Standard Life International dac

Report by the Head of Actuarial Function on the proposed Part VII transfer of Euro-Denominated Business from Standard Life Assurance Limited to its Irish-based subsidiary, Standard Life International Designated Activity Company

Prepared for:

The Board of Standard Life International dac

Prepared by:

Eamonn Phelan, FSAI, FIA, CERA

Head of Actuarial Function

7 Grand Canal
Grand Canal Street Lower
Dublin 2
D02 KW81
Ireland

Tel +353 1 647 5900

milliman.ie

September 18, 2018

TABLE OF CONTENTS

TABLE OF CONTENTS....2

1 EXECUTIVE SUMMARY....4

1.1 Purpose of the report....4
1.2 Background....4
1.3 Scheme of Transfer....4
1.4 Reinsurance Arrangements....5
1.5 Risk Profile....5
1.6 Conclusions....6

2 INTRODUCTION....7

2.1 Purpose of the report....7
2.2 Guidance on its Usage....7
2.3 Independent Expert....7
2.4 Status and Disclosures....7
2.5 Scope....7
2.6 Reliances....8
2.7 Compliance....8

3 BACKGROUND....9

3.1 Overview....9
3.2 Rationale for the Scheme....11

4 OVERVIEW OF SL INTL....12

4.1 History of SL Intl....12
4.2 Legacy Schemes....12
4.3 Fund Structure....12
4.4 Solvency Position....13
4.5 Capital Policy....14
4.6 Risk Management....14
4.7 Risk profile of SL Intl business....14

5 OVERVIEW OF SLAL....16

5.1 History of SLAL....16
5.2 Legacy Schemes....16
5.3 Fund Structure....17
5.4 Solvency Position....20
5.5 Capital Policy....21
5.6 Risk Management....21
5.7 Risk profile of SLAL business....22

6 THE PROPOSED PART VII TRANSFER....23

6.1 Proposed organisational structure of the Part VII transfer....23
6.2 Proposed SLAL and SL Intl fund structure post transfer....24
6.3 New Reinsurance Arrangements....25
6.4 Collateralisation....28
6.5 Existing Reinsurance....29
6.6 Reinsurance Termination Arrangements....29
6.7 Deed Poll....30
6.8 Post Transfer Operating Model....30
6.9 With-Profits Committee....32
6.10 Post-Transfer Solvency....33

6.11 Capital Management Framework 34

7 EFFECT OF PROPOSED CHANGES ON SECURITY OF POLICYHOLDER BENEFITS 35

7.1 Risk Profile and Available Capital 35
7.2 Impact of Transfer on Solvency Capital and Solvency Coverage 37
7.3 Changes in methodology 38
7.4 Terms and Conditions 38
7.5 UK Financial Services Compensation Scheme 38
7.6 Conclusions 38

8 EFFECT OF PROPOSED CHANGES ON RIGHTS AND REASONABLE EXPECTATIONS OF EXISTING SL INTL POLICYHOLDERS 40

8.1 Description of rights and expectations of each group 40
8.2 Ongoing administration and governance 40
8.3 Investment management 40
8.4 Tax considerations 40
8.5 New Business 41

9 CONCLUSIONS 42

10 RELIANCES & LIMITATIONS 43

10.1 Reliances 43
10.2 Limitations 44

11 APPENDIX A: GLOSSARY OF TERMS 45

1 EXECUTIVE SUMMARY

1.1 Purpose of the report

As the Head of Actuarial Function ("**HoAF**") for Standard Life International designated activity company ("**SL Intl**" or "**the Company**"), I have been asked to comment on the proposal for the transfer of all Euro-denominated business from Standard Life Assurance Limited ("**SLAL**") to SL Intl under Part VII of the Financial Services and Markets Act 2000. This proposal is set out in a Scheme of Transfer (the "**Scheme**"). The Court will be invited to sanction the Scheme at a hearing planned for February 2019. If approved, the Scheme will come into effect on the **"Effective Date"**, which is expected to be 28 February 2019.

The objective of this report is to consider:

- The effect of the Scheme's proposals on the financial security of policyholders of SL Intl; and
- The effect of the Scheme on the fair treatment of policyholders of SL Intl, including their legal rights and expected benefits.

SLAL's Chief Actuary has prepared a similar report, which focuses on the effect of the Scheme on both transferring and non-transferring policyholders of SLAL. SLAL's With-Profits Actuary ("**WPA**") has been informed of the Scheme and has also prepared a separate report on the effect of the transfer on With-Profits business of SLAL and the With-Profits business being transferred to SL Intl (which will, in turn, be reinsured back to SLAL). It has been confirmed with the Financial Conduct Authority ("**FCA**") in the UK that SLAL's WPA will cover the perspectives of policyholders of both firms in his report

1.2 Background

On the 23 June 2016 the UK voted to leave the European Union ("**EU**"). The implications of this decision ("**Brexit**") on SLAL, a company servicing policyholders in multiple EU countries, are unclear with the final outcome dependent on the result of the negotiations between the UK and the EU. Under EU cross-border passporting laws, SLAL has written financial services business into Ireland and Germany using a branch structure and an Austrian sales office. As the UK has now voted to leave the EU there is a risk that this branch structure will no longer be viable after Brexit, for the purposes of servicing the in-force business in these territories.

SLAL's approach to mitigate the impact of this on its policyholders requires a Part VII transfer of all Euro-denominated business to SLAL's Dublin based subsidiary SL Intl and the reinsurance of a portion of this business back to SLAL. The Scheme proposes to transfer, from SLAL into SL Intl, all Euro-denominated business written in the branches of SLAL in Germany and Ireland and an Austrian sales office that is in-force at the Effective Date. After the transfer has been completed, SLAL will cease writing business in the EU from the Effective Date with all business being directly written in SL Intl from that point onwards.

A new organisational structure will replace the SLAL branches in Ireland and Germany, and the sales office in Austria, with an expanded SL Intl operation in Ireland, a SL Intl branch in Germany and a sales office in Austria.

These changes are required so that new business can continue to be written within the EU, and existing Irish and German branch policyholders serviced, post-Brexit.

1.3 Scheme of Transfer

The Scheme proposes the Part VII transfer of all assets and liabilities associated with the Euro-denominated policies in-force on the Effective Date from SLAL to SL Intl. These assets and liabilities are defined within the Scheme. These assets and liabilities will be transferred from their current funds into similar funds within SL Intl.

The Scheme will not alter existing policies and does not result in the cancellation or the issue of new policies to existing policyholders. There will be no change to the terms and conditions for existing SL Intl policyholders.

To enable this transfer to be completed, SL Intl has applied to extend its existing licences to include all classes of business currently operated by SLAL in Germany and in Ireland. This approval is expected to occur prior to the Final Court Hearing and will be addressed in my supplementary report submitted to the Court in 2019.

1.4 Reinsurance Arrangements

In order to maintain policyholder security and expectations for both transferring and non-transferring policyholders, a number of reinsurance arrangements are to be established, concerning the With-Profits business that will be transferred from SLAL to SL Intl. These are to be approved by the SLAL and SL Intl Boards with the arrangement established following the principles of a commercial transaction between two willing and knowledgeable parties. SL Intl will retain the risks associated with a significant proportion of the Euro-denominated business as the reinsurance arrangements do not cover all the transferred business. The overarching purpose of these reinsurance arrangements is to minimise any impact of the transfer on policyholders in Ireland, Germany, and Austria. A secondary aim is to ensure capital efficiency.

Given that security and consistency of policyholder benefits is the key driver of the design, the new reinsurance arrangements created by the transfer will be collateralised.

The collateral will be held in a single set of segregated accounts, which, along with relevant derivative contracts, will be subject to a fixed charge in favour of SL Intl, with custodians holding the assets on SLAL's behalf. For the With-Profits reinsurance arrangements, the value of the collateral posted by SLAL into the segregated accounts will be up to the level of the **Asset Share** of the Euro-denominated business (less any assets which cannot be held in the segregated accounts, as described in section 6.4 below). For the non-profit elements of the reinsurance arrangements, the value of the collateral posted will be up to the level of Best Estimate Liability ("**BEL**"). A floating charge will be granted by SLAL in favour of SL Intl over a wider pool of assets to secure the remaining exposure under the reinsurance arrangements.

A consequence of granting legal charges over assets in SLAL is that, in the normal charging arrangement in the event of insolvency, the legal charges rank ahead of the SLAL's direct UK policies. This means that reinsured SL Intl policies would rank ahead of SLAL policies. The effect of such a scenario is reduced by the fact that the floating charge will contain a provision (the "**quantum provision**") which will limit SL Intl's entitlement in the event of SLAL's insolvency to broadly the amount that would be payable if the SL Intl policyholders were direct policyholders of SLAL. The quantum provision does not apply to the fixed charge. In the highly unlikely circumstances that the theoretical total payment to SL Intl was lower than the assets covered by the fixed charge, SL Intl policyholders would receive more than they would have received as direct policyholders.

This arrangement provides the transferring policyholders with sufficient security to ensure that, if SLAL were to default, their recovery is aligned with respect to a claim on the With-Profits funds with what it would have been prior to the proposed Part VII transfer (with reinsurance).

1.5 Risk Profile

It should be noted that there will be not only a change in the level of Solvency Capital Requirement ("**SCR**") of SL Intl post transfer, but the individual components of the SCR will also significantly change under the **Solvency II** Standard Formula. In particular, the Scheme (and associated reinsurance) will lead to a significant increase in counterparty risk and currency risk capital requirements. The transfer of the annuity business will expose SL Intl for the first time to longevity risk, and will also substantially increase the Company's exposure to interest rate risk. Under the proposed transfer, it is planned that the With-Profits book will be reinsured to SLAL. This will contribute to a significant increase in the operational risk capital requirements, as well as introduce the Company to significant reinsurance counterparty default risk for the first time, as mentioned above.

SL Intl has provided me with information demonstrating that, after the transfer, the expected evolution of the solvency coverage ratio does not fall below the defined target set by SL Intl over the business planning horizon. SLAL will provide a capital injection at the time of the transaction. The level of this to maintain the solvency coverage within the target risk appetite can vary depending on how the economic, demographic and business conditions unfold over the future, relative to the best estimate.

At present, SL Intl's solvency coverage ratio is relatively stable over successive reporting periods as the BEL and SCR are quite closely correlated (as is generally the case with unit linked business). The same stability will not be present post transfer as the additional risks retained by SL Intl post transfer will weaken this correlation between the BEL and SCR. This increase in volatility may negatively affect the security of the existing SL Intl policyholders post transfer, relative to the current position, though purely by virtue of the fact that the overall solvency position of the Company may become more volatile. There is no reason to believe that this poses a material risk to any of the Company's policyholders though.

1.6 Conclusions

Based on the information available to me at this time, including the current financial strength of SLAL (Fitch has assigned SLAL a Credit Rating of A+ (Strong)), I do not believe that there is any material risk that the proposed transfer will negatively impact on the legal rights, financial security or expected benefits of the existing SL Intl policyholders.

Furthermore, I do not expect that the proposed changes will have any material adverse impact upon the rights and reasonable expectations of SL Intl's existing policyholders.

However, there are a number of additional risks which will be introduced to SL Intl following the proposed transfer, and which have the potential to negatively impact upon the existing policyholders of SL Intl, the primary one being counterparty risk. Although collateral will be in place at all times, there are instances in which the residual counterparty exposure to SLAL is still significant as the collateral posted into the segregated accounts and subject to the fixed charge is not required to be the same value as the reinsured liability, nor does it have to be made up of the same assets as the underlying assets within the fund. Therefore, shortfalls in collateral relative to the value of the reinsured liability will increase SL Intl's counterparty risk capital requirements. For example, the collateral amount is based on the Asset Share in the fund and the underlying policies have guarantees attached. Thus, if markets fall, then the Asset Share may fall, as will the value of the collateral, however, the liability to policyholders will not similarly reduce. The existence of the floating charge outlined in section 1.4 does help to alleviate this issue though. In addition, the proposed Reinsurance Agreements between SL Intl and SLAL should further reduce this risk, as the value of the assets subject to the fixed charge should never be less than an agreed percentage of the sum of unsmoothed Asset Shares and the BEL for non-profit liabilities. This will ensure that the value of SL Intl's fixed security is not adversely affected by changing the assets backing Asset Shares.

If SLAL were to experience significant solvency issues, it is likely that SL Intl would similarly experience issues, which may impact upon the financial security and expected benefits of the existing SL Intl policyholders, as well as SL Intl's ability to pay such benefits in a timely fashion.

In the event of a termination of the proposed reinsurance of the With-Profits business post transfer, depending on the exact timing and the nature of any event which may cause this to happen, there may temporarily be a weakening of SL Intl's solvency position, until such time as the termination process is fully completed. However, the remoteness of such an event, coupled with the short period of time during which such a weakness would be expected to persist, means that there should be no material adverse impact upon the financial security or benefit expectations of SL Intl's policyholders arising from such an event.

2 INTRODUCTION

2.1 Purpose of the report

As Head of Actuarial Function ("**HoAF**") for SL Intl, I have been asked to comment on the proposal for the transfer of all Euro-denominated business from SLAL to SL Intl under Part VII of the Financial Services and Markets Act 2000. The transfer is to be effected under an insurance business scheme of transfer (the "**Scheme**"). If approved, the Scheme will come into effect on the "**Effective Date**", which is expected to be 28 February 2019.

The objective of this report is to consider:

- The effect of the Scheme's proposals on the financial security of policyholders of SL Intl; and
- The effect of the Scheme on the fair treatment of policyholders of SL Intl, including their legal rights and expected benefits.

This report has been prepared in accordance with the terms of our letter of engagement dated 29 February 2016 and the associated statement of work, dated 4 December 2017.

SLAL's Chief Actuary, Mr Brian Peters, has prepared a similar report, which focuses on the effect of the Scheme on both transferring and non-transferring policyholders of SLAL. SLAL's With-Profits Actuary ("**WPA**") has been informed of the Scheme and has also prepared a separate report on the effect of the transfer on With-Profits business of SLAL and the With-Profits business being transferred to SL Intl (which will, in turn, be reinsured back to SLAL). It has been confirmed with the Financial Conduct Authority ("**FCA**") in the UK that SLAL's WPA will cover the perspectives of both firms in his report.

2.2 Guidance on its Usage

This report is written for the SL Intl Board in my capacity as HoAF. It should be read in conjunction with the Scheme, SLAL's WPA report and the report by the Independent Expert.

A list of the definitions and abbreviations that I have used in this document are included in Appendix A. Defined terms used but not defined in this report have the same meaning as those used in the Scheme document and the Independent Expert's report unless otherwise highlighted.

2.3 Independent Expert

Mr Tim Roff of Grant Thornton has been retained by the Board of SLAL in the capacity of Independent Expert and has been approved by all relevant regulatory bodies.

2.4 Status and Disclosures

I am a Fellow of the Society of Actuaries in Ireland ("**SAI**"), and was appointed as HoAF of SL Intl in November 2015. I am an employee of Milliman Limited, an independent actuarial consulting firm. I have no insurance policies with SL Intl or SLAL.

2.5 Scope

This report is addressed to the SL Intl Board in my current capacity as HoAF.

The transfer is subject to the consent of the Court of Session (the "**Court**") in Scotland.

The Prudential Regulatory Authority ("**PRA**") and the Financial Conduct Authority ("**FCA**") will be provided with a copy of this report so as to facilitate their assessment of the Scheme as part of the Initial Court submission.

The Central Bank of Ireland ("**CBI**"), Federal Financial Supervisory Authority ("**BaFin**") and Financial Market Authority ("**FMA**") will all be provided with a copy of this report following the Initial Court Hearing.

A full copy of this report will be available on request by policyholders. This document can also be viewed and/or downloaded from the following website: www.standardlife.eu

2.6 Reliances

I have read the report prepared by the Chief Actuary of SLAL, and the report prepared by the WPA of SLAL. I have considered their comments on the effect of the Scheme on policyholders.

I have read the report prepared by the Independent Expert. I have considered their comments on the effect of the scheme on policyholders.

In carrying out the work and producing this report, I relied on data and other information provided by SL Intl and SLAL. I have not audited or verified this data and other information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

In producing this report, I have reviewed a number of documents in detail. These are listed in the Reliances and Limitations in section 10 of this document.

