

# Scottish Equitable plc and The Royal London Mutual Insurance Society Limited

**Report by the Independent Expert on the proposed transfer of certain business of Scottish Equitable plc to The Royal London Mutual Insurance Society Limited by means of a Scheme under Part VII of the Financial Services and Markets Act 2000**

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For and on behalf of Hymans Robertson LLP

22 February 2024

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Where a term is underlined in this report, this indicates that it is explained in the glossary, which can be found in Appendix 1. A number of abbreviations are also used throughout this report. These are defined where they are first used and also in Appendix 2.

# 1. Introduction

## Background

- 1.1. Scottish Equitable plc (“SE plc”) and The Royal London Mutual Insurance Society Limited (“Royal London”) propose to transfer a portfolio of individual protection business (“the Transferring Policies”) from SE plc to Royal London. The business will be transferred by means of the process set out in Part VII of the Financial Services and Markets Act 2000 (“FSMA”). SE plc and Royal London (together, “the parties”) are both authorised insurance companies. SE plc is registered in Scotland and Royal London is registered in England and Wales.
- 1.2. Following a strategic review of its business, Aegon UK plc (“Aegon”) concluded that individual protection business is no longer part of its core strategy and therefore decided to transfer this block of business from its insurance subsidiary company SE plc to another insurance company. On 4 April 2023, SE plc entered into an agreement to transfer its individual protection book of business to Royal London (the “Framework Agreement”) and at the same time closed its book of individual protection business to new business. Royal London views the transfer as an opportunity to increase the size of its portfolio of protection business, to generate an attractive return for its members that receive a share of Royal London’s profits, and to achieve greater economies of scale.
- 1.3. The parties plan to make an application to the High Court of Justice in England and Wales (the “Court”) to sanction a scheme of transfer (the “Scheme”) which is planned to take effect on 1 July 2024 (the “Transfer Date”). In the interim, a temporary reinsurance arrangement has been put in place with the effect that the economic exposure of the portfolio was transferred from SE plc to Royal London from 1 July 2022. Should the Court sanction the Scheme, the temporary reinsurance arrangement will cease on the Transfer Date.
- 1.4. Based on data as at 30 June 2023, the Scheme will result in the transfer of c.417,000 policies from SE plc to Royal London. The table below sets out a broad breakdown of the Transferring Policies by product type, benefit, and number.

**Figure 1: Breakdown of the Transferring Policies**

Product Type	Benefit	Number of policies ('000)
<u>Level Life Term Insurance</u>	Level death benefit	205
<u>Reducing Life Term Insurance</u>	Reducing death benefit	62
<u>Critical Illness Insurance and Life Insurance with Critical Illness</u>	Level or reducing benefit payable on death or diagnosis of <u>critical illness</u>	73
<b>Other Products</b>	Various, including: <u>Income Protection</u> , <u>Family Income Benefit</u> , <u>Whole of Life</u> and <u>Gift Inter Vivos</u> , <u>multi-benefit policies</u>	77
<b>Total</b>		<b>417</b>

Source: SE plc

- 1.5. As at 31 January 2023, there were 102 Transferring Policies the holders of which were resident in the Isle of Man, Jersey or Guernsey, some of whom were also resident in the Isle of Man, Jersey or Guernsey when they took out their policies. Based on legal advice commissioned by SE plc, Royal London and SE plc intend that such policies taken out by customers at the time resident in the Isle of Man and Jersey will be transferred pursuant to the Scheme, with no requirement for a separate scheme of transfer in those jurisdictions. However, the holders of four policies were resident in Guernsey at the time they took out their policies, and these policies cannot be included in the Scheme. Rather than present a separate scheme to the Royal Court of Guernsey, which would otherwise be needed, the parties intend to write directly to the holders of these four policies with a view to seeking their permission to novate their policies to Royal London. SE plc has had initial conversations with the holders of these four policies and no objections to this were raised. The working assumption is therefore that these policies will be novated, and SE plc intends to write to these policyholders following the Directions Hearing to seek their written consent to the novation. While they are not covered by the Scheme, I am content that the conclusions I reach in this report would apply equally to these four policies as if they were in the scope of the Scheme.
- 1.6. Should any of the holders of four policies who were resident in Guernsey at the time they took out their policies not agree to the intended novation, the relevant policies would remain with SE plc. Consideration would then be given to either transferring them via a separate scheme presented to the Royal Court of Guernsey, or to the policies being permanently reinsured to and administered by Royal London for the remainder of their term.
- 1.7. For the avoidance of doubt, it is the parties' intention that policies taken out in the UK, the holders of which now reside in the Isle of Man, Jersey or Guernsey will also be transferred pursuant to the Scheme.
- 1.8. For ease of reference, I use the term "Remaining Policies" throughout this report to refer to those SE plc policies which are not Transferring Policies or Residual Policies (if any) as defined in paragraph 5.8. I also use the term "Existing Policies" to refer to policies already written in (or transferred to) Royal London prior to the Transfer Date.

### Instructions

- 1.9. The parties' application to the Court must be accompanied by a report on the terms of the transfer (the "Scheme Report"), produced by a person nominated or approved by the Prudential Regulation Authority ("PRA") for that purpose (the "Independent Expert"). I have been instructed jointly by the parties to report in the capacity of Independent Expert on the terms of the Scheme pursuant to Section 109 of FSMA. My appointment as the Independent Expert has been approved by the PRA in consultation with the Financial Conduct Authority ("FCA").
- 1.10. The purpose of my work is to provide a comprehensive Scheme Report on the likely effects of the proposed Scheme. My duty is to the Court, and this Scheme Report is primarily for the purpose of assisting it in considering the Scheme presented to it for sanction under Section 111 of FSMA. While not the primary audience of my Scheme Report, I also expect it to be used by:
- the policyholders of SE plc and Royal London, to assist them in understanding the likely effects of the proposed Scheme,
  - the directors and senior management of SE plc and Royal London, to assist them in their decision on whether to present the proposed Scheme to the Court,
  - the PRA and the FCA, and
  - the professional advisers of any of the above assisting in the implementation of the proposed Scheme.

1.11. My fees for preparing the Scheme Report will be paid jointly by SE plc and Royal London, split equally between them.

### Scope of the Scheme Report

1.12. My terms of reference, which include rules on expert evidence, and details of how I have fulfilled them are set out in Appendix 3. The form of this Scheme Report has been approved by the PRA in consultation with the FCA.

1.13. The Scheme Report considers the likely effects of the terms of the Scheme in general, but its principal focus is to consider the likely effects of the Scheme on the policyholders of SE plc and Royal London. Consideration is also given to the likely effects on different classes of business, to assess whether the Scheme is expected to have a greater impact on any particular classes in isolation. In that regard, I separately consider the likely effects of the Scheme on unit-linked, other non-profit, and with-profits policies as the main classes of business in SE plc and Royal London.

1.14. My terms of reference require me to assess whether the Scheme is likely to have a material adverse effect on any group of policyholders, in which regard, I separately consider the likely effects of the Scheme for the main classes of business comprised in the Transferring Policies, the Remaining Policies, and the Existing Policies. My assessment of whether the Scheme is likely to have a material adverse effect is ultimately a matter of judgement regarding the likelihood and impact of possible future events.

1.15. In forming my views of what constitutes a material adverse effect, I have had regard to considerations arising from the Court of Appeal's judgement in connection with the recent transfer of a portfolio of annuities from The Prudential Assurance Company Limited to Rothesay Life Plc. This clarified that an adverse effect will only be material to the Court's consideration if (paraphrasing slightly to fit with my drafting): (i) it cannot sensibly be ignored given the nature and gravity of feared harm in the particular case; (ii) it is a consequence of the Scheme in question; and (iii) it is material in the sense that there is the prospect of real or significant (as opposed to fanciful or insignificant) risk to the position of the stakeholder concerned.

1.16. Taking this concept of materiality into account, I would therefore consider the particular Scheme proposed to have a material adverse effect if any of the following were true:

- the Scheme is likely to have a material adverse effect on the benefits expected to be provided to any group of policyholders,
- the Scheme is likely to have a material adverse effect on the level of service that will be provided to any group policyholders, and
- the Scheme is likely to have a material adverse effect on the security of benefits provided to any group of policyholders.

1.17. My determination of whether the level of benefits expected to be paid under a policy reduces as result of the Scheme has been carried out separately for each of the main classes of business, i.e. unit-linked, other non-profit and with-profits contracts. In assessing the impact of the Scheme, my assessment includes consideration of the impact of the application of discretion in the management of the business.

1.18. My determination of whether the security of policyholder benefits is materially reduced as a result of the Scheme is based primarily on the regulatory balance sheets (in some instances with adjustments described later in this report) of SE plc and Royal London, but with consideration also given to risks not captured by those balance sheets, such as risks where holding capital is not an appropriate mitigant or risks which may emerge after the first year. In particular, my determination will consider how the level of

capital held compares to the regulatory requirements, taking into account the risks to which each firm is exposed.

### Status, credentials and independence

- 1.19. I have provided the PRA and the FCA with a statement of my suitability and my independence to fulfil the role of the Independent Expert reporting on the proposed Scheme. My peer reviewer has also provided a similar statement.
- 1.20. I am a partner of Hymans Robertson LLP (“Hymans Robertson”, “we”, “us”, “our”, etc) and a Fellow of the Institute and Faculty of Actuaries (“IFoA”), having qualified in 1999. I have held the Chartered Enterprise Risk Actuary designation since 2011. I hold the Chief Actuary (Life) and With-Profits Actuary practising certificates issued by the IFoA.
- 1.21. In detailing my independence, the independence of those Hymans Robertson employees who have assisted me in preparing this Scheme Report, and that of my peer reviewer, the following matters were disclosed:
- Over the last 10 years, Hymans Robertson has provided consulting services to both Aegon and Royal London, all unrelated to the proposed transfer. The resulting fee income has been modest, at less than 0.6% of Hymans Robertson’s total revenue over that period, and never more than 1% in any financial year.
  - Our personal remuneration is not influenced by, or related to, the outcome of the proposed Scheme. There are no financial incentives, of which I am aware, that could act as an impediment to our independence.
  - None of us, nor any of our immediate families, have any policies, investments, shareholdings or other financial interests in Aegon or Royal London.

### Other advice and opinions

- 1.22. Leigh-Ann Plenderleith, who is the Chief Actuary for SE plc; Alan McBride, who is the With-Profits Actuary for SE plc; Anthony Lee, who is the Chief Actuary for Royal London; and Brian Peters, who is the With-Profits Actuary for Royal London, have each prepared separate reports on the Scheme for their respective firm’s Board. I have relied on the information and analysis set out in these reports, and I note their conclusions in respect of the likely effects of the Scheme, including on policyholders’ benefit expectations and on the future security of those benefits.

### Reliances and limitations

- 1.23. The Scheme Report is subject to the terms and conditions (including the reliances and limitations) of an engagement letter among Hymans Robertson LLP, Aegon UK Corporate Services Limited and Royal London, with an effective date of 31 May 2023.
- 1.24. Prior to being lodged with the Court, the Scheme Report (or drafts thereof) may also be provided to the management and advisers of Aegon and Royal London who have a reasonable requirement to have a copy in the execution of their duties or to ensure the effective implementation of the Scheme.
- 1.25. The parties have provided me with all of the information that I have requested. The principal documents that I have reviewed in preparing the Scheme Report are listed in Appendix 4. I have also had access to and discussions with senior management of SE plc and Royal London to assist me in completing my report. I have reviewed the information provided and, where it appeared to me to be necessary, have sought further detail and clarification. Having considered the explanations and additional information provided by SE plc and Royal London, I am satisfied with the reasonableness, consistency and

completeness of the written and oral information provided. However, I would note that my review is not, and should not be considered to be, a full validation of the information provided. In that context, I have necessarily relied on the information provided to me.

