework. The diagram shows an example where the Capital Buffer is above the target and the experience adjustment is paid from Royal London DAC to RLMIS.

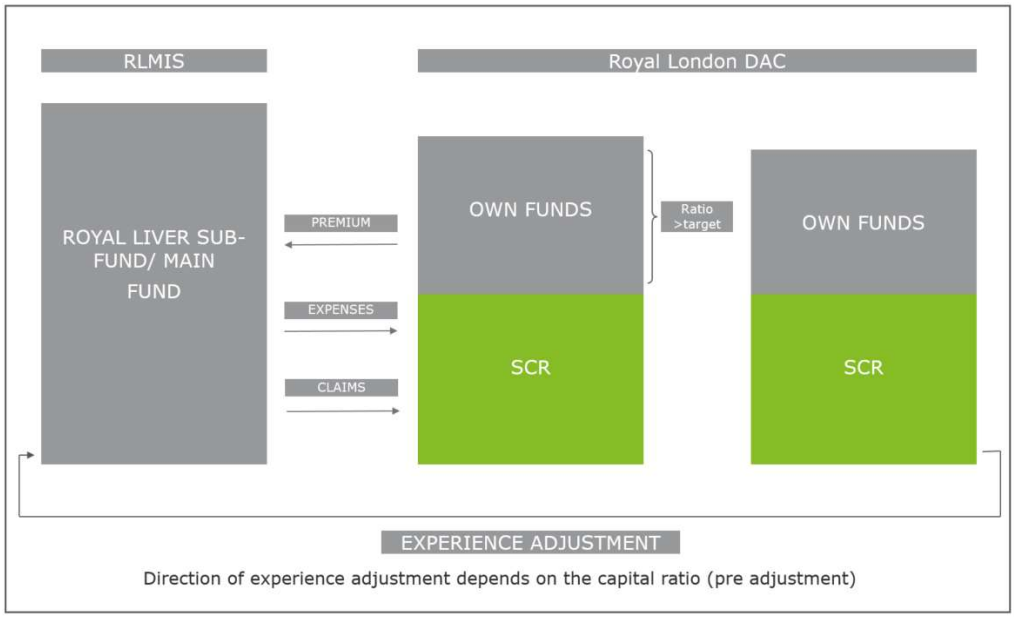


**FIGURE 1: EXPERIENCE ADJUSTMENT**

Under the terms of the Scheme of Transfer, until December 2021, the Liver Ireland Sub-Fund, from an expenses point of view, cannot be charged any more or less than a certain level of pre-defined expense fees plus exceptional expenses. Under the Liver Reinsurance Agreement, the Royal London DAC Liver Ireland Sub-Fund receives these pre-defined expense fees and exceptional expenses from the Royal Liver Sub-Fund. These are then passed from the Liver Ireland Sub-Fund to the Royal London DAC Open Fund. The Royal London DAC Open Fund is responsible for paying the actual expenses associated with the Ireland Liver Business. Thus, the expense risk resides with the Royal London DAC Open Fund as any profits or losses arising in respect of the difference between the actual expenses and the pre-defined expense fees plus exceptional expenses falls to the Royal London DAC Open Fund.

After December 2021, the Royal London DAC Open Fund will charge to the Liver Ireland Sub-Fund the actual expenses incurred in administering the business plus a margin, subject to a comparison against the costs of managing the business through outsourcing plus exceptional expenses. The Royal London DAC Liver Ireland Sub-Fund will receive the actual expenses incurred in administering the business, plus the margin, from the Royal Liver Sub-Fund.

[10] The NTMA is an agency set up by the Irish Government to collect unclaimed funds from banks, building societies and life assurance companies and use them for charitable and social purposes.

A positive expense cashflow is therefore expected to accrue to the Royal London DAC Open Fund. Up to December 2021, this cashflow will be in respect of the difference between the fees charged to the Liver Ireland Sub-Fund and the actual expenses incurred in administering the business. Post December 2021, this cashflow will be in respect of the margin charged by Royal London DAC to the Liver Ireland Sub-Fund. Royal London Management Services ("RLMS"), which is a subsidiary of RLMIS and has an Irish Branch, will provide services to Royal London DAC in respect of the ROI Ireland Liver transferring policyholders. Royal London DAC will pay RLMS the actual expenses incurred by RLMS in respect of services provided on behalf of Royal London DAC. Royal London DAC will also pay an additional margin of between 5% and 8% of expenses charged as per the service agreement between RLMS and Royal London DAC, to allow for transfer pricing. This additional margin will emerge as a positive cashflow in RLMS and will be removed from the Royal London DAC Open Fund BEL. This adjustment reduces to an insignificant level the profits that are expected to emerge in the Royal London DAC Open Fund as a result of the difference between the actual expenses incurred in servicing the Ireland Liver Business and the fees permitted to be deducted from the Liver Ireland Sub-Fund. In summary, it is expected that little or no expense profit or loss will emerge in the Royal London DAC Open Fund in respect of the Ireland Liver Business.

Whilst the Liver Reinsurance Agreement is in place, and RLMIS is solvent, the experience adjustments will ensure that the Liver Ireland Sub-Fund is capitalised in accordance with the Royal London DAC internal capital management framework.

Under the terms of the Security Arrangements, in the event of insolvency of RLMIS, a collateral call could be made and would be made by Royal London DAC, which would mean that Royal London DAC would be provided with assets to the value of 50% of the BEL that has been reinsured. This would provide Royal London DAC with sufficient assets to continue to trade and meet its liabilities whilst RLMIS' solvency proceedings (which could take a number of years) are being concluded. In section 2.5, we discuss in more detail the nature of the Security Arrangements in place.

Termination of the reinsurance arrangement

In the event of termination of the Liver Reinsurance Agreement, the process to determine the various interests of the policyholders of the Royal Liver Sub-Fund and the Liver Ireland Sub-Fund (i.e. the UK and ROI policyholders respectively), as set out in the Scheme of Transfer, would apply. This process would take place prior to the termination of the Liver Reinsurance Agreement taking effect in order to protect the interests of all policyholders. In particular, the inherited estate within the Royal Liver Sub-Fund would need to be split and the assets allocated between relevant policyholders of Royal London DAC and RLMIS.

The Scheme of Transfer 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 With-Profits Committee and Royal London DAC Board when completing this process. The Scheme of Transfer also requires that each party who opines must consider the interests of all policyholders (direct and reinsured) within RLMIS' Royal Liver Sub-Fund in reaching their respective opinions. In addition, an independent expert must be appointed to opine on the fairness of the split of the total assets of the Royal Liver Sub-Fund and the Liver Ireland Sub-Fund between the different groups of policyholders within these funds. As already noted, this includes the allocation of the inherited estate of the Royal Liver Sub-Fund between the Ireland Liver Business with-profits policies in Royal London DAC and the Royal Liver Sub-Fund business with-profits policies in RLMIS.

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. Appropriate provisions have been included in the Scheme of Transfer to ensure that the Royal London DAC Liver Ireland Sub-Fund continues to be managed consistently with the current management of the Royal Liver Sub-Fund. These provisions include a requirement to operate

in line with the Royal London DAC PPFM Guide (or equivalent regulatory requirement i.e. the WPOP), capital support provisions, and a set of CPFM which are aligned to those in the IoT.

Following termination of the Liver Reinsurance Agreement, the Royal London DAC Open Fund will provide capital support, if required, to the Liver Ireland Sub-Fund. The Scheme of Transfer places a restriction on the provision of capital support by the Royal London DAC Open Fund such that capital would not be provided if, in the opinion of the Royal London DAC Board, having regard to the views of the Royal London DAC HoAF, the value of the assets in the Royal London DAC Open Fund was deemed to be:

(i) insufficient or,

(ii) through the provision of such support, would be insufficient

to meet the minimum amount of assets required by the relevant prudential requirements to be maintained in the Royal London DAC Open Fund.

Following termination of the Liver Reinsurance Agreement, Royal London DAC will cease to maintain the Liver Ireland Sub-Fund as a separate ring-fenced fund where the aggregate value of asset shares falls below a certain trigger point, as set out in the Scheme of Transfer. In this scenario, the Ireland Liver transferring policyholders would be supported by the assets of the Royal London DAC Open Fund.

### 2.4.2 RL Post-2011 Business

The RL Post-2011 Business is not subject to any internal reinsurance arrangements either pre or post the Transfer.

### 2.4.3 German Bond Business

Description of the reinsurance agreement

The liabilities under the policies of the Royal London DAC German Bond Business will be reinsured fully to the Royal London Main Fund within RLMIS. The relevant reinsurance agreement is the "**German Bond Reinsurance Agreement"**.

The initial reinsurance premium will be as described above in section 2.2. Ongoing reinsurance premiums will be zero in respect of the German Bond Business (given the fact that the business within this fund is all single premium).

As the ongoing reinsurance premiums are zero, the net payment is generally expected to flow from RLMIS to Royal London DAC under the agreement. This will be equal to:

(i) on a monthly basis, the sum of:

a) the actual expense fees incurred in respect of the reinsured business, and
b) the actual tax paid in Ireland in the Royal London DAC German Bond Sub-Fund, and
c) the claims paid in respect of the reinsured business, plus,

(ii) an experience adjustment (on a quarterly basis) to keep the Capital Buffer for the individual fund in line with the Royal London DAC internal capital management framework.

Figure 1 in section 2.4.1 showed how the experience adjustment will operate for the Liver Ireland Sub-Fund and this is also relevant for the German Bond Sub-Fund.

Under the terms of the Scheme of Transfer, the German Bond Sub-Fund, from an expenses point of view, is charged actual expenses. Under the German Bond Reinsurance Agreement, the Royal London DAC German Bond Sub-Fund receives the actual expenses from the Royal London Main Fund. These are then passed from the German Bond Sub-Fund to the Royal London DAC Open Fund. The Royal London DAC Open Fund is responsible for paying the actual expenses associated with the German Bond Business. As actual expenses are based on pre-defined expenses within an outsourced services agreement with an external provider who provides administrative services in relation to this business, the only expense risk in the German Bond Sub-Fund is the risk that the outsourced service provider terminates the contract. Based on my discussions with management, should the contract be cancelled, mitigating actions would be taken to ensure service standards are maintained and expenses are kept within a reasonable level. Considering the foregoing, I view the expense risk of the German Bond Sub-Fund to be immaterial.

Whilst the German Bond Reinsurance Agreement is in place, and RLMIS is solvent, the experience adjustments will ensure that the German Bond Sub-Fund within Royal London DAC is capitalised in accordance with the Royal London DAC internal capital management framework.

Under the terms of the Security Arrangements, in the event of insolvency of RLMIS, a collateral call could be made and would be made by Royal London DAC, which would mean that Royal London DAC would be provided with assets to the value of 50% of the BEL that has been reinsured. This would provide Royal London DAC with sufficient assets to continue to trade and meet its liabilities whilst RLMIS' solvency proceedings (which could take a number of years) are being concluded. In section 2.5, we discuss in more detail the nature of the Security Arrangements in place.

Termination of the reinsurance arrangement

Following termination of the German Bond Reinsurance Agreement, the German Bond Sub-Fund would not continue to operate as a ring-fenced fund. Any remaining German Bond policies would be allocated to the Royal London DAC Open Fund. The Scheme of Transfer contains provisions to ensure that, on termination of the German Bond Reinsurance Agreement, Royal London DAC is provided with enough assets to meet the BEL, risk margin, SCR and Capital Buffer in relation to the German Bond Business, calculated after the collapse of the German Bond Sub-Fund.

As described in section 2.2.3, the German Bond policyholders will retain their existing benefits in respect of the ProfitShare arrangement post-Transfer whilst the German Bond Reinsurance Agreement is in place. The Scheme of Transfer also includes an allowance for a potential ProfitShare termination payment to compensate relevant policyholders for the loss of future eligibility to ProfitShare payments upon termination of the German Bond Reinsurance agreement. The Scheme of Transfer requires an independent expert to be appointed to opine on the appropriateness of any such payment. Any additional assets required to be transferred by RLMIS to Royal London DAC in relation to this termination payment will be transferred from the Royal London Main Fund.

## 2.5 Summary of proposed Security (collateral) Arrangements

The proposed collateral arrangements comprise a "**First Tier Collateral**", "**Second Tier Collateral**" and an "**Insolvency Floating Charge**".

The diagram below shows the structure of the reinsurance agreements and associated Security Arrangements.

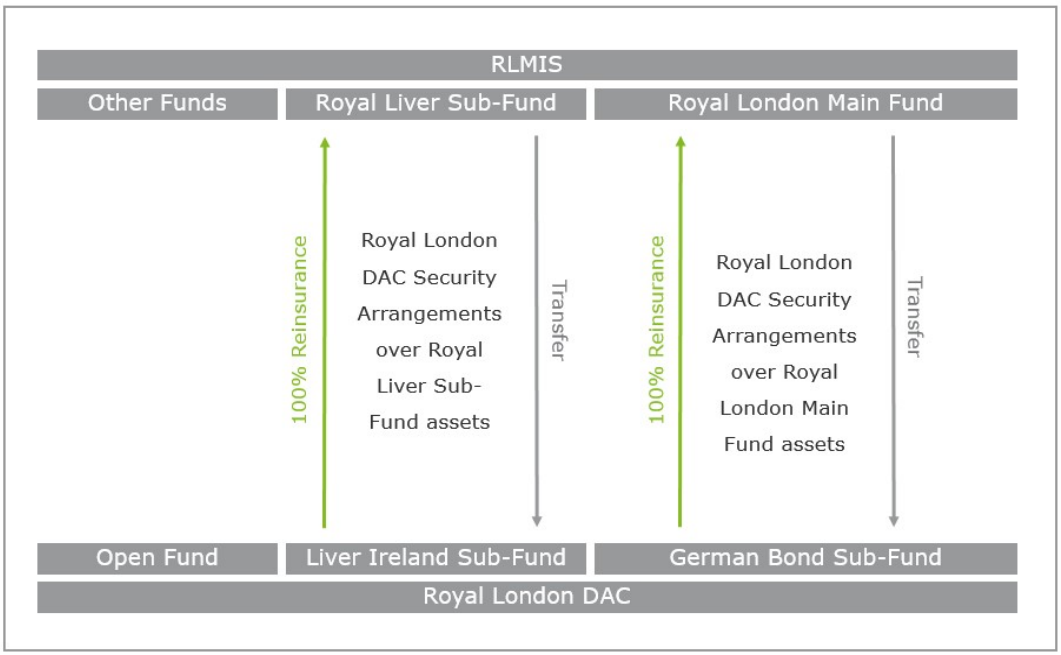


**FIGURE 2: REINSURANCE AND SECURITY ARRANGEMENTS**

The key features of the Security Arrangements in place in respect of the Ireland Liver Business and the German Bond Business are:

- In the event of RLMIS' default under the reinsurance agreements or insolvency of RLMIS, Royal London DAC will be able to obtain a proportion of the collateral (up to 50% of the BEL of relevant policies, assuming the reinsurance was not in place, as at the most recent quarter). This First Tier Collateral is a fixed charge over a part of the assets of the Royal Liver Sub-Fund, in the case of the Ireland Liver Business and the Royal London Main Fund, in the case of the German Bond Business. This tier does not contain equalisation provisions (described below), which in summary means that the reinsured Ireland Liver Business policyholders and reinsured German Bond Business policyholders receive priority from a timing of payment perspective over the relevant direct policyholders of RLMIS, in the event of insolvency. Consequently, it enables Royal London DAC to continue to trade and meet its liabilities whilst RLMIS' solvency proceedings (which could take a number of years) are being concluded.
- The Second Tier Collateral enables Royal London DAC to obtain up to a further 50% of the BEL of the relevant policies. The Second Tier Collateral takes into account amounts already recovered under the First Tier Collateral and the Insolvency Floating Charge. This Second Tier Collateral is a fixed charge over part of the assets of the Royal Liver Sub-Fund, in the case of the Ireland Liver Business and the Royal London Main Fund, in the case of the German Bond Business. The Second Tier Collateral includes equalisation provisions, which ensure that in the event of insolvency of RLMIS, the reinsured Ireland Liver Business policyholders and the reinsured German Bond Business policyholders would not receive any more or less that they would be entitled to receive were they to remain direct policyholders of RLMIS. The equalisation provisions are required to maximise Royal London DAC's security interests while also ensuring equity and fair treatment between the policyholders of RLMIS and Royal London DAC should the First Tier Collateral, Second Tier Collateral and, if relevant the Insolvency Floating Charge, be enforced.