The figures on a **Solvency II** basis have been based on those prepared for Solvency II reporting as of year-end 2017.

This report is based on information made available to me up to 1 June 2018 and takes no account of developments after this date. An updated financial view will be provided within a Supplementary Report.

Further information on reliances and limitations associated with this report can be found in section 10.

In producing this report, I have reviewed, in detail, a number of documents, which have been provided to me by SL Intl. Although the contents of these papers are not outlined in full within this report, I have used them as the basis for many of the conclusions that I have drawn.

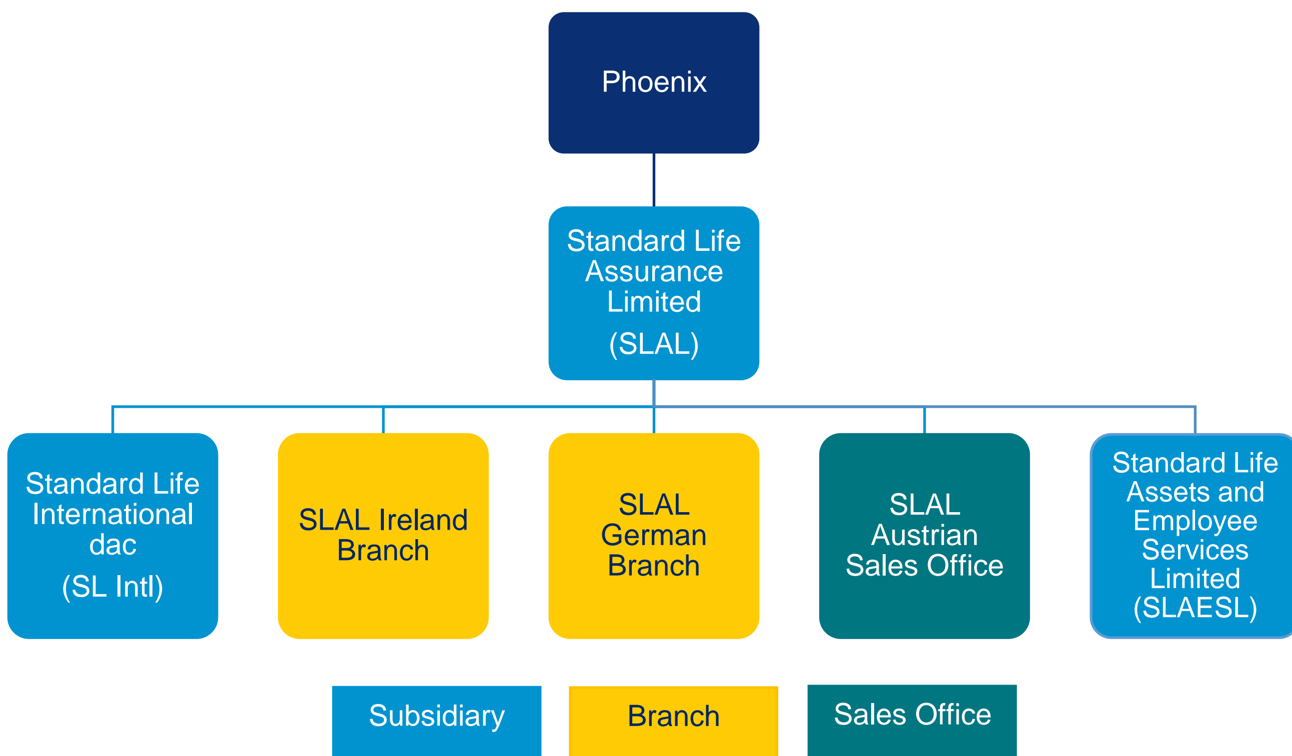
2.7 Compliance

As of 1 July 2017 all members of the SAI must comply with the issued actuarial standards of practice – General Actuarial Practice ("**ASP-PA2**"). As a Fellow member of the Society of Actuaries in Ireland, I have observed this requirement in writing this report and in all work contributing to this report.

3 BACKGROUND

3.1 Overview

Phoenix is the current ultimate holding company of both SLAL and SL Intl having acquired these subsidiaries from Standard Life Aberdeen plc ("**Standard Life Aberdeen**") in 2018.

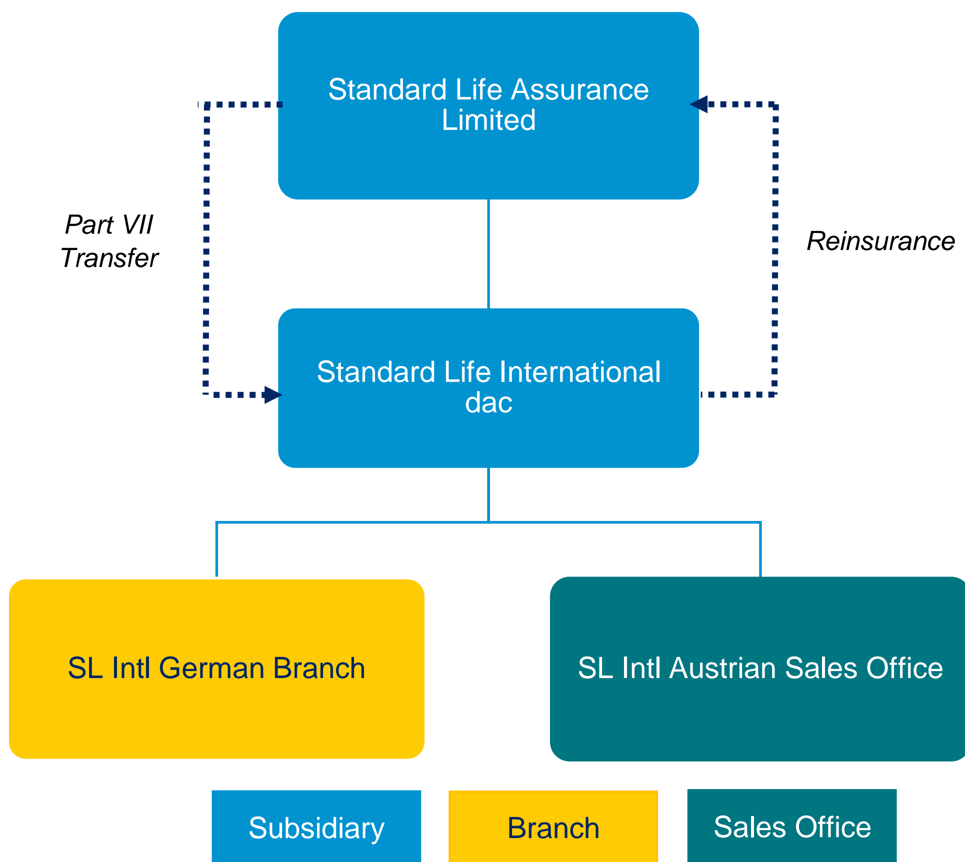


Note that not all subsidiaries of Phoenix or SLAL are shown above.

SLAL currently transacts long-term life insurance business in the UK as well as in Europe through passporting on a Freedom of Establishment ("**FOE**") and Freedom of Service ("**FOS**") basis. SLAL operates in **Ireland** (Dublin) and Germany (Frankfurt) on a FOE basis and through a sales office in Austria (Graz) on a FOS basis. Its wholly owned subsidiary, SL Intl, currently sells International bonds on a FOS basis into the UK from its head office located in Dublin, Ireland.

The Scheme proposes to transfer from SLAL into SL Intl all Euro-denominated business written in the branches of SLAL in Germany and Ireland and an Austrian sales office that is in-force at the Effective Date. After the transfer has been completed, SLAL will cease writing business in the **EU27** (i.e. the EU countries excluding the UK) from the Effective Date, with all new EU business being written by SL Intl. Bespoke reinsurance arrangements will also be put in place between SL Intl and SLAL, as part of the transfer of the business and the details of these arrangements may be found in section 6.3.

The diagram below shows the proposed organisational structure of SLAL and SL Intl following the Part VII transfer (with reinsurance):



To enable this transfer to be completed, SL Intl has applied to extend its existing licenses to include all classes of business currently operated by SLAL in Germany and in Ireland and to accept an external fund link retrocession arrangement under these classes. At the time of writing, SL Intl expects to receive this authorisation as part of its Change in Business Plan in December 2018.

The relevant classes are:

- Class I – Annuities and With Profits
- Class IV - Permanent Health Insurance (as a feature of some life policies)
- Class VII – Management of Group Pensions

The new organisational structure will replace the SLAL branches in Germany and Ireland and the sales office in Austria, with an expanded SL Intl operation in Ireland, a SL Intl branch in Germany and a sales office in Austria.

These changes are required so that new business can continue to be written within the EU, and existing Irish and German branch policyholders serviced, post the UK's withdrawal from the EU ("**Brexit**").

The Scheme proposes the Part VII transfer of all assets and liabilities associated with the Euro-denominated policies in-force on the Effective Date from SLAL to SL Intl. These assets and liabilities are defined within the Scheme.

These assets and liabilities will be transferred from their current fund into a similar fund within SL Intl; this will require the establishment of three With-Profits funds within SL Intl, and an additional (Euro-denominated) Proprietary Business Fund for those transferring policyholders. In order to maintain policyholder security and expectations for both transferring and non-transferring policyholders, a number of reinsurance arrangements are to be established (See section 6.3 for further details).

The Court will be invited to sanction the Scheme at a hearing expected to be in February 2019.

Subject to the consent of the Court, the Scheme will take effect on the Effective Date.

3.2 Rationale for the Scheme

On the 23 June 2016 the UK voted to leave the EU. The implications of this decision on SLAL, a company servicing policyholders in multiple EU countries, are unclear with the final outcome dependent on the result of the negotiations between the UK and the EU.

Under EU cross-border passporting laws, SLAL has written financial services business into Ireland and Germany using a branch structure and Austria using a services office. As the UK has now voted to leave the EU there is a risk that this branch structure will no longer be viable after Brexit.

Following the formal triggering of Article 50 of the Lisbon Treaty on 29 March 2017, the proposed timetable for the UK's withdrawal from the EU concluded that the process would be completed within a two year timeframe i.e. by 29 March 2019.

In the absence of a transitional period, this places a deadline on SLAL and the legality of the contracts it holds with its EU27 policyholders. On 19 March 2018, the UK and EU reached an agreement on the terms of a transitional period following Brexit. However as of 28 May 2018 this deal was yet to be ratified by either the UK or EU Parliament and so is not certain. It would therefore not be appropriate for SLAL to depend on the transitional period in its approach to Brexit at this stage.

SLAL considered an adverse Brexit Scenario based on the following characteristics:

- It is no longer possible to rely on the existing passporting regime to operate to or from EU Member States from April 2019.
- Loss of passporting is not mitigated by other arrangements allowing continued access to the EU Single Market.
- The UK Government is unwilling or unable to negotiate an implementation framework ('transitionals') to cover the period between the UK leaving the EU and negotiation/ratification of new trading arrangements with the remaining 27 Member States.

SLAL's approach to mitigate the impact of this on its EU27 policyholders requires a Part VII transfer of all Euro-denominated business to SLAL's Dublin based subsidiary SL Intl and the reinsurance of a portion of this business written or invested in With-Profits funds back to SLAL.

The Part VII transfer will result in all Euro-denominated business being issued by SL Intl, an EU firm. This mitigates the potential loss of passporting, as Ireland will remain within the EU post-Brexit. This enables Standard Life to continue to service these policyholders, independent of the outcome of the UK-EU negotiations.

As part of the Part VII transfer, it is intended that SLAL reinsures the Euro-denominated liabilities within the With-Profits funds.

The reinsurance of the With-Profits business back to SLAL maintains the protection of the UK With-Profits regime; there is no equivalent With-Profits regime in Ireland. The terms of reference for the WPA will be amended, such that there will be no difference in the treatment of the direct policyholders of SLAL and the reinsured policyholders of SL Intl within the relevant With-Profits funds.

The reinsurance of the With-Profits funds enables the fund to be managed on the same basis as it is currently managed – including allowing the continuance of the sharing of experience between UK, German and Irish policyholder groups in the Heritage With Profits Fund ("**HWPF**") as it avoids splitting the fund.

The reinsurance arrangements will be collateralised with a security structure designed to maintain consistency of UK and the Euro-denominated policyholders in the With-Profits funds after the Effective Date. In the absence of this structure, the level of security which the Euro-denominated policyholders have over their benefits would be negatively impacted by the transfer.

The details of the proposed Scheme are discussed in section 6.

4 OVERVIEW OF SL INTL

4.1 History of SL Intl

SL Intl was set up as a 100% directly owned and controlled subsidiary of SLAL in 2006 to sell its International Bond product into the UK, thereby offering an alternative proposition compared to onshore options. The business has been highly successful and is now one of the leading life insurance product providers in this segment.

SL Intl is authorised and regulated by the CBI and is subject to limited regulation in the UK by the FCA. There are no close links between existing group operations and SL Intl that prevent or inhibit the CBI from carrying out its supervisory functions.

SL Intl distributes the International Bond under EU cross-border passporting laws, on a FOS basis to policyholders in the UK. SL Intl is authorised to transact Class III and Class VI life assurance business on a FOS basis from Ireland into the UK and to other EEA countries (excluding Spain). It is registered in Ireland and subject to Irish law. It is also authorised to sell insurance contracts in the Isle of Man, Guernsey and Jersey.

Post-Brexit, in the context where passporting from the EU to the UK may cease to be an option, SL Intl is exploring ways to continue to service existing International Bond contracts, as well as sell new business.

SL Intl has taken external legal advice which has confirmed that SL Intl may utilise the Overseas Persons Exclusion ("**OPE**"), as set out in Article 72 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 ("**RAO**"), provided it conducts its business in line with the criteria set out in the RAO. The effect of the OPE provision is that a non-UK authorised insurer, like SL Intl, could sell offshore insurance products into the UK without triggering UK authorisation requirements.

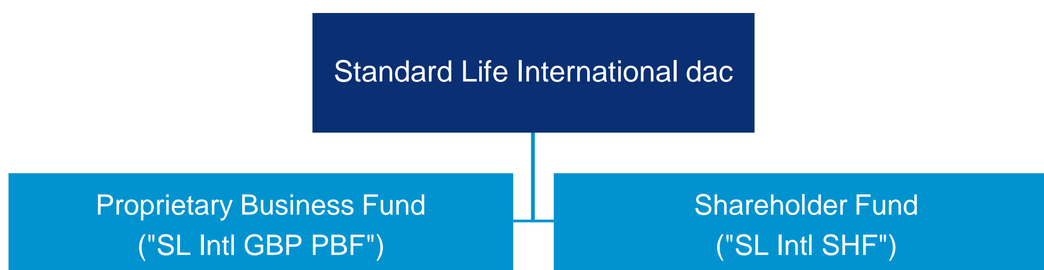
The OPE is not subject to any specific FCA approval or other prior notice, provided that SL Intl carries on its business in line with the criteria specified in the RAO and is available in respect to qualifying contracts of insurance. In relying on the OPE, SL Intl (which will not be maintaining a permanent place of business in the UK) will distribute the International Bond to UK policyholders, "with or through" an intermediary that is authorised to carry on regulated activities in the UK, thus satisfying the relevant RAO criteria. The actual regulated activities of the effecting and carrying out of the insurance activity underlying the International Bond will continue to take place in Ireland, as it does at present.

4.2 Legacy Schemes

There have been no schemes in the past which have impacted upon SL Intl.

4.3 Fund Structure

The existing fund structure of SL Intl is shown below:



There are two funds, the Proprietary Business Fund ("**SL Intl GBP PBF**") and the Shareholder Fund ("**SL Intl SHF**"). The SL Intl GBP PBF writes unit linked business (the International Bond) and is currently open to new business. It contains the assets underlying the policyholder liabilities. The SL Intl SHF contains the assets and non-policyholder liabilities of the shareholder of SL Intl.