- 1.26. I have considered whether any elements of the Scheme and its implementation introduce matters which are outside my professional and practical experience as an actuary working in the life insurance and financial services industry. In particular, I have considered whether there are any aspects of the Scheme which rely on legal or tax opinions or advice and which would materially influence my assessment of the Scheme and the conclusions which I have reached. In my opinion, there are no such features present in the Scheme and I have not considered it necessary to seek expert advice on such matters.
- 1.27. The Scheme Report should be considered in its entirety as individual sections, if taken in isolation, could be misleading. I have provided a summary of the Scheme Report for inclusion in the communications to the various groups of policyholders (and, where relevant, distributed to any persons requesting a copy of such communications). Any other purported summary of the Scheme Report or part thereof must not be treated as having been approved or authorised by me.
- 1.28. The Scheme Report has been prepared on an agreed basis for SE plc and Royal London and must not be relied upon for any other purpose than that intended, namely to report to the Court on the terms and likely effects of the Scheme. No liability will be accepted for use of the Scheme Report for any purpose other than for which it was intended, nor for any misunderstanding of any aspect of the Scheme Report by any user. No liability is accepted to any third parties unless it has been accepted in writing. Furthermore, no liability will be accepted under the terms of the Contracts (Rights of Third Parties) Act 1999. Draft versions of the Scheme Report may not be relied upon by any person for any purpose and must not be used or distributed by SE plc or Royal London (or any other party receiving such a draft).
- 1.29. This report should not be interpreted as fact or likelihood or expectation of a particular financial outcome. Any assessment of the likely effects of a Scheme on the various affected classes and groups of policies is ultimately a matter of judgement regarding the likelihood and impact of possible future events. Given the inherent uncertainty of the outcome of such future events, it is not possible to be certain about their effect on the policies. Hymans Robertson therefore accepts no liability of any kind for any resulting loss, whether direct or indirect, from any decisions made using the information contained in this report. Any analysis included is provided “as-is” and without warranty or guarantee of any kind.
- 1.30. Hymans Robertson does not provide legal services and therefore we accept no liability to SE plc or Royal London, or to any other third party, in respect of any opinions on legal matters. Furthermore, and noting my comments in paragraph 1.26, nothing in this report should be considered to be investment, accounting or tax advice, which are also outside of the scope of our work. The parties will therefore need to take their own advice in respect of any such matters arising out of this report. No part of this Scheme Report should be taken as a recommendation for any person to maintain, surrender, invest further or refrain from investing in policies issued by any relevant subsidiaries of Aegon (including SE plc) or by Royal London.
- 1.31. The information in the report has been compiled by Hymans Robertson and is based upon our understanding of legislation and of events at the date of this report. I will prepare a supplementary report for the Sanction Hearing, expected to be held on 14 June 2024, at which the approval of the Scheme will be considered by the Court, to confirm or otherwise update the conclusions set out in the Scheme Report in the light of any changed circumstances.

### **Regulatory and Professional Guidance**

- 1.32. The Scheme Report has been prepared in line with the regulatory guidance issued by the PRA, as set out in Statement of Policy “The PRA’s approach to insurance business transfers” January 2022. Its

preparation is also in line with the regulations set out in Chapter 18 of the Supervision Manual of the FCA Handbook (“SUP 18”) and the FCA’s guidance set out in Finalised Guidance “FG22/1: The FCA’s approach to the review of Part VII insurance business transfers”. Compliance with these requirements is demonstrated in Appendix 5.

1.33. The Financial Reporting Council sets out technical actuarial standards for members of the IFoA. This report is subject to and complies with the following standards:

- Technical Actuarial Standard 100: General Actuarial Standards, and
- Technical Actuarial Standard 200: Insurance.

1.34. In addition, the IFoA sets professional standards for its members. This report has been prepared having due regard to APS X2: Review of Actuarial Work and has been subject to independent peer review.

### Structure of the Scheme Report

1.35. The remainder of the Scheme Report is structured as follows:

- Section 2 sets out a summary of the Scheme Report and its conclusions.
- Section 3 provides background to SE plc.
- Section 4 provides background to Royal London.
- Section 5 provides an outline of the Scheme.
- Section 6 discusses the likely impact of the Scheme on the financial positions of SE plc and Royal London.
- Section 7 analyses the likely effects of the Scheme on the holders of SE plc’s Transferring Policies.
- Section 8 analyses the likely effects of the Scheme on holders of SE plc’s Remaining Policies.
- Section 9 analyses the likely effects of the Scheme on holders of Royal London’s Existing Policies.
- Section 10 analyses the likely effects of the Scheme on other stakeholders.
- Section 11 describes the communications to be made to policyholders in relation to the Scheme and my review of these communications.
- Section 12 discusses other considerations arising from the Scheme.
- Section 13 discusses the potential consequences of the Scheme not completing.
- Section 14 sets out my conclusions.
- Section 15 certifies that the Scheme Report complies with Part 35 of the Civil Procedure Rules, Practice Direction 35 and Guidance for the instruction of Experts in Civil Claims.

I then include a copy of my summary report for policyholders.

The Scheme Report also has six appendices:

- Appendix 1 provides a glossary for certain terms used throughout the Scheme Report. Where a term is underlined in the Scheme Report, this indicates that it is explained in the glossary.



- Appendix 2 provides definitions of the abbreviations used throughout the Scheme Report.
- Appendix 3 sets out my terms of reference, and how I have fulfilled them.
- Appendix 4 lists the principal documents I have considered and relied upon in preparing the Scheme Report.
- Appendix 5 sets out how the Scheme Report complies with the relevant regulatory rules and guidance.
- Appendix 6 describes the prudential regulatory regime for life insurers regulated in the United Kingdom (“UK”).

## 2. Executive Summary

### Background to the parties

2.1. SE plc is a public limited company and is part of the Aegon Group. It primarily sells and services individual and group pension business, but it also manages existing protection, whole of life, and conventional annuity business. Royal London is a UK-based mutual life, pensions and investment company. Royal London offers long-term savings, protection and asset management propositions and is the parent company in the Royal London Group. The governance and management of SE plc and Royal London are broadly comparable.

### Outline of the Scheme

- 2.2. Other than for the four Guernsey policies outlined in paragraph 1.5, the Scheme is intended to transfer all of SE plc's individual protection business to Royal London. At 30 June 2023 there were c.417,000 Transferring Policies. There will be no changes to policy terms and conditions as a result of the Scheme, other than changing references from SE plc to Royal London.
- 2.3. The Scheme will also transfer to Royal London a number of contracts relating to the Transferring Policies, including SE plc's reinsurance treaties relating to the Transferring Policies.
- 2.4. Administration of the Transferring Policies will continue to be carried out by Atos BPS Limited ("Atos"). SE plc's contract with Atos will not transfer as part of the Scheme, but will be terminated and replaced on the Transfer Date by a new agreement between Atos and Royal London on terms that are materially similar.
- 2.5. The holders of Transferring Policies will not become members of Royal London, nor will they become eligible to share in Royal London's profits through its "ProfitShare" programme.

### Benefit security

- 2.6. The parties have different ownership structures, business plans, and operating models, and each have capital management policies that set targets for their solvency coverage ratios. These capital management policies inevitably differ to some extent, but they have been approved as being appropriate by the parties' Boards, in the context of their businesses, the regulatory environment in which the parties operate, and the options available to them to manage their financial positions. I would therefore consider the two companies to be of approximately equal financial strength so long as they both complied with their capital management policies, which I note require each party to hold capital in excess of the regulatory minimum.
- 2.7. SE plc targets a solvency coverage ratio of over 135% but expects to operate holding a solvency coverage ratio of around 150% under business as usual circumstances. In addition to its regulatory capital position, Royal London manages its capital on an "investor view", as described in paragraph 4.64. Royal London has an acceptable range for its investor view solvency coverage ratio, the lower end of which is 165%. In practice Royal London expects to operate with a larger solvency coverage ratio than this. For both firms, if the solvency coverage ratios were to fall below the target level, management actions would be taken to return the capital position to the target level. Both parties complied with their capital management policies at 30 June 2023. Additionally, analysis of their pro-forma balance sheets shows that their solvency coverage ratios would also have complied with their capital management policies on 30 June 2023 had the Scheme become effective on that date and that no management actions would have been required to improve either party's capital position.
- 2.8. The quality of the parties' Eligible Own Funds is expected to be materially unchanged following the Scheme. While I note that Royal London's Eligible Own Funds are of a slightly lower quality, on average,

than SE plc's, I do not consider this to represent a material adverse effect to benefit security for Transferring Policies as Royal London complies with all relevant regulatory requirements in this regard.

- 2.9. Both SE plc and Royal London currently have regulatory approval to apply the Volatility Adjustment ("VA") and Matching Adjustment ("MA") in their valuation of certain liabilities. Additionally, Royal London also has approval to apply the Transitional Measure on Technical Provisions ("TMTP") for business that was in force on 1 January 2016. SE plc uses a Partial Internal Model ("PIM") to calculate its SCR and Royal London uses an Internal Model. I do not expect that the Scheme will impact either party's regulatory approvals, or the suitability of SE plc's PIM or Royal London's Internal Model for use in calculating their SCRs.
- 2.10. The parties are both currently exposed to similar risks and the Scheme is expected to have an immaterial impact on the parties' risk exposures, which are expected to remain within their risk appetite. The key risks transferring as part of the Scheme are mortality and morbidity risk.
- 2.11. As discussed in paragraph 2.3, SE plc's reinsurance treaties relating to the Transferring Policies will transfer to Royal London as part of the Scheme. I have assessed Royal London's expected exposure to these reinsurers following the Scheme relative to its risk appetite and am satisfied that the Scheme does not change its risk appetite position.
- 2.12. I have discussed future business plans with management of both parties, and these are unchanged by the Scheme. The ability to continue to write new business and otherwise implement business plans will be subject to each party's risk appetite frameworks and capital management policy. In that regard, I note that SE plc and Royal London have carried out projections of their solvency coverage ratios over their business planning periods. These analyses show that, following the Scheme, the parties are expected to continue to comply with their capital management policies over the projection period.
- 2.13. Overall, I am satisfied that the Scheme will not have a material adverse effect on the benefit security for holders of any group of policies.

### Benefit expectations

- 2.14. The Transferring Policies are entitled to benefits on claim, subject to their terms and conditions, which will not change as a result of the Scheme, other than changing references from SE plc to Royal London. SE plc applies discretion in a number of areas when managing the Transferring Policies. Royal London has reviewed these areas and will adopt approaches which are materially aligned with those currently applied by SE plc.
- 2.15. The Scheme will not change the terms and conditions of the unit-linked Remaining or Existing Policies. The Scheme will also not change the way in which SE plc or Royal London manage their unit-linked business, the charges applying to those lines of business, their unit-linked PPFMs (where relevant), and the range of unit-linked funds available to their policyholders.
- 2.16. The premiums payable and benefits due under non-profit Remaining and Existing Policies are codified in the policy terms and conditions, which will not be altered by the Scheme. SE plc and Royal London will also not change the way in which they apply certain areas of discretion in managing non-profit Remaining and Existing Policies as a result of the Scheme.
- 2.17. The Scheme will not change the terms and conditions of the with-profits Remaining or Existing Policies. The Scheme will not affect or dilute the rights of with-profits Remaining or Existing Policies to share in profits arising in the relevant firm. Similarly, the Scheme will not change the management of the with-profits business, including the way in which SE plc and Royal London apply discretion in managing their

with-profits business, e.g. in relation to investment strategy, the allocation of expenses, determining surrender values, and setting bonus rates.

- 2.18. The holders of Transferring Policies will not become members of Royal London and will not become eligible to receive distributions of Royal London's profits through ProfitShare. The Scheme will therefore not lead to any loss or dilution of the rights of Royal London's existing members to receive ProfitShare, which I also note does not form part of policyholders' benefit expectations.
- 2.19. Overall, I am satisfied that the Scheme will not have a material adverse effect on benefit expectations for any group of policyholders.