- The effect of the First Tier Collateral and the Second Tier Collateral together is that Royal London DAC would be able to recover up to 100% of the BEL and no less than 50% of the BEL in respect of the reinsured policies.
- The Insolvency Floating Charge is a floating charge over the assets of RLMIS (excluding circa £3bn of unit-linked funds). The Insolvency Floating Charge ensures that the Royal London DAC reinsured policyholders of RLMIS have the same entitlement priority on wind-up as the direct policyholders of RLMIS to all of the assets available for distribution in the event of insolvency of RLMIS.

The reinsurance agreements and associated Security Arrangements have been designed to ensure that the direct impact on this group of transferring policyholders of the insolvency of RLMIS will be broadly unchanged post-Transfer. However, the additional indirect or external impact of the Financial Services Compensation Scheme ("**FSCS**") is considered in further detail in section 4.2.

### 2.5.1 Ireland Liver Business

As already outlined, RLMIS and Royal London DAC will establish Security Arrangements, which can be called upon in the event of a breach of the terms of the Liver Reinsurance Agreement by RLMIS. Both fixed charge tiers provide Royal London DAC with a charge over a proportion of the assets of RLMIS' Royal Liver Sub-Fund in respect of the Ireland Liver Business. The floating charge provides Royal London DAC with a charge over the assets of RLMIS (excluding approximately £3bn of unit-linked assets) in the case of insolvency.

The assets subject to the fixed charges will be a proportion of the assets of the Royal Liver Sub-Fund and will be allocated to two separate ring fenced collateral pools (one per fixed charge), by the appointed custodian. The assets are currently, and will continue to be managed by Royal London Asset Management (RLAM) to the relevant investment benchmarks and will be available to meet claims arising under the reinsured policies using the monthly settlement arrangements. The value of the collateral relative to the reinsured liabilities will be rebalanced as part of the monthly settlement process under the Liver Reinsurance Agreement with quarterly restatements based on Royal London DAC's regulatory reporting figures.

Each tier is in respect of a charge on assets equal to 50% of the BEL that has been reinsured. Therefore, on a combined basis the two tiers provide a charge over assets equal to 100% of the BEL that has been reinsured. These fixed charges mean that, in the event of a breach of the Liver Reinsurance Agreement, Royal London DAC can take control of sufficient assets to meet the reinsured liabilities. The key differences between the two tiers are:

- The First Tier is an absolute charge with no allowance for recoveries under tier 2 or any other mechanism. This allows Royal London DAC to access sufficient assets to continue operating to trade and meet its liabilities whilst RLMIS' solvency proceedings (which could take a number of years) are being concluded.
- The Second Tier makes allowance for recoveries under the First Tier and under the Insolvency Floating Charge, where relevant. Additionally, this tier includes equalisation provisions, as described above.

The Insolvency Floating Charge crystallises into a fixed charge immediately prior to the appointment of an insolvency office holder in respect of RLMIS. The maximum amount recoverable under the Insolvency Floating Charge may not exceed the aggregate value of the BEL that has been reinsured. Without such a charge, the reinsured policyholders would rank behind direct policyholders of RLMIS in priority in the event of RLMIS being wound up.

As the First Tier provides Royal London DAC with access in short order to assets equal to 50% of the BEL, there is a possibility that transferring policies could receive more than direct policies of RLMIS under this arrangement (if we ignore the impact of the FSCS). However, for

this to be true, it would require RLMIS to become insolvent and to be only able to meet less than 50% of BEL in respect of the relevant policyholders. Given the current capitalisation level of RLMIS, this is currently a remote possibility.

### 2.5.2 RL Post-2011 Business

The Royal London DAC Open Fund is not subject to any security (collateral) arrangements either pre or post the Transfer.

### 2.5.3 German Bond Business

The structure of the Security Arrangements for the German Bond Business will be as described above for the Liver Reinsurance Agreement. The only difference is that the tier 1 and tier 2 charges are over a proportion of the assets of the Royal London Main Fund rather than the Royal Liver Sub-Fund.

## 2.6 Financial Impacts

The sub-sections below set out the key capital figures in relation to the Solvency II Pillar 1 calculations using data as at 30 June 2018.

The tables in each sub-section illustrate the financial impact of the Transfer. The figures are based on published financial information as at 30 June 2018 in respect of existing business. I am satisfied that the use of data up to 30 June 2018 in respect of existing business, with no allowance for any roll-forward will not have a material impact on the conclusions reached in this report.

The figures presented in the sub-sections below are denominated in GBP (Sterling) as this is the current reporting currency of RLMIS. However, the reporting currency of Royal London DAC will be Euro and all transferring business is denominated in Euro.

The capital requirement (SCR) shown in the tables is based upon the Solvency II standard formula, which is the proposed regulatory reporting basis for Royal London DAC and the current regulatory reporting basis for RLMIS. I have considered these figures in assessing the likely financial impact of the Transfer on the relevant groups of policyholders.

A commonly used measure of security in the insurance industry is the SCR Cover position which is Own Funds (or the excess assets available over and above liabilities) as a percentage of the SCR. In my opinion, the SCR Cover is an appropriate measure of the capital position of an entity and I have made reference to this measure throughout this report.

### 2.6.1 RLMIS

The business proposed for transfer from RLMIS is the ROI business from the Royal Liver Sub-Fund and both the ROI and German businesses from the Royal London Main Fund. The tables below summarise the assets and liabilities of each of these funds in turn, along with the SCR Cover.

**Royal Liver Sub-Fund**

| £m | Royal Liver Sub-Fund Pre-Transfer | Project Costs | Transfer from Royal Liver Sub-Fund | Reinsurance from Royal London DAC to Royal Liver Sub-Fund | Royal Liver Sub-Fund Post Transfer |
|---|---|---|---|---|---|
| **Assets** | 2,240 | (10) | (887) | 877 | 2,220 |
| **BEL** | 1,693 | 17 | (735) | 735 | 1,709 |
| **Risk Margin** | 46 | | (20) | 20 | 46 |
| **TMTP** | (46) | | 0 | 0 | (46) |
| **Current Liabilities** | 96 | | 0 | 0 | 96 |
| **Subordinated debt** | 0 | | 0 | 0 | 0 |
| **Own funds** | 452 | (26) | (131) | 122 | 416 |
| **Capital requirement (SCR)** | 184 | | (80) | 80 | 184 |
| **Excess capital** | 267 | | (51) | 42 | 231 |
| **Own Funds (% of capital requirement)** | **245%** | | | | **225%** |

**TABLE 1: ROYAL LIVER SUB-FUND ASSETS AND LIABILITIES**

Table 1 shows that Solvency II SCR Cover of the Royal Liver Sub-Fund reduces post Transfer, albeit it is still at a very healthy level in terms of its coverage of the SCR. The SCR Cover reduction is primarily due to the following factors:

- £20m decrease in assets due to:
  - Project costs of £10m (set-up of the new subsidiary, legal process and agreements, etc.), none of which had been charged to the Royal Liver Sub-Fund as at 30 June 2018
  - Difference between the assets transferred to Royal London DAC and the reinsurance premium received in respect of the same business of £10m. This difference is due to regulatory driven capital inefficiencies, as Royal London DAC is required to retain a proportion of the assets to meet its residual capital requirements in respect of this business.
- £17m increase in BEL due to the increase in ongoing expenses allocated to the Royal Liver Sub-Fund as a result of the Transfer.
- £36m reduction in Own Funds due to the total impact of the above changes in assets and BEL.

**Royal London Main Fund**

| £m | Royal London Main Fund Pre-Transfer | Project Costs | Transfer RL Post-2011 Business from Royal London Main Fund (inc. initial capital) | Transfer German Business to German Bond Sub-Fund | Reinsurance from Royal London DAC to Royal London Main Fund | Royal London Main Fund Post transfer |
|---|---|---|---|---|---|---|
| **Assets** | 53,481 | (3) | (63) | (114) | 112 | 53,413 |
| **BEL** | 48,090 | 7 | 65 | (105) | 105 | 48,162 |
| **Risk Margin** | 731 | | (7) | (2) | 2 | 724 |
| **TMTP** | (729) | | | | | (729) |
| **Current Liabilities** | 1,710 | | | | | 1,710 |
| **Subordinated debt** | 861 | | | | | 861 |
| **Own funds** | 4,540 | (10) | (121) | (8) | 6 | 4,407 |
| **Capital requirement (SCR)** | 2,119 | | (17) | (5) | 5 | 2,102 |
| **Excess capital** | 2,421 | (10) | (103) | (3) | 1 | 2,306 |
| **Own Funds (% of capital requirement)** | **214%** | | | | | **210%** |

**TABLE 2: ROYAL LONDON MAIN FUND ASSETS AND LIABILITIES**

Table 2 shows that Solvency II SCR Cover of the Royal London Main Fund reduces post Transfer, albeit it is still at a very healthy level in terms of its coverage of the SCR.

The Own Funds will reduce in total by c. £133m. Of this:

- £35m relates to the reduction due to transfer of initial capital of €40m (£35m) to Royal London DAC to support the RL Post-2011 Business, and;
- £86m relates to a reduction due to transfer of net assets (assets less liabilities), to cover the BEL and the risk margin, including the value of the external novated reinsurance assets in respect of the RL Post-2011 Business

There is a small corresponding reduction in the SCR as a result of the Transfer due to the removal of the RL Post-2011 Business and hence risk from the fund.

The remaining £12m reduction in Own Funds is driven by:

- £3m reduction due to costs associated with the transfer project. It should be noted that a further £8m of project costs had already been incurred and allocated to the Royal London Main Fund prior to 30 June 2018.
- £7m increase in BEL, as a result of a reduction in the present value of future profits, due to the Transfer of rate card payments and actual Ireland Liver Business expenses to Royal London DAC.
- £2m reduction due to the net impact of the Transfer of the German Bond Business to Royal London DAC, as the amount transferred to Royal London DAC is greater than the reinsurance premium received in respect of the same business. This is due to regulatory driven capital inefficiencies, as Royal London DAC is required to retain a proportion of the assets to meet its residual capital requirements in respect of this business.

Overall, the Transfer results in a small reduction in the SCR Cover of the Royal London Main Fund.

I have reviewed the most recent version of the RLMIS ORSA report, which shows the projected capital position of RLMIS, based on the business plan. The projections, which do not allow for the Transfer, show that RLMIS is expected to remain very well capitalised and the capital position is expected to remain relatively stable over the planning horizon. Thus, the transferring policyholders could reasonably expect Royal London DAC, the entity to which they are to be transferred, to be a very well capitalised entity with a relatively stable projected capital position. I discuss the expected financial impact of the Transfer on Royal London DAC in the following section.

### 2.6.2 Royal London DAC

In order to compare the financials of Royal London DAC, pre-Transfer to post-Transfer, I have considered the following:

- The pre-Transfer position, which will be the £35m (€40m) of assets that have been transferred from RLMIS to Royal London DAC and very small, immaterial liabilities in relation to the less than 1,000 policies that are expected to be sold between 7 January 2019 and the Effective Date. This level of capitalisation was derived on the expectation of the RL Post-2011 Business transferring in from RLMIS.
- The projected post-Transfer position of Royal London DAC, based on published figures for the transferring business as at 30 June 2018.

Table 3 below shows the projected post-Transfer position of Royal London DAC.

| £m | Open Fund | German Bond Sub-Fund | Liver Ireland Sub-Fund | Royal London DAC Total |
|---|---|---|---|---|
| Assets | 63 | 2 | 10 | 75 |
| BEL | (65) | 1 | 2 | (62) |
| Risk Margin | 7 | 0 | 2 | 10 |
| TMTP | 0 | 0 | 0 | 0 |
| Current Liabilities | 0 | 0 | 0 | 0 |
| Subordinated debt | 0 | 0 | 0 | 0 |
| Own funds | 121 | 1 | 5 | 127 |
| Capital requirement (SCR) | 29 | 1 | 3 | 33 |
| Excess capital | 92 | 0 | 2 | 94 |
| **Own Funds (% of capital requirement)** | **416%** | **164%** | **164%** | **386%** |

**Table 3: Royal London DAC Assets and liabilities**

The £63m of assets in respect of the Open Fund includes the £35m (€40m) of seed capital which was derived on the expectation of the RL Post-2011 Business transferring in from RLMIS.

The transferring BEL in respect of the Open Fund is negative £65m.

Royal London DAC was established specifically to write the ROI business currently written into the Irish branch of RLMIS and the initial capitalisation was derived on the expectation that the Irish branch business would transfer. Therefore, there is no valid pre-Transfer position to compare against when considering the existing policyholders of Royal London DAC at the time

of the Transfer. However, these policyholders being newly written into the Royal London DAC Open Fund could reasonably expect to be in an appropriately capitalised entity, similar to the policyholders written before 7 January 2019, into the Royal London Main Fund of RLMIS.

To this end, the significant capital injection into Royal London DAC recognises the greater volatility to which Royal London DAC will be exposed, compared to RLMIS, due to its relatively smaller size. I have reviewed the most recent version of the Royal London DAC ORSA report. The projections in the ORSA indicate that Royal London DAC is expected to be very well capitalised over the five-year projection period. The Royal London DAC ORSA considers several stress and scenario tests that would be expected to have a materially adverse impact on the solvency position of Royal London DAC. Although the SCR Cover falls under the adverse stress and scenario tests, the SCR Cover remains very well capitalised over the five-year projection period.

My analysis in sections 3 and 4, which considers the likely impact of the Transfer on the existing policyholders of Royal London DAC at the time of Transfer and those policyholders transferring to Royal London DAC from RLMIS, should also be considered in relation to the above.

# 3. Impact on existing policyholders of Royal London DAC at time of the Transfer

## 3.1 Factors considered

I have considered the likely impact of the proposed Transfer on the existing policyholders of Royal London DAC at the Effective Date, i.e. any new policies written between 7 January 2019) and the Effective Date, in respect 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) Policyholder communications (section 3.9).

Royal London DAC expects to write less than 1,000 policies between 7 January 2019 and the Effective Date. The new business that Royal London DAC writes is the same as the business previously written through the Irish Branch of RLMIS. It comprises the following types of policies:

- TA (Life and Serious Illness) and MP (Life and Serious Illness) business;
- IP business; and
- WOL product.

## 3.2 Security of benefits

In the sub-sections below, I consider the likely impact of the Transfer on the existing policyholders of Royal London DAC as it relates to the security of their benefits. In considering the financial positions of RLMIS and Royal London DAC, I refer to the SCR Cover. In considering the risk profile of Royal London DAC, I refer to the SCR in respect of those risks.

I have also considered the potential liquidity risk that Royal London DAC will be exposed to post-Transfer and the reinsurance agreements being effected, which is not captured in the SCR. Liquidity risk will arise due to the fact that Royal London DAC will be required to pay claims as they arise in respect of the Ireland Liver Business and the German Bond Business. These claims will ultimately be paid by RLMIS via the reinsurance arrangements. However, there will be a delay between the date claims are paid by Royal London DAC and the date Royal London DAC is compensated by RLMIS. I understand that a solution to this issue has been constructed whereby it is expected that RLMIS will issue a “rolling-loan” to Royal London DAC in order to mitigate this particular risk. For the purposes of forming my opinions, I am assuming that this solution will be in place by the Effective Date.

### 3.2.1 SCR Cover

As outlined in section 2.6, Royal London DAC will be very well capitalised immediately before the Transfer, due to the capital contribution from RLMIS of €40m (£35m). Immediately after the Transfer, Royal London DAC will be less well capitalised but is still projected to be very well capitalised.

Arguably, the existing policyholders of Royal London DAC will have greater benefit security prior to the Transfer due to the higher SCR coverage (as a result of the €40m seed capital and less than1,000 policies being written into the newly authorised entity during the period up to the Effective Date). However, the establishment of Royal London DAC is required to enable the transfer of business from RLMIS that could not otherwise be serviced post Brexit and to enable the Group to continue to sell new business to customers based in the ROI. Thus, the capitalisation of Royal London DAC with €40m of seed capital was based on the assumption that the Transfer takes place. The pre-Transfer SCR Cover position of Royal London DAC is not, in my view, an appropriate comparison in this context relative to the post-Transfer SCR Cover position.