The following table shows the Best Estimate Liability ("**BEL**"), Unit liability (i.e. "**Technical Provisions as a whole**"), Risk Margin and the **Technical Provisions** for the policyholder fund (in £m) at year-end 2017

Fund	BEL	Unit liability	Risk Margin	Technical Provisions
SL Intl GBP PBF	(129)	6,207	41	6,119
SL Intl SHF	0	0	0	0
Total	**(129)**	**6,207**	**41**	**6,119**

After completion of the Part VII transfer, it is planned that SL Intl will have a number of new funds in addition to the two stated above, mostly notably, it will need to establish the following funds:

- Heritage With Profits Fund ("**SL Intl HWPF**"): Euro-denominated policies which are currently invested in the SLAL HWPF will be transferred into a new With-Profits fund in SL Intl, and then reinsured from this new With-Profits fund back into the SLAL HWPF. Where SLAL HWPF policies can invest in unit linked funds held in SLAL's Proprietary Business Fund ("**SLAL PBF**"), these will be accessed via an External Fund Link ("**EFL**") retrocession arrangement from SLAL HWPF and into SL Intl. The relevant SLAL PBF unit linked funds will be transferred to SL Intl as part of the proposed Scheme (see below).
- German With Profits Fund ("**SL Intl GWPF**"): The policies that invest in this fund will be transferred to SL Intl with the entire liability fully reinsured back to SLAL.
- German Smoothed With Profits Fund ("**SL Intl GSMWPF**"): Similar to the SL Intl GWPF, the policies that invest in this fund will also be transferred to SL Intl with the entire liability fully reinsured back to SLAL.
- A Euro-denominated Proprietary Business Fund ("**SL Intl EUR PBF**"): All Euro-denominated annuities within the SLAL PBF, and all Euro-denominated unit linked policies within the SLAL PBF, will be transferred into a new Euro-denominated proprietary business fund within SL Intl. This includes a small number of Irish policyholders who have investment content in the SLAL HWPF.

Further details on the With-Profits funds, into which SL Intl's With-Profits liabilities will be reinsured, can be found below in section 5.3 in the SLAL overview. Further details on the post-transfer funds structure of SL Intl can be found in section 6.2.

4.4 Solvency Position

The security of a policyholder's investment is dependent on the solvency of SL Intl. The Solvency II regime provides a mechanism to value the liability of SL Intl under different conditions to ensure that it holds sufficient assets.

The Solvency Capital Requirement ("**SCR**") is set at a level to ensure that SL Intl can meet its obligations to policyholders and beneficiaries over the following year with a 99.5% probability (i.e. it can meet these obligations even if a 1-in-200 year event occurs over the next 12 months). For SL Intl, the SCR is calculated using the Solvency II Standard Formula.

The solvency position of SL Intl (on a Solvency II Standard Formula basis) is shown below for both 31 December 2016 and 31 December 2017:

(£m)	31 December 2016	31 December 2017
Own Funds (A)	112	137
Solvency Capital Requirement (B)	94	102
Excess Own Funds (C= A – B)	18	35
Solvency Coverage Ratio (D = A/B)	**119%**	**134%**

SL Intl plans to implement an enhanced capital management framework following the proposed transfer.

4.5 Capital Policy

SL Intl is subject to regulatory oversight by the CBI and complies with the Solvency II rules as set out in the Solvency II Directive and supporting documentation. These regulations set out the minimum amount of capital that SL Intl is required to hold to cover the risks associated with its liabilities. This minimum amount of capital is represented by a solvency coverage ratio of 100%.

SL Intl also seeks to maintain a capital position in line with the target range outlined in its risk appetite framework, which results in a target solvency coverage ratio which is in excess of the regulatory required ratio of 100%.

4.6 Risk Management

SL Intl operates a "three lines of defence" model of risk management, with clearly defined roles and responsibilities for individuals and committees:

- First line: Day-to-day risk management is delegated from the Board to the Chief Executive Officer and, through a system of delegated authorities and limits, to business managers.
- Second line: Risk oversight is provided by the SL Intl Chief Risk Officer and supported by specialist Risk Management and Compliance functions as well as through established risk committees such as the Standard Life Enterprise Risk Management Committee ("**ERMC**"). The ERMC is a First Line Committee. The majority of members of the ERMC are senior First Line representatives.
- Third line: Independent verification of the adequacy and effectiveness of the internal risk and control management systems is provided by our internal audit function. This is independent from all other operational functions. It operates subject to supervision and challenge by the Audit Committee.

Standard Life's Enterprise Risk Management framework enables a risk based approach to managing the business. It integrates concepts of strategic planning, operational management and internal control. The framework has been embedded in the business over a number of years.

4.7 Risk profile of SL Intl business

SL Intl is exposed to a variety of risks, the most material of which are as follows:

- **Persistency Risk** - Lapse is the key underwriting risk exposure of SL Intl. An increase in lapse rates, or a mass lapse event, will reduce the amount of assets under management, thereby reducing the present value of annual management charges the Company expects to earn over the future.
- **Equity Risk** – SL Intl has significant exposure to Equity Risk. Although SL Intl does not seek direct equity exposure by investing shareholder assets in equities; it has a second order exposure to equity risk through the investment of the unit linked funds in equities. A fall in equity markets will result in a fall in the value of assets under management, thereby reducing the present value of annual management charges the company expects to earn in the future. This gives rise to the equity risk on SL Intl's Solvency II balance sheet.
- **Currency Risk** – SL Intl does not have material direct exposure to currency risk as most shareholder fund assets are invested in GBP (SL Intl's current reporting currency). Only a small amount of operating cash is held in Euro. However, SL Intl is exposed to material currency risk because the unit linked funds invest in assets denominated in different currencies. For example, a fall in the value of non-GBP currencies relative to the GBP will result in a reduction in the GBP-denominated value of assets under management. Therefore, the present value of future annual management charges (in GBP) will reduce leading to an adverse impact on the Solvency II balance sheet.
- **Expense Risk** – An increase in the future maintenance expenses will reduce the present value of future profits.

SL Intl is also exposed to a number of qualitative risks. A qualitative assessment has been performed to classify these risks into high, medium and low risk categories. The following risks are categorised as high risk:

- **Liquidity Risk** – There are two sources of liquidity risk on SL Intl's regulatory balance sheet:
  - Liquidity risk associated with insufficient cash, or cash type instruments

- Liquidity risk associated with illiquid capital

- **Strategic Risk** – Strategic risks are those risks which threaten the achievement of the strategy through poor strategic decision-making, implementation or response to changing circumstances. SL Intl is prepared to take this risk as it arises as a result of the company's core strategic activities.

SL Intl primarily manages its capital position by reference to its Risk Appetite Framework. A key component of the framework is the intention to maintain a minimum capital coverage under the most onerous of a range of plausible stress scenarios which are reviewed at least tri-annually. The framework is used to inform all key Board decisions with capital implications, in particular dividend proposals, investment strategy, capital planning and other management actions.

5 OVERVIEW OF SLAL

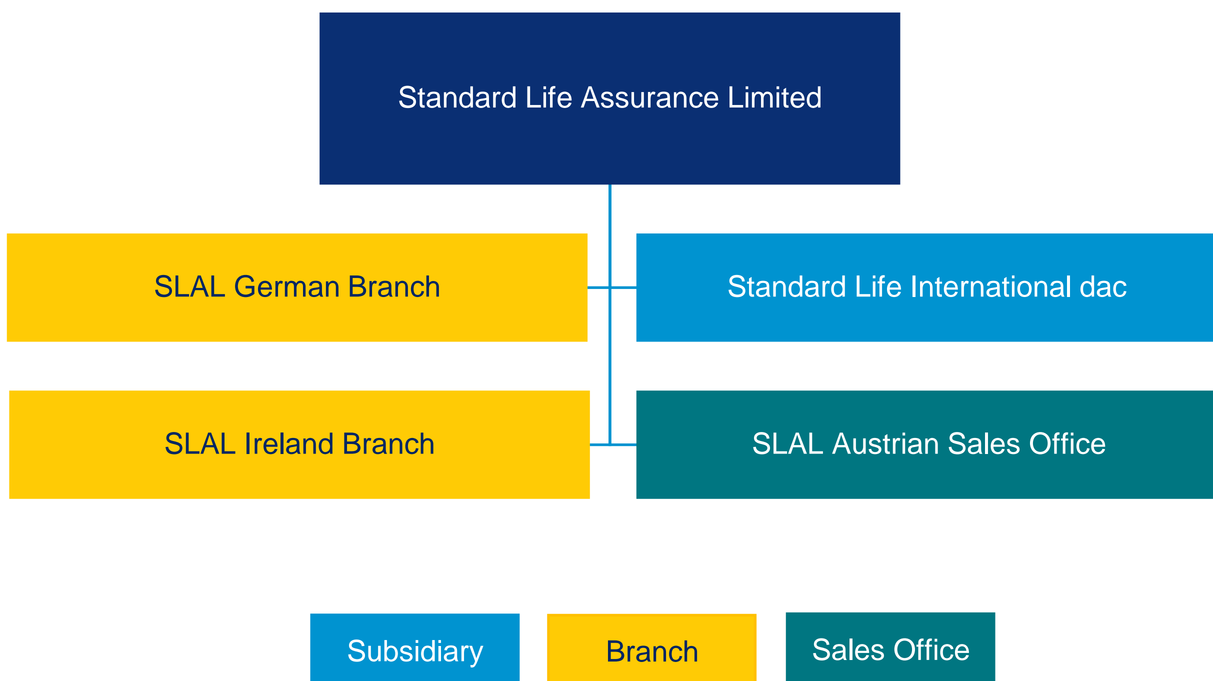
5.1 History of SLAL

The Life Insurance Company of Scotland was established in 1825, changing its name to The Standard Life Assurance Company ("**SLAC**") in 1832. It began as a partnership and was converted to a limited company in 1910. In 1925, after a century of expansion, both in the UK and overseas, SLAC was converted to a mutual.

On 10 July 2006, SLAC demutualised and, substantially, all of the long-term business of SLAC was transferred to its new parent life insurance company, SLAL.

Since this date SLAL has continued to grow and has a number of wholly owned subsidiaries (including SL Intl). It continues to operate in the EU through its branches in Germany and Ireland (as well as its sales office in Austria).

The current structure of the SLAL subgroup is provided below:



5.2 Legacy Schemes

The demutualisation of SLAC and the establishment of SLAL was governed by the 2006 Scheme of Demutualisation (the "**2006 Scheme**") pursuant to a Part VII scheme. This scheme provides a framework in which SLAL operates its business.

The Scheme of Demutualisation contains the core principles for the operation of the With-Profits Fund (now known as the SLAL HWPF). It also defines the payments between this fund and the remainder of SLAL. This Scheme has been varied three times since 2006.

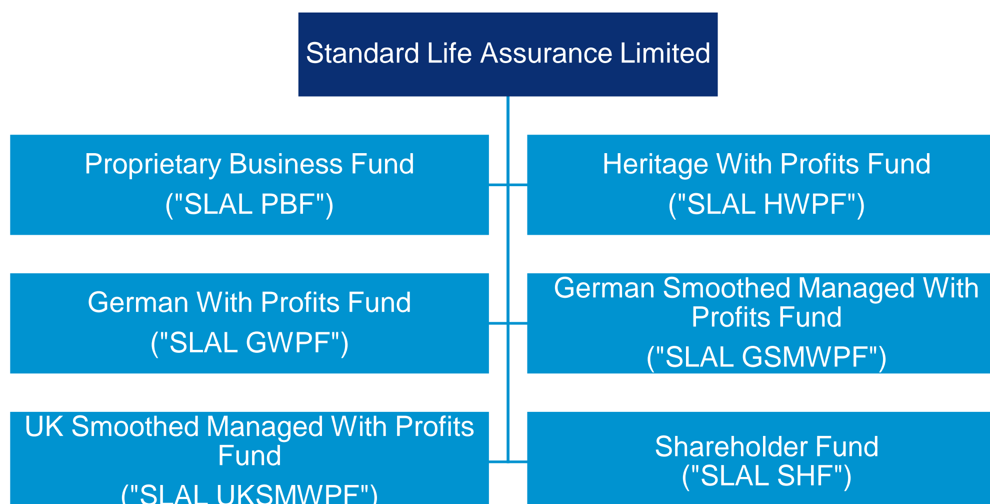
It was varied under paragraph 70.2(D) in connection with the transfer of insurance business from Standard Life Investment Funds Limited ("**SLIF**") to SLAL on 31 December 2011 (the "**2011 Scheme**"). The 2011 Scheme transferred the substantial majority of the assets and liabilities of SLIF to SLAL. This will be varied as a result of the Scheme.

It was varied under paragraph 70.2(C) from 1 January 2016 and under paragraph 70.2(D) from 27 April 2016 to reflect changes needed to continue to operate the Scheme following the replacement of the previous insurance regulatory regime (known as Solvency I) with a new regime from 1 January 2016 (Solvency II).

The 2006 Scheme of Demutualisation will be varied under paragraph 70.2(D) as a result of the Scheme.

5.3 Fund Structure

SLAL is composed of a number of sub-funds, with the current fund structure of SLAL is shown below:



The substantial majority of SLAL's business is held within either the SLAL PBF or the SLAL HWPF. The business proposed to be transferred from SLAL to SL Intl is currently written in these funds and includes investment in the SLAL GWPF and the SLAL GSMWPF.

The below is a summary of the types of business written by each fund:

Fund	Conventional With-Profits	Unitised With-Profits	Unit linked	Annuities	Open to New Business
SLAL PBF			✓	✓	Yes
SLAL HWPF	✓	✓	✓	✓	Yes***
SLAL GWPF		✓*			**
SLAL GSMWPF		✓*			**
SLAL UKSMWPF		✓*			Yes
SLAL SHF					N/A

** No policies are directly written into these funds. Instead, policies are written into the* SLAL *PBF with their investment content being in the SLAL GWPF, SLAL GSMWPF or SLAL UKSMWPF.*

*** These funds are closed to new business other than increments.*

**** The SLAL HWPF can write small volumes of new business as set out in the 2006 Scheme.*

The following table shows the Best Estimate Liability, Unit liability, Risk Margin, Transitional Measure on Technical Provisions ("**TMTP**") and the Technical Provision in each fund at year-end 2017:

Fund	Country	Number of transferring Policies (thousands)	BEL (£m)	Unit liability (£m)	Risk Margin (£m)	TMTP (£m)	Technical Provision (£m)
SLAL PBF	A	8	-2	79	-	-	76
	E	49	-90	6,076	52	-51	5,987
	G	38	57	496	111	-103	561
	U	-	4,091	99,271	1,242	-1,178	103,426
SLAL HWPF	A	28	874	-	-	2	876
	E	38	1,231	-	1	16	1,247
	G	271	7,314	-	16	6	7,336
	U	-	24,358	-	12	28	24,398
SLAL GSMWPF	A	0	9	-	-	-	9
	G	7	114	-	-	-	114
SLAL GWPF	A	19	211	-	-	-	211
	G	124	1,768	-	-	-	1,768
SLAL UKSMWPF	U	-	60	-	-	-	60
SLAL SHF	U	-	26	-	-	-12	14
Total		582	40,021	105,921	1,433	-1,292	146,083

** A – Austria, E – Ireland, G – Germany and U – United Kingdom*

The Technical Provision is the sum of the BEL, Unit Liability and Risk Margin less the TMTP adjustment. These figures were provided by SLAL for this report, thus I have not carried out a detailed review of these results.

PROPRIETARY BUSINESS FUND (“SLAL PBF”)

Within the 2006 Scheme the SLAL PBF is referred to as the Non Profit Fund.

This fund contains:

- Certain non-profit classes of business written by SLAC prior to demutualisation that were not allocated to the SLAL HWPF at demutualisation; and
- All business written by SLAL post demutualisation other than business (or elements of business) allocated to SLAL HWPF, SLAL UKSMWPF, SLAL GWPF, or SLAL GSMWPF as described below.

All profits and losses arising in the SLAL PBF are allocated to the shareholders.

The majority of the business within this fund arises from UK unit linked policies, however at year-end 2017, the SLAL PBF held Technical Provisions of £6,625m associated with Euro-denominated business.

HERITAGE WITH PROFITS FUND ("SLAL HWPF")

The SLAL HWPF is the With-Profits Fund as defined in the 2006 Scheme. Its governance involves both a WPA and a With-Profits Committee ("**WPC**"). The WPC act in an advisory capacity to inform the exercise of discretion of the SLAL Board.

This fund contains all the UK, Irish and German business, including that originating in Austria, (both With-Profits and non With-Profits) written by SLAC prior to demutualisation, with the exception of a small number of policies. It contains policy increments that are written after demutualisation and allocated to the SLAL HWPF. Other new business may be allocated to the SLAL HWPF subject to limitations set out in the Scheme of Demutualisation.