### Service standards

- 2.20. As discussed in paragraph 2.4, Atos will continue to administer the Transferring Policies, albeit under a new contract between Royal London and Atos, on materially similar terms to SE plc's current contract with Atos which will be terminated.
- 2.21. The contracts relating to the additional support services – marketed by SE plc as "Policy Plus" – that holders of the Transferring Policies have access to, and the bank account provided by Barclays Bank PLC (the "Barclays Bank Account" and "Barclays", respectively) which is used to manage cash flows in respect of the Transferring Policies, will be novated to Royal London with effect on the Transfer Date. The terms of these agreements will be unaffected by the transfer.
- 2.22. I am therefore satisfied that the Scheme will not have a material adverse effect on service standards for Transferring Policies.
- 2.23. SE plc's current administration agreement with Atos for the Transferring Policies also covers a small book of group protection Remaining Policies. As that agreement with Atos is to be terminated, SE plc intends to bring the administration of the group protection Remaining Policies into the scope of another agreement it has with Atos on identical terms.
- 2.24. There are no other planned changes as a result of the Scheme to policy administration or available additional services.
- 2.25. I am therefore satisfied that the Scheme will not have material adverse effect on service standards for the Remaining Policies or Existing Policies.

### Outsourced service providers

- 2.26. Other than as discussed in paragraphs 2.3, 2.20 and 2.23, there will be no other changes to existing outsourcing arrangements as a result of the Scheme. All outsourced service providers have been notified about the Scheme and have not raised any concerns. I am satisfied that the Scheme will not have a material adverse effect on the parties' outsourced service providers.

### Reinsurers and other stakeholders

- 2.27. As discussed in paragraphs 2.3, SE plc's reinsurance treaties relating to the Transferring Policies will transfer to Royal London as part of the Scheme. I have considered those reinsurers' current exposures to Royal London, compared to their expected exposures following the implementation of the Scheme, and I am satisfied that they are not expected to change materially as a result of the transfer.
- 2.28. The parties' reinsurers, pension schemes, and – where relevant – insurance subsidiaries have been notified about the Scheme and have not raised any concerns. Royal London does not intend to individually notify all holders of its subordinated debt given the modest impact of the Scheme on its capital position. As the analysis and conclusions set out in paragraphs 2.6 to 2.13 in respect of policyholders

apply equally to these stakeholders, and noting also that I do not expect that the Scheme will have a material adverse effect on benefit expectations, I am satisfied that I do not expect the Scheme to have a material adverse effect on any of these stakeholders.

### **Policyholder communications**

- 2.29. I have reviewed the parties' proposed approach to notifying policyholders. I have reviewed the notification packs that will be sent to the relevant policyholders, as well as the information that will appear on the parties' websites. I am satisfied that the notification packs adequately describe the key features of the Scheme and are written in a language that I consider to be appropriate for the intended recipients. I am similarly satisfied with the information that will appear on the parties' websites.
- 2.30. There are certain groups of policyholders who the parties do not intend to notify directly, which needs waivers from the requirement to otherwise do so. I support the waiver applications that the parties intend to make.

### 3. Background to SE plc

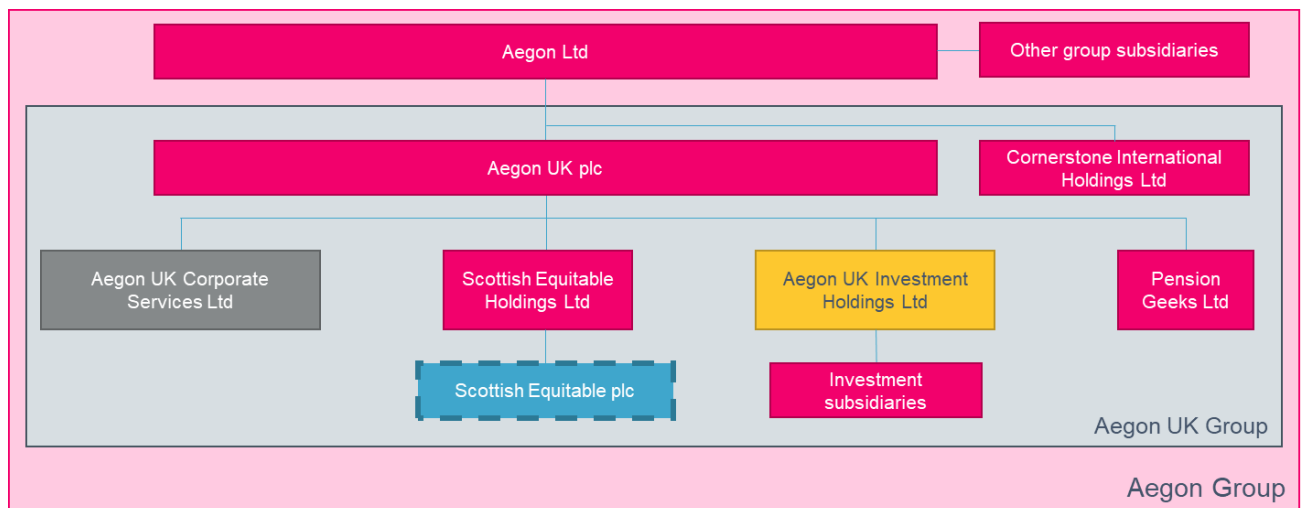
#### Background and history

- 3.1. SE plc originated from the Scottish Equitable Life Assurance Society, which was founded in Edinburgh in 1831. The society was demutualised in 1993, and its assets and liabilities were transferred into the newly-incorporated Scottish Equitable plc. Upon demutualisation, Aegon N.V. (a Netherlands-based public company, listed on the Amsterdam Stock Exchange) took a 40% stake in SE plc. This stake increased to 100% in 1998, shortly before SE plc became a part of the newly-established Aegon UK group. On 30 September 2023, Aegon N.V. was redomiciled to become a Bermudan-based company and was renamed Aegon Ltd.
- 3.2. SE plc is now a public limited company registered in Scotland, operating under the laws of Scotland and the laws of England and Wales. It primarily sells and services unit-linked individual and group pension business through sales intermediaries, but it also manages existing with-profits, individual protection (covering against death, critical illness and sickness), group protection, unit-linked whole of life, and conventional annuity business.
- 3.3. Scottish Equitable is authorised by the PRA and regulated by the PRA and the FCA.

#### Group structure

- 3.4. SE plc is wholly owned by Scottish Equitable Holdings Ltd, as summarised in **Figure 2**. Scottish Equitable Holdings Ltd is part of the Aegon UK group, which belongs to the Aegon Group and its ultimate parent company, Aegon Ltd. The wider Aegon Group companies not based in the UK are not shown.

**Figure 2: SE plc's position within the Aegon Group**



**KEY:**

- Solvency II regulated insurance undertakings
- Regulated companies
- Management service company
- Other companies

Source: SE plc's 2022 SFCR, updated to reflect change in parent company from Aegon N.V. to Aegon Ltd on 30 September 2023

### Outsourcing

- 3.5. SE plc currently outsources the following functions related to managing and administering its individual protection business to Atos:
- operations,
  - underwriting and claims,
  - IT, and
  - service delivery.
- 3.6. SE plc also uses a Barclays Bank Account to manage cash flows in respect of the individual protection business, for example receiving direct debit premiums and paying policyholder claims.
- 3.7. A small book of group protection claims-in-payment policies, which do not form part of the Transferring Policies, currently falls into the scope of the outsourcing arrangement with Atos noted in paragraph 3.5.
- 3.8. Atos also currently provides administration services for an older block of unit-linked pensions and investment bond business as part of a separate outsourcing arrangement. SE plc has started the process of migrating this business to a platform serviced by Sapiens International Corp NV (“Sapiens”), although Atos will continue to provide the administration services for these policies. This migration is unrelated to the Scheme.
- 3.9. SE plc also outsources finance and property support services to Aegon UK through its group services company, Aegon UK Corporate Services Ltd.
- 3.10. The core services provided under the outsourcing arrangements described above are subject to agreed service levels. Performance against these service levels is tracked over time and monitored through an established joint governance framework between SE plc and the providers of outsourced services.

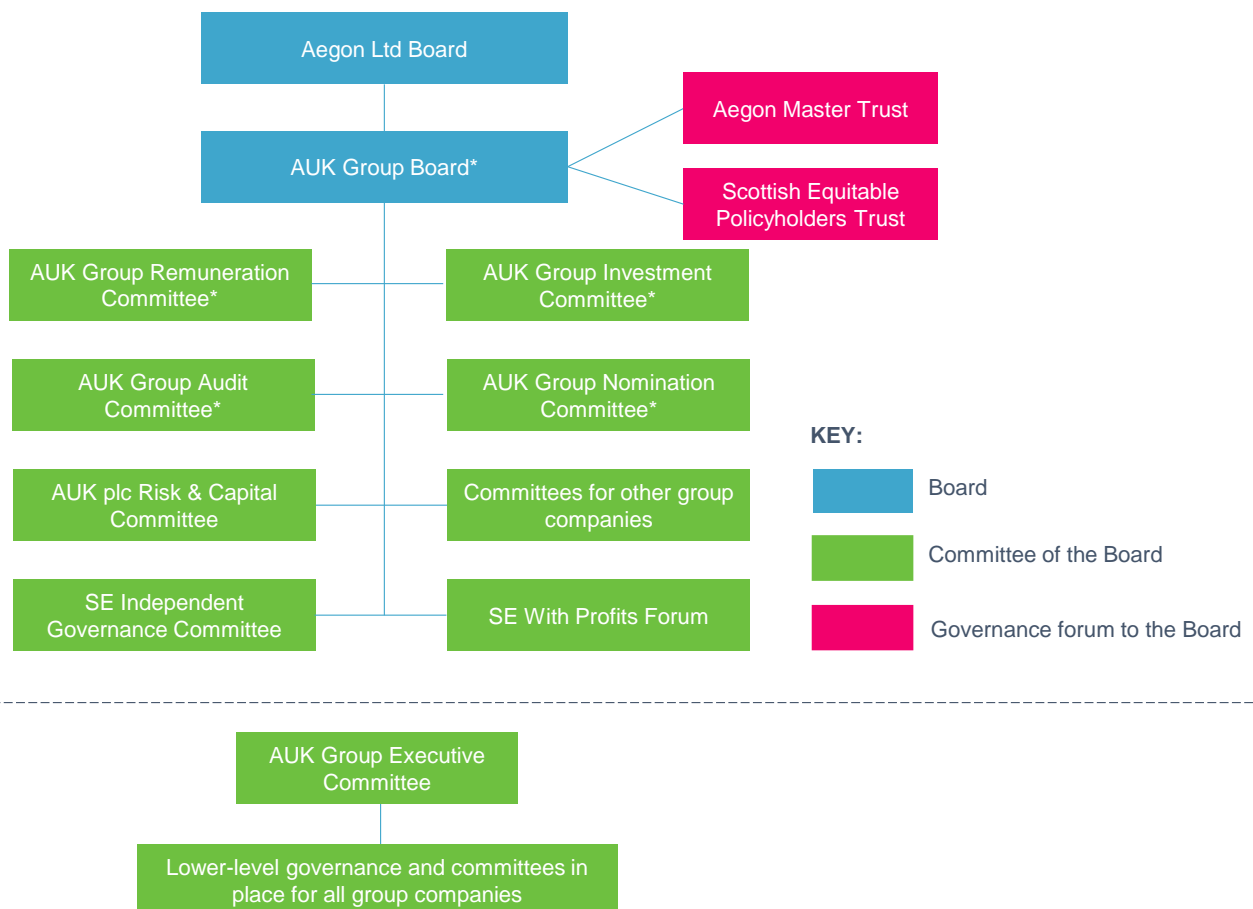
### Value-add services

- 3.11. All holders of Transferring Policies have access to a range of additional support services throughout the term of their policy, marketed by SE plc as “Policy Plus”. These services include health and wellbeing support, key person replacement services, as well as second medical opinions, and are provided through SE plc’s contracts with Health Assured Ltd, FPSG Connect Ltd and Red Arc Assured Limited, respectively. It is proposed that these contracts will be novated to Royal London with effect on the Transfer Date.