In assessing what the expectations of these existing policyholders are in the context of the SCR Cover position they could reasonably have expected, it is perhaps relevant to consider the SCR Cover position which pertained to the same business written into the Irish Branch of RLMIS immediately prior to Royal London DAC's authorisation (in other words, SCR Cover position pre-Transfer of RLMIS). In this context, they could reasonably have expected an SCR Cover position of c. 200%.

Considering this as a benchmark, the immediate post-Transfer SCR Cover position of Royal London DAC is expected to be c. 400%, which is significantly higher than the expected SCR Cover of the Royal London Main Fund in RLMIS. In addition, projections of the SCR Cover position for Royal London DAC indicate that it is expected to be very well capitalised over a projected 5-year period. Whilst it is worth noting that Royal London DAC will be a significantly smaller entity relative to RLMIS, the Transfer provides a critical mass of business for Royal London DAC and enables cashflows to be generated from the existing inforce book of business to support the future writing of new business into the Open Fund of Royal London DAC rather than it being a drain on capital and being a liquidity challenge.

Overall, having considered the foregoing, I am satisfied that the existing policyholders of Royal London DAC will not be significantly disadvantaged as a result of Transfer, as it relates to their security of benefits.

### 3.2.2 Risk profile

The risk profile of Royal London DAC will change post Transfer. The key risks to which Royal London DAC is expected to be exposed to prior to the Transfer are:

- lapse risk;
- expense risk;
- interest rate risk;
- mortality risk;
- life catastrophe risk; and
- liquidity risk.

These risks are typically associated with writing new protection business, which is the business that Royal London DAC has written and will continue to write between 7 January 2019 and the Effective Date.

The risk profile of Royal London DAC will change post-Transfer, mainly due to the additional counterparty risk that will be acquired due to the reinsurance agreements between Royal London DAC and RLMIS in respect of the Ireland Liver Business and the German Bond Business.

As a consequence of the proposed reinsurance agreements with RLMIS, the existing policyholders of Royal London DAC at the point of Transfer will be exposed to a significant counterparty credit risk post Transfer via the Royal London DAC Closed Funds that they were not exposed to prior to the Transfer. The main significant risk acquired for the existing policyholders is the potential risk of RLMIS going insolvent. This is particularly acute given the relative size, in particular, of the Ireland Liver Business relative to the Open Fund of Royal London DAC. However, the Security Arrangements act as a mitigant to this additional risk. The Security Arrangements are described in more detail in section 2.5. I also take comfort from the fact that RLMIS is currently well capitalised overall and the Ireland Liver Business is projected to run off relatively quickly (in 5 years from now, the BEL is expected to be £0.3bn or 49% of its current level).

Liquidity risk will be less of an issue post-Transfer due to the positive cash inflows expected to come from the more mature RL Post-2011 Business being transferred in, which helps mitigate new business strain.

Overall, having considered the foregoing, I am satisfied that the changes to the risk profile of Royal London DAC post-Transfer will not have a material adverse impact on the security of benefits of the existing policyholders.

## 3.3 Policyholders benefit expectations and contractual rights

All of the policies written into the Royal London DAC Open Fund between 7 January 2019 and the Effective Date are/will be protection policies with no discretionary elements. The Transfer will not result in any change to policy terms and conditions.

Consequently, I am satisfied that the existing policyholders of Royal London DAC will be unaffected by the Transfer as it relates to policyholder benefit expectations and contractual rights.

## 3.4 Application of discretionary management actions

All of the policies written into the Royal London DAC Open Fund between 7 January 2019 and the Effective Date are/will be protection policies with no discretionary elements. Existing policyholders will not share in the profits or losses of Royal London DAC.

Consequently, I am satisfied that the existing policyholders of Royal London DAC will be unaffected by the Transfer as it relates to the application of discretionary management actions.

## 3.5 Expenses

All of the policies written into the Royal London DAC Open Fund between 7 January 2019 and the Effective Date are/will be protection policies with no discretionary elements.

If the Transfer did not occur, it is highly likely that the fixed costs of running Royal London DAC would eventually make Royal London DAC an unviable business, based on the €40m capital

injection. It is unlikely that the marginal costs included within the pricing of new business protection policies' sold would be sufficient to cover the fixed costs of running Royal London DAC, as the new business would not reach a viable level quickly enough. An analysis has been carried out to examine how much initial capital would need to be transferred to Royal London DAC to support this new business in isolation, i.e. without the Transfer of the RL Post-2011 Business. This analysis indicated that €60m initial capital would be needed.

Post-Transfer, Royal London DAC will receive the RL Post-2011 Business, which gives it critical mass in terms of managing the fixed costs of running Royal London DAC. In addition, post-Transfer, Royal London DAC will be responsible for the actual expenses associated with the Liver Ireland Sub-Fund and the German Bond Sub-Fund. Some fixed costs such as the cost of the Board will also be charged to the policies within the Royal London DAC Sub-Funds which will support the ongoing management of Royal London DAC.

As described in section 2.4.1, the Royal London DAC Open Fund will accrue the expense profit or loss arising from the difference between the actual expenses incurred in servicing the Ireland Liver Business and the fees permitted to be deducted from the Liver Ireland Sub-Fund. Up to 2021, the difference between these two numbers is projected to be a positive cashflow. Post 2021, it is projected to be the additional margin charged by Royal London DAC to the Liver Ireland Sub-Fund.

The recharge of UK based services, and any non-regulated activity performed by ROI based staff in the Irish branch of RLMS will result a transfer pricing adjustment to the expenses charged under the service agreement of between 5% and 8%. This adjustment will fall to the service company and will be removed from the Royal London DAC Open Fund BEL. This adjustment reduces to an insignificant level the profits that are expected to emerge in the Royal London DAC Open Fund as a result of the difference between the actual expenses incurred in servicing the Ireland Liver Business and the fees permitted to be deducted from the Liver Ireland Sub-Fund.

In relation to the German Bond Business, the Royal London DAC Open Fund is responsible for paying the expenses associated with this book. However, this book is currently administered by a third party outsourced provider for which a fee has been agreed. The fees permitted to be deducted from the German Bond Sub-Fund and paid to the Royal London DAC Open Fund are recoverable via the German Bond Reinsurance Agreement. Thus, there is no additional expense risk arising as a result of this business.

In conclusion, there is some additional expense risk introduced as a result of the transfer of the Ireland Liver Business; however, in my view, this is not a significant risk to the existing policyholders in terms of the security of their benefits. Overall, given the foregoing, I am satisfied that the existing policyholders of Royal London DAC are not materially adversely impacted by the Transfer as it relates to expense risk.

## 3.6 Service standards/standards of administration

The Transfer will not have an impact on service standards for the existing policyholders of Royal London DAC at the point of Transfer.

Prior to the Transfer, existing policyholders will be serviced and administered in Dublin by Royal London DAC staff, and will be subject to Royal London DAC service standards. This will continue to be the case following the Transfer, so existing policyholders will not experience any change in service. The Dublin based administration team has expanded significantly in order to take on the administration of the Ireland Liver Business. The UK team who currently administer the Ireland Liver Business is training the newly recruited staff.

The existing policyholders will continue to have access to the Financial Services and Pensions Ombudsman ("**FSPO**") in the ROI in the event of a dispute regarding their policy after the Transfer.

The policies are/will be written in ROI and are, therefore, be subject to Irish General Good requirements. This will not change as a result of the Transfer.

Overall, I am satisfied that the existing policyholders will not be impacted post-Transfer in relation to the administration and servicing of their policies.

## 3.7 Investment Strategy

Royal London Asset Management ("RLAM"), a member of the Royal London Group, is the investment manager of the RLMIS funds, and will also be the investment manager for Royal London DAC.

All of the policies written into the Royal London DAC Open Fund between 7 January 2019 and the Effective Date are/will be protection policies with no discretionary elements. The existing policyholders will not share in the investment profits or losses of Royal London DAC.

In addition, the investment strategy pursued by Royal London DAC in relation to the existing policyholders pre-Transfer is not expected to change post-Transfer in relation to assets held to support the liabilities and capital required on the business.

Therefore, I am satisfied that the existing policyholders will not be materially adversely impacted by investment strategy post-Transfer as it relates to changes in their policyholder benefits and/or benefit security.

## 3.8 Tax

Any additional taxes arising as a result of the Transfer will be incurred by the Royal London DAC Open Fund. However, any such additional taxes will not have an impact on benefits for existing policyholders of Royal London DAC at the time of Transfer because their benefits will be fixed benefits with no discretionary elements.

## 3.9 Policyholder communications

New business is sold via insurance intermediaries in the ROI, who will have been provided with information about the proposed Transfer and have been asked to share it with prospective customers prior to a policy being issued. If a policy is issued, the new policyholder is provided with an information pack about the proposed Transfer. This process will continue until the Effective Date. A full copy of the Scheme of Transfer, the Independent Expert's report, the Chief Actuary's report, this report and the WPA Report will be available online or on request (in writing or by telephone).

There will be no change to any other policyholder communications for existing policyholders post-Transfer.

I am satisfied that the proposed communication plan in respect of existing policyholders as described above is appropriate.

# 4. Impact on transferring policyholders

## 4.1 Factors considered

As outlined in section 2, the existing ROI business of RLMIS, which consists of an open book of business and a closed book of business, will be transferred to Royal London DAC, as will a closed book of German Bond Business. In considering the impact of the proposed Transfer on policyholders transferring from RLMIS to Royal London DAC, I have classified the transferring policyholders into three categories as follows:

- Transferring ROI policyholders from the Ireland Liver Business;
- Transferring ROI policyholders from the RL Post-2011 Business; and
- Transferring German policyholders from the German Bond Business.

I have assessed the impact of the following on each of these policyholder groups:

(a) Security of benefits (section 4.2).

(b) Benefits payable under participating policies (section 4.3).

(c) Application of discretionary management actions (section 4.4).

(d) Policyholder options (section 4.5).

(e) Expenses (section 4.6).

(f) Service standards/standards of administration (section 4.7).

(g) Investment strategy (section 4.8).

(h) Tax (section 4.9).

(i) Membership rights (section 4.10).

(j) Policyholder communications (section 4.11).

## 4.2 Security of benefits

In the sub-sections below, I consider the likely impact of the Transfer on the transferring policyholders as it relates to the security of their benefits. In considering the financial positions of RLMIS and Royal London DAC, I refer to the SCR Cover. In considering the risk profile of Royal London DAC, I refer to the SCR in respect of those risks.

As outlined in section 3.2, I have also considered the potential liquidity risk that Royal London DAC will be exposed to post-Transfer and for the purposes of forming my opinions, I am assuming that a solution to this will be in place by the Effective Date.

### 4.2.1 Ireland Liver Business

As outlined in section 2.2, under the proposed Transfer, existing ROI policies of RLMIS' Royal Liver Sub-Fund will transfer into a new ring-fenced fund in Royal London DAC, the Liver Ireland Sub-Fund, on the Effective Date. Coincidental with the proposed Transfer (i.e. on the same date as the Transfer):

- the business that has transferred to Royal London DAC will be 100% reinsured back into the Royal Liver Sub-Fund; and
- Security Arrangements will be effected in order to mitigate the risk of insolvency of RLMIS and to ensure that, were such an event to arise, this group of transferring policyholders' benefit security will not be materially impacted relative to their current position.

In considering the security of benefits of this group of transferring policyholders before and after the proposed Transfer, I have considered the Liver Reinsurance Agreement and relevant Security Arrangements in detail and their impact on the following areas:

- respective financial positions of RLMIS and Royal London DAC;
- respective risk profiles of RLMIS and Royal London DAC;
- impact of the insolvency of RLMIS; and,
- impact of the insolvency of Royal London DAC.

**Financial position of RLMIS and Royal London DAC**

As outlined in section 2.6, the SCR Cover is, in my opinion, an appropriate measure of the capital position of an entity and I have used this measure to analyse whether the Transfer materially adversely affects the security of policyholder benefits.

The table below shows the projected capital position of:

- RLMIS immediately before the Transfer;
- the Royal Liver Sub-Fund immediately before the Transfer;
- the Royal Liver Sub-Fund immediately after the Transfer and after allowing for the reinsurance;
- Royal London DAC immediately after the Transfer; and
- the Liver Ireland Sub-Fund immediately after the Transfer and after allowing for the reinsurance.

| | | RLMIS | | Royal London DAC | |
|---|---|---|---|---|---|
| **£m** | RLMIS before Transfer | Royal Liver Sub-Fund before Transfer | Royal Liver Sub-Fund after Transfer and after allowing for reinsurance | Royal London DAC after Transfer | Liver Ireland Sub-Fund after Transfer and after allowing for reinsurance |
| **Own Funds** | 9,753 | 452 | 416 | 127 | 5 |
| **SCR** | 4,338 | 184 | 184 | 33 | 3 |
| **Excess Own Funds** | 5,415 | 267 | 231 | 94 | 2 |
| **SCR Cover** | **225%** | **245%** | **225%** | **386%** | **164%** |

**TABLE 4: IMPACT OF TRANSFER ON SCR COVER OF IRELAND LIVER BUSINESS**

The Royal Liver Sub-Fund of RLMIS accounts for a small proportion of both the SCR and the Own Funds of RLMIS. The ROI policies, within this, account for less than 2% of the SCR. Immediately before the proposed Transfer, both RLMIS itself and the Royal Liver Sub-Fund of RLMIS are projected to be very well capitalised with 225% and 245% SCR Cover respectively. In the unlikely event that the Royal Liver Sub-Fund of RLMIS needs additional funding, the Royal London Main Fund of RLMIS would provide capital support to this sub-fund.

Post-Transfer, the transferring policyholders from the Royal Liver Sub-Fund of RLMIS will be allocated to the Liver Ireland Sub-Fund within Royal London DAC. The Royal London DAC entity will be approximately 1% of the size of RLMIS in respect of both its SCR and Own Funds

and the Liver Ireland Sub-Fund accounts for approximately 10% of the total SCR of Royal London DAC. Consequently, this group of transferring policyholders are more exposed to volatility in Royal London DAC than they were in RLMIS. However, both Royal London DAC as an entity and the Liver Ireland Sub-Fund within Royal London DAC are projected to be well capitalised with 386% and 164% SCR Cover respectively, after allowing for the reinsurance of the business back to RLMIS.

Although the SCR Cover is projected to be significantly lower for the Liver Ireland Sub-Fund post-Transfer than for the Royal Liver Sub-Fund pre-Transfer, it is important to consider the effect of the reinsurance. The policyholders in this fund will be 100% reinsured back into the Royal Liver Sub-Fund within RLMIS which is projected to be very well capitalised post-Transfer (i.e. SCR Cover of 225%). Further, it is important to note that the Capital Buffer for the Liver-Ireland Sub-Fund will be calibrated as per the Royal London DAC internal capital management framework which is aligned to the Group internal capital management framework. Thus, overall, while the reinsurance is in place, the security of the policyholder benefits remains broadly unchanged.

Termination of the Liver Reinsurance Agreement

As outlined in section 2.4.1, termination of the Liver Reinsurance Agreement would mean that the assets in the Royal Liver Sub-Fund would be split between Royal London DAC (i.e. ROI) policyholders and RLMIS (i.e. UK) policyholders within that fund, which would include a split of the inherited estate. This would ensure that policyholders in this fund receive what they are entitled to upon termination of the Liver Reinsurance Agreement.

In the event that the Liver Reinsurance Agreement is terminated, the Liver Ireland Sub-Fund may continue to operate as a ring-fenced fund without the link to the Royal Liver Sub-Fund. In this case, if necessary, the business in the Liver Ireland Sub-Fund would be supported by the assets of the Royal London DAC Open Fund, subject to certain restrictions as outlined in section 2.4.1. Appropriate provisions for capital support have been included in the Scheme of Transfer to ensure that the Royal London DAC Open Fund would support the Liver Ireland Sub-Fund, if necessary.

As outlined in section 2.4.1, Royal London DAC may cease to maintain the Liver Ireland Sub-Fund as a separate ring-fenced fund where the aggregate value of asset shares falls below a trigger point, as defined in the Scheme of Transfer. This could happen sooner or later than the closure of the Royal Liver Sub-Fund and hence sooner or later than if the policyholders were to remain as direct policyholders in the Royal Liver Sub-Fund.