Both Conventional and Unitised With-Profits policies have been written within the SLAL HWPF. Where policies can invest in both With-Profits and unit linked funds, the unit linked elements of the unitised policies are invested in the SLAL PBF.

All UK With-Profits providers are required by the FCA to document and make available the Principles and Practices of Financial Management ("**PPFM**"). This requirement is also included within the 2006 Scheme. The PPFM not only provides policyholders with an explanation of how With-Profits business is operated, but also forms an important part of the governance arrangements of the SLAL HWPF business. In line with regulatory requirements, SLAL reports each year to its UK With-Profits policyholders on compliance with this PPFM.

The SLAL HWPF also contains With-Profits business originating from three countries other than the UK (i.e. Ireland, Germany and Austria). The published PPFM applies only to With-Profits policies effected and carried out from an establishment in the UK. However, the principles applicable to the UK business also apply to With-Profits business issued by branches in Ireland and Germany (including that originating in Austria).

The SLAL HWPF is open to new business with the amount it can write each year restricted by the 2006 Scheme. At year-end 2017 it held Technical Provisions of £9,459m associated with Euro-denominated business.

There is one capital support arrangement between the SLAL HWPF and the SLAL Shareholder: a restriction on the Recourse Cash Flow ("**RCF**"). This capital support is not currently being called upon. The RCF is a payment made from the SLAL HWPF to the shareholder based on defined UK and Irish blocks of business. This provides the shareholder with a share in the profits of the SLAL HWPF. This payment is contingent on the financial position of the SLAL HWPF. Capital support occurs where the proposed transfer amount is negative; in this instance the SLAL Board must provide a contingent loan, or otherwise make assets available, to the SLAL HWPF to a sum equal to or greater than the absolute value of the proposed transfer amount. The RCF can only be paid if:

(i) The SLAL HWPF has a surplus;

(ii) SLAL can demonstrate that it is reasonable to expect continued compliance with the requirements in Conduct of Business Rules ("**COBS**") 20.1A.5R in respect of the SLAL HWPF; and

(iii) (Unless there is a current Capital Event) the Notional Company has sufficient assets to cover its technical provisions.

Additional Expenses are defined for German business. This debits the SLAL HWPF and provides a transfer to the SLAL SHF. The additional expenses and RCF are described in greater detail in Schedule 2 and 3 respectively of the 2006 Scheme of Demutualisation.

GERMAN WITH PROFITS FUND ("SLAL GWPF")

After demutualisation, SLAL continued to sell significant volumes of With-Profits policies within both Germany and Austria. In order to do this, whilst maintaining its operation of SLAL HWPF as outlined in the Scheme of Demutualisation, two new German With-Profit Funds were established (the SLAL GWPF and SLAL GSMWPF).

The SLAL GWPF is allocated the With-Profits investment element (and corresponding guarantees), of all the new With-Profits business, other than smoothed managed With-Profits business, written by SLAL in Germany (including plans originating in Austria) in its SLAL PBF after demutualisation. That is, policies are written in the SLAL PBF, however, their investment content is allocated to the SLAL GWPF.

As the SLAL GWPF contains no UK With-Profits policyholders, it is not required by regulation to have a PPFM. SLAL operates the GWPF in a manner which is to be documented prior to the proposed transfer within an Internal Principles and

Practices of Financial Management ("**IPPFM**"). This will set out how the GWPF business is operated and will form an important part of the governance of the fund.

The SLAL GWPF, like the SLAL HWPF, offers a variety of guarantees on the investment content within the fund. In order to meet these guarantees, a charge is made to meet their assessed cost. Any costs that cannot be met by the fund are met by the shareholder.

The SLAL Board can waive their right to future charges from the fund in advance of injecting physical assets into the fund. The SLAL GWPF can therefore be supported in the event of it holding insufficient assets to meet any guarantees.

In 2015, the decision was made to stop selling With-Profits business in Europe. It is closed to new business other than increments. At year-end 2017 the SLAL GWPF held Technical Provisions of £1,979m.

GERMAN SMOOTHED MANAGED WITH PROFITS FUND ("SLAL GSMWPF")

The SLAL GSMWPF was established following the 2006 demutualisation to allow SLAL to continue to write smoothed managed With-Profits business in the German and Austrian markets. The GSMWPF is allocated the With-Profits investment element of all the new smoothed managed With-Profits business written by SLAL in Germany (including plans originating in Austria) in its SLAL PBF after demutualisation. That is, policies are written into the SLAL PBF with their investment content invested in the SLAL GSMWPF.

As with the SLAL GWPF, SLAL is putting in place an IPPFM for the SLAL GSMWPF.

The SLAL GSMWPF is closed to new business other than increments, and at year-end 2017 held Technical Provisions of £123m.

UK SMOOTHED MANAGED WITH PROFITS FUND ("SLAL UKSMWPF")

At demutualisation, Stakeholder pensions were expected to generate significant new With-Profits business and so the SLAL UKSMWPF was established. The SLAL UKSMWPF is allocated the With-Profits investment element of all the new Stakeholder pension plans written by SLAL in the UK in its SLAL PBF after demutualisation.

This fund operates in a similar manner to the SLAL GSMWPF and the SLAL GWPF, with policies written in the SLAL PBF and their With-Profits investment content in the SLAL UKSMWPF.

Similarly to the HWPF, the UKSMWPF has a PPFM that provides policyholders with an explanation of how With-Profits business is operated and forms an important part of the governance arrangements of the UKSMWPF business.

The SLAL UKSMWPF only contains the With-Profits element of UK Stakeholder pension plans written after 09 July 2006. These contain no guarantees, but any policy investment returns are smoothed and any smoothing profits or losses are shared among all policies in the fund.

The SLAL UKSMWPF is open to new business.

SHAREHOLDER FUND ("SLAL SHF")

The SLAL SHF is defined in the 2006 Scheme of Demutualisation as the property and liabilities of SLAL, excluding those allocated or attributable to, or represented by, a long term fund.

No policies are written in this fund however it does receive regular cash flows on defined blocks of business. This reflects the profits and losses that are attributable to the shareholder on business written in the long term business funds. The RCF and additional expenses charges outlined above are two such examples.

At year end 2017 the SLAL SHF held Technical Provisions of £14m. This predominately arose in respect of Group Corporate Centre costs and ex-gratia payments to policyholders.

5.4 Solvency Position

The security of a SLAL policyholders' investment is dependent on the solvency of SLAL. The Solvency II regime provides a mechanism to value the liabilities of SLAL under different conditions to ensure that it holds sufficient assets.

In addition to holding Technical Provisions to cover the policyholder liabilities, SLAL holds an additional amount, the Solvency Capital Requirement, which is set at a level to ensure that SLAL can meet its obligations to policyholders and beneficiaries over the following year with a 99.5% probability (commonly referred to as a 1-in-200 year event).

The solvency position of SLAL (on a Solvency II basis), assuming it were a subsidiary of Phoenix, is shown below for the 31 December 2017. This assumes that a number of actions have been taken as outlined to the PRA in the UK:

(£m)	SLAL HWPF	Rest of Company	Total
Own Funds (A)	420	3,360	3,780
Solvency Capital Requirement (B)	420	2,060	2,480
Excess Own Funds (C= A – B)	-	1,300	1,300
Solvency Coverage Ratio (D = A/B)	**100%**	**163%**	**152%**

The SCR is calculated using SLAL's PRA approved Internal Model. As a subsidiary of SLAL, SL Intl's capital requirement, calculated using a Standard Formula, is currently incorporated within this using Method 2 ("Deduction and Aggregation"). In accordance with SLAL methodology, the GWPF currently has no SCR whilst the HWPF has a notional SCR of circa £420m. Due to Solvency II regulations, SLAL can only recognise Own Funds up to the value of the HWPF SCR for reporting purposes however the HWPF has Own Funds equal to circa £1,320m as at year-end 2017.

5.5 Capital Policy

SLAL is subject to regulatory oversight by the PRA and complies with the Solvency II rules as set out in the Solvency II Directive and supporting documentation. These regulations set out the minimum amount of capital that SLAL is required to hold to cover the risks associated to its liabilities. This minimum amount of capital is reflected by a solvency coverage ratio of 100%. Both SLAL and SL Intl are currently subject to these same regulations (with the SL Intl being subject to regulatory oversight by the CBI).

SLAL seeks to maintain a capital position in line with its Board approved capital target framework. This assesses the capital that SLAL aims to hold, taking into consideration SL Intl, and results in a target solvency coverage ratio which is in excess of the regulatory required 100%.

Under SLAL's capital targets framework, SLAL's capital coverage is assessed under three absolute stress scenarios. These scenarios are reviewed regularly with the capital position monitored continuously.

These scenarios are designed to reflect the most severe scenarios of recent periods and therefore reflect severely adverse but foreseeable scenario.

SLAL's capital coverage is given a rating based on both its current capital coverage and its coverage in the adverse scenarios. This rating can be broadly considered to be:

- Green – Capital coverage is appropriate under both base and stress scenarios
- Amber – that pre-emptive restorative actions may be required in order to support the longer term capital position, and hence dividend payments into the future
- Red – Urgent action necessary. Immediate action plan necessary to rectify situation. There is the expectation that no dividend will be paid if SLAL is in the Red zone, unless there was a plan to restore coverage within a clearly defined timescale.

5.6 Risk Management

SLAL operates the same 'three lines of defence' model as SL Intl (discussed in section 4.6). SLAL's Enterprise Risk Management framework enables a risk based approach to managing the business. It integrates concepts of strategic planning, operational management and internal control. The framework has been embedded in the business over a

number of years. In addition to this, SLAL has an established risk control process which includes policies for each of the key risks that threaten the achievement of the business strategy and objectives.

Risk and control assessments are performed and evidenced with quantitative risk metrics providing benchmarks against which risk exposures can be monitored and managed.

This risk control process is subject to a comprehensive risk management oversight structure which includes:

- The SLAL Board
- The SLAL RCC
- The SLAL ERMC

5.7 Risk profile of SLAL business

As SLAL services a variety of products to policyholders in several countries, it is exposed to a range of risks. These risks are identified, assessed, monitored, managed and, where possible, mitigated as part of the aforementioned risk management process. This mitigation includes holding capital against the risks to which SLAL is exposed.

The dominant post-diversification risks faced by SLAL are driven by the business in which it writes. These risks are:

- **Credit risk** – the key material credit risk to which SLAL is exposed is in respect of corporate bond holdings, being the risk that the issuers of those bonds fail to meet their contractual payments.
- **Longevity Risk** - the risk that policyholders, or members of the defined benefit pension scheme, live longer than expected (based on best estimate assumptions), and therefore give rise to a loss to SLAL. This risk is relevant for policies where payments are made until the death of the policyholder, for example annuities, deferred annuities and guaranteed annuity options.
- **Persistency Risk** - the risk arises as a result that policyholders voluntarily discontinue their policies ('lapse') at a different rate than assumed or there is a mass lapse event. This reduces the Assets Under Management ("**AUM**") reducing the expected annual management charge that SLAL earns in the future.
- **Fixed Interest risk** - In respect to its annuity business, SLAL is exposed to fixed interest risk if there is a mismatch between future expected payments to policyholders and the cash flows on the fixed interest assets backing those liabilities.

Persistency risk is the most material and continues to grow as SLAL continues to grow its investment linked pensions and savings business.

Longevity risk will reduce over time due to the natural run-off of the annuity business, with very little new business being written. Increases in interest rates from their current low levels will amplify the rate of run-off. Similarly, SLAL expects the credit risk exposure to fall over time as the assets backing annuity liabilities reduce as the business naturally runs off.

6 THE PROPOSED PART VII TRANSFER

6.1 Proposed organisational structure of the Part VII transfer

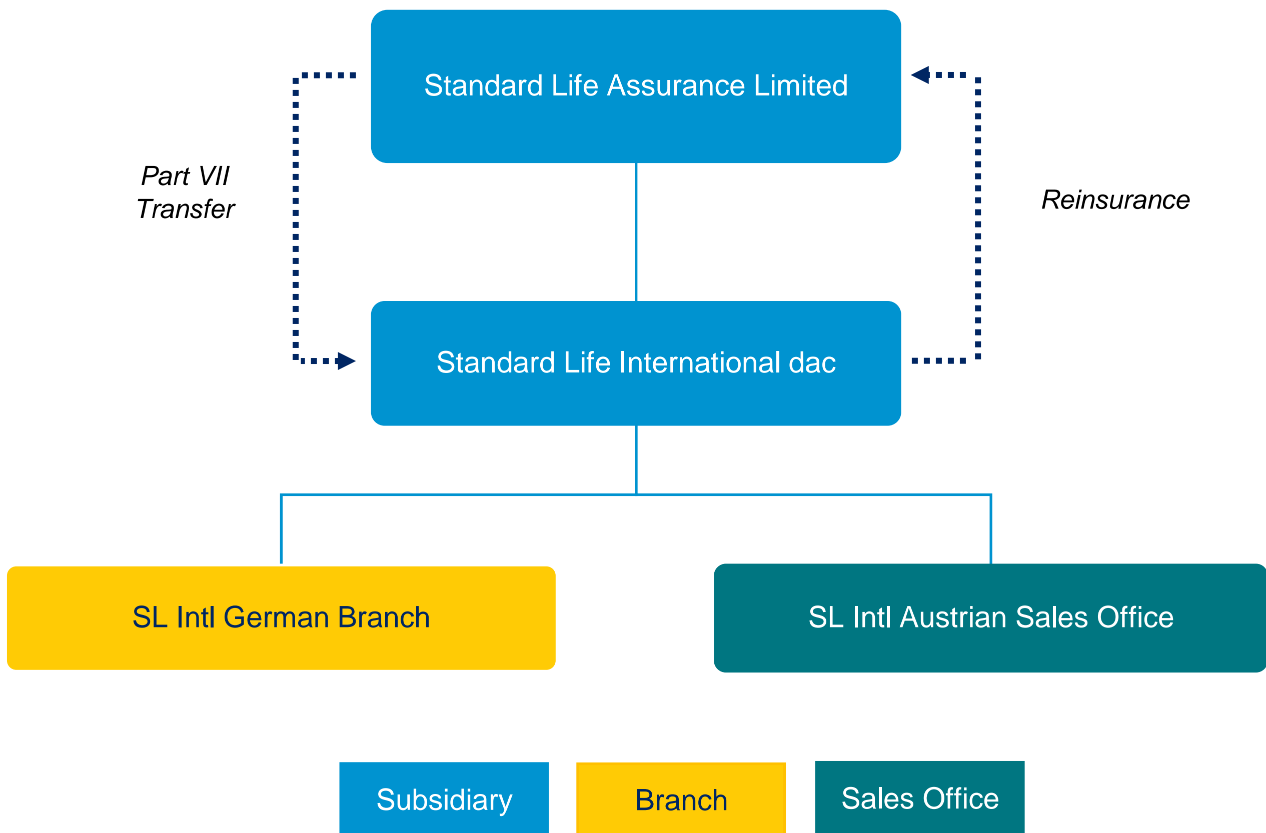
Following the implementation of the Scheme, SLAL will no longer sell policies into the EU27 from the Effective Date with all new European business being written by SL Intl. To enable this to occur, and SL Intl to continue to service the existing German, Austrian and Irish policyholders, a change in the company structure is required.

Following the proposed transfer, Standard Life will continue to be able to service the circa 600,000 existing policyholders in Germany, Austria & Ireland via SL Intl and write new business in these markets, by way of varying and extending its existing regulatory permissions.

The use of reinsurance alongside the Part VII transfer will support the achievement of maintaining policyholder security (notwithstanding the unavoidable loss of the Financial Services Compensation Scheme protection) and expectations for both transferring and non-transferring policyholders in SLAL.

The SLAL German and Irish Branches will be closed with a new SL Intl German branch established. This will be operated by the same staff as at present.

The diagram below shows the organisational structure of SLAL and SL Intl following the proposed transfer:



The Scheme transfers all of the assets and liabilities associated with the Euro-denominated policies in-force on the Effective Date from SLAL to SL Intl. These assets and liabilities are defined within the Scheme.

These assets and liabilities will be transferred from their current fund into a similar fund within SL Intl; this will require the establishment of three With-Profits funds within SL Intl and a new Euro-denominated PBF for those transferring policyholders.