### Management and governance

- 3.12. The Aegon UK Group Board acts as the SE plc Board. It oversees the company and assumes overall management responsibilities of the company (except for “reserved matters” which require prior written approval of the Executive Board and/or the Supervisory Board of Aegon Ltd, for example any major organisational changes or changes in lines of business). **Figure 3** illustrates SE plc’s governance structure.

Figure 3 : SE plc's system of governance



Source: SE plc's 2022 SFCR, updated to reflect change in parent company from Aegon N.V. to Aegon Ltd

\* With over-arching responsibility for Aegon UK plc and its subsidiary companies

- 3.13. SE plc's Board and the other committees shown above each have a terms of reference setting out their purpose, membership, procedures, duties, responsibilities, and reporting requirements. In its 2022 Annual Report, SE plc stated that its approach to corporate governance is based on the UK Corporate Governance Codes, but that it has not formally applied any corporate governance code.
- 3.14. SE plc's Board comprises of seven non-executive directors (including the Chairman of the Board), the Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO").
- 3.15. The Aegon UK Group has an Executive Committee which is comprised of the following Aegon UK directors and senior leadership:
- CEO (the Chair of the Executive Committee),
  - CFO,
  - Chief Risk Officer ("CRO"),
  - Chief Marketing Officer,
  - General Counsel and Company Secretary,
  - Chief Distribution Officer,



- Chief Service Officer,
- HR Director,
- Transformation Director, and
- Chief Technology Officer.

Its purpose is to provide executive management of each company, including SE plc, on behalf of the Aegon UK Group Board, and it operates through its own sub-committees that are not detailed in the organisational chart shown in **Figure 3** above.

3.16. The high-level responsibilities of the committees and governance forums shown in **Figure 3** which are relevant to SE plc are set out below:

- Aegon UK Group **Remuneration Committee** recommends the remuneration philosophy of Aegon UK. In particular it determines and regularly reviews specified remuneration packages for the senior leadership of the Aegon UK Group companies. The committee also consults with the Aegon UK CEO on their proposals relating to the remuneration of other executives.
- Aegon UK Group **Investment Committee** oversees the management of investment performance of SE plc's unit-linked funds and the non-insured funds belonging to other Aegon UK group companies. It also oversees investment proposition development for the group.
- Aegon UK Group **Audit Committee** oversees internal control and financial reporting matters.
- Aegon UK Group **Nomination Committee** recommends the appointment of executive and non-executive directors, direct reports of the Aegon UK CEO, and leads the Board appointment process of each group company.
- The **Risk & Capital Committee** of Aegon UK Group oversees management of risk and capital for all entities in the Aegon UK Group.
- The SE plc Board uses SE plc's **With-Profits Forum** to discharge most decision-making responsibilities relating to the governance of with-profits business, including for setting with-profits bonus rates, investment strategy, and other key elements of the management of with-profits business.
- The **Independent Governance Committee** ("IGC") advises the SE plc's Board on matters relating to value for money of workplace pensions and investment pathways.
- The **Scottish Equitable Policyholders' Trust** ("SEPT") advises the SE plc Board on matters relating to with-profits business but does not hold the same decision-making responsibilities as the With-Profits Forum. In this regard, the SEPT carries out the role of the With-Profits Committee as defined in FCA rules.
- The **Aegon Master Trust Board** may escalate issues to the SE plc Board in relation to its purpose of performing the functions given to the Trustees of the Aegon Master Trust.

3.17. SE plc also maintains the following key internal governance functions, as required by Solvency II:

- a risk management function, which is independent of business operations and holds the responsibility for monitoring and reporting of risk,

- an actuarial function that coordinates the calculation of Technical Provisions, provides opinions on the underwriting policy and reinsurance arrangements, and contributes to the effectiveness of the risk management system,
- a compliance function that provides independent oversight and monitoring of regulatory compliance, which supports the business in managing its regulatory risk exposures appropriately, and
- an internal audit function which provides independent, objective assurance over the complete control framework reporting to the Chair of the Aegon UK Group Audit Committee and with direct access to all Executive Committee members, including the CEO.

### Business lines

3.18. SE plc's portfolio of insurance business consists of unit-linked business (across life and pensions), non-profit business (including protection business, annuities and health), and with-profits business (both conventional with-profits and unitised with-profits). **Figure 4** below shows SE plc's Solvency II BEL (gross of reinsurance) and policy count for each line of business as at 31 December 2022.

**Figure 4: Breakdown of SE plc's BEL and policy count at 31 December 2022**

Line of business	Product Type	Number of policies ('000)	<u>BEL</u> <sup>1</sup> (£m)
<u>Conventional with-profits</u>	Life	1	31.8
	Pensions	6	27.5
<u>Unitised with-profits</u>	Life	5	197.2
	Pensions	90	2,383.8
<u>Unit-linked</u>	Life	18	727.0
	Pensions	2,875	73,402.5
	Health	0	0.0
<u>Non-profit</u>	<u>Protection</u>	420	(17.6)
	Health	21	(13.4)
	Other	0	15.6
<u>Accepted reinsurance</u>	<u>Annuity</u>	31	433.0
<b>Total</b>		<b>3,467</b>	<b>77,187.4</b>

Source: SE plc

(1) BEL is shown gross of reinsurance

- 3.19. The accepted reinsurance business shown in **Figure 4** relates to annuity business that is reinsured from Reassure Ltd to SE plc, under which SE plc meets all future costs for the underlying annuity obligations.
- 3.20. Scottish Equitable has a single long-term insurance fund, which is split into a Non-Profit Sub-Fund (“NPSF”), a With-Profits Sub-Fund (“WPSF”), and a shareholder fund. Profits and losses in the NPSF are for the benefit of the shareholder. Profits and losses in the WPSF are for the benefit of the with-profits policyholders. The shareholder charges an annual management fee for certain business in the WPSF.
- 3.21. The WPSF contains conventional with-profits policies and the investment element of unitised with-profits policies. It is also liable to meet the cost of certain annuity guarantees attaching to unit-linked policies in the NPSF. The NPSF contains all other insurance policies, and all new business is written into the NPSF. The Transferring Policies currently sit in the NPSF. The WPSF has been closed to new business since 2013, with the exception of certain contractual obligations such as regular premiums. As at 31 December 2022, there was c.£3.4bn of assets in the WPSF and c.£78.1bn of assets in the NPSF and shareholder fund.

### The application of discretion

- 3.22. SE plc can exercise discretion in the management of its individual protection, group protection, with-profits and unit-linked business, and the ways in which it can do this are detailed in the following sub-sections.

### Individual protection business

- 3.23. SE plc exercises discretion in a number of areas when managing its individual protection business, including:
- **Claims underwriting:** The standards applied when deciding whether to make a claim payment will affect the likelihood of a claim being accepted (partially or fully) or declined.
  - **Reviewable premiums:** Some policyholders have elected to have reviewable premiums on their policy. Where this is the case, premiums are reviewed every five years, taking account of changes in the pricing factors defined in the policy terms and conditions, excluding any changes in personal circumstances of the policyholder. These factors include demographic and economic assumptions, which are set at the discretion of SE plc on a best-estimate basis, although SE plc aims to maintain the same level of profitability before and after premium reviews. Where premiums increase, policyholders can choose to pay the higher premium for the same benefit, continue to pay the same premium for a reduced benefit, or to cancel their policy. For policies sold before September 2005, the reinsurer performs the premium review on SE plc’s behalf (with SE plc’s agreement on the final rates proposed) due to the nature of the reinsurance arrangement where the reinsurance premium is equal to the premium paid by the policyholder. Terms and conditions for these policies state that premium reviews will be set using principles that ensure the level of benefits after the review will be maintained to the same degree as before the review.
  - **Benefit commutation:** Some Family Income Benefit policies pay a level of income to beneficiaries on the death or serious illness of the life assured. While it is not a contractual option, beneficiaries often request that this income be converted into a lump sum, and indeed this is offered to beneficiaries at the point of claim. Approval for this request and the basis used to calculate the lump sum is at the discretion of SE plc. If approved, the lump sum is calculated on a cost-neutral basis, such that SE plc neither profits nor loses from granting the request, using a basis that is reviewed quarterly.
  - **Guaranteed insurability option:** Most individual protection policies have the option to increase the level of benefit following any of the life-changing events defined in the policy terms and conditions.

Should this option be exercised, the policy is typically re-priced such that the premium payable matches what a new policyholder would pay for the same level of benefit, without additional underwriting. The pricing basis used to calculate the premium is at the discretion of SE plc.

- **Renewal option:** Most individual protection policies have the option to extend insurance cover for a term equal to that of the original contract, with the same level of benefit, without any further underwriting. At the time of exercising this option, SE plc sets premiums in line with rates offered to new business customers, reflecting the policyholder's age at the time. Premiums are therefore generally expected to increase as a result, but the policyholder is under no obligation to accept the terms offered. SE plc also reserves the right, within the policy terms and conditions, to decline or restrict cover based on the policyholder's financial position or then-current occupation.
- **Change of smoker status:** SE plc allows a policyholder that has not smoked for at least a year to request to change their smoker status (which is used as a factor by SE plc to set the premiums on policies) from smoker to non-smoker, and therefore to potentially benefit from a change in premium as a result. This request is not a contractual right outlined in the terms and conditions and is at the discretion of SE plc.

### Group protection business

3.24. The group protection policies relate to claims in payment that will continue until the expiry of the policy or until the death of the policyholder. While it is in theory possible to commute outstanding payments to a single lump sum, this is normally not considered, and so there are no real ongoing areas of discretion in the management of these group protection policies.

### With-profits business

- 3.25. SE plc has some key aspects of discretion in the management of its with-profits business, including setting investment strategy, determining bonus rates, and how and when to distribute the surplus of the WPSF.
- 3.26. The management of the WPSF is governed by the sub-fund's Principles and Practices of Financial Management ("PPFM") and the historical Scheme of Demutualisation. The PPFM outlines the approach to be taken for all areas of discretion in managing the WPSF, including the investment strategy, the management and use of the estate, and how policy pay-outs will be determined, which are set with reference to their asset share. The PPFM details how the asset share should be calculated for unitised and conventional with-profits business. The PPFM also discusses how regular and final bonuses should be set, how smoothing is applied, and how and when market value reductions ("MVRs") are applied.
- 3.27. As discussed in paragraph 3.16, the management of with-profits business is also governed by the With-Profits Forum and SEPT.
- 3.28. Assets in the NPSF and the shareholder fund are available to support the solvency of the WPSF should the WPSF have insufficient assets to meet its liabilities.

### Unit-linked business

3.29. SE plc can also exercise discretion with respect to its unit-linked business. The primary ways this can occur is in the way it sets unit prices for its unit-linked funds, and in setting the level of charges levied against those same funds and policies investing in them.

### Tax

3.30. The Transferring Policies include business which is taxed on a BLAGAB basis and business where corporation tax (currently 25% in the UK) is applied to trading profits. BLAGAB business is currently taxed at a rate of 20% on an 'Income less Expenses' basis.

3.31. There are c.4,000 life insurance policies included in the Transferring Policies which were sold under the rules of the Scottish Equitable Personal Pension Scheme. These policies are referred to as Life Protection with Tax Relief ("LPTR"). As a result, these policies benefit from tax relief on the life insurance policy premiums.

3.32. SE plc's Remaining Policies relate mostly to with-profits and unit-linked business which are currently taxed at a rate of 20% on an 'Income less Expenses' basis.

### Staff pension schemes

3.33. Aegon UK operates one defined benefit staff pension scheme and one defined contribution staff pension scheme. Aegon UK is responsible for funding the defined benefit scheme and for making contributions to the defined contribution scheme.

3.34. Aegon UK's defined benefit staff pension scheme is the Aegon UK Staff Retirement and Death Benefit Scheme. The pension scheme closed to new members in 2003 and to all future benefit accrual in 2013. Aegon UK is liable for the cost of contributions to fund the pension scheme and, as at 30 June 2023, the pension scheme had a small deficit on its "technical provisions" basis. As SE plc is the principal holding of Aegon UK, it is the primary source of capital to fund Aegon UK's pension scheme obligations. Past practice has been that where dividends are paid from SE plc, a portion of those dividends are paid in the pension scheme.