The risk of insolvency of Royal London DAC, although remote given the €40m capital injection by RLMIS, is, in my view, higher than the risk of insolvency of RLMIS because it is a smaller entity and is, therefore, likely to experience greater volatility. In my opinion, this increased risk will not have a material impact on this group of transferring policyholders due to the remote possibility of insolvency of Royal London DAC. I discuss the impact of insolvency of RLMIS and Royal London DAC in the following paragraphs.

**Risk Profile of RLMIS and Royal London DAC**

I have considered the risk profiles of RLMIS and Royal London DAC before and after the Transfer, after allowing for the reinsurance, by reference to the risk components of their respective SCR's. The table below outlines the top five risk exposures of RLMIS and Royal London DAC pre-Transfer and post-Transfer respectively:

| RLMIS pre-Transfer | Royal London DAC post-Transfer |
|---|---|
| Equity Price | Lapse risk |
| Longevity Trend | Expense risk |
| GAO take-up | Interest rate risk |
| Persistency level | Mortality risk |
| Corporate bond spread | Operational risk |

**TABLE 5: RISK PROFILE OF RLMIS AND ROYAL LONDON DAC**

The risks to which RLMIS and Royal London DAC are, and will be, exposed are typical of insurance entities. The top five risks that this group of transferring policyholders are exposed to will change as a result of the Transfer, as can be seen in the table above, and thus it is difficult to compare relative levels of specific risks at an entity level.

As discussed earlier, post-Transfer, the Liver Ireland Sub-Fund will be a ring-fenced fund within Royal London DAC and will be 100% reinsured to the Royal Liver Sub-Fund within RLMIS. After allowing for reinsurance, the only risks that will remain in the Liver Ireland Sub-Fund of Royal London DAC are operational risk and counterparty default risk (i.e. the risk of insolvency of the reinsurer, which is RLMIS). The fund will hold sufficient capital to cover the SCR for these risks plus the Capital Buffer under the Royal London DAC internal capital management framework.

The reinsurance agreements increase the counterparty default risk and operational risk to which Royal London DAC is exposed. The counterparty default risk is largely mitigated by the Security Arrangements in place between RLMIS and Royal London DAC. The increase in operational risk is driven by the complexities introduced by the new reinsurance agreements, and the increased volume and complexity of business within Royal London DAC as a result of the Transfer.

In the event of termination of the reinsurance agreements, this group of transferring policyholders would continue to be exposed to this increased operational risk within Royal London DAC.

There are a number of arrangements within Royal London DAC that act to manage operational risk. Royal London DAC will use similar risk appetite frameworks and assessment criteria to those used by RLMIS. Detailed assessments covering administration, systems, staff and data transfer requirements of the Transfer is ongoing. In order to mitigate operational risk, tests of the new administration systems will be conducted prior to the Transfer.

**Impact of insolvency of RLMIS on Ireland Liver Business transferring policyholders**

The impact on this group of transferring policyholders in the event of insolvency of RLMIS will change post-Transfer. Whereas currently this group of transferring policyholders are directly exposed to the risk of insolvency of RLMIS, they will be indirectly exposed post-Transfer as they will become reinsured policyholders of RLMIS rather than directly insured policyholders. Royal London DAC's claim in the event of the insolvency of RLMIS, would (as a reinsurance claim) rank behind other insurance debts of RLMIS. However, the Liver Reinsurance Agreement and associated Security Arrangements have been constructed to ensure that, in the event of the insolvency of the reinsurer (RLMIS), ROI reinsured policyholders into the Royal Liver Sub-Fund in RLMIS would be ranked at the same level as the UK policyholders written directly into the Royal Liver Sub-Fund. In addition, I note that in coming up with the tiered collateral approach, significant consideration was given to the appropriate level of collateral to include within tier 1, taking into account the need to balance the interests of both this group of transferring policyholders and those remaining. The Liver Reinsurance Agreement and associated Security Arrangements are described in detail in sections 2.4 and 2.5.

*Financial Services Compensation Scheme (FSCS*)

Prior to the Effective Date, the UK Financial Services Compensation Scheme (**"FSCS"**) covers policyholders in the Royal Liver Sub-Fund that were written on or after 1 December 2001 by a UK entity. The FSCS is a statutory "fund of last resort" which compensates customers in the event of the insolvency or default of insurers authorised in the UK or EEA insurers with a UK branch. Insurance protection exists for private policyholders and small businesses when an insurer is unable to meet its liabilities fully. For long-term insurance policies, the FSCS will ensure that 100% of any successful eligible claim is paid. The policyholder protection provided under the FSCS only applies to direct policyholders of the insurer.

The following transferring policyholders are not currently covered under the FSCS:

- holders of policies that were written before 1 December 2001;
- holders of policies that were originally written by Irish Life Assurance plc.("**Irish Life**"); and
- holders of policies that were originally written by GRE Life Ireland Limited ("**GRELI**").

ROI policyholders whose policies were originally written into an Irish branch of a UK regulated company (other than the pre-2001, Irish Life and GRELI policyholders listed above) acquired this benefit on transferring to RLMIS as part of the acquisition of Royal Liver Assurance Limited.

Post-Transfer, the protection offered through the FSCS will no longer be available to the transferring policyholders and there is no equivalent statutory scheme in Ireland. This is primarily a consideration in the scenario where both Royal London DAC and RLMIS have solvency issues.

Given the financial strength of RLMIS, my opinion is that the risk of insolvency of RLMIS is remote. RLMIS and Royal London DAC are well capitalised businesses, with robust capital management plans and, in the case of RLMIS, a recovery plan, such that the likelihood of a potential claim on the FSCS for transferring policyholders is very low.

Nonetheless, the loss of FSCS coverage does represent a loss of security. However, in reaching my opinion as to whether or not it is a material loss of security for this group of transferring policyholders, I have considered:

- the likelihood of RLMIS and Royal London DAC going insolvent;
- the mitigation provided via the tiered collateral structure;
- the fact that the FSCS protection is a statutory protection and could be removed; and
- the fact that the purpose of the Transfer is to enable the continued servicing of the ROI policies in the Royal Liver Sub-Fund and the loss of the FSCS protection is an unavoidable consequence of ensuring this.

Having considered the foregoing, I have formed the opinion that the loss of FSCS coverage does not represent a material loss of security for this group of transferring policyholders.

**Impact of insolvency of Royal London DAC on Ireland Liver Business transferring policyholders**

The Ireland Liver transferring policyholders are currently direct policyholders of RLMIS. Post-Transfer, they will be direct policyholders of Royal London DAC and will therefore be exposed to the risk of insolvency of Royal London DAC.

Where insolvency of Royal London DAC is due to insolvency of RLMIS, the Liver Reinsurance Agreement and associated Security Arrangements have been constructed such that the security of policyholder benefits would be broadly unchanged compared to the pre-Transfer position, other than the loss of the FSCS, where relevant.

As described in section 2.4.1, in the event of termination of the Liver Reinsurance Agreement, the Liver Ireland Sub-Fund within Royal London DAC could continue to operate as a ring-fenced

fund without the link to the Royal Liver Sub-Fund. The assets in the Royal Liver Sub-Fund would be split between Royal London DAC (i.e. ROI) policyholders and RLMIS (i.e. UK) policyholders within that fund, which would include a split of the inherited estate. The Royal London DAC Open Fund would provide capital support, if required, to the Liver Ireland Sub-Fund subject to certain restrictions as outlined in section 2.4.1.

In the event of insolvency of Royal London DAC, management actions would have to be taken which could include termination of the Liver Reinsurance Agreement and potentially breaking the ring-fencing of the Liver Ireland Sub-Fund. In this scenario, the Ireland Liver transferring policyholder would not have a call over the assets of RLMIS but would instead have a call over the assets of Royal London DAC. This is a change in security of policyholder benefits for the Ireland Liver transferring policyholders compared to the pre-Transfer position. However, in my opinion, in the situation where RLMIS is solvent and well capitalised, the risk of insolvency of Royal London DAC is remote, for the following reasons:

- As outlined in section 1.2, before authorisation of Royal London DAC by the CBI, RLMIS provided Royal London DAC with capital of €40m comprising €1m share capital and a €39m capital contribution. The size of this capital contribution was determined based on the risk and liquidity profile of both the new business expected to be written into Royal London DAC and the open book of business expected to be transferred into Royal London DAC on the Effective Date.

- The Royal London DAC ORSA considers several stress and scenario tests that would be expected to have a materially adverse impact on the solvency position of Royal London DAC. Although the SCR Cover falls under the adverse stress and scenario tests, the SCR Cover remains very well capitalised over the five-year projection period.

- Royal London DAC will keep the position of the Royal London DAC Open Fund under review relative to the internal capital framework.

**Conclusion on security of benefits of the Ireland Liver Business transferring policyholders**

In my opinion, the security of policyholder benefits for transferring policyholders of the Ireland Liver Business is not materially impacted, for the following reasons:

- The Liver Reinsurance Agreement and associated Security Arrangements have been structured to ensure that;
    - the Royal Liver Sub-Fund of RLMIS remains economically intact and the expectations of policyholders under their existing PPFM are maintained;
    - in the event of the insolvency of RLMIS, Royal London DAC policyholders of the Liver Ireland Sub-Fund will rank at the same level as the direct policyholders of RLMIS.
- The capitalisation of the ring-fenced Royal Liver Sub-Fund within RLMIS will be well capitalised post-Transfer, with a projected SCR Cover of 225%.
- The Royal London Main Fund of RLMIS will continue to provide capital support to the ring-fenced Royal Liver Sub-Fund in the unlikely event that the fund requires additional funding.
- Both the Liver Ireland Sub-Fund and Royal London DAC itself are projected to be well-capitalised post-Transfer, with projected SCR Cover ratios of 164% and 386% respectively.
- The change in the risk profile of the company to which the policyholders are directly exposed will not have a material impact on the security of policyholder benefits.
- The policyholders are transferring to a well-capitalised entity with a robust capital management plan and risk management policy.

- Arguably, the most material change for certain transferring policyholders will be the loss of the FSCS. Post-Transfer, the protection offered through the FSCS to certain transferring policyholders will no longer be available and there is no equivalent statutory scheme in Ireland. However, I am satisfied that the loss of FSCS coverage is not a material loss of benefit security for these transferring policyholders.

### 4.2.2 RL Post-2011 Business

As outlined in section 2.2, the Royal London DAC Open Fund has and will continue to accept the new protection business written by Royal London DAC from 7 January 2019. The transfer of the RL Post-2011 Business is expected to take place on the Effective Date under the Scheme of Transfer. The transferring protection business and the new protection business will be the same type of business written by RLMIS up to the date that Royal London DAC first accepted new business. This business is supported by reinsurance of the morbidity and mortality benefits, which is provided by a number of strongly rated reinsurers, and which will be novated to Royal London DAC. The novated treaties will be closed to new business (with the exception of pipeline policies) and Royal London DAC has entered into new treaties with the same reinsurers on substantially the same terms as the current treaties in place with RLMIS.

The Royal London DAC Open Fund will be capitalised to cover the SCR and the risk margin of this business plus a Capital Buffer in line with Royal London DAC's internal capital management framework. The injection of capital from RLMIS into Royal London DAC was €40m (c£35m) which has been stress tested to provide adequate security relative to the capital framework together with the value of transferred RL Post-2011 Business (negative liability of £65m[11] at 30 June 2018). The Royal London DAC Open Fund will also receive a negative liability of £7.3m in respect of the best estimate of the difference between the actual expenses payable in respect of the Ireland Liver Business and the fees received from the Liver Ireland Sub-Fund in respect of that business. As described in section 3.5, the transfer pricing adjustment will largely offset this negative liability of £7.3m.

In considering the security of benefits of this group of transferring policyholders before and after the proposed Transfer, I have considered the following:

- respective financial positions of RLMIS and Royal London DAC;
- respective risk profiles of RLMIS and Royal London DAC;
- impact of the insolvency of RLMIS; and,
- impact of the insolvency of Royal London DAC

**Financial position of RLMIS and Royal London DAC**

As outlined above for the Ireland Liver Business, a commonly used measure of security in the insurance industry is the SCR Cover. I have used this measure to analyse whether the Transfer materially adversely affects the security of policyholder benefits.

The table below shows the projected capital position of;

- RLMIS immediately before the Transfer;
- the Royal London Main Fund immediately before the Transfer;
- Royal London DAC immediately after the Transfer;
- the Royal London DAC Open Fund immediately after the Transfer.

[11] Negative BEL

| £m | RLMIS | | Royal London DAC | |
|---|---|---|---|---|
| | RLMIS before Transfer | Royal London Main Fund before Transfer | Royal London DAC after Transfer and after allowing for reinsurance | Royal London DAC Open Fund after Transfer |
| **Own Funds** | 9,753 | 4,540 | 127 | 121 |
| **SCR** | 4,338 | 2,119 | 33 | 29 |
| **Excess Own Funds** | 5,415 | 2,421 | 94 | 92 |
| **SCR Cover** | **225%** | **214%** | **386%** | **416%** |

**TABLE 6: IMPACT OF TRANSFER ON SCR COVER OF RL POST-2011 BUSINESS**

Immediately before the Transfer, both RLMIS itself and the Royal London Main Fund of RLMIS are projected to be very well capitalised, with 225% and 214% SCR Cover respectively.

Post-Transfer, the policyholders transferring from the Royal London Main Fund will be allocated to the Royal London DAC Open Fund. The Royal London DAC entity will be approximately 1% of the size of RLMIS in respect of both its SCR and Own Funds. Consequently, this group of transferring policyholders will be more exposed to volatility in Royal London DAC than they were in RLMIS. However, Royal London DAC is projected to be well capitalised with 386% SCR Cover, after allowing for the reinsurance of the Ireland Liver Business and the German Bond Business back to RLMIS.

**Risk Profile of RLMIS and Royal London DAC**

As described above for the Ireland Liver Business, I have considered the risk profiles of RLMIS and Royal London DAC both before and after the Transfer, and after allowing for the reinsurance by reference to the risk components of their respective SCRs. Table 5 in section 4.2.1 shows that the top five risks this group of transferring policyholders are exposed to will change as a result of the Transfer at an entity level and thus it is difficult to compare relative levels of specific risks.

It is worth noting that this group of transferring policyholders will have the same risk profile as the existing policyholders. In particular, the external reinsurance arrangements that will be put in place and/or novated (see section 2.3) provide the same level of protection pre and post Transfer. As outlined in section 4.2.1, the closed book businesses introduce additional counterparty default and operational risks.

**Impact of insolvency of RLMIS on RL Post-2011 Business transferring policyholders**

The impact on this group of transferring policyholders in the event of insolvency of RLMIS will change post-Transfer. Whereas currently this group of transferring policyholders are directly exposed to the risk of insolvency of RLMIS, they will be indirectly exposed to insolvency of RLMIS as the parent company of Royal London DAC.

In the event of insolvency of RLMIS, depending on the capital position of Royal London DAC at that time, this group of transferring policyholders could be adversely impacted, for example, if RLMIS decided to take management actions in order to access the excess capital of Royal London DAC for support. However, that said, RLMIS is currently, and is projected to be, a very well capitalised entity with a robust capital management plan and therefore, in my opinion, the risk of insolvency of RLMIS is currently remote.

Arguably, any external adverse event that would lead to the insolvency of RLMIS would have a market-wide impact and would therefore be highly likely to lead to the insolvency of Royal London DAC. I discuss the risk of insolvency of Royal London DAC below.

In terms of the impact on security of policyholders' benefits, the most material change for this group of transferring policyholders is the loss of the FSCS, which I discuss below.

*Financial Services Compensation Scheme (FSCS)*

The FSCS does cover the RL Post-2011 Business transferring policyholders.

A description of the FSCS is outlined in section 4.2.1. As noted there, the loss of FSCS coverage does represent a loss of security for this group of transferring policyholders. However, in reaching my opinion as to whether or not it is a material loss of security, for the same reasons as those outlined in section 4.2.1, I have formed the opinion that the loss of FSCS coverage does not represent a material loss of security for the RL Post-2011 Business transferring policyholders.

**Impact of insolvency of Royal London DAC on RL Post-2011 Business transferring policyholders**

The RL DAC Post-2011 transferring policyholders are currently direct policyholders of RLMIS. Post-Transfer, they will be direct policyholders of Royal London DAC and will therefore be exposed to the risk of insolvency of Royal London DAC.