The Euro-denominated business proposed to be transferred can be grouped into the following four blocks:

- HWPF – all Euro-denominated policies within the SLAL HWPF.
- Post Demutualisation German With-Profits Business – all policies with their investment content in the SLAL GWPF and SLAL GSMWPF.
- PBF Annuities – all Euro-denominated annuities within the SLAL PBF.
- PBF Unit Linked – all Euro-denominated unit linked policies within the SLAL PBF. This includes a small number of Irish policyholders who have investment content in the SLAL HWPF

In order to maintain policyholder security and expectations for both transferring and non-transferring policyholders, a number of reinsurance arrangements are to be established (See section 6.3 for further details).

The reinsurance of the With-Profits business back to SLAL seeks to maintain the protection of the UK With-Profits regime. There is no equivalent With-Profits regime in Ireland. It also enables the fund to be managed on the same basis as it is currently managed – including allowing the continuance of the sharing of experience between UK, German and Irish policyholder groups – as it avoids splitting the fund.

The EFL retrocession allows the transferring Irish policyholders in the SLAL HWPF to maintain their current unit linked investment options. This is as a result of enabling them to continue to invest in the same funds following the proposed transfer.

The With-Profits reinsurance arrangements are to be collateralised.

The proposed collateralisation structure is designed to maintain consistency of UK, Euro-denominated policyholders post the proposed transfer. In the absence of this collateral, the level of security which German, Austrian and Irish policyholders have over their benefits would be negatively impacted by the proposed Part VII transfer (with reinsurance). More details on the proposed collateral arrangements may be found in section 6.4.

The direct costs of the proposed transfer will be allocated between SLAL's shareholders and the SLAL HWPF. This is to be done adhering to the same principles as other costs arising in SLAL affecting the HWPF and in accordance with the 2006 Scheme. This approach has been agreed with the WPA.

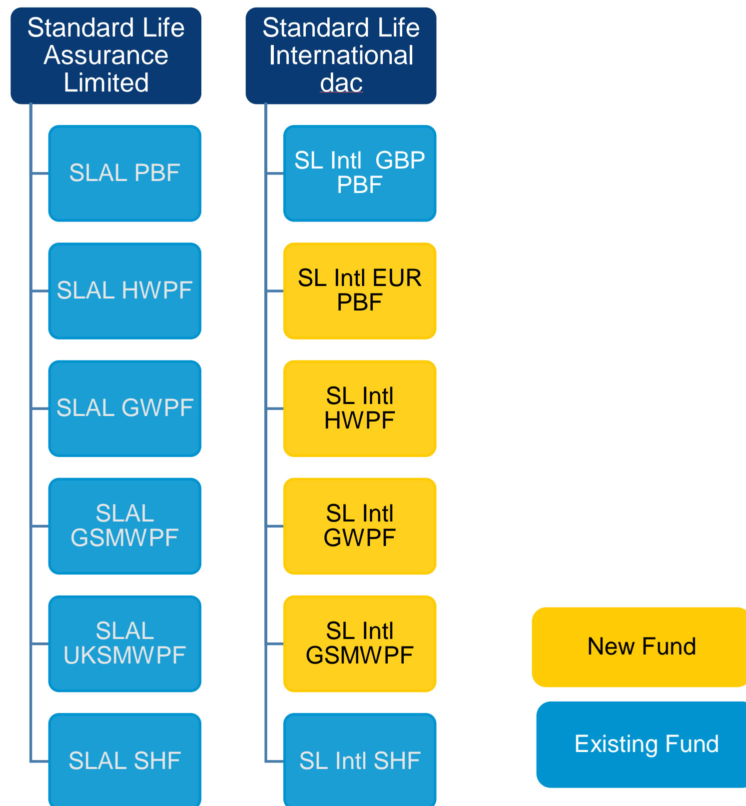
SLAL will incur an expense equal to the reinsurance commissions which it pays to SL Intl. This reinsurance commission will be comprised of an 'actual costs' component and a 'profit margin' component.

The 'actual cost' component in respect of the HWPF reinsurance is charged to the SLAL HWPF fund, even if, as expected, the costs incurred by SL Intl are different from those which are currently incurred by SLAL. This is because the Scheme is unavoidable in order to allow the Standard Life sub-group to continue to service its Euro-denominated policies. Therefore, the actual costs incurred by SL Intl, even if these are higher than current costs, are unavoidable and it is in line with the 2006 Scheme to pass them to the HWPF. The 'profit margin' component is not charged to the SLAL HWPF fund and will be borne by the SLAL shareholder.

For the GWPF and GSMWPF reinsurance arrangements, both the 'actual costs' component and 'profit margin' component will be borne by the SLAL shareholder as the shareholder bears all costs of operating these funds.

6.2 Proposed SLAL and SL Intl fund structure post transfer

The fund structure of SLAL and SL Intl following the proposed transfer is as follows:



The SL Intl EUR PBF, SL Intl HWPF, SL Intl GWPF and SL Intl GSMWPF will be new funds established as part of transfer. Within the proposed new fund structure, each fund will have a well-defined and clear purpose and the overall structure should support the International Bond being managed as a discrete operation.

6.3 New Reinsurance Arrangements

As part of the proposed Part VII transfer, new reinsurance arrangements will be established between SLAL and SL Intl, in order to facilitate the effective management of this business following the transfer into SL Intl. The overarching purpose of these reinsurance arrangements is to minimise any impact of the transfer on all SLAL and SL Intl policyholders. A secondary aim is to ensure capital efficiency.

In particular, it would avoid the need to split the SLAL HWPF, which would incur significant time, effort and expense. Splitting the funds would also reduce the ability to pool risks and rewards between policyholders.

These will be approved by the SLAL and SL Intl Boards with the arrangement established following the principles of a commercial transaction between two willing and knowledgeable parties.

SL Intl will retain the risks associated with a proportion of the Euro-denominated business as the reinsurance arrangements do not cover all the transferred business.

The business to be transferred can be split into four groups, as follows:

1. Business in the HWPF ;
2. Business that invests in the GWPF or the GSMWPF;
3. Annuity business written in Germany (including the business sold via the sales office in Austria) and Ireland; and
4. Unit linked business written in Germany and Ireland.

There will be reinsurance back to SLAL in respect of the With-Profits contracts (groups 1 and 2).

BUSINESS IN THE HERITAGE WITH-PROFITS FUND

(i) Treatment of SLAL HWPF business

The SLAL HWPF contains UK, Irish, German and Austrian policies and is managed as one unit, pooling risks and rewards through the With-Profits framework. The reinsurance arrangements allow the SLAL HWPF to continue to be managed as one, thus allowing policyholders invested in this fund to continue to benefit from the sharing of experience as has been the case in the past.

The vast majority of the non UK policies in the SLAL HWPF are With-Profits contracts. However, a small number of annuities, as well as contracts held by Irish policyholders, who have the option to invest in unit linked funds, are also included.

A further characteristic of this business is that the longevity risk on pre demutualisation annuities for both Ireland and the UK (which were written in the SLAL HWPF) is currently transferred from the SLAL HWPF to SLAL PBF using a longevity risk transfer agreement. This arrangement will remain in place post-transfer.

(ii) Level and type of reinsurance

The policies proposed to be transferred from the SLAL HWPF to the SL Intl HWPF will be reinsured back to the SLAL HWPF, in order to allow the fund to continue to be managed as a single fund. The reinsurance of the policies back to SLAL will have automatic ceding, on a natural expiry basis.

This means that the SLAL HWPF will continue to be liable to meet the claims and benefits of the transferring Euro-denominated policyholders. Without the reinsurance arrangement the HWPF would need to be split between SLAL and SL Intl. This would be a complex and time consuming task which would entail a significant amount of subjective judgement. It would be very challenging to achieve within the timescales required (without any policyholders being materially adversely affected).

The Euro-denominated unit linked funds which are available to the small number of unit linked contracts which were written in the SLAL HWPF are currently SLAL funds. Following the transfer, these funds will become SL Intl funds and so the HWPF unit linked contracts will access these via EFL retrocession back to SL Intl.

The reinsurance in respect of the unit linked investments will be EFL retrocession, with automatic ceding, on a natural expiry basis, and will be denominated in Euro. The reinsurance maintains the benefits and expectations of both the transferring and non-transferring policyholders within the HWPF as it enables the HWPF to be managed on the same basis as it is currently managed.

The counterparty to the current longevity risk transfer agreement on Irish annuities will remain unchanged between SLAL HWPF and SLAL PBF.

(iii) Operational aspects

The operation of the SLAL HWPF is governed by Standard Life's 2006 Scheme. Servicing is currently carried out locally in Germany and Ireland and the plan is for this to continue to be the case.

The proposed with profits governance, whilst the reinsurance is in place, require SLAL to manage its obligation to SL Intl under the terms of the reinsurance as if the HWPF policyholders were still its own policyholders. SL Intl will have access to the information it needs in order to hold SLAL to account in relation to SLAL's obligations under the reinsurance. An exchange of information between the two parties to the reinsurance is needed in order to enable it to work effectively and the reinsurance treaties will oblige SLAL and SL Intl to keep each other appropriately informed.

SL Intl will have a right to make representations to the WPC and to the SLAL Board on matters affecting the reinsured policies, and to receive an explanation of the basis of decisions which affect those policies. It is expected that this will be put into practice through a suitably qualified individual, likely to be the SL Intl Head of Actuarial Function or their delegate, attending the WPC for discussions that are relevant to SL Intl's reinsured With-Profits business.

BUSINESS THAT INVESTS IN THE SLAL GWPF OR THE SLAL GSMWPF

(i) Treatment of SLAL GWPF and SLAL GSMWPF business

All business in SLAL GWPF and SLAL GSMWPF are post-demutualisation German and Austrian Unitised With-Profits contracts which are written into the SLAL PBF with the investment content in the SLAL GWPF or SLAL GSMWPF

respectively. There is currently a support mechanism between the SLAL GWPF and SLAL through which SLAL covers the guarantee costs on the contract in the event the provision within the fund is inadequate.

The underlying policyholder contracts will be transferred to the SL Intl EUR PBF, and will invest in the SL Intl GWPF or the SL Intl GSMWPF, as appropriate.

(ii) Level and type of reinsurance

The contracts transferred will be reinsured back to the SLAL PBF with the investment content to be invested in the SLAL GWPF and SLAL GSMWPF as appropriate.

This means that the SLAL PBF and the SLAL GWPF and SLAL GSMWPF as appropriate will continue to be liable for the claims and benefits of these transferring Euro-denominated policyholders.

The reinsurance of the With-Profits business maintains the benefits and expectations of the transferring policyholders. This is because it maintains the protection of the UK With-Profits regime; there is no equivalent With-Profits regime in Ireland.

(iii) Operational aspects

It is planned for servicing to continue to be carried out in Ireland and Germany, with day to day with-profits management outsourced to SLAL. The accountability for the With-Profits contracts will nonetheless sit with SL Intl as is the case for all contracts issued by SL Intl.

Similar to the SLAL HWPF, governance processes are being put in place to facilitate effective management of the With-Profits business by SL Intl.

EXTERNAL FUND LINKS

A number of Irish policyholders which are to be Part VII transferred to the SL Intl HWPF (with the related risk being reinsured into the SLAL HWPF) have the option to invest in unit linked funds. These unit linked funds are to be transferred from SLAL to SL Intl as part of the proposed Part VII transfer.

To maintain the current investment of these policyholders, these unit linked funds will be accessed via EFL retrocession from the SLAL HWPF back into the SL Intl EUR PBF via the proposed EFL retrocession arrangement.

SUMMARY OF PLANNED REINSURANCE

The reinsurance that is planned for the legacy lines of business that are to be transferred is shown in the table below.

Business	HWPF	HWPF Unit Linked	GWPF	GSMWPF
Cedent	SL Intl HWPF	SLAL HWPF	SL Intl EUR PBF & SL Intl GWPF	SL Intl EUR PBF & SL Intl GSMWPF
Reinsurer	SLAL HWPF	SL Intl EUR PBF	SLAL PBF & SLAL GWPF	SLAL PBF & SLAL GSMWPF
Type	Quota share	EFL retrocession	Quota share	Quota share
Ceding	Automatic	Automatic	Automatic	Automatic
Share	100%	100%	100%	100%
Loss attachment	Natural expiry	Natural expiry	Natural expiry	Natural expiry

6.4 Collateralisation

Under the proposed reinsurance structure SL Intl will have a significant counterparty exposure to SLAL. In the absence of any form of counterparty risk mitigation, the level of security which German, Austrian and Irish policyholders have over their benefits would be negatively impacted by the proposed Part VII transfer (with reinsurance).

Given that security and consistency of policyholder benefits is the key driver of the design, the new reinsurance arrangements created by the transfer will be collateralised. The collateral will be held in a single set of segregated accounts, with custodians holding the assets on SLAL's behalf. The segregated accounts, and the assets held in the accounts, will be subject to a fixed charge granted by SLAL in favour of SL Intl to secure SLAL's liabilities under the reinsurance arrangements. The fixed charge will also cover certain derivative contracts. In the unlikely event of any insolvency of, or non-payment by, SLAL, SL Intl would have a right to enforce the fixed charge against SLAL and to recover a suitable proportion of the assets from the charged account.

In the event SLAL defaults, SL Intl would therefore be able to recover collateral from SLAL. It could then use these assets to meet policyholder claims and benefits. This helps to ensure that the policyholders' security is not materially affected by the Part VII transfer with reinsurance, assuming the collateral is sufficient.

In addition to the fixed charge arrangements, there will also be a separate floating charge granted by SLAL in favour of SL Intl to secure SLAL's liabilities under the reinsurance arrangements. The floating charge will be over a wider pool of SLAL's assets and will ensure that, in the event of a SLAL default or insolvency, SL Intl will have a right to recover assets from SLAL to the extent that SLAL's outstanding liabilities under the reinsurance arrangements are not covered by the value of assets subject to the fixed charge.

For the With-Profits reinsurance arrangements, the value of the collateral posted by SLAL into the segregated accounts will be up to the level of the Asset Share of the Euro-denominated business (less any assets which cannot be held in segregated accounts, as described below), and for the non-profit elements of the reinsurance arrangements, the value of the collateral posted will be up to the level of BEL, in each case with the floating charge used to secure the remaining exposure under the reinsurance arrangements. All assets posted to the segregated accounts will be covered by the fixed charge. However, there may be assets within the relevant reinsured funds which cannot easily be apportioned between SLAL and (reinsured) SL Intl policies or cannot be subject to a segregated fixed charge and so cannot be posted into the segregated accounts. These include, in particular, property and infrastructure equity assets in both the SLAL HWPF and SLAL GWPF. Such assets will not therefore be subject to the fixed charge arrangements, but will be within the scope of the assets subject to the floating charge.

The recapture amounts in respect of the EFL reinsured liabilities will be netted against the unit linked element of the HWPF reinsurance, to ensure that SL Intl's liabilities to SLAL in respect of the EFL reinsured liabilities are discharged upon termination and SL Intl is able to retain the assets backing these liabilities.

A consequence of granting legal charges over assets in SLAL is that, in the normal charging arrangement in the event of insolvency, the legal charges rank ahead of the SLAL's direct UK policies. This means that reinsured SL Intl policies would rank ahead of SLAL policies. The effect of such a scenario is reduced by the fact that the floating charge will contain a provision (the "**quantum provision**") which will limit SL Intl's entitlement in the event of SLAL's insolvency to broadly the amount that would be payable if the SL Intl policyholders were direct policyholders of SLAL. The quantum provision does not apply to the fixed charge. In the highly unlikely circumstances that the theoretical total payment to SL Intl was lower than the assets covered by the fixed charge, SL Intl policyholders would receive more than they would have received as direct policyholders.

This arrangement provides the transferring policyholders, with sufficient security to ensure that, if SLAL were to default, their recovery is consistent with respect to a claim on the With-Profits funds with what it would have been prior to the proposed Part VII transfer (with reinsurance).

The collateral also mitigates the capital requirements to SL Intl of the reinsurance arrangements.