3.35. Aegon UK's defined contribution pension scheme is the Aegon UK Group Personal Pension Plan, which is currently open to new entrants.

### Reinsurance

3.36. SE plc uses reinsurance arrangements to manage exposure to risk on its individual protection business and annuity business. I summarise these arrangements in paragraphs 3.37 to 3.39.

3.37. At 30 June 2023, SE plc had 25 quota share reinsurance arrangements in place with nine reinsurers on its individual protection business. These arrangements cover mortality and morbidity risk, typically reinsuring between 75% and 90% of these risks. At 30 June 2023, SE plc had a positive exposure to all these counterparties reinsuring its protection business, which means that the reinsurer has a net total payment due to SE plc, with the opposite being true for a negative exposure.

3.38. SE plc also has an arrangement in place with another reinsurer to cover the investment experience of some of SE plc's annuities. At 30 June 2023, SE plc had a small negative exposure to this reinsurance counterparty.

3.39. In addition to the arrangements described above, there is also a temporary reinsurance arrangement with Royal London, as described in paragraph 1.3, under which SE plc has already transferred the economic exposure of the Transferring Policies to Royal London.

## Assets

3.40. **Figure 5** shows a high-level breakdown of SE plc's assets as at 31 December 2022.

**Figure 5: SE plc's asset portfolio as at 31 December 2022**

Asset Category	Asset Value (£m)	% of Total
<u>Deferred tax asset</u>	-	-
Pension benefit surplus	-	-
Property, plant & equipment held for own use	68.2	0.1%
Property (other than for own use)	106.9	0.1%
Holdings in related undertakings, including participations <sup>1</sup>	846.2	1.0%
Equities	889.3	1.1%
Government bonds	794.7	1.0%
Corporate bonds	708.6	0.9%
<u>Structured notes</u>	0.0	0.0%
<u>Collateralised securities</u>	156.3	0.2%
<u>Collective investment undertakings</u>	14.8	0.0%
Derivatives	32.9	0.0%
Deposits other than cash equivalents	242.8	0.3%
Assets held for <u>unit-linked</u> contracts	70,051.1	86.0%
Loans and mortgages	0.0	0.0%
<u>Reinsurance recoverables</u>	6,409.9	7.9%
Insurance and intermediaries receivables <sup>2</sup>	38.9	0.0%
<u>Reinsurance receivables</u>	47.0	0.1%
Receivables (trade, not insurance) <sup>3</sup>	993.0	1.2%
Cash and cash equivalents	53.0	0.1%
Other assets <sup>4</sup>	1.1	0.0%
<b>Total</b>	<b>81,454.8</b>	<b>100.0%</b>

Source: SE plc's 2022 SFCR

(1) Refers to the non-insurance subsidiaries (e.g. Scottish Equitable Managed Funds Ltd)

(2) Includes debtors arising out of direct insurance operations

(3) Relates to other debtors not captured elsewhere on the balance sheet

(4) Includes other assets not captured elsewhere on the balance sheet, e.g. dividends receivable

## Financial position

3.41. **Figure 6** sets out SE plc's regulatory balance sheet as at 31 December 2022.

**Figure 6: Regulatory balance sheet of SE plc as at 31 December 2022**

Balance Sheet as at 31 December 2022	£m
Assets (A)	81,454.8
<u>Best Estimate Liabilities</u> (B)	77,187.4
<u>Risk Margin</u> (C)	721.2
<u>Technical Provisions</u> (D = B + C)	77,908.6
Other liabilities (E)	1,475.7
Excess of assets over liabilities (F = A – D – E)	2,070.6
Restrictions to <u>Basic Own Funds</u> (G) <sup>1</sup>	77.8
<u>Basic Own Funds</u> (H = F – G)	1,992.8
<u>Eligible Own Funds</u> (I = H)	1,992.8
<u>Solvency Capital Requirement</u> (“ <u>SCR</u> ”) (J)	1,181.8
<u>Excess Own Funds</u> (K = I – J)	811
<u>Solvency coverage ratio</u> ( <u>Eligible Own Funds</u> / <u>SCR</u> ) (I / J)	169%

Source: SE plc's 2022 SFCR

(1) Funds ring-fenced for the WPSF

3.42. The “other liabilities” shown above is comprised of the following:

- £731.0m of derivatives,
- £9.7m of reinsurance payables,
- £149.4m of insurance payables,
- £313.4m of trade payables,
- £271.4m of deferred tax liabilities, and
- £0.8m of any other liabilities.

3.43. SE plc did not have any subordinated liabilities at 31 December 2022.

3.44. The Solvency II insurance regulatory regime requires insurers to rank their Eligible Own Funds by their quality in relation to the ability to absorb losses, subordination to insurance liabilities and/or debtholders, and term. All of SE plc's Eligible Own Funds are classified as Unrestricted Tier 1 Own Funds, which is the

highest quality ranking and is made up of the combination of ordinary share capital and the share premium account of SE plc.

### Solvency II implementation

- 3.45. Appendix 6 describes the UK prudential regulatory regime, including the concepts of Standard Formula, Partial Internal Model, TMTP, the MA, and the VA.
- 3.46. SE plc has regulatory approval to calculate its SCR for some risks using an Internal Model, and uses the Solvency II Standard Formula for the remaining risks for which it must hold capital under Solvency II. This combination of approaches and how the results from each are integrated collectively form SE plc's Partial Internal Model ("PIM").
- 3.47. The SCR, which is calculated using SE plc's PIM, is calculated by determining the amount that SE plc's Basic Own Funds could fall over the course of a year, such that the probability that the fall in Basic Own Funds is greater than the SCR is 0.5%. This is consistent with the calibration standard applying to the Standard Formula.
- 3.48. SE plc's PIM is subject to internal governance and external regulatory scrutiny. Internally, Aegon UK's CRO is responsible for the PIM. The Model Management Committee, a committee that oversees and manages the development of the PIM, is chaired by Aegon UK's Prudential Risk Director, who reports directly to the CRO. Externally, the PRA requires all regulated firms to demonstrate the appropriateness of using their Internal Models or the Standard Formula, or some combination of both (as is the case for SE plc).
- 3.49. In its 2022 Own Risk and Solvency Assessment ("ORSA"), SE plc stated that "*the Partial Internal Model for SE plc, including the underlying Internal Models, Standard Formula shocks, and aggregation methodology are considered fit for purpose to calculate the SCR". It justifies this statement based on its PIM Overarching Validation Report which sets out predominantly positive testing results of various aspects of the PIM.*
- 3.50. SE plc's PIM does not allow for certain risks either because they cannot be quantified or because there are reasonable grounds not to hold additional capital. Instead, these risks are captured as part of SE plc's annual ORSA process. Examples of such risks include climate change risk (see paragraphs 3.57 to 3.60) and liquidity risk (see paragraphs 3.69 to 3.71).
- 3.51. SE plc does not have regulatory approval to use the TMTP.
- 3.52. SE plc has regulatory approval to use the MA for most of its conventional annuities, which reduces the value of future liabilities on its regulatory balance sheet by linking the value of those liabilities to the value of the assets used to back them. Analysis presented in SE plc's 2022 SFCR shows the MA reduced the SCR by c.£15m and increased Basic Own Funds by c.£18m as at 31 December 2022. Removing these benefits would together have resulted in approximately a four percentage point reduction to the solvency coverage ratio (from c.169% to c.165%) as at 31 December 2022.
- 3.53. SE plc also has regulatory approval to use the VA in the valuation of some liabilities in the WPSF, to reduce the impact of short-term market volatility on its regulatory balance sheet. SE plc stated in its 2022 ORSA that this helps to support stable distributions of the estate of the WPSF. Removing the VA would have zero impact on the surplus or solvency coverage ratio of SE plc because the WPSF is ring-fenced from the rest of the business. However, it would result in greater volatility of the estate and therefore potentially SE plc's ability to maintain a stable distribution of the estate to with-profits policyholders.



### Risk profile

3.54. The most significant risks to which SE plc is exposed, as measured by the regulatory balance sheet, are lapse/policyholder behaviour risk, equity risk and expense risk. This is shown in **Figure 7** which sets out the components of SE plc's SCR before any allowance for diversification effects.

**Figure 7: Breakdown of SE plc's SCR (before diversification effects) as at 31 December 2022**

Risk	Capital requirement (£m)	Percentage of Total
<i>Mortality risk</i>	25.5	0.7%
<i>Longevity risk</i>	58.8	1.5%
<i>Disability risk</i>	8.1	0.2%
<i>Expense risk</i>	349.8	8.9%
<i>Lapse/policyholder behaviour risk</i>	1,577.3	40.3%
<i>Life catastrophe risk</i>	14.7	0.4%
<b>Total – Life Underwriting risk</b>	<b>2,034.1</b>	<b>52.0%</b>
<b>Total – Health Underwriting risk</b>	<b>7.6</b>	<b>0.2%</b>
<i>Interest rate risk</i>	238.2	6.1%
<i>Interest rate volatility risk</i>	-	-
<i>Equity risk</i>	777.1	19.9%
<i>Equity volatility risk</i>	9.5	0.2%
<i>Alternative investment risk</i>	7.0	0.2%
<i>Fixed income investment risk</i>	191.4	4.9%
<i>Inflation risk</i>	-	-
<i>Concentration risk</i>	13.8	0.4%
<i>Currency risk</i>	272.5	7.0%
<b>Total – Market risk</b>	<b>1,509.5</b>	<b>38.6%</b>
<b>Total – Counterparty Default risk</b>	<b>68.8</b>	<b>1.8%</b>
<b>Total – Operational risk</b>	<b>292.6</b>	<b>7.5%</b>
<b>Total <u>Undiversified</u> Components</b>	<b>3,912.6</b>	<b>100.0%</b>

Source: SE plc

3.55. SE plc identifies the risks to which it is exposed through top-down risk registers which are owned by accountable executives and their leadership teams, with oversight by the risk management function. They provide a record of the most significant risks in the business and related actions to manage and mitigate their exposures.

3.56. SE plc's identifies its risk profile as consisting of the risks set out in **Figure 8**.

**Figure 8: SE plc's risk definitions**

Risk	Description of risk
Mortality risk	The risk of higher numbers of deaths than expected resulting in lower profits and/or higher than expected claim payments on <u>unit-linked</u> and <u>protection</u> business.
Longevity risk	The risk that improvements in life expectancy result in higher-than-expected benefit payments for <u>annuity</u> business.
Disability risk	The risk that higher levels of sickness or lower levels of recovery rates result in higher-than-expected benefit payments for <u>protection</u> business.
Expense risk	The risk that the value of future expenses is higher than expected resulting in lower profits.
Lapse/ Policyholder Behaviour risk	The risk that lapse rates are higher or lower than expected resulting in lower profits and/or higher claim payments than expected. The risk that policyholder behaviour leads to higher or lower guarantee claims.
Life catastrophe risk	The risk that a one-off event could cause a large increase in claim payments over the next year e.g. a pandemic.
Interest rate risk	The risk of decrease in the net value of the business due to different sensitivities in the value of assets and the value of liabilities to a change in interest rates.
Interest rate volatility risk	The risk of decrease in the net value of the business due to unequal fluctuations in the value of assets and the value of liabilities given a change in interest rate volatility levels.
Equity risk	The risk that the market value of equity-like investments fluctuates because of changes in the financial condition, reduced prospects, or a change in relative value of the issuing company.
Equity Volatility risk	The risk that the value of assets or liabilities decreases/increases because of a change in equity volatilities.
Alternative investment risk	The risk that the market value of alternative asset classes (e.g. property) changes because of changes in the financial conditions of the underlying entity, reduced prospects, or a change in other underlying risk drivers.
Fixed Income Investment risk	The risk that the market value of fixed income investments fluctuates because of changes in the financial condition of the obligor or the appetite in the market for this risk.
Inflation risk	The risk of decrease in the net value of the business due to changes in market implied future inflation rates.
Concentration risk	The risk of loss due to over-concentration of exposure to any individual issuer or counterparty of investments.
Currency risk	The risk of decrease in the net value of the business due to unequal fluctuations in the value of assets and the value of liabilities given a change in relative currency rates.