Where insolvency of Royal London DAC is due to insolvency of RLMIS, security of policyholder benefits is broadly unchanged, compared to the pre-Transfer position, other than the loss of the FSCS.

In my opinion, the risk of insolvency of Royal London DAC is higher than the risk of insolvency of RLMIS due to the greater volatility risk to which it will be exposed, due to it being a smaller entity. However, I view the risk of insolvency of Royal London DAC to be remote for the reasons outlined in section 4.2.1.

**Conclusion on security of benefits for RL Post-2011 Business transferring policyholders to the Royal London DAC Open Fund**

In my opinion, the security of policyholder benefits for this group of transferring policyholders from the Royal London Main Fund of RLMIS to the Open Fund of Royal London DAC is not materially impacted, for the following reasons:

- the policyholders are moving to a well-capitalised entity with a projected SCR Cover of 386%;
- the policyholders are moving to an entity with a robust capital management plan and risk management policy;
- the change in risk profile of the company to which the policyholders are directly exposed will not have a material impact on the security of policyholder benefits, due primarily to the reinsurance agreements and collateral Security Arrangements that have been put in place;
- arguably the most material change for this group of transferring policyholders will be the loss of the FSCS. Post-Transfer, the protection offered through the FSCS will no longer be available to the relevant transferring policyholders and there is no equivalent statutory scheme in Ireland. However, I am satisfied that the loss of FSCS coverage is not a material loss of security for this group of transferring policyholders.

### 4.2.3 German Bond Business

As outlined in section 2.2, under the proposed Transfer, existing German policyholders in the Royal London Main Fund will transfer to a new ring-fenced fund in Royal London DAC, the German Bond Sub-Fund, on the Effective Date. This fund will be closed to new business and will be ring-fenced.

Coincidental with the proposed Transfer (i.e. on the same date as the Transfer), the business that has transferred to Royal London DAC will:

- be 100% reinsured back into the Royal London Main Fund within RLMIS; and
- a series of security and collateral arrangements will be effected in order to mitigate the risk of insolvency of RLMIS and to ensure that, were such an event to arise, this group of transferring policyholders' benefit security will not be materially impacted relative to their current position.

In considering the security of benefits of this group of transferring policyholders before and after the proposed Transfer, I have considered the German Bond Reinsurance Agreement and relevant Security Arrangements in detail and their impact on the following areas:

- respective financial positions of RLMIS and Royal London DAC;
- respective risk profiles of RLMIS and Royal London DAC;
- impact of the insolvency of RLMIS; and
- impact of the insolvency of Royal London DAC

**Financial position of RLMIS and Royal London DAC**

As outlined above, a commonly used measure of security in the insurance industry is the SCR Cover. I have used this measure to analyse whether the Transfer materially adversely affects the security of policyholder benefits.

The table below shows the projected capital position of:

- RLMIS immediately before the Transfer;
- the Royal London Main Fund immediately before the Transfer;
- the Royal London Main Fund immediately after the Transfer;
- Royal London DAC immediately after the Transfer; and
- the German Bond Sub-Fund immediately after the Transfer.

| | RLMIS | | | Royal London DAC | |
|---|---|---|---|---|---|
| £m | RLMIS before Transfer | Royal London Main Fund before Transfer | Royal London Main Fund after Transfer | Royal London DAC after Transfer and after allowing for reinsurance | German Bond Sub-Fund after Transfer |
| Own Funds | 9,753 | 4,540 | 4,407 | 127 | 1 |
| SCR | 4,338 | 2,119 | 2,102 | 33 | 1 |
| Excess Own Funds | 5,415 | 2,421 | 2,306 | 94 | 0 |
| **SCR Cover** | **225%** | **214%** | **210%** | **386%** | **164%** |

**Table 7: Impact of Transfer on SCR Cover of German Bond Business**

Immediately before the Transfer, both RLMIS itself and the Royal London Main Fund of RLMIS are projected to be very well capitalised, with 225% and 214% SCR Cover respectively.

Post-Transfer, the policies of the German Bond policyholders transferring from the Royal London Main Fund of RLMIS will be allocated to the German Bond Sub-Fund within Royal London DAC. The Royal London DAC entity will be approximately 1% of the size of RLMIS in respect of both the SCR and own funds and the German Bond Sub-Fund will account for approximately 1.5% of the total SCR of Royal London DAC. Both Royal London DAC and the German Bond Sub-Fund within Royal London DAC are projected to be well capitalised with 386% and 164% SCR Cover respectively, after allowing for the reinsurance of the business back to RLMIS.

Although the SCR Cover is projected to be significantly lower for the German Bond Sub-Fund post-Transfer than for the Royal London Main Fund pre-Transfer, it is important to consider the effect of the reinsurance. The policyholders in this fund will be 100% reinsured back into the Royal London Main Fund within RLMIS, which is projected to be very well capitalised post-Transfer (i.e. SCR Cover of 210%). This is slightly lower than the pre-Transfer SCR Cover, due to the expected cost of executing the Transfer. Further, it is important to note that the Capital Buffer for the German Bond Sub-Fund will be calibrated as per the Royal London DAC internal capital management framework, which is aligned to the Group internal capital management framework. Thus, overall, while the reinsurance is in place, the security of the policyholder benefits remains broadly unchanged.

It is worth noting that the volume of this business means that, without the German Reinsurance Agreement in place, it would not be otherwise economically viable to manage this business in Royal London DAC as that business runs off.

In the event that the German Bond Reinsurance Agreement is terminated, the German Bond Sub-Fund would not continue to operate as a ring-fenced fund. Any remaining German Bond policies would be allocated to the Royal London DAC Open Fund and would therefore be supported by the assets of the Royal London DAC Open Fund.

This would arguably have an adverse impact on the security of policyholder benefits as the risk of insolvency of Royal London DAC, although remote, is, in my view, higher than the risk of insolvency of RLMIS because it is a smaller entity and is, therefore, likely to experience greater volatility. In my opinion, this increased risk will not have a material impact on this group of transferring policyholders due to the remote possibility of insolvency of Royal London DAC. I discuss the impact of insolvency of RLMIS and Royal London DAC in the following paragraphs.

**Risk Profile of RLMIS and Royal London DAC**

As discussed above for the Ireland Liver Business, the top five risks to which the German Bond transferring policyholders are exposed will change as a result of the Transfer, and it is difficult to compare relative levels of specific risks at an entity level.

Post-Transfer, the German Bond Sub-Fund will be a ring-fenced fund within Royal London DAC and will be 100% reinsured into the Royal London Main Fund within RLMIS. After allowing for the reinsurance, the only risks that will remain in the German Bond Sub-Fund of Royal London DAC are operational risk and counterparty default risk (i.e. the risk of insolvency of the reinsurer, which is RLMIS). The German Bond Sub-Fund will hold sufficient capital to cover the SCR for these risks plus the Capital Buffer under the Royal London DAC internal capital management framework.

In addition, 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 Transfer are that such liabilities, i.e. mis-selling liabilities which pre-date the Transfer in respect of the German Bond Business, will be transferred to Royal London DAC but would be discharged by RLMIS on behalf of Royal London DAC or, failing that, would be subject to an indemnity from RLMIS. In this way, there would be no change to the current responsibility for payment of those liabilities should they arise after the Transfer. In the event of insolvency of RLMIS before the Federal Court ruling or before all payments in respect of the ruling have been made, the mis-selling liabilities would fall to Royal London DAC.

As noted in section 4.2.1, the reinsurance agreements increase the counterparty default risk and operational risk to which Royal London DAC is exposed for the same reasons as outlined for the Ireland Liver Business. Similar to that business, there are mitigating actions and agreements in place.

Overall, I am satisfied that the risk profile to which the German Bond Business transferring policyholders are exposed will not change materially post-Transfer.

**Impact of insolvency of RLMIS on German Bond Business transferring policyholders**

The impact on this group of transferring policyholders in the event of insolvency of RLMIS will change post-Transfer. Whereas currently this group of transferring policyholders are directly exposed to the risk of insolvency of RLMIS, they will be indirectly exposed post-Transfer as they will become reinsured policyholders of RLMIS rather than directly insured policyholders. Royal London DAC's claim in the event of insolvency of RLMIS would (as a reinsurance claim) rank behind other insurance debts of RLMIS. However, the German Bond Reinsurance Agreement and associated Security Arrangements have been constructed to ensure that, in the event of the insolvency of the reinsurer (RLMIS), German Bond reinsured policyholders into the Royal London Main Fund in RLMIS would be ranked at the same level as the UK policyholders written directly into the Royal London Main Fund in RLMIS. In addition, I note that in coming up with the tiered collateral approach, significant consideration was given to the appropriate level of collateral to include within tier 1, taking into account the need to balance the interests of both the transferring policyholders and those remaining.

*Financial Services Compensation Scheme (FSCS*)

Prior to the Effective Date, the UK FSCS covers German Bond Business transferring policyholders.

A description of the FSCS is outlined in section 4.2.1. As noted there, the loss of FSCS coverage does represent a loss of security for this group of transferring policyholders. However, in reaching my opinion as to whether or not it is a material loss of security, for the same reasons as those outlined in section 4.2.1, I have formed the opinion that the loss of FSCS coverage does not represent a material loss of security for the German Bond Business transferring policyholders.

**Impact of insolvency of Royal London DAC on German Bond transferring policyholders**

The German Bond transferring policyholders are currently direct policyholders of RLMIS. Post-Transfer, they will be direct policyholders of Royal London DAC and will therefore be exposed to the risk of insolvency of Royal London DAC.

Where insolvency of Royal London DAC is due to insolvency of RLMIS, the German Bond Reinsurance Agreement and associated Security Arrangements have been constructed such that there would be no change to security of policyholder benefits, compared to the pre-Transfer position, other than the loss of the FSCS.

As described in section 2.4.3, in the event of termination of the German Bond Reinsurance Agreement, the German Bond Sub-Fund within Royal London DAC would not continue to operate as a ring-fenced fund. In the event of insolvency of Royal London DAC, management actions would have to be taken which could include termination of the German Bond Reinsurance Agreement. In this scenario, RLMIS would transfer assets to Royal London DAC to meet the BEL, risk margin, SCR and Capital Buffer in relation to the German Bond Business, calculated after the collapse of the German Bond Sub-Fund. A ProfitShare termination payment would also potentially be transferred, as described in section 2.4.3. In this scenario, the German Bond transferring policyholders would not have a call over the assets of RLMIS but would instead have a call over the assets of Royal London DAC. This is a change in security of

policyholder benefits for the German Bond transferring policyholders compared to the pre-Transfer position. However, in my opinion, in the situation where RLMIS is solvent and well capitalised, the risk of insolvency of Royal London DAC is remote for the reasons outlined in section 4.2.1.

**Conclusion on security of benefits for German Bond Business transferring policyholders to the German Bond Sub-Fund**

In my opinion, the security of policyholder benefits for transferring policyholders of the German Bond Business is not materially impacted, for the following reasons:

- The German Bond Reinsurance Agreement and associated Security Arrangements have been structured to ensure that;
    - The expectations of policyholders under their existing PPFM are maintained
    - In the event of insolvency of RLMIS, Royal London DAC policyholders will rank at the same level as the direct policyholders of RLMIS.
- The capitalisation of the Royal London Main Fund of RLMIS will be broadly unchanged post-Transfer, with a projected SCR Cover of 210%.
- Both the German Bond Sub-Fund and Royal London DAC itself are projected to be well-capitalised post-Transfer, with projected SCR Cover ratios of 164% and 386% respectively.
- The change in risk profile of the company to which the policyholders are directly exposed will not have a material impact on the security of policyholder benefits.
- The policyholders are moving to a well-capitalised entity with a robust capital management plan and risk management policy.
- Arguably, the most material change for this group of transferring policyholders will be the loss of the FSCS. Post transfer, the protection offered through the FSCS will no longer be available to this group of transferring policyholders and there is no equivalent statutory scheme in Ireland. I am satisfied that the loss of FSCS coverage is not a material loss of security for this group of transferring policyholders.

## 4.3 Benefits payable under participating policies

### 4.3.1 Ireland Liver Business

As outlined in section 2.2, under the proposed Transfer, existing Irish policyholders of RLMIS's Royal Liver Sub-Fund will transfer to a new ring-fenced fund in Royal London DAC, the Liver Ireland Sub-Fund. Coincidental with the proposed Transfer (i.e. on the same date as the Transfer):

- the business that has transferred to Royal London DAC will be 100% reinsured back into the Royal Liver Sub-Fund; and
- a series of security and collateral arrangements will be effected in order to mitigate the risk of the insolvency of RLMIS and to ensure that, were such an event to arise, this group of transferring policyholders' benefit security will not be materially compromised relative to their current position.

The Royal Liver Sub-Fund within RLMIS currently has both with-profit (or participating) and non-profit (or non-participating) business written into it from both the UK and ROI. This fund was set up when RLMIS acquired Royal Liver Assurance Limited in 2011. The business was transferred from Royal Liver Assurance Limited to the Royal Liver Sub-Fund within RLMIS under the IoT (the GRELI business was subsequently transferred in 2012 as described in section 2.1.1). The IoT sets out the legal basis of the original transfer and determines how RLMIS should manage the Royal Liver Sub-Fund. The total BEL of the Royal Liver Sub-Fund

as at 30 June 2018 was £1,693m, of which £735m related to the ROI policyholders in the Royal Liver Sub-Fund. The ROI business is, therefore, a material proportion of the Royal Liver Sub-Fund.

In considering the benefits payable before and after the proposed Transfer for this group of transferring policyholders of participating policies, I have considered the following:

- the impact of the costs of the Transfer on the estate of the Royal Liver Sub-Fund and hence on bonus distributions;
- the impact of the Transfer on the ongoing management of participating policies.

**Impact on the estate of the Royal Liver Sub-Fund**

*Reinsurance premiums*

As discussed in section 4.2.1, after allowing for the reinsurance, the only risks that will remain in the Liver Ireland Sub-Fund of Royal London DAC are operational risk and counterparty default risk. The fund will need to hold sufficient capital to cover the SCR and risk margin for these risks plus the Capital Buffer under the Royal London DAC internal capital framework. This will be maintained via the Liver Reinsurance Agreement, by way of a quarterly experience adjustment, as described in section 2.4. The Transfer will therefore lead to additional capital requirements in respect of the Liver Ireland Sub-Fund, over and above the current, pre-Transfer requirements. The additional capital requirements will have a small impact on the estate of the Royal Liver Sub-Fund and, therefore, on the distributions made from the fund.

*Expenses*

The table below outlines the various expenses that are currently, and will be in the future, incurred by the Royal-Liver Sub-Fund, how the expenses are applied currently to the fund and how they will be applied post-Transfer.

| Type of expense | Pre-Transfer | Post-Transfer UK policyholders | Post-Transfer ROI policyholders |
|---|---|---|---|
| Initial Project Costs | • Non-applicable. | • Due proportion of the project costs required to enable the Transfer of business borne by the estate of the Royal Liver Sub-Fund. | • Due proportion of the project costs required to enable the Transfer of business borne by the estate of the Royal Liver Sub-Fund. |
| Policy administration services | • Provided by RLMIS to UK and ROI policyholders.<br>• Fees prescribed in IoT are fixed up to December 2021 and are equal to actual expenses plus a margin thereafter, subject to a comparison against the costs of managing the business through outsourcing.<br>• Such fees are deducted from Royal Liver Sub-Fund and paid to the Royal London Main Fund, out of which actual expenses are paid. | • Provided by RLMIS to UK policyholders.<br>• Fees prescribed in IoT are fixed up to December 2021 and are equal to actual expenses plus a margin thereafter.<br>• Such fees are deducted from Royal Liver Sub-Fund and paid to the Royal London Main Fund, out of which actual expenses are paid. | • Provided by Royal London DAC to ROI policyholders.<br>• Fees prescribed in Scheme of Transfer (note: same as IoT) are fixed up to December 2021 and are equal to actual expenses plus a margin thereafter.<br>• Such fees are deducted from the Liver Ireland Sub-Fund and paid to the Open Fund within Royal London DAC, out of which actual expenses, plus a transfer pricing margin, are paid.<br>• The fees deducted from the Liver Ireland Sub-Fund are recoverable from RLMIS' Royal Liver Sub-Fund through the Liver Reinsurance Agreement. |
| Exceptional expenses | • Exceptional expenses can be charged to the Royal Liver Sub-Fund if they meet the definition of same within the IoT. | • Exceptional expenses can be charged to the Royal Liver Sub-Fund if they meet the definition of same within the IoT. | • Exceptional expenses can be charged and allocated by the Royal London DAC Board to the Liver Ireland Sub-Fund if they meet the definition of same within the Scheme of Transfer.<br>• The expenses deducted from the Liver Ireland Sub-Fund are recoverable from RLMIS' Royal Liver Sub-Fund through the Liver Reinsurance Agreement. |
| Investment expenses | • Investment expenses on assets within the Royal Liver Sub-Fund can be charged to the sub-fund, at a level defined in the IoT. | • Investment expenses on assets within the Royal Liver Sub-Fund can be charged to the sub-fund. | • Investment expenses on the assets within the Liver Ireland Sub-Fund can be charged to the sub-fund. However, it is worth noting that, due to the Liver Reinsurance Agreement, the majority of the assets backing the ROI policies are held within the RLMIS' Royal Liver Sub-Fund (where investment expenses are charged in respect of those assets).<br>• Investment expenses on assets in Liver Ireland Sub-Fund are not recoverable through the Liver Reinsurance Agreement. |

The initial project costs to establish Royal London DAC and to enable the transfers of business will be borne by RLMIS, of which £9.6m will be allocated to the Royal Liver Sub-Fund estate. The impact of this additional cost to the fund is immaterial, given that the size of the Royal Liver Sub-Fund was £2.2bn as at 30 June 2018. Therefore, this will not have a material impact on benefits payable under participating policies for this group of transferring policyholders.