The collateral posted into the segregated accounts and subject to the fixed charge is not required to be the same value as the reinsured liability nor does it have to be made up of the same assets as the underlying assets within the fund. Therefore, shortfalls in collateral relative to the value of the reinsured liability will increase SL Intl's counterparty risk capital requirements. However, the proposed Reinsurance Agreements between SL Intl and SLAL should help to mitigate this risk, as the value of the assets subject to the fixed charge should never be less than an agreed percentage of the sum of unsmoothed Asset Shares and the BEL for non-profit liabilities. This will ensure that the value of SL Intl's fixed security is not adversely affected by changing the assets backing Asset Shares.

It is not envisaged that there will material differences between the split of asset classes in the collateral pool subject to the fixed charge relative to the split of asset classes underlying the Asset Shares with the underlying With-Profits funds. Collateral subject to the fixed charge is also expected to be rebalanced on a frequent basis, in order to keep the value of this collateral pool broadly line with the value of the Asset Share that is reinsured at all times.

6.5 Existing Reinsurance

There are a number of external (third party) reinsurance arrangements in place for the German branch and the Irish branch (including that sold from Germany into Austria). These relate to the reinsurance of mortality and morbidity risk. Where the treaties are in respect only of transferring business, they will either be transferred via novation from SLAL to SL Intl or transferred as part of the Part VII insurance business transfer. Where the treaties are in respect of both transferring and UK business, the treaties will be amended to include SL Intl as a co-cedant.

For the Irish business, reinsurance relates to protection features of older contracts and the reinsurance is of a relatively low volume.

For the German business, the reinsurance relates to the life and disability options which are available on the majority of products sold in German and Austria. These options have been available on most back-book products and some are still available on current products. In addition to this, compulsory life cover on the most recent German product, Weitblick, is reinsured through the same treaty arrangements.

6.6 Reinsurance Termination Arrangements

The proposed reinsurance treaties can be terminated by mutual agreement of the parties or following the occurrence of one of the termination events specified within the reinsurance treaties. These include termination in the following events:

- By mutual agreement (option for either party)
- If either party materially breaches a fundamental provision of the agreement (option for either party)
- If SLAL becomes insolvent, fails to make payment in accordance with the terms of the reinsurance agreement within a specified timeframe or there is some other event which may indicate a weakening of SLAL’s solvency (defined as an “Event of Default”) (SL Intl option)
- If SLAL’s credit rating drops below a certain level or it loses its credit rating by either of these agencies or SLAL ceases to satisfy the “Minimum Capital Requirement” under Solvency II (SL Intl option)
- If there is a change of control of either party, the result of which is that SLAL and SL Intl cease to be part of the same corporate group (option for either party)
- The performance of all or any material part of a reinsurance treaty by either party becoming unlawful (option for either party)
- SL Intl and SLAL cease to have same parent company

The EFL retrocession agreement also includes a similar list of termination events (although under this agreement, certain of the triggers are replaced with equivalent provisions that are focused on the solvency of SL Intl (as reinsurer under this agreement rather than SLAL)).

The reinsurance treaties and the EFL retrocession agreement also include cross-default provisions, such that:

(a) the HWPF reinsurance treaty and the EFL retrocession agreement shall terminate automatically following termination of the other agreement; and

(b) each of the three reinsurance treaties shall terminate automatically following termination of any of the other agreements in circumstances where SLAL has suffered an Event of Default.

Following termination, the reinsurance agreements include an obligation on the parties to negotiate and agree any amendments to the Scheme, the 2006 Scheme and the 2011 Scheme as is required (although it is acknowledged that such amendment is not expected to be required following termination of the GWPF or the GSMWPF reinsurance treaties).

In the event of a termination, the principle to be applied when determining the amount of any termination payment to be made between SLAL and SL Intl will be that of fair value.

In respect of the HWPF reinsurance agreement, this calculation will be by reference to the reinsured liabilities as at the termination date but shall exclude any liabilities that relate to the unit linked policies (which are retroceded back to SL Intl pursuant to the terms of the EFL retrocession agreement). The termination amount in respect of these policies under the HWPF reinsurance treaty will be netted off against the termination amount under the EFL retrocession agreement directly.

In recognition of the fact that it could take a considerable amount of time to calculate the final termination amount (which effectively amounts to the splitting of the HWPF), it is envisaged that any termination payment (save for following the occurrence of an Event of Default of SLAL) would take the form of a three-step process, with an initial payment being paid by SLAL to SL Intl within three business days of termination, followed by a further interim payment being made promptly thereafter. The final 'true-up' payment (being the difference between the amounts already paid and the recapture value finally determined in accordance with the termination amount calculation set out above) will then be transferred from SLAL to SL Intl as soon as possible.

The purpose of the initial and interim payments is to ensure the immediate liquidity of SL Intl following termination. However, how these interim amounts are calculated will depend on whether the termination is the result of SLAL becoming insolvent (or an insolvency type event having occurred), as in these circumstances the security will be invoked and the initial and interim payments will be made by reference to the assets covered by the fixed charge.

6.7 Deed Poll

A number of Deed Polls are to be issued by SL Intl as part of the proposed reinsurance of With-Profits business to SLAL. These are used to help ensure that the rights and expectations of transferring policyholders, whose liability is reinsured back to SLAL, are not materially adversely affected by the proposed transfer.

Under the Deed Polls, SL Intl will give undertakings vis-à-vis policyholders who transfer from SLAL to SL Intl. The undertakings relate to performance of the policies transferred to SL Intl from SLAL. This will mean that those transferring With-Profits policyholders will continue to participate in the profits of the with profit fund they currently do and the reinsured amount will reference the aggregate liability under their policies.

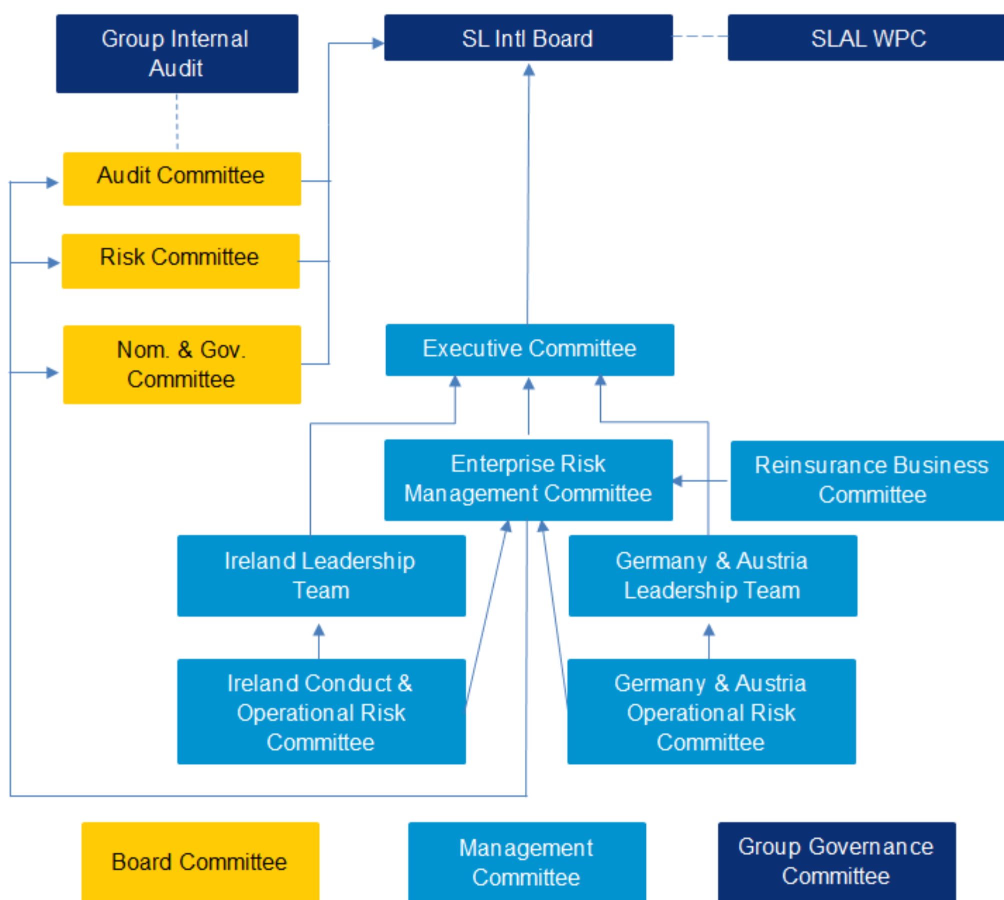
6.8 Post Transfer Operating Model

SL Intl's post-Brexit Operating model is envisaged as a seamless continuation of business for Standard Life's European clients and employees, with a new legal and corporate structure to oversee and govern a broader post-Brexit business model. This will deliver an end-to-end service and capability model to serve existing policyholders and continue to write business across EU markets.

Given the extensive local management and servicing already in place in the existing branch structures, the local organisations are of adequate size to manage and service each business locally. The significant changes to the SL Intl organisation in Ireland, apart from the addition of employees currently assigned to SLAL branches in Germany, Austria and Ireland, lie in the oversight functions of finance, actuarial and risk management which require additional headcount, expertise and ways of working under the new international operating model. The SL Intl Board will also be strengthened to encompass the necessary skills and competencies needed to oversee the enlarged scope of its business.

The policies currently serviced by SLAL Ireland will transfer to SL Intl, and services carried out by the SLAL branch in Germany will transfer across to a SL Intl branch. The services provided by the sales office in Austria will also transfer and will continue to be provided on a FOS basis.

The proposed governance framework of SL Intl is shown below:



SL Intl's Head of Actuarial Function will change from being an outsourced function to an internal role in the new structure. It is proposed that this individual has suitable With-Profits experience.

It is proposed to establish a new Executive Committee who will have overall responsibility for the delivery of SL Intl Board approved Strategy and oversight of the key operational areas for Ireland (including international bond business), Germany and Austria.

The Director of Europe will be supported by an Executive Committee comprising key positions and expertise from both the Irish and German Leadership teams. Appointments to the Executive Committee will be subject to review and recommendation and subsequent approval of the Board. It is proposed that the Director of Europe will be the SL Intl CEO and also a member of SLAL (SL Intl's parent) Executive Committee.

It is proposed that the Managing Director of Germany will be appointed as an Executive Director to the SL Intl Board and a recruitment process is performed to identify a new Independent Non-Executive Director who has relevant experience of the market.

The Risk Management Function within SL Intl will be strengthened to reflect the change in the risk profile as a result of the Scheme with the capital target framework developed to ensure SL Intl continues to hold sufficient capital to protect policyholders.

As the Scheme proposes to transfer With-Profits business from SLAL to SL Intl, I have paid attention to the changes to the operating model surrounding those With-Profits policyholders. This has also been considered by the With-Profits Actuary.

There is currently no equivalent With-Profits regime in Ireland compared to that of the UK. In particular, there is currently no regulatory requirement to appoint a WPA or a WPC. The WPC and its governance is discussed in section 6.9 below.

The role of the WPA is outlined in SUP 4.3.16A of the FCA handbook. In advising or reporting on the exercise of discretion, the WPA should cover the implications for the fair treatment of the relevant classes of the firm's With-Profits

policyholders. Their opinion on any communication or report to them should also take into account their information needs and the extent to which the communication or report may be regarded as clear, fair and not misleading.

Servicing of the With-Profits policyholders is currently carried out locally in Germany and Ireland with this to continue to be the case following the proposed Part VII transfer with reinsurance. The bonus declarations in respect of SL Intl HWPF contracts will be overseen by the SL Intl Board with much of the With-Profits analysis outsourced to SLAL.

The SL Intl Board will be advised by a qualified actuary with appropriate skills and experience and who is internal to SL Intl, in exercising independent judgement on the achievement of fair treatment for With-Profits policyholders. This is expected to be SL Intl’s Head of Actuarial Function.

Publicly available documents such as 2006 Scheme and PPFM will help SL Intl’s policyholders, and hence SL Intl itself, to set an expectation around how the fund and reinsurance contract will be managed to ensure fair policyholder benefits. The SLAL WPC and WPA will also play key roles in ensuring that the payments made to SL Intl under the reinsurance treaty are fair and consistent with payments made to SLAL’s own With-Profits policyholders.

The objective of these changes within the operating model of SL Intl is to provide those transferred policyholders with the appropriate governance and ensure that there are sufficient operational controls so that they are not materially adversely affected by the transfer.

6.9 With-Profits Committee

The role of the SLAL WPC is to consider the interests of With-Profits policyholders and exercise independent judgement in advising the Group Board and SLAL Board on the achievement of fair treatment for those policyholders, reflecting a fair balance of interests amongst policyholders and between policyholders and shareholders in the ongoing management of With-Profits policies and With-Profits funds and in any proposed actions affecting those policyholders.

The reinsurance arrangements established as part of the proposed transfer allow the SLAL HWPF, SLAL GWPF and SLAL GSMWPF to continue to operate as they do at present. To ensure that those transferring policyholders continue to be provided with the same level of security, it is important that the SLAL WPC continues to consider these policyholders.

To achieve this, the Constitution and Terms of Reference of the SLAL WPC is to be extended to continue to cover those transferring policyholders whose liability is reinsured back to a SLAL With-Profits fund.

SLAL’s WPC responsibilities will be extended to all With-Profits policyholders who participate in a SLAL With-Profits fund. These policyholders are either SLAL policyholders whose policies were written in the UK or SL Intl policyholders whose polices were written in Ireland or Germany and who participate in a SLAL With-Profits fund via reinsurance.

The SLAL WPC does not itself exercise management responsibility for the With-Profits business. Its role is to assess, report on and provide clear advice (including where appropriate making recommendations) to the SLAL Board on the management of such business, whether written by SLAL in the UK or by SL Intl in Ireland or Germany, providing independent judgment on the fair treatment of With-Profits policyholders, and to take a proactive role in raising any issues that merit further consideration.

All material discretionary actions proposed in relation to the With-Profits business of SLAL and SL Intl will be discussed by the SLAL WPC with SLAL’s WPA. One of the most significant of these relates to the bonuses declared.

As bonuses in the HWPF are declared at SLAL’s discretion, post transfer SL Intl will take a role in the bonus declaration process to ensure fairness to its policyholders. SL Intl will have access to the information it needs in order to hold SLAL to account in relation to SLAL’s obligations under the proposed reinsurance. An exchange of information between the two parties to the reinsurance is needed to enable it to work and the reinsurance treaties will oblige SLAL and SL Intl to keep each other appropriately informed.

SL Intl will have a right to make representations to the SLAL WPC and to the SLAL Board on matters affecting the reinsured policies, and to receive an explanation of the basis of decisions which affect these policies. It is expected that this will be put into practice through a suitably qualified individual, likely to be the SL Intl Head of Actuarial Function or their delegate, attending the SLALWPC for discussions that are relevant to SL Intl’s reinsured With-Profits business.

In this way, SL Intl will have the opportunity to challenge proposed bonus levels, with SLAL having the opportunity to consider any such challenge.

If the SLAL Board disagrees, any bonus in excess of the one declared by SLAL will be paid by SL Intl. This ensures that the SL Intl Board cannot use bonus declarations to distribute the estate to its policyholders to the detriment of the UK policyholders within the HWPF.

6.10 Post-Transfer Solvency

The proposed transfer has the following expected high-level impacts on the solvency of SL Intl as at the Effective Date:

- The Part VII transfer will increase the Own Funds of SL Intl as a result of the business being transferred to SL Intl.
- There will be an increase the capital requirements for all risk modules currently held within SL Intl as well as introduce longevity risk to the business.
- This is a direct result of the volume of the business being transferred and the reinsurance arrangements established.
- The increase in risks within SL Intl results in an increase in the undiversified SCR.
- This increase is partially offset as a result of the transferring business containing a significant portion of longevity risk which diversifies with the other risks to which SL Intl is exposed.

The Brexit Part VII transfer (with reinsurance) results in a net reduction in SLAL's excess own funds, reflecting the requirement for SL Intl to hold counterparty default capital for the risk that SLAL defaults on the reinsurance; increased operational risk across both entities; and the subsequent increase in the Risk Margin arising from these higher capital requirements.

SLAL will be required to inject capital into SL Intl to cover both the new tangible asset requirement and to meet the SL Intl target coverage of regulatory capital requirements.