Risk	Description of risk
Counterparty default risk	The risk that the counterparty in a risk mitigation contract is unable to meet its obligations to the insurer.
Operational risk	<p>The risk of loss resulting from inadequate or failed internal processes and controls, people and systems or from external events. This risk category covers the following components:</p> <ul style="list-style-type: none"> <li>• <b>Legal, regulatory, conduct and compliance risk:</b> The risk of loss due to (i) non-voluntary legal liabilities and inadequate legal documentation, (ii) failure of products, services, people and actions to deliver reasonable expectations of customers and other stakeholders, (iii) failure to comply with laws, regulations and internal company rules and policies, and iv) late identification of significant and potential legal and regulatory developments.</li> <li>• <b>Processing risk:</b> The risk of loss due to inadequate or failing administrative processes and related internal controls, inadequate capturing of source data, reporting errors, modelling errors and failing outsourcing and supplier arrangements.</li> <li>• <b>Business risks:</b> The risk of loss due to failed or inadequate strategy execution, marketing and sales practices, distribution channels, pricing, investment returns, handling of customer complaints, or late reaction to changes in the business environment.</li> <li>• <b>Tax risk:</b> The risk of loss due to fiscal authorities challenging SE plc's tax treatment of transactions on technical grounds or as a result of inconsistent argumentation, imperfections in implementation of restructuring or projects, concentration risk and late identification of significant tax developments in relevant jurisdictions.</li> <li>• <b>Financial crime risk:</b> The risk of loss due to a wrongful act (including money laundering), omission, breach of duty or trust, intentionally performed by an SE plc employee, intermediary or external party.</li> <li>• <b>People risk:</b> The risk of loss due to acts inconsistent with employment, health or safety laws or agreements, or losses resulting from an insufficient number of, or appropriately trained, personnel.</li> <li>• <b>Facility risk:</b> The risk of loss due to inadequate or failing physical asset management and events causing damage to physical assets.</li> <li>• <b>Information technology and business disruption risk:</b> The risk of loss due to failure or misuse of IT and associated assets or inefficiency of these assets. This includes inadequate or failed business continuity and disaster recovery planning and execution.</li> </ul>

Source: SE plc's 2022 SFCR

### Climate change risk

3.57. In line with other life insurers, SE plc groups climate change risks into two categories:

- **Transition risks:** the risk of losses arising due to the process of change towards a low-carbon economy, including climate-related developments in policy and regulation, technological change and shifting social attitudes, and

- **Physical risks:** the risk of losses arising as a direct impact of climate-related events such as heatwaves, floods and wildfires.

- 3.58. As mentioned in paragraph 3.50 risks such as climate change risks are not explicitly allowed for in the SCR. In lieu of such an allowance, SE plc has carried out assessments of its climate risk exposure as part of its ORSA and it considers its main exposure to climate risk in the short-term to fall in the transition risk category. This primarily stems for the potential for SE plc's strategy for managing climate risk to lag behind its peers and not keep the pace with the wider industry. SE plc also identifies the risk that political, regulatory or societal change could lead to increased reporting requirements or quicker transition plans, leading to resource and funding challenges.
- 3.59. SE plc has placed the responsibility for climate change risks with the Aegon UK Risk & Capital Committee, and the accountable person for the identification and management of financial risks of climate change is SE plc's Chief Actuary.
- 3.60. SE plc states in its ORSA that it has updated its risk policies, sustainability risk philosophy, and risk tolerance statements to explicitly consider climate change. It also stated that it will continue to consider how best to measure exposure to financial risks from climate change, and that the development of quantitative climate risk appetite and risk limit statements will continue.

### Capital, risk and liquidity management

#### Capital management

- 3.61. SE plc's capital management policy outlines management actions that would be taken when its solvency coverage ratio falls within prescribed ranges. These ranges are reviewed on an annual basis and are subject to the overarching Aegon Ltd Group Capital Management Policy. The ranges are outlined below.

Figure 9: SE plc's capital management zones

Capital Management Zone	<u>Solvency Coverage Ratio</u>	Additional comments
Operating level	Around 150%	This is the capital position expected under business as usual.
Target	Above 135%	This is the target zone for executing strategy and generating capital.  Management actions may be required to offset one-off events which could lead to the capital position moving into the Recovery Zone.
Recovery	100% to 135%	This capital management zone allows for some buffer over the regulatory minimum, to decrease the probability of holding insufficient funds to cover the <u>SCR</u> .  Management actions are required to return the capital position to the Target Zone and dividends are suspended. Should management actions be insufficient, Aegon Ltd will inject capital to SE plc to return the <u>solvency coverage ratio</u> to 135%.
Regulatory plan	Below 100%	In this capital management zone insufficient funds are held to meet the regulatory requirements.  In this instance a recovery plan would be required to bring the <u>solvency coverage ratio</u> to above 100%.

Source: SE plc Chief Actuary report

3.62. SE plc's capital management policy aims to maintain a solvency coverage ratio of at least 135%, but expects to operate with a solvency coverage ratio of around 150%. As set out in **Figure 9**, management actions, including possible capital injections, are expected if the solvency coverage ratio fell below 135%, with a formal recovery plan being required should it fall below 100%. Management actions available include raising capital, withholding dividends, increasing market risk hedging, changing charging structures, and increasing the use of reinsurance.

### Risk management

3.63. SE plc has an established enterprise risk management framework, and this is built upon the 'three lines of defence' model:

- First line of defence: line management within the business that is accountable for managing risks and complying with the risk framework,
- Second line of defence: a risk function that provides support to the business and independent oversight of compliance with the enterprise risk management framework, and
- Third line of defence: an internal audit function that provides independent assurance over the risk management activities undertaken by the first and second lines of defence.

- 3.64. This framework is implemented across all levels of SE plc, with the intention to provide a coherent and integrated approach to risk management throughout the business.
- 3.65. SE plc maintains a risk appetite framework, incorporating various risk appetite statements that set out the firm's strategy for its risks. The specific risks covered by the risk appetite statements are:
- **Underwriting risks:** mortality/longevity, morbidity, persistency, property & casualty, and expense risks.
  - **Investment and counterparty risks:** fixed income (credit), concentration, equity, alternative investment (property), counterparty default, and equity volatility risks.
  - **Mismatch risks:** interest rate, interest rate volatility, currency, and liquidity mismatch risks.
  - **Operational risks:** business, legal, regulatory, conduct & compliance, tax, financial crime, processing, information technology & business disruption, people, and facility risks.
- 3.66. Climate change is not identified explicitly as a risk in its own right in the risk appetite framework. However, it has been identified by SE plc as a causal factor that acts across each of the risks detailed above and SE plc intends to develop a quantitative risk appetite for climate risk.
- 3.67. For each risk to which SE plc is exposed, the risk appetite statements set out whether there is:
- no appetite for the risk, and therefore the firm will seek to mitigate or otherwise avoid the risk,
  - limited appetite for the risk, and so some exposure to the risk will be accepted, subject to stringent management and governance, or
  - appetite for the risk, and so the risk is recognised as inherent in the operation of the business and exposure will be measured through a series of Key Risk Indicators.
- 3.68. SE plc's risk appetite framework also sets out risk tolerance limits which define target levels of risk which SE plc's current risk exposures are measured against. These are used as a guide to drive consideration and discussion of potential actions in cases where SE plc's actual risk profile deviates from its intended risk profile as set out in the risk appetite statements.

### Liquidity risk

- 3.69. SE plc defines liquidity risk as the risk of being unable to meet financial obligations as they fall due owing to the timing of commitments being inconsistent with expectations, a lack of available assets that can be sold quickly to generate cash to meet the commitments, or a lack of access to credit or funding facilities to meet the commitments.
- 3.70. The sources of liquidity risk that SE plc's management considers to be most material are discussed below:
- **NPSE:** income may be insufficient to cover mandatory commitments (e.g. maintenance expenses, mandatory project costs, tax, etc.), or interest rates may move adversely leading to collateral calls on interest rate swaps, or due to the fungibility of liquidity assets, or due to short-term cash volatility.
  - **MA fund:** asset downgrades or cash flow mismatches within the MA fund may lead to liquidity risk.
  - **Unit-linked funds:** mass lapse events, where there is a significant and instantaneous fall in the number of in-force policies due to extreme scenarios, e.g. natural disaster or pandemic event. This

type of event can lead to large volumes of customers wishing to withdraw funds and where those funds are held in illiquid assets this gives rise to liquidity risk.

- **WPSF:** adverse interest rate movements could lead to collateral calls on interest rate swaps, or mass lapses could occur with illiquid asset share assets.

3.71. SE plc manages liquidity risk through a combination of:

- projections to ensure that sufficient liquid assets are held to cover future plans,
- stress testing to ensure that existing liquidity commitments can be safely covered, and
- holding an additional cash Liquidity Buffer.

The liquidity required to cover the stress tests is monitored monthly and four portfolios of illiquid assets are held to cover each of the key sources of liquidity risk in the list above for a period of two years. The assessment of liquidity requirements also makes allowance for the payment (or non-payment, as may be the case under certain stressed conditions) of dividends to Aegon Group.

## 4. Background to Royal London

### Background and history

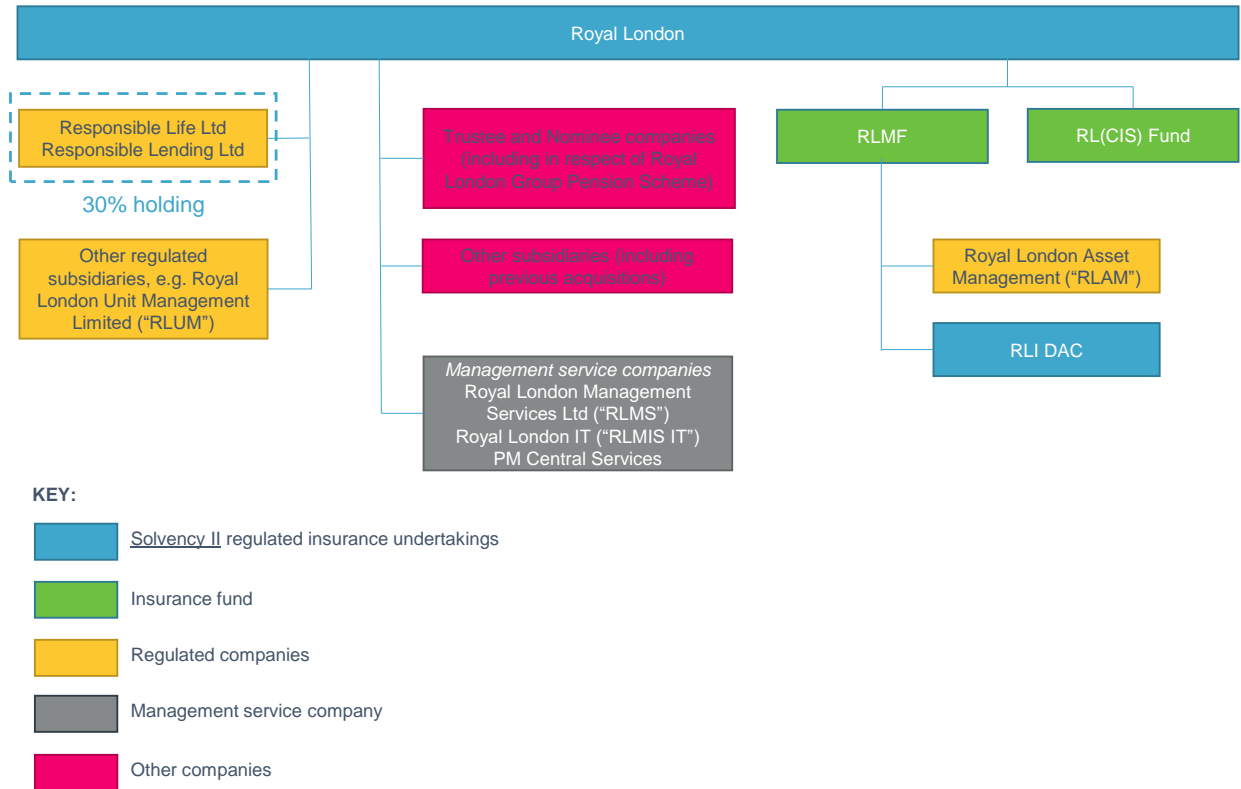
- 4.1. Royal London is a UK-based mutual life, pensions and investment company and the parent company in the Royal London Group. It was originally founded as a friendly society, the Royal London Life Insurance and Benefit Society, in 1861. In 1908, the friendly society was converted to a mutual company, The Royal London Mutual Insurance Society Limited.
- 4.2. Royal London is registered in England and Wales and offers long-term savings, protection and asset management propositions in the UK and Ireland. Its insurance and savings business is predominantly distributed via financial advisors in the UK and brokers in Ireland. As at 30 June 2023, Royal London had 8.6 million active life and pension policies on its books. Royal London has no shareholders and is instead owned by its members. As at 30 June 2023, Royal London had c.2 million members.
- 4.3. Royal London is authorised by the PRA and regulated by the PRA and the FCA.
- 4.4. Since 2000 Royal London has successfully acquired and completed the transfer of the long-term business of a number of insurance companies, including:
  - in 2000, the United Assurance Group,
  - in 2001, the Scottish Life Assurance Company,
  - in 2008, the business of Phoenix Life Assurance Limited, and certain protection business of Scottish Mutual Assurance Limited and Scottish Provident Limited,
  - in 2011, Royal Liver Assurance Limited,
  - in 2013, the Co-operative Insurance Society, and
  - in 2020, the Police Mutual Assurance Society.