The ongoing policy administration expenses of the Ireland Liver Business (UK and ROI) are expected to be higher after the Transfer than before because of the additional governance required for the separate legal entity and the increased administration costs e.g. due to additional headcount in ROI. Processes have been arranged (including the transfer of activities to Ireland) to minimise these costs, which are an unavoidable consequence of the need to move the business to an entity in the EU to ensure that business can continue to be serviced when the UK leaves the EU.

These additional expenses (i.e. those additional specific areas which only exist post-Transfer because of Brexit and which are giving rise to expense) will be classified as 'exceptional' expenses arising as a consequence of regulatory change. As outlined in the table above, it has been agreed that ultimately such expenses will be borne by RLMIS as they are recoverable by Royal London DAC under the terms of the Liver Reinsurance Agreement. RLMIS proposes to charge such exceptional expenses in respect of the Ireland Liver Business to the estate of the Royal Liver Sub-Fund rather than to the asset shares. The Ireland Liver Business transferring policyholders have not had a choice in the Transfer happening. Consequently, in my view, it is appropriate to share the costs across the entire 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. I also note that the WPA has expressed the same opinion in the WPA report on the Transfer.

Overall, the additional initial and ongoing costs that will arise as a result of the Transfer will lead to a reduction in the surplus emerging in the Royal Liver Sub-Fund. The reduction in surplus emerging will be allocated to asset-shares at year-end 2018 and 2019. It is estimated that the reduction in surplus will lead to a reduction in the distribution of the estate (i.e. a reduction in the increase to asset shares for with-profits policies and sums assured for contingent bonus policies) of 3% at year-end 2018 and 2% at year-end 2019 when compared to the current run-off plan for the Royal Liver Sub-Fund, which does not allow for the Transfer. After this point, the distribution of the estate is projected to be broadly unchanged.

**Impact on the management of with-profits policies**

*Bonus distributions*

Pre-Transfer, the Royal Liver Sub-Fund contains both ROI and UK policyholders. Bonus rates and distributions are determined based on all assets within the fund.

Post-Transfer and effecting the Liver Reinsurance Agreement, RLMIS' Royal Liver Sub-Fund will contain UK policyholders who are direct policyholders of RLMIS and ROI policyholders who are reinsured policyholders of RLMIS.

The Liver Reinsurance Agreement ensures that the assets within the Royal Liver Sub-Fund (which includes an inherited estate) do not need to be split between the ROI policyholders transferring to Royal London DAC and UK policyholders remaining in RLMIS and that past management practices, including those covered within the relevant PPFM Guides, can continue. In the absence of the Liver Reinsurance Agreement, the assets within the Royal Liver Sub-Fund would need to be split between the UK and ROI policyholders and be managed separately, with separate investment strategies and bonus distribution policies (albeit both aligned to the CPFM). While splitting the assets between the two sets of policyholders could impact on their respective distribution rates compared to the current situation, the primary reason for not splitting the fund now is that the time constraints imposed by Brexit make it difficult to ensure that any such split would maintain fairness between different groups and generations of policyholders.

*Governance*

The transferring policies have, to-date, been managed in accordance with the IoT which sets out the legal basis of the transfer of business from Royal Liver Assurance Limited to RLMIS. The IoT determines how RLMIS should manage the Royal Liver Sub-Fund and includes CPFM that must be adhered to.

The transferring policies have also been subject to oversight from the Liver Supervisory Committee established under the IoT. The Liver Supervisory Committee has a remit to monitor the management of the Royal Liver Sub-Fund to ensure that it operates in compliance with the IoT and the Royal Liver PPFM.

The terms of the IoT, where applicable, including the Terms of Reference of the Liver Supervisory Committee have been updated to reflect the transfer of the ROI business and the establishment of the Liver Reinsurance Agreement. The updates reflect the reinsured status of the ROI Ireland Liver Business transferring policyholders and require RLMIS to have regard to the reasonable expectations of this group of transferring policyholders in relation to the benefits payable (in the same manner post-Transfer as pre-Transfer) for as long as the Liver Reinsurance Agreement remains in place.

The Liver Supervisory Committee retains its role of oversight in relation to the Royal Liver Sub-Fund including the management of the Liver Reinsurance Agreement and the reinsured transferring policyholders within. As a committee of RLMIS, it does not have direct responsibilities to the Royal London DAC Board; however, it is part of the with-profits governance process within RLMIS, as described in the WPA Report.

Post-Transfer, bonuses declared on the transferring policies are the responsibility of the Royal London DAC Board. The Liver Reinsurance Agreement contains a bonus declaration process which must be followed and which includes the Royal London DAC Board and HoAF and the RLMIS Board, With-Profits Committee and WPA. All parties are required to consider the interests of both sets of policyholders within RLMIS' Royal Liver Sub-Fund.

The terms of the Scheme of Transfer ensure that, whilst the Liver Reinsurance Agreement is in place, the PPFM Guide (or equivalent regulatory requirement i.e. the WPOP) for the Ireland Liver Business is consistent with the Royal Liver Sub-Fund PPFM Guide.

In the event of termination of the Liver Reinsurance Agreement and associated Security Arrangements, the Royal Liver Sub-Fund would need to be split. This would involve splitting all of the assets in the fund between this group of transferring policyholders and the non-transferring policyholders in the Royal Liver Sub-Fund, including a split of the inherited estate.

Prior to the termination taking effect, a process to determine the various interests of the policyholders in the Royal Liver Sub-Fund would be exercised. The Scheme of Transfer specifies the methodology and process that must be followed in this scenario, which would involve the CBI, the UK Regulators and an independent actuarial expert as well as the boards

of RLMIS and Royal London DAC, the RLMIS WPA, RLMIS Chief Actuary and Royal London DAC HoAF.

Post termination of the Liver Reinsurance Agreement, Royal London DAC is required to adhere to the requirements contained in the Scheme of Transfer, which include Core Principles of Financial Management to be followed in such an event. The Scheme of Transfer also includes provisions to ensure that a PPFM Guide (or equivalent regulatory requirement i.e. the WPOP) is maintained in respect of the transferring Ireland Liver Business. The CPFM in the Scheme of Transfer align with the CPFM contained in the IoT, thus ensuring protection of this group of transferring policyholders in a post-termination scenario.

Overall, I am satisfied that the benefits payable under participating policies will not be materially impacted post-Transfer because:

- the updated terms of the IoT and the role of the Liver Supervisory Committee have been appropriately allowed for in the Scheme of Transfer and the Liver Reinsurance Agreement;
- the Liver Reinsurance Agreement contains appropriate governance processes with respect to bonus distributions;
- the Scheme of Transfer and the Liver Reinsurance Agreement will ensure a fair split of the assets of the Royal Liver Sub-Fund and Liver Ireland Sub-Fund if the Liver Reinsurance Agreement is terminated in the future; and
- the CPFM in the Scheme of Transfer and the IoT are aligned, thus ensuring continuity of such principles post termination of the Liver Reinsurance Agreement;
- the Scheme of Transfer ensures that, whilst the Liver Reinsurance Agreement is in place, the PPFM Guide (or equivalent regulatory requirement i.e. the WPOP) for the Ireland Liver Business is aligned to the Royal Liver Sub-Fund PPFM Guide, thus ensuring continuity of such principles and practices post-Transfer.

**Conclusion on benefits payable under participating policies for Ireland Liver Business**

I am satisfied that there will be no material impact on the benefits payable under participating policies for this group of transferring policyholders for the following reasons:

- The impact on the inherited estate of the Royal Liver Sub-Fund will not have a material impact on bonus distribution.
- The overall effect of the Liver Reinsurance Agreement (including the governance processes around bonus distributions), together with the amendments to the Royal Liver IoT, mean that the policyholders of the Ireland Liver Business will continue to benefit from the Royal Liver Sub-Fund in the same way as they would have before the Transfer during the period of the reinsurance.
- In the event of termination of the Liver Reinsurance Agreement, the Scheme of Transfer specifies an appropriate methodology and governance process to ensure that the Royal Liver Sub-Fund is split fairly between this group of transferring policyholders and non-transferring policyholders. It contains principles and practices in relation to the management of the assets and distribution of surplus in the Liver Ireland Sub-Fund, which align with those in place pre-termination.

### 4.3.2 RL Post-2011 Business

All of the policies that will be transferred into the Royal London DAC Open Fund will be protection policies with no participating features.

### 4.3.3 German Bond Business

As outlined in section 2.2, under the proposed Transfer, existing German Bond policyholders currently written in the Royal London Main Fund will transfer to a new ring-fenced fund in Royal London DAC, the German Bond Sub-Fund. Coincidental with the proposed Transfer (i.e. on the same date as the Transfer):

- the business that has transferred to Royal London DAC will be 100% reinsured back into the Royal London Main Fund; and
- a series of security and collateral arrangements will be effected in order to mitigate the risk of insolvency of RLMIS and to ensure that, were such an event to arise, this group of transferring policyholders' benefit security will not be materially compromised relative to their current position.

The closed book of German Bond Business, which has a BEL of £115m, sits within the Royal London Main Fund, which is where RLMIS currently writes its new business.

In considering the benefits payable before and after the proposed Transfer for this group of transferring policyholders under participating policies, I have considered the following:

- impact of the costs of the Transfer on bonus distributions; and
- impact of the Transfer on the ongoing management of with-profits policies.

**Impact of costs on bonus distributions**

The German Bond Business is administered in the Isle of Man by RL360º Management Services Limited under the terms of a services agreement with RLMIS. This agreement will novate to Royal London DAC with effect from the Effective Date. These expenses will then be recoverable from RLMIS via the German Bond Reinsurance Agreement. The overall costs associated with the German Bond Business are expected to increase post-Transfer. These increases will be immaterial relative to the total increase in costs associated with the Transfer.

The initial project costs to establish Royal London DAC and to enable the Transfers of business will be borne by the Royal London Main Fund of RLMIS.

The German Bond policyholders share in the distribution of profits from the Royal London Main Fund of RLMIS via the ProfitShare arrangement. The impact of additional costs (i.e. those additional specific areas which only arise as a result of the Transfer and which are giving rise to expense) on the Royal London Main Fund of RLMIS and hence the distributions made from that fund in respect of the ProfitShare for German Bond Business will be immaterial. The costs are extremely small relative to the size of the Royal London Main Fund of RLMIS. Further, the Royal London Main Fund of RLMIS will benefit from the value of Royal London DAC as an asset and will receive any dividend distributions made by Royal London DAC.

**Impact of Transfer on ongoing management of with-profits policies**

The unitised with-profits German Bond Business currently participates in RLMIS's ProfitShare arrangements, which allocates part of the operating profits of RLMIS to asset shares and unit fund values of eligible policies by means of a discretionary enhancement. These policies will continue to benefit from ProfitShare after the Transfer to Royal London DAC while the German Bond Reinsurance Agreement is in place.

The termination of the German Bond Reinsurance Agreement requires RLMIS to pay a termination amount to Royal London DAC. The calculation of this termination amount includes consideration of whether any compensation is required for eligible with-profits German Bond Business policyholders in respect of the loss of any future ProfitShare allocations, and if so the amount of such compensation. The German Bond Reinsurance Agreement specifies a

methodology and process that must be followed to determine the termination amount. The process involves the CBI, the UK Regulators and an independent actuarial expert.

Post-Transfer, bonuses declared on the German Bond transferring policies are the responsibility of the Royal London DAC Board. The Scheme of Transfer ensures that the Royal London DAC PPFM Guide (or equivalent regulatory requirement i.e. the WPOP) will continue to be aligned with the Royal London Main Fund PPFM Guide whilst the German Bond Reinsurance Agreement is in place. Post termination of the German Bond Reinsurance Agreement, the Royal London DAC German Bond Sub-Fund would not continue to operate as a ring-fenced fund. It is likely that the policies in the German Bond Sub-Fund would be converted to non-profit or unit-linked policies upon termination of the German Reinsurance Agreement. Consideration would need to be given to ensure that the German Bond transferring policyholders would be allocated their fair share of the termination amount received, as described above. I am satisfied that appropriate consideration would be given and that the governance arrangements in the Scheme are such to ensure the fair treatment of the German Bond transferring policyholders upon termination of the German Reinsurance Agreement.

**Conclusion on benefits payable under participating policies for German Bond Business**

I am satisfied that there will be no material impact on the benefits payable under participating policies for the German Bond transferring policyholders for the following reasons:

- The impact of increased costs due to the Transfer will not have a material impact on bonus distributions;
- While the German Bond Reinsurance Agreement is in place, the Royal London DAC German Bond PPFM Guide (or equivalent regulatory requirement i.e. the WPOP) is aligned to the Royal London Main Fund PPFM Guide, thus ensuring continuity of such principles and practices post-Transfer;
- The overall effect of the German Bond Reinsurance Agreement and the Scheme of Transfer means that the policyholders of the German Bond Business will continue to benefit from RLMIS's ProfitShare arrangement.
  In the event of termination of the German Bond Reinsurance Agreement, the Scheme of Transfer specifies an appropriate methodology to ensure that the German Bond policyholders are treated fairly and will receive appropriate compensation for the loss of the ProfitShare arrangement.

## 4.4 Application of discretionary management actions

Discretionary actions taken by management can take a number of forms. For example, for participating policies, discretion is applied when calculating asset shares and setting rates of annual and final bonuses. In adverse scenarios, management actions may need to be taken in order to maintain the solvency of Royal London DAC and/or RLMIS.

For non-participating policies, discretion can be required for certain products; for example, where the amount of premium and/or benefit is reviewable or where the amount of a policy charge is reviewable.

For all policies, the handling of claims, in particular illness-related or disability-related claims, is subject to an insurer's policies and procedures and attitude to the acceptance or otherwise of claims where the validity of the claim is not clear-cut. Similarly, the handling of complaints is also subject to the policies and procedures set by the individual firm. In relation to the handling of claims, there will be no change for this group of transferring policyholders. Service and administration standards are discussed in section 4.7.

Section 4.3 considers in more detail how benefits will be determined for participating policyholders after the Transfer has become effective. As a result of the reinsurance of all of

the participating policies to RLMIS, discretionary management actions will be applied within the relevant ring-fenced fund of RLMIS as would be applied in the same circumstances before the Transfer, both in terms of their assumed application in the calculation of the SCR and also their actual usage, if required. Therefore, in my opinion, the application of discretionary management actions will not be materially different after the Transfer compared to before the Transfer.

**With-profits governance**

All of the with-profits policies of RLMIS, including the Ireland Liver Business and the German Bond Business have been governed in accordance with the UK Conduct of Business rules for with-profits business (Conduct of Business Sourcebook Chapter 20). The RLMIS with-profits governance process therefore involves oversight by a With-Profits Committee, advice from a With-Profits Actuary and the establishment of PPFMs. The existing Royal London PPFMs currently apply to the with-profits transferring policies, and will continue to apply post-Transfer while the reinsurance agreements are in place, via the relevant Royal London DAC PPFM Guides (or equivalent regulatory requirement i.e. the WPOP).