The solvency of SLAL and SL Intl prior to the transfer (as of year-end17), and assuming both were a member of Phoenix is shown below:

	SLAL (£m)	SL Intl (£m)
Own Funds (A)	3,780	137
Solvency Capital Requirement (B)	2,480	102
Excess Own Funds (C= A – B)	1,300	35
Solvency Coverage Ratio (D = A/B)	**152%**	**134%**

Following the proposed Part VII transfer (and reinsurance), this position is projected to be as follows:

	SLAL (£m)	SL Intl (£m)
Own Funds (A)	3,885	570*
Solvency Capital Requirement (B)	2,650	420
Excess Own Funds (C= A – B)	1,235	150
Solvency Coverage Ratio (D = A/B)	**147%**	**136%**

This includes a proforma capital injection of circa £250m from SLAL to SL Intl with this expected to be in cash. The amount injected may differ from that disclosed here and will dependent on the financial strength of SL Intl at the Effective Date.

These figures are shown using year-end 2017 data and use an exchange rate of 0.88771 (£ to €). It assumes that the volatility adjustment application referenced in section 7.3 is approved. If this is not the case, the above figures are not expected to be materially different.

The SCR and Own Funds within the SLAL HWPF, as a result of the reinsurance, are expected to remain materially unchanged.

6.11 Capital Management Framework

Post-transfer, SL Intl will seek to maintain its solvency coverage ratio in line with its Board approved capital target framework. This assesses the capital that SL Intl aims to hold under both normal and stressed conditions.

Under SL Intl's capital target framework, solvency capital coverage is assessed under a number of specific stress scenarios. These scenarios are intended to capture adverse but plausible economic events. The impact of a significant deterioration in its counterparty risk exposure is also considered.

SL Intl's capital coverage is to be managed within upper and lower bounds, with the lower bound being greater than 100% of the calculated SCR in the case of a defined (and extreme) adverse economic event. Potential options for the restoration of SL Intl's solvency coverage ratio to its target level, in the event of a deterioration due to economic conditions or a fall in SLAL's credit rating, are also considered in detail by the capital management framework.

7 EFFECT OF PROPOSED CHANGES ON SECURITY OF POLICYHOLDER BENEFITS

As HoAF for SL Intl, the focus on my commentary in this section is on the impact of the proposed transfer on the security of the existing policyholders of SL Intl (i.e. those policyholders which are on the books prior to the date of the transfer).

7.1 Risk Profile and Available Capital

ANALYSIS OF CHANGE IN RISK PROFILE – QUANTIFIABLE RISKS

It should be noted that there will be not only a change in the level of SCR, but the individual components of the SCR will also significantly change. In particular, the proposed transfer (including reinsurance) will lead to a significant increase in counterparty risk and currency risk capital requirements. The transfer of the annuity business will expose SL Intl for the first time to longevity risk, and will also substantially increase exposure to interest rate risk. Under the proposed transfer, it is planned that the With-Profits book will be reinsured to SLAL. This will contribute to a significant increase in the operational risk capital requirements, as well as introduce significant reinsurance counterparty default risk for the first time, as mentioned above.

The changes to the risk profile are discussed in further detail below along with the actions taken by SL Intl to reduce this risk to policyholders. These actions have helped allow me to draw the conclusion that the financial security and expected benefits of existing SL Intl policyholders should not be materially impaired by the proposed transfer.

Market Risks

Most of the increase in market risks is due to an increase in the “scale” of unit linked business. The notable exception is fixed interest risk that will increase predominantly due to the acquisition of annuity portfolio and fixed interest exposures in the shareholder funds.

The main changes to market risks are as follows:

- Equity risk – Although SL Intl does not seek direct equity exposure by investing shareholder assets in equities; it has a second order exposure to equity risk through the investment of the unit linked funds in equities. The equity risk will increase due to the increase in the assets under management, and a corresponding increase in the equity exposures within the policyholder unit linked funds.
- Currency risk – The currency risk will increase due to an increase in non-Euro denominated exposures for SL Intl. It should be noted that SL Intl will change its reporting currency from GBP to EUR as at the date of transfer which partially mitigates this increase.
- Interest rate risk –The fixed interest exposure will substantially increase due to the nature of the business being transferred-in (particularly the annuity business). This increase is partially mitigated by assets being chosen that reasonably match liabilities and so any change in interest rates will impact both assets and liabilities. This helps to protect policyholders from this risk.
- Spread risk and property risk – Similar to equity risk, spread and property risks will increase due to an increase in assets under management and a corresponding increase in the corporate bond and property risk exposures.

Underwriting Risks

The main underwriting risks are lapse risk, expense risk and longevity risk.

The lapse and the expense risks increase mainly due to an increase in the scale of unit linked business.

However, longevity is a new risk exposure for SL Intl under the proposed transfer, and it relates to the annuity portfolio currently managed by the German and the Irish branches. In particular, SL Intl will be taking on circa £6.8bn of deferred annuities as part of the transfer (over 60% of which is due to vest within the next 15 years), which will materially increase longevity risk exposure.

Counterparty Default Risk

The increase in counterparty default risk SCR mainly relates to the reinsurance counterparty default exposure that SL Intl will be exposed to if it reinsures the transferred With-Profits book to SLAL. This increase is a direct result of the reinsurance arrangements between SLAL and SL Intl and without which SL Intl would be subject other sources of risk exposure.

Following the acquisition of SLAL by Phoenix, SLAL was assigned a crediting rating A+ (Strong) by Fitch Ratings. Notwithstanding the collateral arrangements that are in place, a post-transfer downgrade in SLAL's credit rating to a certain level would cause SL Intl to breach its regulatory solvency capital requirements, in the absence of a further capital injection from its shareholder. However, rating agencies do not tend to make immediate changes to ratings based on short term developments. Typically, though not always, they will change the outlook to 'negative' and wait a period of time before forming a view as to whether or not to actually downgrade, during which time circumstances may change such that the downgrade is not required. In the case of the proposed reinsurance arrangements between SLAL and SL Intl, this would also allow time to take actions to manage the counterparty exposure, and consequently the regulatory solvency capital requirements, of SL Intl, if such action was deemed to be necessary.

The size of the reinsurance counterparty default SCR is high because the ceded technical provisions are not fully collateralised. The total value of the collateral (representing effectively the Asset Share of the With-Profits policies and BEL of the non-profits policies that are reinsured) is expected to be lower than the best estimate reinsurance recoverable (representing the current estimated value of policyholder benefits), at the time of the transfer. Moreover, there is an element of market risk associated with the collateral itself that may increase this gap. In the event of certain extreme market movements, the gap between the value of collateral and the value of the reinsured policyholder benefits could widen, which would lead to an increase in counterparty risk. The proposed Reinsurance Agreements between SL Intl and SLAL should reduce this risk though.

The application of the relevant provisions of the floating charges (as described in section 6.4) effectively means that, in the event of an insolvency of SLAL, the amounts which may be recovered by SL Intl through the collateral arrangements may be limited by any shortfall of assets within SLAL relative to policyholder benefits. This may leave SL Intl in a position whereby it faces a shortfall in its reinsurance recoverable relative to the value of its obligations to its With-Profits policyholders.

Operational Risk

As discussed above, SL Intl will retain the operational risk associated with the With-Profits policies in the With-Profits Fund, which will lead to a significant increase in its overall operational risk exposure. It will also retain the operational risk on PBF annuities and unit linked business. The operational risk SCR has been calculated using the Standard Formula, which uses a factor based approach for the calculation of the operational risk capital requirement.

ANALYSIS OF CHANGE IN RISK PROFILE – NON-QUANTIFIABLE RISKS

Once the proposed transfer goes ahead, there will be a significant change in the risk profile for non-quantifiable. The main non-quantifiable risks which are set to increase include: liquidity risk, strategy risk, emerging risk, conduct risk and reputational risk. These are all risks which would generally be associated with most companies, though the increased volume of business which SL Intl will have post-transfer will cause these risks to scale up in size.

Specifically in relation to liquidity risk, the proposed reinsurance treaty with SLAL has the potential to introduce a specific (and new) liquidity risk.

In an extreme scenario in which SLAL's solvency position is deteriorating (as outlined in section 6.6), such that SL Intl wishes to exercise its option to terminate the reinsurance, a formal split of HWPF would be required. This would be expected to take time and would be likely to require Court approval. There may also be circumstances in which Court approval would be necessary upon termination of the GWPF and GSMWPF reinsurance treaties. To mitigate the risk to SL Intl during this period, the termination process includes a mechanism for payment of a substantial proportion of SL Intl's share of the assets underlying the With-Profits business shortly after notification of termination, with a final true-up payment due when the analysis is completed. This termination option and repayment mechanism is an important safeguard for SL Intl in the event that SLAL's solvency position is deteriorating, as it allows SL Intl to significantly reduce its counterparty risk exposure in advance of any potential SLAL default, thereby mitigating the risk of SL Intl having to recover its assets through the insolvency process, something which would pose obvious liquidity challenges.

ANALYSIS OF CHANGE IN OWN FUNDS

As with the Risk Profile, the own funds for SL Intl will change substantially in 2019 due to the transfer of German branch and Austrian business, as well as Irish branch business. This increase will be funded mainly through a significant capital injection from SLAL, in addition to the Technical Provisions of the business being transferred, on the Effective Date.

The net of reinsurance technical provisions for the unit linked and With-Profits business being transferred is negative (i.e. an asset), excluding unit values, as the business transferred is profitable, and therefore represents a net asset within the Solvency II own funds. The transferred annuity portfolio will also make a positive contribution to own funds.

The business being transferred and retained in SL Intl is, and is expected to continue to be, profitable following the Part VII transfer (with reinsurance). It is therefore anticipated that following the initial capital injection by SLAL, SL Intl's business should help increase own funds following the Effective Date (although this is subject to economic conditions and to the experience of the business in future years). Further, in creating a larger book of business, the Scheme acts to reduce pressure on discretionary policy charges. This is in the interests of policyholders.

7.2 Impact of Transfer on Solvency Capital and Solvency Coverage

SL Intl has provided me with information demonstrating that, after the transfer (with reinsurance), the expected evolution of the solvency coverage ratio does not fall below the defined target set by SL Intl over the business planning horizon. The level of capital injection required to maintain solvency coverage within the target risk appetite can vary considerably depending on how the economic, demographic and business conditions unfold over the future, relative to the best estimate.

The analysis that has been prepared by SL Intl considers the calculation of the SCR on a standard formula basis, over a projection period of six years, and covers a central scenario (i.e. SL Intl's view of future best estimate assumptions), together with a wide range of adverse scenarios, including:

- A market scenario, in which economic conditions are assumed to be relatively flat compared to the base scenario (i.e. a reduction in investment returns in Ireland, Germany and Austria and UK across all years). Exchange rates remain constant.
- A mass lapse of a significant proportion of the total in force book of policies midway through calendar year 2019.
- A significant reduction in lapse rates combined with an increase in maintenance expenses.
- A significant reduction in the annuitant mortality rates.
- Combined market and underwriting risk scenarios of varying degrees of severity.
- Two reinsurance counterparty scenarios which assess different levels of credit downgrade of SLAL.

In order to maintain the solvency coverage ratio above the target threshold set by SL Intl, the central scenario assumes that SL Intl will receive a capital injection from SLAL at the date of the transfer. Under most of the adverse scenarios considered, additional capital would be required in future years. If sufficient capital is not provided under these adverse scenarios, were they to unfold, then SL Intl would breach its target solvency coverage ratio.

Based on the analysis that I have seen, the Solvency II balance sheet, and therefore the solvency coverage ratio, will be more volatile post transfer. At present, SL Intl's solvency coverage ratio is relatively stable over successive reporting periods as the BEL and SCR are quite closely correlated (as is generally the case with unit linked business). However, the same stability will not be present post transfer as the additional risks retained by SL Intl post transfer will weaken this correlation between the BEL and SCR. This increase in volatility may adversely affect the security of the SL Intl policyholders post transfer, relative to the current position, if an extreme event were to occur.

I note that the scenario which assesses the more severe of the two credit downgrades of SLAL (mentioned above) will require a much larger capital injection than the others. However, this scenario is significantly more severe than a 1-in-200 year event, as SLAL currently has a strong financial position, as discussed in section 5.4. If such a scenario emerges it could be problematic for SL Intl (as SLAL may be unable to extend significant capital support to SL Intl at a time when it would be going through significant financial difficulty itself).

SL Intl also defines a target minimum solvency coverage ratio, which is lower than the target solvency coverage ratio. The target ratio is comfortably in excess of the regulatory minimum, while the target minimum ratio also provides some buffer

above the regulatory minimum. For the majority of the adverse scenarios, the projected solvency coverage ratio does not fall below the minimum regulatory target. However additional capital from SLAL would be required in some scenarios in order to maintain the solvency coverage ratio above this minimum threshold.

In the event of a termination of the proposed reinsurance arrangements between SL Intl and SLAL, it is possible that SL Intl's solvency coverage ratio may temporarily drop below its target minimum level, until such time as the termination process is fully completed. However, this is highly dependent on a number of factors, including the timing of any such termination, and the exact nature of any event which may have led to the decision to terminate. Based on detailed analysis that I have seen, the likelihood of such a breach on the target minimum solvency coverage ratio appears to be quite remote, and the length of time for which such a situation would be expected to persist is quite limited.

7.3 Changes in methodology

SL Intl currently calculates its capital requirements using the Solvency II Standard Formula and does not have permission to use any of the matching adjustment, or volatility adjustment, or transitional measures on technical provisions. Its operating currency is currently GBP.

In light of the volume of annuity business that the company is expected to inherit as part of the transfer, SL Intl is to make an application to the CBI to use the volatility adjustment (a countercyclical adjustment which is benenficial to the valuation of liabilities in certain adverse market conditions).

Approvals to use other measures will continue to be reviewed and will be discussed with and sought from the CBI, as necessary. The figures produced within this paper assume that the volatility adjustment application is successful. If this were not to be true, the impact on the reported figures is currently negible and it has no impact on the conclusions drawn. The volatility adjustment is a countercyclical adjustment and, at this current time, has little affect on SL Intl's reported figures.

7.4 Terms and Conditions

The Scheme will not alter existing policies and does not result in the cancelation or the issue of new policies to existing policyholders. Therefore, there will be no change to the terms and conditions for existing SL Intl policyholders.

7.5 UK Financial Services Compensation Scheme

The Financial Services Compensation Scheme ("**FSCS**") is the UK's statutory compensation scheme which protects consumers of authorised financial services firms. It was set up under the Financial Services and Markets Act 2000 and became active on 1 December 2001. The protection scheme covers business conducted by firms authorised by the FCA and the PRA, including undertakings selling insurance policies and investment business. FSCS is free to consumers and is independent of government and the financial industry. Existing policyholders of SL Intl will remain eligible for protection through the FSCS, although new policyholders (post-Brexit) will be ineligible.

Post transfer, the policyholders being transferred-in from SLAL will lose access to the UK policyholder protection scheme, the FSCS), as they will no longer be eligible to qualify for this scheme. The FSCS provides protection to eligible policyholders in respect of (amongst other things) insurance policies issued by a UK based insurance firm (or by an EEA firm passporting into the UK to a UK resident). In the unlikely event that such a firm were to fail (and the policyholder satisfied the eligibility criteria), the policyholder's contracts would be protected and they would receive 100% cover in respect of their policy values.

7.6 Conclusions

Given the current financial strength of SLAL (Fitch has assigned SLAL a Credit Rating of A+ (Strong)), the additional capital which will be injected into SL Intl as part of the proposed transfer of business, and the fact that the proposed reinsurance transaction is intra-group, the financial security and expected benefits of existing SL Intl policyholders should not be materially impaired.

However, the proposed transfer of business, and the associated reinsurance of the With-Profits element of the transfer, will significantly heighten the level of risk faced by SL Intl.

The key risks are as follows: counterparty risk, currency risk, operational risk and liquidity risk. SL Intl will put in place a number of mitigants to address these risks (principally the collateralisation of the reinsurance treaty with SLAL), together

with receiving an appropriate level of capital injection from SLAL as part of the proposed transfer to maintain its target solvency coverage ratio. Whilst these mitigants will significantly reduce much of the risk exposure of SL Intl, or provide capital to protect against others, these additional risks will remain.

At present, SL Intl's solvency coverage ratio is relatively stable over successive reporting periods as the BEL and SCR are quite closely correlated (as is generally the case with unit linked business). However, the same stability will not be present post transfer as the additional risks retained by SL Intl post transfer will weaken this correlation between the BEL and SCR. This increase in volatility may adversely affect the security of the SL Intl policyholders post transfer, relative to the current position, if an extreme event were to occur.