### Group structure

- 4.5. As noted in paragraph 4.1, Royal London is the parent company in the Royal London Group. A summarised version of the Royal London Group is outlined in **Figure 10:** below. There are two insurance entities within the Royal London Group, namely Royal London itself and Royal London Insurance Designated Activity Company (“RLI DAC”), which is based in Ireland.
- 4.6. Historically, Royal London has managed its business through a number of distinct insurance funds resulting from the acquisitions mentioned in paragraph 4.4. A consolidation programme was completed in 2022, streamlining the number of funds in the business, and from 31 December 2022 there are now only two, namely the Royal London Main Fund (“RLMF”) and the Royal London Co-operative Insurance Society Fund (“RL(CIS) Fund”).



Figure 10: Royal London's group structure as at 31 December 2022



Source: Royal London's 2022 SFCR

- 4.7. In extreme circumstances the RLMF estate is available to provide capital support to the RL(CIS) Fund, and vice versa. However, any support provided must be refunded (with interest) to the relevant fund as soon as possible. Any support provided by the RL(CIS) Fund to the RLMF is subject to the terms of the scheme which transferred the RL(CIS) Fund into Royal London.
- 4.8. RLI DAC was established following the referendum vote in favour of the UK leaving the European Union in 2016, and was authorised by the Central Bank of Ireland to write new life insurance business in Ireland from 1 January 2019. RLI DAC is a subsidiary investment of the RLMF.
- 4.9. RLAM provides investment management services to other entities within the Royal London Group and to external clients, such as pension funds, local authorities, and individuals. As at 30 June 2023, RLAM had assets under management of c.£153bn. RLAM is also a subsidiary investment of the RLMF.

### Outsourcing

- 4.10. Royal London outsources a number of functions related to managing and administering its business. The most material outsourcing arrangements are summarised in **Figure 11** below.

**Figure 11: Royal London's material outsourcing arrangements as at 31 December 2022**

Function	Supplier(s)
Back-office policy and investment administration	<ul style="list-style-type: none"> <li>• SS&amp;C Financial Services International Ltd</li> <li>• HSBC UK Bank plc</li> <li>• Link Fund Administrators Limited</li> <li>• XPS Pensions (RL) Limited</li> <li>• Equiniti Limited</li> </ul>
Customer administration, support and complaints handling	<ul style="list-style-type: none"> <li>• Capita Life and Pensions Regulated Services Limited ("Capita")</li> <li>• HUB Financial Solutions Ltd</li> <li>• Equiniti Limited</li> <li>• Underwrite.me Limited</li> </ul>
Asset and fund management	<ul style="list-style-type: none"> <li>• Aviva Investors Global Services Limited</li> <li>• Blackrock Limited</li> </ul>
IT services	<ul style="list-style-type: none"> <li>• Kyndryl UK Limited</li> <li>• Tata Consultancy Services Limited ("TCS")</li> <li>• Microsoft Ireland Limited</li> <li>• Cognizant Limited</li> <li>• Sapiens (UK) Insurance Software Solutions Limited</li> <li>• Equinix Limited</li> <li>• Accenture plc</li> </ul>
Facilities management services	<ul style="list-style-type: none"> <li>• Mitie Limited</li> </ul>

Source: Royal London's 2022 SFCR

4.11. Royal London also has a number of intra-group arrangements, of which the most significant include:

- RLAM provides asset management services to the Royal London Group,
- RLMS provides administration services to the Royal London Group, and
- RLMIS IT provides workplace and politically-exposed persons and sanctions screening services to RLAM and RLUM.

4.12. Royal London retains responsibility for the oversight, management and performance of each supplier noted above. This role is performed in-house by the Risk & Capital Committee.

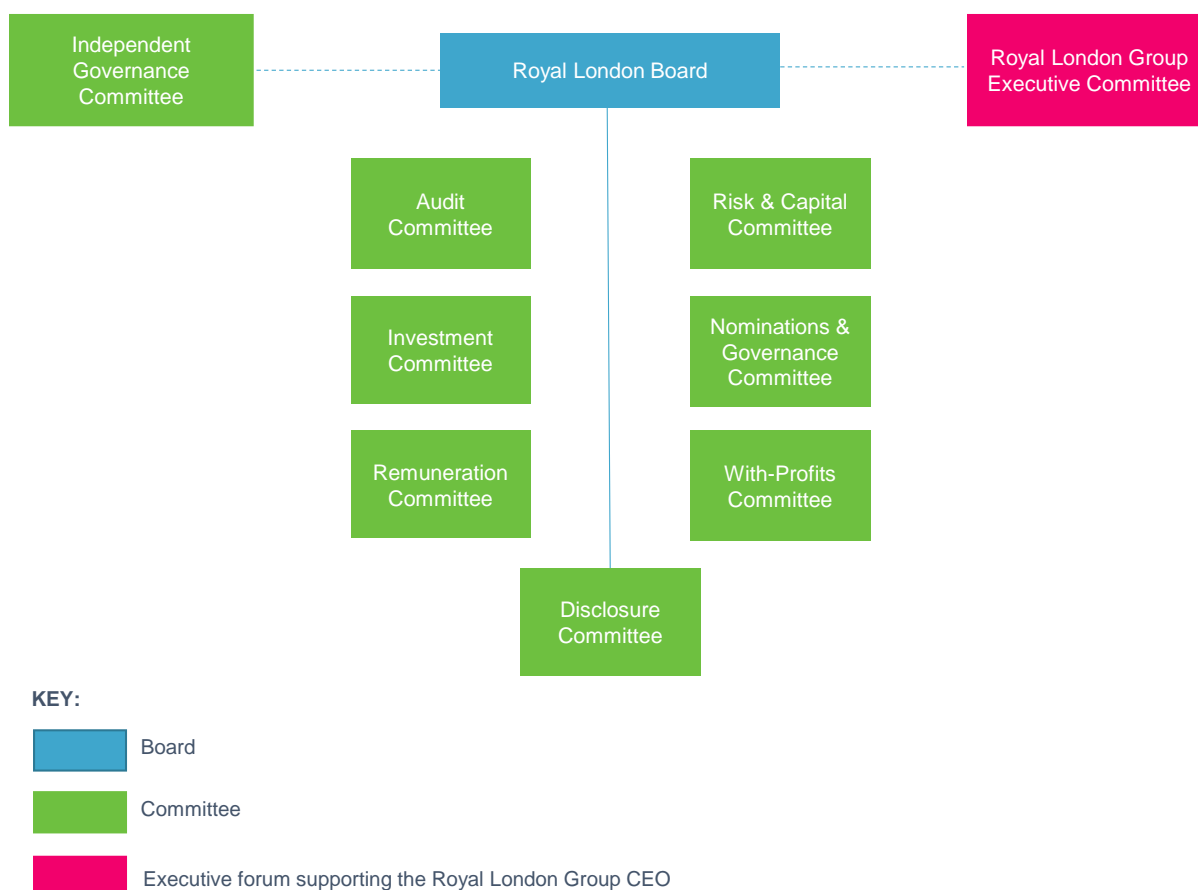
### Value-add services

- 4.13. Royal London offers a range of additional support services to holders of Existing Policies who were sold a protection insurance policy through an independent financial advisor, collectively marketed as “Helping Hand” by Royal London. The services include a range of health and wellbeing services, such as 24/7 access to virtual GP consultations, an NHS-approved mental health app, physiotherapy support and advice, and independent helplines to support with legal advice, medical advice and career advice.
- 4.14. These services are provided through Royal London’s contracts with various third parties, including LiveSmart UK Limited, Healthhero Solutions Limited, Active Health Tech Ltd, Red Arc Assured Limited, and Epoq Legal Ltd.
- 4.15. These services do not form part of a policy’s terms and conditions and are offered on a discretionary basis.

### Management and governance

- 4.16. **Figure 12** illustrates the governance structure of Royal London.

**Figure 12: Royal London’s system of governance**



Source: *Royal London’s 2022 SFCR and Annual Report & Accounts*

- 4.17. The Royal London Board and each committee have terms of reference setting out their purpose, membership, procedures, duties and responsibilities, and reporting requirements. In its 2022 Annual Report, Royal London stated that its approach to corporate governance is based on the principles and provisions of the 2018 UK Corporate Governance Code.

4.18. Royal London's Board comprises the Chairman, the Royal London Group CEO, the Royal London Group CFO, the Royal London Group Company Secretary, a senior independent director and eight other independent non-executive directors.

4.19. The high-level responsibilities of the Committees shown in **Figure 12** are set out below:

- The **Independent Governance Committee** is responsible for assessing whether the Royal London Group is providing value for money for its workplace pension policyholders and investment pathways customers.
- The **Audit Committee** is responsible for setting and overseeing the standard for financial and actuarial reporting, compliance, risk management, conduct risk management, internal controls and ethical conduct within the company.
- The **Investment Committee** is responsible for ensuring that the investments held by the Royal London Group are managed in a manner that is consistent with the company's investment strategy. This includes investment matters relating to climate change risks and opportunities.
- The **Remuneration Committee** is responsible for the Royal London Group remuneration policy and the compensation of the Chairman, Executive Directors and Designated Employees. Designated Employees includes members of the Royal London Group Executive Committee, executives who perform Senior Management Functions and the Company Secretary, among others.
- The **Risk & Capital Committee** is responsible for ensuring the Royal London Group is managing risk and capital in line with internal guidance and controls, and for ensuring compliance with the relevant prudential and conduct regulations. This includes governance and management of Royal London's Internal Model, management of non-investment related climate-related risks, and oversight of the risks associated with material outsourcing and supplier relationships.
- The **Nominations & Governance Committee** is responsible for appointing senior management roles for the company and ensuring there are high standards of governance in place.
- The **With-Profits Committee** is responsible for advising Royal London's Board in relation to its with-profits business. This includes advising on whether its with-profits policyholders are being treated fairly and whether the business is being managed in accordance with the relevant PPFM documents.
- The **Disclosure Committee** is responsible for approving the Royal London Group's Solvency II financial disclosures, the annual report and accounts, results announcements and investor presentations.