The Royal London DAC Board will have responsibility for decisions relating to bonus rates and distributions and the Royal London DAC HoAF will be required to provide an opinion to the Board on the compliance of the with-profits fund with the principles of the PPFM (or equivalent regulatory requirement i.e. the WPOP).

Under the terms of the Liver Reinsurance Agreement and the German Bond Reinsurance Agreement, with effect from 1 January 2020, RLMIS will report to Royal London DAC on RLMIS' compliance with the relevant PPFMs.

On 27 November 2018, the CBI published updates to the '*Domestic Actuarial Regime and Related Governance Requirements under Solvency II'*. The updates include amendments to the actuarial regime in the ROI relating to the governance of with-profits business.

It requires the following in relation to with-profits business:

- insurance undertakings will be required to produce a With-Profits Operating Principles ("WPOP") document, which will be available to members of the respective with-profits funds;
- (re)insurance undertakings will be required to send an annual report to with-profits policyholders on the compliance of the fund with the principles of the WPOP;
- the HoAF will be required to report to the Board and with-profits policyholders on the compliance of the with-profits funds with the principles of the WPOP;
- the HoAF will be required to provide an opinion to the Board on compliance of the Technical Provisions with the WPOP in the actuarial report on Technical Provisions.

The governance that has already been put in place by Royal London DAC in respect of its with-profits' business is consistent with the CBI's amendments. Royal London DAC will be compliant with these new requirements on the Effective Date.

**Unit Linked Funds**

For unit-linked policies, discretionary actions may be required in relation to the management of unit-linked funds. Under the terms of the Scheme of Transfer, Royal London DAC will have the authority to implement discretionary actions, which are clearly defined in the Scheme of Transfer, in respect of relevant Ireland Liver Business policyholders and German Bond Business policyholders (similar to the actions that can currently, pre-Transfer, be enacted by RLMIS). Discretionary actions that may be implemented by Royal London DAC include, but are not limited to:

- closing a unit-linked fund to further investment or amalgamating unit-linked funds;
- dividing a unit-linked fund into more than one unit-linked fund;
- winding-up a unit-linked fund and switching policyholders into an appropriate alternative unit-linked fund;
- modifying or changing the investment strategy of a unit-linked fund to permit investment in assets which are reasonably similar to those already permitted to be held in the unit-linked fund.

Under the terms of the Scheme of Transfer, the Royal London DAC Board must consider the equitable treatment of affected policyholders and must take into account the advice of the Royal London DAC HoAF if any such action is to be implemented. The implementation of any discretionary action in relation to unit-linked funds, as defined in the Scheme of Transfer, is subject to the terms and conditions of the relevant policies.

### 4.4.1 Ireland Liver Business

The Scheme of Transfer recognises that the Royal London DAC Board will make decisions in relation to participating policyholders in the Liver Ireland Sub-Fund, including decisions relating to bonus rates and distributions. This ensures that Royal London DAC has a clear responsibility in respect of its policyholders.

The Liver Reinsurance Agreement includes an approach to setting bonuses for both direct and reinsured policies, which includes input from the RLMIS WPA, the RLMIS With-Profits Committee, the Liver Supervisory Committee and the Royal London DAC HoAF. In most circumstances, it is expected that the RLMIS Board and the Royal London DAC Board will agree on the bonuses to be paid. In the event of a disagreement, there is an expert determination process written into the Liver Reinsurance Agreement that involves nominating an independent actuary to opine on the fairness of the bonus declaration to the reinsured with-profits policyholders, or on any regulatory reasons why the bonus declaration should differ. The opinion of the independent actuary would be binding on both boards.

The likely overall impact of this governance process is to ensure that the benefits payable under transferred participating policies are consistent with the expectations of the policyholders and are as close as practicable to the benefits that would have been payable if they had not transferred. Overall, I am satisfied that for this group of transferring policyholders, participating policies will not be materially impacted by the Transfer, as it relates to the application of discretionary management actions.

### 4.4.2 RL Post-2011 Business

All of the policies that will be transferred into the Royal London DAC Open Fund will be protection policies with no participating features. As described above, the claims handling process will not change for such transferring policyholders as a result of the Transfer.

### 4.4.3 German Bond Business

Similar to that outlined for the Ireland Liver Business, the German Bond Reinsurance Agreement includes a collaborative approach to setting bonuses for both direct and reinsured policies including input from the RLMIS WPA, the RLMIS With-Profits Committee and the Royal London DAC HoAF.

In the event of a disagreement, there is an expert determination process, which is the same as that outlined in section 4.4.1. The likely overall impact of this governance process is to ensure that the benefits payable under the transferring policies are consistent with the expectations of policyholders and are as close as practicable to the benefits that would have been payable if they had not transferred.

Overall, I am satisfied that for this group of transferring policyholders, participating policies will not be materially impacted by the Transfer, as it relates to the application of discretionary management actions.

In relation to unit-linked transferring policyholders within the German Bond Business, I am satisfied that there will be no material change in terms of the application of discretionary management actions to unit-linked funds of such transferring policyholders.

## 4.5 Policyholder Options

With respect to transferring policyholders, the Scheme of Transfer ensures that any policyholder who, as per the terms of their contract, is entitled to exercise any right or option will continue to benefit from that right or option post-Transfer. If at the time of exercise of such a right or option, Royal London DAC does not write the type of contract to which the right or option refers, Royal London DAC shall be entitled to offer another contract as an alternative. Any such alternative contract would be one that is commonly offered by Royal London DAC or another member of the Royal London Group at the time of exercise of the right or option. Any such alternative contract would be considered by Royal London DAC to be the nearest equivalent contract to the type of contract to which the right or option refers. In this situation, as per the terms of the Scheme of Transfer, Royal London DAC would be required to:

- ensure that the issue of such an alternative policy would not result in an increase in liability to taxation, taking into account the advice of the Royal London DAC HoAF; and
- ensure that the issue of such an alternative policy would not otherwise fail to meet the CBI's General Good Requirements.

Overall, given the provisions in the Scheme of Transfer, I am satisfied that the transferring policyholders will not be materially impacted by the Transfer, as it relates to policyholder options.

## 4.6 Expenses

### 4.6.1 Ireland Liver Business

Section 4.3.1 discusses the impact on the Ireland Liver Business of the additional expenses arising from the establishment and ongoing management of Royal London DAC.

### 4.6.2 RL Post-2011 Business

The cost of servicing the RL Post-2011 Business will increase post-Transfer as a result of the establishment and ongoing management of Royal London DAC. The additional costs allocated to the Royal London DAC Open Fund will be borne by Royal London DAC. The policies will all be non-participating in nature so the costs will be met from the profits of that business, which is expected to be profitable.

Overall, given the policies are non-participating and the business is profitable, the increase in expenses will not impact on the benefits payable under those policies post-Transfer.

### 4.6.3 German Bond Business

Section 4.3.3 discusses the impact on the German Bond Business of the additional expenses arising from the establishment and ongoing management of Royal London DAC.

## 4.7 Service standards/standards of administration

### 4.7.1 Ireland Liver Business

For the policyholders transferring into the Liver Ireland Sub-Fund, the policy administration will move from the UK to ROI to allow Royal London DAC to provide closer oversight. The terms of the Scheme of Transfer require Royal London DAC to use all reasonable endeavours to provide standards of service to this group of transferring policyholders that are not inconsistent with those provided by RLMIS immediately before the Transfer. The Royal London Group (the group of entities that makes up Royal London Group, which includes Royal London DAC) is committed to ensuring that all of its policyholders receive a good level of service. Within its current business in RLMIS and the Irish Branch of RLMIS, it has well-established administration operations. In addition, RLMIS and Royal London DAC have a detailed project plan in place to ensure that the transfer of administration is as smooth as practicable, including a suitably phased handover of activity from the UK to ROI, with an appropriate level of training.

Royal London DAC is aware of the risk of a loss of experience in administering the Ireland Liver Business and, in particular, knowledge of the terms of those policies and the background to RLMIS's current operations. Any of these losses could lead to a reduction in the standard of administration and this risk is currently being carefully monitored and managed by the Royal London Group as part of the transition process.

I understand from discussions with RLMIS management that previous changes in administration arrangements following other similar transfers have been well managed (e.g. the transfer of the Royal Liver business to RLMIS). I am also aware of the level of oversight and consideration that has been given by both RLMIS and Royal London DAC to ensure a smooth transition. Given the successful experience of the Royal London Group in performing similar transfers in the past and its commitment in terms of the planning and execution of detailed plans in relation to this Transfer, I am satisfied that the standard of administration that transferring policies will receive after the Transfer will be of a similar standard to that which they currently receive.

### 4.7.2 RL Post-2011 Business

For the policyholders transferring into the Royal London DAC Open Fund, there will be no change to the existing service arrangements and standards.

### 4.7.3 German Bond Business

The German Bond Business is currently serviced via an outsourced services agreement with an external provider who provides administrative services in relation to this business. This agreement will continue to operate post-Transfer, with a change in counterparty to Royal London DAC from RLMIS. Therefore, there will be no change to the existing service arrangements and standards in respect of the German Bond Business.

## 4.8 Investment strategy

Royal London Asset Management (**"RLAM"**), a member of the Royal London Group, is the investment manager of the RLMIS funds. RLAM will also be the investment manager for Royal London DAC.

Below, consideration is given to whether there are changes in the investment strategy and, where there are, whether these may have a material impact on policyholder benefits.

### 4.8.1 Ireland Liver Business

The Ireland Liver Business will be 100% reinsured into the Royal Liver Sub-Fund within RLMIS on the Effective Date as described in section 2.4. Thus, the investment strategy pursued in respect of the asset shares underpinning the participating business is not expected to change post-Transfer.

There will be a small amount of assets within the Liver Ireland Sub-Fund, mainly to cover the counterparty and operational risk SCR and Capital Buffer requirements of that sub-fund, whilst the reinsurance and security arrangements remain in place. However, these assets are immaterial relative to the overall assets of the Royal Liver Sub-Fund.

In conclusion, the investment strategy pursued in respect of the Ireland Liver Business is not expected to materially change post-Transfer and, consequently, I am satisfied that it will not have a material impact on transferring policyholder benefits nor on their benefit security.

### 4.8.2 RL Post-2011 Business

The RL Post-2011 Business will be transferred to the Royal London DAC Open Fund from the Royal London Main Fund where the investment strategy pursued will be more conservative than that pursued by the Royal London Main Fund, primarily due to the relative overall sizes of both funds and the type of business within each. The nature of protection business is such that there is little requirement for material levels of invested assets as technical provisions are projected to be negative. Therefore, invested assets in respect of the RL Post-2011 Business are only required to meet capital requirements, including the risk margin, and any Capital Buffer. In addition, the business is non-participating in nature so its benefits will not be impacted.

Overall, given the fact that assets are required to back capital requirements rather than technical provisions and that the business is non-participating, I am satisfied that the change in investment strategy will not have a material impact on transferring policyholder benefits nor on their benefit security.

### 4.8.3 German Bond Business

The German Bond Business will be 100% reinsured into the Royal London Main Fund within RLMIS on the Effective Date as described in section 2.4. Thus, the investment strategy pursued in respect of the asset shares underpinning the unitised with profits business within that block is not expected to change post-Transfer. The unit-linked business within the block is not expected to be impacted.

There will be a small amount of assets within the German Bond Sub-Fund, mainly to cover the counterparty and operational risk SCR and Capital Buffer requirements of that sub-fund, whilst

the reinsurance and security arrangements remain in place. However, these assets are immaterial relative to the overall assets of the Royal London Main Fund.

In conclusion, the investment strategy pursued in respect of the German Bond Business is not expected to materially change post-Transfer and, consequently, I am satisfied that it will not have a material impact on transferring policyholder benefits nor on their benefit security.

## 4.9 Tax

### 4.9.1 Ireland Liver Business

No changes are anticipated in respect of direct policyholder taxation for the Ireland Liver Business as the fund is expected to be taxed on the same basis post-Transfer. No trading profits are expected to arise in the Liver Ireland Sub-Fund whilst the reinsurance is in place. Additional taxes arising as a result of the Transfer of the Ireland Liver Business, for example due to transfer pricing, are expected to be immaterial.

Overall, I am satisfied that the tax impacts will not have a material impact on Ireland Liver Business transferring policyholders' benefits nor on their benefit security.

### 4.9.2 RL Post-2011 Business

No changes are anticipated in respect of direct policyholder taxation for the RL Post-2011 Business as the fund is expected to be taxed on the same basis post-Transfer.

The most significant change in taxation is that the profits of the RL Post-2011 Business written in Royal London DAC Open Fund will be subject to corporation tax at 12.5%. This block of business will no longer benefit from the concessionary treatment applied to the profits of such business that currently emerge in the Royal London Main Fund, a mutual with-profits fund.

As the Royal London DAC Open Fund only has non-profit business with defined benefits, this additional taxation will not affect transferring policyholder values.

Additional corporation tax arising from the transfer of the RL Post-2011 Business will be funded from the capital of, and the profits arising in, the Royal London DAC Open Fund and will not affect the benefits payable under those policies.

Overall, I am satisfied that the tax impacts will not have a material impact on the benefits of RL Post-2011 Business transferring policyholders, nor on their benefit security.

### 4.9.3 German Bond Business

No changes are anticipated in respect of direct policyholder taxation for the German Bond Business, unless a policyholder has taken up residency in the ROI since the policy was written. Prior to the Transfer, this same point applies if a policyholder were to take up residency in the UK. No trading profits are expected to arise in the German Bond Sub-Fund whilst the reinsurance is in place. Additional taxes arising as a result of the Transfer of the German Bond Business, for example due to transfer pricing, are expected to be immaterial. Overall, I am satisfied that the tax impacts will not have a material impact on the German Bond Business transferring policyholders' benefits nor on their benefit security.

## 4.10 Membership rights

The only transferring policies which confer membership of RLMIS are the unitised with-profits policies of the German Bond Business. Membership is only available to specific policies written by, and remaining with, RLMIS. The holders of these policies will lose that membership on transferring to Royal London DAC.

The main benefits of membership of RLMIS are:

- the right to vote at an Annual General Meeting (”AGM”) or Extraordinary General Meeting (”EGM”) of RLMIS;
- the right to support a resolution to call an EGM of RLMIS which requires a minimum of 500 members;
- the right to include a resolution in the notice of an AGM which requires a minimum of 500 members; and
- 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 not considered a material benefit. The German Bond policyholders represent c. 0.1% of the total membership of RLMIS. Their power to have specific influence on the voting or decision-making at any particular meeting is extremely low.

In terms of the potential for compensation in the event of the demutualisation of RLMIS, it is reasonable to consider the potential for this to occur albeit it is very difficult to predict. As of now, RLMIS is committed to its mutual status and has no intention of demutualising in the foreseeable future. However, in order to provide protection for the unitised with-profits German Bond policyholders, should this position change in the medium term, the Scheme of Transfer includes a provision to protect the German Bond Business transferring policyholders in the event that RLMIS demutualises within five years of the Effective Date.

The provision states that the German Bond Business policyholders would be paid compensation for loss of membership, provided that they continue to hold their policy on the relevant date. Compensation would be paid on the same basis as any form of compensation that is made by RLMIS in the event of demutualisation to **“Equivalent Members”** (i.e. members of RLMIS who, as at the date of demutualisation, hold with-profits policies allocated to the Royal London Main Fund).

The loss of membership rights does represent a loss for the German Bond Business transferring policyholders. However, to enable the continued servicing of this group of transferring policyholders means that there is no choice but to effect the Transfer and thus lose these membership rights.

Overall, having considered the above, I am satisfied that the loss of membership rights is justified by the need to make the Transfer in order to be able to service these policies after the UK leaves the EU. I am further satisfied that the provision for compensation which is allowed for in the Scheme of Transfer is appropriate.

## 4.11 Policyholder communications

A detailed communication plan was produced which sought to ensure that all of the policyholders impacted by the Transfer would be adequately informed of the nature and likely effect of the Transfer, where practicable. The information provided includes an explanatory letter, policyholder booklet, including a set of anticipated frequently asked questions with answers.