In the event of a termination of the proposed reinsurance of the With-Profits business post transfer, depending on the exact timing and the nature of any event which may cause this to happen, there may temporarily be a weakening of SL Intl's solvency position, until such time as the termination process is fully completed. However, the remoteness of such an event, coupled with the short period of time during which such a weakness would be expected to persist, means that there should be no material adverse impact upon the financial security or benefit expectations of SL Intl's policyholders arising from such an event.

8 EFFECT OF PROPOSED CHANGES ON RIGHTS AND REASONABLE EXPECTATIONS OF EXISTING SL INTL POLICYHOLDERS

This section considers the effect of the proposed transfer and reinsurance on the rights and expectations of the existing SL Intl policyholders. This considers the effect of the transfer on the administration of the policyholders, ongoing communication with them, investment of policies and other significant factors.

Legislation requires that policyholders are notified of the Scheme. I understand that all policyholders of SL Intl will be notified of the Scheme by way of a direct mailing.

8.1 Description of rights and expectations of each group

There is only one group of existing policyholders in SL Intl, and none of these policyholders participate in profits related to particular funds (or parts of funds). The Scheme will have no effect on the servicing arrangements for SL Intl policyholders. Consequently, the policyholders will continue to receive the same standard of service before and after the Scheme.

SL Intl does have discretion to change the charges applied on underlying investment funds. However, this would be seen as normal practice for unit linked policies. In creating a larger book of business, the Scheme acts to reduce pressure on discretionary policy charges. This is in the interests of policyholders. The policy conditions do not confer any additional discretionary powers in reviewing certain charges or product features that would be seen to be disadvantageous to policyholders.

My current interpretation of the key aspects of policyholders' reasonable expectations ("**PRE**") in respect of the unit linked investment business written by SL Intl is as follows:

- That investment risks will be properly explained;
- That there will be no surprises with regard to charges i.e. charges will be disclosed in a transparent manner;
- That (i) any illustrations of potential product returns will not be unreasonably optimistic and (ii) that any deviations between actual and illustrative product performance can be reasonably justified by SL Intl; and
- That any discretionary powers of SL Intl will be exercised fairly and not solely for the purposes of generating additional profits for SL Intl e.g. with regard to the power to increase charges.

8.2 Ongoing administration and governance

The proposed business model for the International Bond business remains largely unchanged from the current model operated by SL Intl. The Irish Leadership Team currently coordinates business planning, proposition & product development, risk and compliance management, HR, tax, financial reporting and analysis. Policy administration is part of the operations overseen in Ireland. The Head of Actuarial Function will change from being an outsourced function to an internal role in the new structure. The Irish Leadership Team will continue to oversee outsourced services including group support services (e.g. marketing and investment governance support), platform services, Discretionary Fund Management services and Independent Financial Advisor arrangements.

8.3 Investment management

There will be no change to the investment management of the existing business post transfer as the business is unit linked (and therefore investment choices are driven by the policyholders themselves). There are no plans to widen or narrow the range of fund choice available to the existing policyholders, post transfer.

8.4 Tax considerations

The Scheme will not alter existing policies and does not result in the cancellation or the issue of new policies to existing policyholders. As such, I understand that the Scheme gives rise to no tax impact on existing policyholders. I have seen tax advice prepared for SL Intl, which indicates that no tax issues will arise for existing policyholders as a result of the Scheme.

There is a risk that the tax law changes during the life of the project which results in an unexpected tax outcome for existing SL Intl policyholders. Also, given the complexity of the project and the various inter-dependencies, it is possible that new tax risks emerge over the life of the project.

8.5 New Business

There will be no change to the right and expectations of SL Intl's existing policyholders (or product lines), except to the extent that the expanded size of the business may allow SL Intl to lower charges due to economies of scale, which would be in the interests of policyholders.

9 CONCLUSIONS

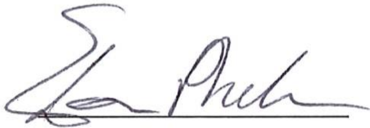
Based on the information available to me at this time, including the current financial strength of SLAL (Fitch has assigned SLAL a Credit Rating of A+ (Strong)), I do not believe that there is any material risk that the proposed Scheme will negatively impact on the legal rights, financial security or expected benefits of the existing SL Intl policyholders.

Furthermore, I do not expect that the proposed changes will have any material adverse impact upon the rights and reasonable expectations of SL Intl's existing policyholders.

There are a number of additional risks which will be introduced to SL Intl following the proposed transfer, and which have the potential to negatively impact upon the existing policyholders of SL Intl, the primary one being counterparty risk. Although collateral will be in place at all times, there are instances in which the residual counterparty exposure to SLAL is still significant as the collateral posted into the segregated accounts and subject to the fixed charge, is not required to be the same value as the reinsured liability, nor does it have to be made up of the same assets as the underlying assets within the fund. Therefore, shortfalls in collateral relative to the value of the reinsured liability will increase SL Intl's counterparty risk capital requirements. For example, the collateral amount is based on the Asset Share in the fund and the underlying policies have guarantees attached. Thus, if markets fall, then the Asset Share may fall, as will the value of the collateral, however, the liability to policyholders will not similarly reduce. The existence of the floating charge outlined in section 6.4 does help to alleviate this issue though. In addition, the proposed Reinsurance Agreements between SL Intl and SLAL should further reduce this risk, as the value of the assets subject to the fixed charge should never be less than an agreed percentage of the sum of unsmoothed Asset Shares and the BEL for non-profit liabilities. This will ensure that the value of SL Intl's fixed security is not adversely affected by changing the assets backing Asset Shares.

If SLAL were to experience significant solvency issues, it is highly likely that SL Intl would similarly experience issues, which may impact upon the financial security and expected benefits of the existing SL Intl policyholders, as well as SL Intl's ability to pay such benefits in a timely fashion.

In the event of a termination of the proposed reinsurance of the With-Profits business post transfer, depending on the exact timing and the nature of any event which may cause this to happen, there may temporarily be a weakening of SL Intl's solvency position, until such time as the termination process is fully completed. However, the remoteness of such an event, coupled with the short period of time during which such a weakness would be expected to persist, means that there should be no material adverse impact upon the financial security or benefit expectations of SL Intl's policyholders arising from such an event.

Signed: 

Name: Eamonn Phelan

Fellow of the Society of Actuaries in Ireland

Date: 18th September 2018

10 RELIANCES & LIMITATIONS

10.1 Reliances

DATA

Data Provision and Data Reliance

In carrying out the work and producing this report, I relied on data and other information provided by SL Intl and SLAL. I have not audited or verified this data and other information. If the underlying data or information is inaccurate or incomplete, the results of our analysis may likewise be inaccurate or incomplete.

I performed a limited review of the data used directly in my analysis for reasonableness and consistency and have not found material defects in the data. If there are material defects in the data, it is possible that they would be uncovered by a detailed, systematic review and comparison of the data to search for data values that are questionable or for relationships that are materially inconsistent. Such a review was beyond the scope of my assignment.

This report is based on the following assumptions:

- We were provided with access to accurate and complete data and information.
- SL Intl has informed us about the source and the intended use of the data and information and has disclosed to us (Milliman) all limitations of and adjustments made to such data and have provided us with all other information reports and conclusions of any internal or external relevant analysis performed on the quality of data.
- SL Intl has ensured that all data received from external service providers such as market data, financial data and other general available data are accurate and reliable.
- SL Intl has provided us with all information about the reliability of the sources of information and their consistency and stability of the processes of collecting and publishing of such information over time.
- SL Intl has informed us about any changes that have been applied over time to external data, whether those changes relate to assumptions or associated methodologies or any other procedures regarding the collection of external data.
- SL Intl has informed us about any data limitations or uncertainties which may affect the data.

In carrying out the work and producing this report, reliance has been placed upon, but not limited to, the following information:

- Details of the products and business of SL Intl and SLAL.
- Fund details for SL Intl and SLAL, including details of funds proposed to be retained in those companies after the Scheme is complete.
- Solvency II balance sheets and Solvency Capital Requirements as at 31 December 2016 and 2017.
- SL Intl material change of business plan submitted to the CBI.
- The Chief Actuary of SLAL report, and the report prepared by the With-Profits Actuary of SLAL.
- The Independent Expert's report.
- The ORSA for SL Intl presented to the board in November 2017.
- Details of reinsurance treaties for the entities involved in the Scheme.
- The Scheme.
- Risk Appetite Statement.
- Capital Management Framework.

This report was based on data available to us at, or prior to, 18 September 2018, and takes no account of developments after that date.

10.2 Limitations

DISTRIBUTION & USAGE

This report has been prepared for use by various interested parties as follows:

- The Court having jurisdiction over the proposed transfer
- The Directors of SL Intl
- Policyholders of SL Intl
- Policyholders of SLAL who are directly affected by the proposed Part VII transfer
- The Chief Actuary and With-Profits Actuary of SLAL
- The Central Bank of Ireland, the Prudential Regulatory Authority, the Financial Conduct Authority, the Federal Financial Supervisory Authority and Financial Market Authority
- Professional advisors appointed by any of the above in connection with the proposed transfer, including the Independent Actuary

This report may not be published without my written consent, with the exception of making the report available for inspection by or circulation to policyholders as required by legislation or in order to meet any other specified legal requirements.

A summary of this report may not be made without my written consent and, in particular, a summary of this report should not be distributed to policyholders without my prior approval.

This report has been prepared by me as Head of Actuarial Function of SL Intl under the terms and conditions of the letter of engagement dated 29 February 2016 and the associated statement of work, dated 4 December 2017, and within the context of the assessment of the terms of the proposed Scheme. No liability will be accepted by Milliman, or me, for any application of this report to a purpose for which it was not intended nor for the results of any misunderstanding by any user of any aspect of this report (or any summary thereof).

Judgments as to the conclusions contained in our report should be made only after studying the report in its entirety. Furthermore, conclusions reached by review of a section or sections on an isolated basis may be incorrect.

The report is intended to be used by a person with a certain level of expertise in the areas addressed and for the stated purposes only. Any reader of this report must possess a certain level of expertise in areas relevant to this analysis to appreciate the significance of the assumptions and the impact of these assumptions on the illustrated results. The reader should be advised by their own actuaries or other qualified professionals competent in the subject matter of this report, so as to properly interpret the material.

VARIABILITY OF RESULTS

Differences between our projections and actual amounts depend on the extent to which future experience conforms to the assumptions made for this analysis. The assumptions we have used have, in our view, been made on the basis of reasonable hypotheses. It is certain, however, that actual experience will not conform exactly to the assumptions used in this analysis. Actual amounts will differ from projected amounts to the extent that actual experience deviates from expected experience. Such variations in experience could have a significant effect on the results and conclusions of this report. No warranty is given that the assumptions made in this report will be reflected in actual future experience.

RECOMMENDED OTHER PROFESSIONAL ADVICE

The consultants who worked on this assignment are life insurance actuaries. As such, they are familiar with statutory accounting and GAAP accounting, but are by no means experts in law, taxation, or accounting. Our advice is not, nor is it intended to be, a substitute for qualified legal, tax, or accounting advice.

11 APPENDIX A: GLOSSARY OF TERMS

	Meaning
Asset Share	**The asset share of a policy is the accumulation of premiums (less any amounts in respect of withdrawals) at the investment returns on the With-Profits assets, less deductions for expenses and charges (including any deductions for guarantees or contributions to capital), tax and any other experience adjustments.**
AUM	**Assets Under Management**
BaFin	**Federal Financial Supervisory Authority**
BEL	**Best Estimate Liability is the part of technical provisions representing a probability weighted average of future cash flows, taking account of the time value of money, using an appropriate risk-free interest rate term structure. The calculation is based upon realistic assumptions, using appropriate actuarial and statistical methods and taking account of all future cash inflows and outflows required to settle the insurance obligations.**
Brexit	**The United Kingdom's withdrawal from the European Union**
CBI	**Central Bank of Ireland**
Cedent	**A cedent is a party in a reinsurance contract who passes (or cedes) financial obligation for certain potential losses to the reinsurer. In return the cedent pays a premium.**
CEO	**Chief Executive Officer**
COBS	**Conduct of Business Rules**
Corporate Governance Requirements	**A set of principles of good corporate governance aimed at companies regulated by the Central Bank of Ireland**
Deed Poll	**A deed poll is a legal document binding only to a single person or several persons acting jointly to express an active intention**
EEA	**European Economic Area**
Effective Date	**The date in which the Scheme comes into effect. This is expected to be the 28 February 2019.**
EFL	**External Fund Link**
ERMC	**Enterprise Risk Management Committee**
EU	**European Union**
EU27	**The 27 remaining member states of the EU once the UK has left**
FCA	**Financial Conduct Authority (UK)**

FMA	**Financial Market Authority**
FOS	**Freedom of Services**
FSCS	**Financial Services Compensation Scheme**
GSMWPF	**German Smoothed Managed With Profits Fund**
GWPF	**German With Profits Fund**
HoAF	**Head of Actuarial Function**
HWPF	**Heritage With Profits Fund**
Internal Model	**Risk management system of an insurer for the analysis of the overall risk situation of the insurance undertaking, to quantify risks and/or to determine the capital requirement on the basis of the company specific risk profile.**
IPPFM	**Internal Principles and Practices of Financial Management**
Ireland	**The Republic of Ireland**
Loss Attachment	**The period of a reinsurance contract over which the losses are covered**
OPE	**Overseas Persons Exclusion**
PBF	**Proprietary Business Fund**
Phoenix	**Phoenix Group Holdings**
PPFM	**Principles and Practices of Financial Management**
PRA	**Prudential Regulatory Authority (UK)**
PRE	**Policyholders' Reasonable Expectations**
Quantum Provision	**A provision that restricts SL Intl's recovery under the charges to such amount as SL Intl would have been entitled to recover, had SL Intl been a policyholder (rather than a secured creditor) of SLAL.**
Quota Share	**A type of reinsurance contract in which the insurer and reinsurer share premiums and losses according to an agreed percentage**
RAO	**Article 72 of the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001**
RCC	**Risk and Capital Committee**
RCF	**Recourse Cash Flow (as defined in the 2006 Scheme of Demutualisation)**
Reinsurance	**Insurance that is purchased by an insurance company from a Reinsurer**

Regulatory View	**The Company's capital position under Solvency II is determined by aggregating the assets and liabilities of the Company recognised and measured on a Solvency II basis (being own funds) and comparing this to the Company's SCR to determine surplus capital.**
Retrocession	**The practice of reinsuring of reinsurance (i.e. one reinsurance company providing services to another by insuring the activities of another reinsurance company).**
Risk Margin	**The Risk Margin is the part of technical provisions in addition to the best estimate liability required to ensure that the value of the technical provisions is equivalent to the amount that insurance undertakings would be expected to require in order to take over and meet the insurance obligations.**
SCR	**Solvency Capital Requirement**
SAI	**Society of Actuaries in Ireland**
SHF	**Shareholder Fund**
SL Intl	**Standard Life International designated activity company**
SLAC	**The Standard Life Assurance Company**
SLAL	**Standard Life Assurance Limited**
SLAESL	**Standard Life Assets and Employee Services Limited**
SLIF	**Standard Life Investment Funds Limited**
Solvency II	**The Solvency II Directive (2009//138/EC) is the set of regulations that regulate the insurance firms within the EU.**
The Court	**Court of Session**
The Scheme	**Scheme of Transfer under Part VII of the Financial Services and Markets Act 2000 of the euro-denominated life assurance business of SLAL to SL Intl.**
TMTP	**Transitional Measure on Technical Provisions**
Technical Provisions	**The sum of the best estimate of liabilities, unit liability and the risk margin less the TMTP**
Technical Provisions as a whole	**The best estimate and the risk margin are typically calculated separately. However where the future cash flows can be replicated reliably using financial instruments for which a reliable market value is observable (such as unit linked fund values) then the value of technical provisions equals the market value of those financial instruments ('technical provisions as a whole'). This is referred to as the "Unit liability" throughout the document.**
UKSMWPF	**UK Smoothed Managed With-Profits Fund**
VA	**Volatility Adjustment**
WPA	**With-Profits Actuary**

WPC	**With-Profits Committee**