Supplementing the written communications, information has been posted on the royallondon.com, royallondon.ie and royallondongroup.de websites and legal notices have been published in a variety of UK, Ireland and Germany newspapers. Dedicated telephone lines have been put in place to handle customer responses, with separate lines available for UK, Ireland and Germany customers. A full copy of the Scheme of Transfer, the Independent Expert's report, the Chief Actuary's report, this report and the WPA Report will be available online or on request (in writing or by telephone).

A detailed process has been put in place to handle any queries arising from transferring policyholders including taking action in respect of any objections or expressions of dissatisfaction with regard to the Scheme of Transfer, which need to be brought to the attention of the Court.

Mailings have been tailored to the different transferring policyholder groups with further details contained in the sub-sections below, namely;

- Ireland Liver Business;
- RL Post-2011 Business; and
- German Bond Business.

I am satisfied that the communications to date and the proposed communications expected to happen in respect of transferring policyholders are appropriate. I am further satisfied that any objections and expressions of dissatisfaction are being managed appropriately.

### 4.11.1 Ireland Liver Business

At the time of writing, mailings have been issued to all of the ROI transferring policyholders. To date, there have been very few Transfer related queries from this group. The majority of follow up calls have been related to general queries such as requests for policy valuations with some telephone queries about the Transfer.

### 4.11.2 RL Post-2011 Business

As described above for the Ireland Liver Business, mailings have been issued to all of the RL Post-2011 Business transferring policyholders. To date, there have been very few Transfer related queries from this group. The majority of follow up calls have been related to general queries with some telephone queries about the Transfer.

### 4.11.3 German Bond Business

At the time of writing, mailings have been issued to all of the German Bond transferring policyholders. To date, there have been very few Transfer related queries from this group. The majority of follow up calls have been related to general queries such as requests for policy valuations with some telephone queries about the Transfer.

# 5. Conclusions

In summary, I am of the opinion that:

(a) the Transfer will not adversely impact, to any material extent, the interests and, more particularly, the security of the benefits of the transferring policyholders and the benefit expectations of transferring with-profits policyholders; and

(b) the Transfer will not adversely impact, to any material extent, the interests and, more particularly, the security of the benefits of the existing policyholders

**Ciara Regan**
**Head of Actuarial Function**
**Royal London Insurance DAC**
**21 January 2019**

# 6. Appendix

## 6.1 Glossary of terms and abbreviations

| Term | Definition |
|---|---|
| BEL | Best Estimate Liability<br>The probability-weighted average of future cash-flows calculated in accordance with article 77 of Solvency II Directive. |
| BEL Counterparty Default Adjustment | The adjustment to the BEL to take account of expected losses due to default of the counterparty (i.e. RLMIS) in Royal London DAC after the reinsurance is affected. As per Article 81 of the Solvency II Directive. |
| Capital Buffer | Assets held in excess of the sum of the BEL, SCR and risk margin in line with the Royal London DAC internal capital management framework. |
| CBI | Central Bank of Ireland. |
| Closed Book German Bond Business | A closed book of bonds written on a freedom of services basis out of the UK into Germany and written into the Royal London Main Fund. |
| Closed Fund Royal Liver Business | A closed block of (RLMIS) business originally written in Ireland and currently written into the Royal Liver Sub-Fund. |
| COBS 20 | Chapter 20 of the Financial Conduct Authority's Conduct of Business Sourcebook |
| Collateral Arrangements | Collateral structure that will be put in place between RLMIS and Royal London DAC, effective from the Effective Date, in respect of the German Bond Reinsurance Agreement and the Liver Reinsurance Agreement.<br>A two tiered collateral structure will apply to each of the Reinsurance Agreements as follows:<br>• The First Tier collateral provides for a separate fixed charge in favour of Royal London DAC in respect of each Reinsurance Agreement (the First Tier Collateral). The Amount Recoverable (as defined in each of the tier 1 Security Agreements, being 50% of BEL Amount (as defined in each Reinsurance Agreement)), does not take into account any recovery by Royal London DAC under the Second Tier Collateral or the Insolvency Floating Charge.<br>• The Second Tier collateral secures amounts up to 100% of the BEL Termination Amount, but taking into account amounts recovered under the First Tier Collateral and the Insolvency Floating Charge, which provides for a separate fixed charge in favour of Royal London DAC in respect of each Reinsurance Agreement (the Second Tier Collateral).<br>• In addition to the First and Second Tier Collateral and separate to such collateral, a floating charge (the "Insolvency Floating Charge") shall be put in place over all of the assets of Royal London (excluding circa £3 billion of unit linked funds under the terms of the Existing Charges). The maximum amount recoverable under the Insolvency Floating Charge may not exceed the aggregate value of the BEL Termination Amount under each of the reinsurance agreements. The Insolvency Floating Charge ensures that the Royal London DAC reinsured policyholders of RLMIS have the same entitlement priority on wind-up as the direct policyholders of RLMIS to all of the assets available for distribution in the event of insolvency of RLMIS.<br>• The Second Tier Collateral includes equalisation provisions in order to maximise Royal London DAC's security interests while also ensuring equity and fair treatment between direct and reinsured policyholders of RLMIS in the event of insolvency of RLMIS. |

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| Collateral Framework Agreements | The legal documentation setting out the Collateral Arrangements |
| Core Principles of Financial Management | The principles underlying the management of policies within the Royal Liver Sub-Fund that are set out in the Royal Liver IoT, Schedule 2. |
| Deeds of Charge | See Insolvency Floating Charge |
| Effective Date | 00.01 GMT on 7 February 2019<br>The date on which the transfer of business from RLMIS to Royal London DAC will be made (via a Part VII Transfer), assuming approval is granted by the High Court. |
| Equivalent Members | Members of RLMIS who, as at the date of demutualisation, hold with-profits policies allocated to the Royal London Main Fund. |
| EU | European Union |
| Existing Business/ Existing policyholders | Business written by Royal London DAC between 7 January 2019) and the Effective Date. |
| Excess Own Funds | The excess of the Own Funds over the SCR. |
| FCA | Financial Conduct Authority.<br>The FCA is a UK financial regulatory body, established in April 2013 as a successor of the FSA when the Financial Services Act 2012 came into force. The FCA regulates financial firms providing services to consumers and maintains the integrity of the financial markets in the United Kingdom. The FCA is independent of the UK government and is financed by charging fees to members of the financial services industry. |
| First Tier Collateral | See Collateral Arrangements |
| FSCS | UK Financial Services Compensation Scheme |
| FSPO | Financial Services and Pensions Ombudsman of Ireland.<br>A public body, established in 2017 to merge the offices of the Financial Services Ombudsman's Bureau and the Office of the Pensions Ombudsman, which aims to resolve disputes and complaints with pensions providers and regulated financial services providers. |
| German Bond Business | A closed block of German bonds written in Germany on a freedom of services basis out of the UK into the Royal London Main Fund within RLMIS. It is proposed that this business will be transferred to the German Bond Sub-Fund of Royal London DAC at the Effective Date. |
| German Bond Sub-Fund | Under the proposed Transfer, Royal London DAC will establish a separate ring-fenced fund, the "German Bond Sub-Fund". The German Bond Business will transfer from the Royal London Main Fund within RLMIS into the German Bond Sub-Fund within Royal London DAC on the Effective Date and Royal London DAC will take on all existing rights and obligations applicable to the transferring business from the Effective Date. |
| German Bond Reinsurance Agreement | A reinsurance arrangement whereby the liabilities under all policies in the German Bond Sub-Fund of Royal London DAC will be reinsured fully to the Royal London Main Fund of RLMIS. |
| GRE | Guardian Royal Exchange |
| GRELI | GRE Life Ireland Limited |
| The Group | Royal London Group |
| Head of Actuarial Function (HoAF) | The Head of Actuarial Function (HoAF) is a role established by the Central Bank of Ireland (CBI) under the 'Domestic Actuarial Regime and Related Governance Requirements Under Solvency II',<br><br>The HoAF role must be held by one individual who must be pre-approved by the CBI through its Fitness and Probity (F&P) regime. The HoAF is responsible for: |

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| | - the AOTPs (Actuarial Opinion on Technical Provisions) and ARTPs (Actuarial Report on Technical Provisions);<br>- An opinion on the overall underwriting policy;<br>- An opinion on the adequacy of reinsurance arrangements; and<br>Contribution to the Risk Management System, i.e. input to the review of the SCR calculation and an actuarial opinion on the ORSA process. |
| IB | Industrial Branch |
| Insolvency Floating Charge | See Collateral Arrangements. |
| Instrument of Transfer (IoT) | The agreement under the Friendly Societies Act 1992 between the Liver Society and RLMIS, pursuant to which all of the engagements of the Liver Society (including its Long-Term Business) were transferred to RLMIS, with effect from 00:01 on 1 July 2011,as amended and restated with effect from the Effective Date |
| IP | Income Protection |
| Ireland Liver Business | Closed Fund Royal Liver Business |
| Irish General Good Requirement | Guidelines set out by the CBI to which insurance and reinsurance undertakings operating in Ireland must adhere. They include for instance, a consumer protection code, a minimum competency code, a non-life premium levy and a funding levy as well as special requirements for motor and health insurance. |
| Irish Life | Irish Life Assurance plc |
| Liver Ireland Sub-Fund | A sub-fund of Royal London DAC into which the Irish Royal Liver business is transferring. This is a ring fenced sub-fund. |
| Liver Reinsurance Agreement | A reinsurance arrangement whereby liabilities under all policies in the Liver Ireland Sub-Fund of Royal London DAC will be reinsured fully to the Royal Liver Fund of RLMIS. |
| Liver Supervisory Committee | Committee formed at the time of the transfer of the Royal Liver business to RLMIS. The purpose of this committee is to ensure that the Royal Liver Sub-Fund is managed in line with the Instrument of Transfer. |
| MP | Mortgage Protection |
| NTMA | National Treasury Management Agency |
| OB | Ordinary Branch |
| ORSA | Own Risk and Solvency Assessment, defined as the entirety of the process and procedures employed to identify, assess, monitor, manage and report the short and long term risks a (re)insurance undertaking faces or may face and to determine the own funds necessary to ensure that the undertaking's overall solvency needs are met at all times. As set out in Article 45 of the Solvency II Directive, the undertaking must<br>• conduct its own ORSA to include all material risks quantifiable and non-quantifiable<br>• assess the overall solvency needs as relates to future business plans, approved risk limits and risk profile of undertaking<br>• ascertain significance with which risk profile deviates from assumptions underlying the SCR calculation when calculated using the standard formula, partial or full internal model<br>• indicate the risk changes which would trigger a revision and reassessment or the ORSA<br>• assess the impact of key management decisions (stress testing, scenario analysis). |
| Own Funds | Under Solvency II, this is the eligible capital for the capital requirements. It is split into two types: basic own funds and ancillary own funds.<br>• Basic own funds is the excess of assets over liabilities, reduced by the amount of own shares held directly by the (re)insurance undertaking as well as subordinated liabilities.<br>• Ancillary own funds consist of off balance sheet items that can be called upon to absorb loss. These are therefore items which have not yet been called up or paid in. Once an ancillary own fund is paid in, it |

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| | is treated as a basic own fund and no longer forms part of the ancillary own funds. Thus, ancillary funds are off balance sheet arrangements that can increase basic own funds (under pre-defined circumstances). Recognition of ancillary own funds is always subject to supervisory approval. |
| Part VII / Section 13 | The regulation under which insurance business can be transferred from one business to another. The applicable regulations in the UK and Ireland are:<br>• **Part VII** of the UK Financial Services and Market Act 2000 (as amended) ("FSMA").<br>• **Section 13** Transfer under the ROI Assurance Companies Act 1909. |
| Pillar 1 | Solvency II Measurement of assets, liabilities and capital<br>The valuation of assets and liabilities, technical provisions and capital requirements as per Chapter VI of the Solvency II Directive. |
| Pillar 2 | Solvency II Supervisory review process<br>Qualitative requirements as well as rules on supervision and governance of insurers. |
| PPFM | Principles and Practices of Financial Management.<br>Guidance for the operation of with-profits business. Establishment and maintenance of PPFM is a UK regulatory requirement under COBS20, for all companies writing with-profits business.<br>There is no requirement for a PPFM in Ireland but the terms of the Scheme of Transfer are such that Royal London DAC will establish a PPFM Guide (or equivalent regulatory requirement i.e. the WPOP) and operate in accordance with it. In November 2018, the CBI published updates to the '*Domestic Actuarial Regime and Related Governance Requirements under Solvency II'*. The updates include amendments to the actuarial regime in the ROI relating to the governance of with-profits business, and now requires insurance undertakings to produce a With-Profits Operating Principles ("WPOP") document, which will be made available to with-profits policyholders. |
| PRA | Prudential Regulation Authority.<br>The UK financial services regulatory body, created by the Financial Services Act 2012 as a successor of the Financial Services Authority (FSA). It is a limited company owned by the Bank of England. It is responsible for the prudential regulation and supervision of financial services firms (such as banks, building societies, insurers and major investment firms) as well as financial market infrastructures. |
| Risk Margin | An amount, under Solvency II, which insurers are required to hold in addition to the BEL. Calculated in accordance with article 77 of Solvency II Directive. Under the European Union's **Solvency II** directive, risk margin represents the potential costs of transferring insurance obligations to a third party should an insurer fail. It is equal to an insurer's baseline solvency capital requirement for non-hedgeable risks multiplied by the cost of capital at 6% and discounted at current interest rates. |
| RLAM | Royal London Asset Management, a member of the Royal London Group. |
| RLMS | Royal London Management Services. |
| RLMIS | The Royal London Mutual Insurance Society Limited<br>It is a company incorporated in England and Wales with registered number 99064. The registered office of Royal London is at 55 Gracechurch Street, London EC3V 0RL. |
| RL Post-2011 Business | An existing block of open RLMIS business written into the Royal London Main Fund and serviced on a freedom of establishment basis through the Irish branch of RLMIS. It is proposed to transfer this block to the Royal London DAC Open Fund. |
| ROI | Republic of Ireland |
| Royal Liver Sub-Fund | A closed Sub-Fund of RLMIS.<br><br>Established on 1 July 2011 by way of a scheme of transfer of business from Royal Liver Assurance Limited to RLMIS under Section 86 of the Friendly |

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| | Societies Act 1992. Subsequently the business of GRELI was transferred into this fund on 1 July 2012.<br><br>The Royal Liver Sub-Fund has both with-profits and non-profit business written in both the UK and Ireland. It is proposed that the business written in Ireland will be transferred from this fund to the Liver Ireland Sub-Fund of RL DAC. |
| Royal London DAC | Royal London Insurance DAC<br>A wholly owned subsidiary of RLMIS, authorised by the CBI on 1 January 2019 to write life insurance business.. |
| Royal London DAC Open Fund | An open fund of Royal London DAC into which the RL Post 2011 Business is proposed to be written. From 7 January 2019, any ROI new business that would have been written via the Irish branch of RLMIS has been and will continue to be written into the Royal London DAC Open Fund. |
| Royal London Main Fund | An Open Fund into which all new RLMIS business (except increments or options on existing policies) is written.<br><br>The fund from which the RL Post-2011 Business and the German Bond Business will be transferred. |
| Scheme of Transfer | The legal document setting out the terms upon which the business will be transferred from RLMIS to Royal London DAC. |
| SCR | Solvency Capital Requirement |
| SCR ratio | The ratio of Own Funds to the SCR. |
| Second Tier Collateral | See Collateral Arrangements |
| Security Arrangements | The collateral framework agreements and insolvency floating charge. |
| TA | Term Assurance |
| TMTP | Transitional Measures on Technical Provisions.<br>This allows firms to increase their technical provisions to the level required by Solvency II at a gradual rate (between 2016 and 2032) rather than all in one go. |
| The Transfer/ Royal London Ireland Transfer | The proposed transfer of business from RLMIS to Royal London DAC at the Effective Date. |
| Transferring Policyholder/Transferring Business | The policyholders of RLMIS that are proposed to be transferred into Royal London DAC. |
| UK | United Kingdom |
| UK Conduct of Business Rules | COBS |
| WPA | With Profits Actuary |
| WOL | Whole of Life |
| WPOP | With Profits Operating Principles. In November 2018, the CBI published updates to the '*Domestic Actuarial Regime and Related Governance Requirements under Solvency II'*. The updates include amendments to the actuarial regime in the ROI relating to the governance of with-profits business, and now requires insurance undertakings to produce a With-Profits Operating Principles ("WPOP") document, which will be available to with-profits policyholders. |