4.20. Alongside the Royal London Board, there is a Royal London Group Executive Committee to support the Royal London Group CEO. All members of the Executive Committee report to the Royal London Group CEO. Members of the Executive Committee include:

- RLI DAC's CEO,
- RLAM's CEO,
- Chief Transformation Officer,
- Chief Customer Officer,
- Chief People Officer,

- Chief Marketing Officer,
- Chief Risk Officer,
- Chief Operating Officer,
- Chief Commercial Officer, and
- General Counsel.

4.21. Royal London also maintains the following key internal governance functions, as required by Solvency II:

- a risk function which provides independent oversight and challenge over the identification, assessment and management of all significant risks,
- an actuarial function that coordinates the calculation of Technical Provisions, provides opinions on the underwriting policy and reinsurance arrangements, and contributes to the effectiveness of the risk management system,
- a compliance function that provides independent oversight and monitoring of regulatory compliance, which supports the business in managing its regulatory risk exposures appropriately, and
- an internal audit function that acts as an independent body in assessing the adequacy and effectiveness of the risk management system and the internal control system. This includes challenging those with day-to-day management duties to improve the effectiveness of governance, risk management and controls.

### Business lines

4.22. Royal London's portfolio of insurance business consists of unit-linked business (across life, pensions and health), non-profit business (including protection business, annuities and health), and with-profits business (both conventional with-profits and unitised with-profits). **Figure 13** below shows Royal London's Solvency II BEL (gross of reinsurance) and policy count for each line of business as at 31 December 2022.

Figure 13: Breakdown of Royal London's BEL and policy count at 31 December 2022

Line of business	Product Type	Number of policies ('000)	<u>BEL</u> <sup>1</sup> (£m)
<u>Conventional with-profits</u>	Life	2,134	2,573.0
	Pensions	455	11,165.0
<u>Unitised with-profits</u>	Life	305	1,095.0
	Pensions	2,507	9,613.0
<u>Unit-linked</u>	Life	237	1,189.0
	Pensions	950	66,957.0
	Health	49	1.0
<u>Non-profit</u>	<u>Protection</u>	1,395	140.1
	<u>Annuity</u>	217	3,375.9 <sup>2</sup>
	Health	11	(207.0)
<u>Accepted reinsurance</u>	Life	108	440.0
	Pensions	64	18.0
	<u>Protection</u>	266	151.2
	<u>Annuity</u>	1	55.8
	Health	71	1.0
<b>Total</b>		<b>8,770</b>	<b>96,568.0</b>

Source: Royal London

(1) BEL is gross of reinsurance.

(2) This includes £78m of annuities with index-linked benefits (i.e. where benefits move in line with various inflation indices), where Royal London takes on the risk of movements in the index.

4.23. Accepted reinsurance included in **Figure 13** relates to an internal reinsurance arrangement between Royal London and RLI DAC where all of the business in RLI DAC is reinsured to Royal London. This agreement was implemented in 2019 as a means of ensuring policyholders with Euro-denominated benefits were materially unaffected by structural changes which needed to be made by Royal London in response to the UK leaving the European Union. This arrangement ensured that Royal London retained the appropriate exposure to these policies.

### The application of discretion

4.24. Royal London can exercise discretion in the management of its individual protection, with-profits and unit-linked business, and the ways in which it can do this are detailed in the following sub-sections.

#### Individual protection business

4.25. Royal London exercises discretion on its individual protection business in the following areas:

- Claims underwriting;
- Reviewable premiums;
- Benefit commutation;
- Guaranteed insurability option;
- Renewal option; and
- Change of smoker status.

4.26. The areas of discretion noted in paragraph 4.25 are consistent with those exercised by SE plc on the Transferring Policies (as outlined in paragraph 3.23). Royal London has not identified any other areas of discretion on its individual protection business.

#### Other non-profit business

4.27. Royal London has confirmed that no additional areas of discretion are applied for other non-profit business in addition to those noted in paragraph 4.25 for protection business.

#### With-profits business

4.28. Both the RLMF and the RL(CIS) Fund contain with-profits and non-profit business. The RLMF is governed by its own PPFM document, while the management of the RL(CIS) Fund is governed by three PPFM documents, which each consider different policy types. The management of certain policies in these funds is also governed by historical Schemes of Transfer, which date back to when Royal London acquired business from other companies.

4.29. The RL(CIS) Fund is ring-fenced and was closed to new business in 2014. All new business is now written into the RLMF. As at 31 December 2022, there were c.£87.4 billion of assets in the RLMF and c.£23.4 billion of assets in the RL(CIS) Fund.

4.30. The funds' PPFMs outline the approach to be taken for all areas of discretion in managing them, including the investment strategy, writing new business (RLMF only), the management and use of the estate, and how policy pay-outs will be determined, which are typically set with reference to their asset share. The PPFMs detail how the asset share should be calculated for each type of business. They also discuss how regular and final bonuses should be set, how smoothing is applied, and how and when MVRs are applied.

#### Unit-linked business

4.31. Similar to SE plc, Royal London can also exercise discretion with respect to its unit-linked business. The primary ways this can occur is in the way it sets unit prices for its unit-linked funds, and in setting the level of charges levied against those same funds and policies investing in them.

#### ProfitShare

4.32. Royal London awards eligible policies a share of its profits each year via a scheme called "ProfitShare". The eligibility criteria depend, among other things, upon the date of policy issue, the type of product, and

its acquisition history. The precise criteria are not important in the context of the proposed transfer, so I do not go into them in detail here.

- 4.33. ProfitShare is awarded once a year, and its award in any given year is not guaranteed and is at the discretion of Royal London's Board, taking into account the ongoing profitability of the business and financial strength of the RLMF.

### Tax

- 4.34. Similar to SE plc, Royal London's business is taxed on a BLAGAB basis or on the basis of trading profits, depending on the nature of the business. BLAGAB business is currently taxed at a rate of 20% on an 'Income less Expenses' basis. However, given Royal London's mutual status, the applicable rate of corporation tax rate is 0% and so there is no tax liability on business that is not classified as BLAGAB.

### Staff pension schemes

- 4.35. Royal London operates three defined benefit pension schemes and two defined contribution schemes. Royal London is responsible for funding the defined benefit schemes and for making contributions to the defined contribution schemes.
- 4.36. The defined benefit pension schemes are the Royal London Group Pension Scheme ("RLGPS"), and two schemes relating to former Royal Liver employees (the Royal Liver Assurance Superannuation Fund, and the Irish Royal Liver Assurance Limited Superannuation Fund).
- RLGPS is Royal London's largest pension scheme, with a surplus of £112m as at 31 December 2022. RLGPS closed to new entrants on 1 September 2005 and to future benefit accruals on 31 March 2016.
  - The two Royal Liver pension schemes originated through the acquisition of Royal Liver Assurance Limited as noted in paragraph 4.4. These pension schemes had a combined surplus of £95m as at 31 December 2022. Royal Liver employees in these schemes stopped accruing additional defined benefit pensions on 30 June 2011.
- 4.37. The defined contribution pension schemes include the Royal London Group Personal Pension and the Royal London Ireland Pension Plan, both of which are open to new entrants.

### Insurance subsidiaries

- 4.38. RLI DAC has three insurance funds, one of which is open to new business. Non-profit protection business and some unit-linked business is written into the open fund. The business in RLI DAC's closed funds is fully reinsured to Royal London via a collateralised quota share reinsurance agreement. Should Royal London fail to meet its obligations to RLI DAC under this agreement, RLI DAC's open fund would provide capital support to the closed funds in certain circumstances, for example where a sub-fund has insufficient assets to cover its BEL and SCR. There is no formal capital support agreement between Royal London and RLI DAC.

### Reinsurance

- 4.39. Royal London uses reinsurance to manage the risks that it faces, and it has a number of different reinsurance treaties in place. I summarise these arrangements in paragraphs 4.40 to 4.43.
- 4.40. At 30 June 2023, Royal London had c.130 reinsurance agreements with 13 reinsurance counterparties. Royal London monitors its exposure to reinsurance counterparties after allowing for the credit-risk-mitigating effects of collateral arrangements.



- 4.41. At 30 June 2023, the majority of Royal London's exposures to reinsurance counterparties are positive, which means that the reinsurer has a net total payment due to Royal London, with the opposite being true for a negative exposure. Royal London's largest positive exposures relate to counterparties that reinsure annuities and protection business in the RLMF, whereas the negative exposures relate to counterparties that reinsure health business and annuities in the RL(CIS) Fund.
- 4.42. Royal London's protection business contributes to a relatively small portion of its reinsurance counterparty exposure, and this is split across nine of its 13 reinsurers. In general, the treaties underlying these arrangements transfer a high proportion of insurance risk to the reinsurers, leaving Royal London with a small amount of retained risk.
- 4.43. Royal London monitors its exposure to reinsurance counterparties by considering the reinsurance counterparties' credit ratings and its relative exposure to each counterparty as a proportion of Eligible Own Funds. This is monitored at a fund level, i.e. separately for the RLMF and the RL(CIS) Fund, taking account of any credit-risk-mitigating effects, such as collateral arrangements. Should any exposures breach risk appetite, Royal London considers these on a case-by-case basis, looking at potential actions such as recapturing the risks ceded to the relevant reinsurers.

### Assets

- 4.44. **Figure 14** shows a high-level breakdown of Royal London's assets as at 31 December 2022.

Figure 14: Royal London's asset portfolio as at 31 December 2022

Asset Category	Asset Value (£m)	% of Total
<u>Deferred tax asset</u>	33.4	0.0%
Pension benefit surplus	206.6	0.2%
Property, plant & equipment held for own use	-	-
Property (other than for own use)	127.9	0.1%
Holdings in related undertakings, including participations <sup>1</sup>	13,884.3	12.5%
Equities	6,053.7	5.5%
Government bonds	3,483.0	3.1%
Corporate bonds	6,224.3	5.6%
<u>Structured notes</u>	48.7	0.0%
<u>Collateralised securities</u>	284.7	0.3%
<u>Collective investment undertakings</u>	1,206.4	1.1%
Derivatives	1,835.2	1.7%
Deposits other than cash equivalents	605.3	0.5%
Assets held for <u>unit-linked</u> contracts	70,839.9	64.0%
Loans and mortgages <sup>2</sup>	91.6	0.1%
<u>Reinsurance recoverables</u>	2,969.8	2.7%
Insurance and intermediaries receivables <sup>3</sup>	48.2	0.0%
<u>Reinsurance receivables</u> <sup>4</sup>	183.7	0.2%
Receivables (trade, not insurance) <sup>5</sup>	2,199.7	2.0%
Cash and cash equivalents	431.6	0.4%
Other assets	-	-
<b>Total</b>	<b>110,758.2</b>	<b>100.0%</b>

Source: Royal London's 2022 SFCR

(1) Refers to the non-insurance subsidiaries (e.g. RLAM, but not RLMIS, RLI DAC, RLMS)

(2) Includes loans secured by policies and commercial real estate loans

(3) Includes debtors arising out of direct insurance operations

(4) Includes debtors arising out of reinsurance operations

(5) Relates to other debtors not captured elsewhere on the balance sheet

## Financial position

4.45. **Figure 15** sets out Royal London's regulatory balance sheet as at 31 December 2022.

**Figure 15: Regulatory balance sheet of Royal London as at 31 December 2022**

Balance Sheet as at 31 December 2022	£m
Assets (A)	110,758.2
<u>Best Estimate Liabilities</u> (B)	25,815.0
<u>Risk Margin</u> (C)	1,274.0
<u>Technical Provisions Calculated as a Whole</u> (D)	70,753.0
<u>TMTP</u> (E)	1,164.0
<u>Technical Provisions</u> (F = B + C + D – E)	96,678.0
Other liabilities (G)	7,548.0
Excess of assets over liabilities (H = A – F – G)	6,532.2
<u>Subordinated liabilities</u> (I)	1,210.1
Restrictions to <u>Basic Own Funds</u> <sup>1</sup> (J)	2,737.0
<u>Basic Own Funds</u> (K = H + I – J)	5,005.3
Restrictions to <u>Eligible Own Funds</u> <sup>2</sup> (L)	152.0
<u>Eligible Own Funds</u> (M = K – L)	4,853.3
<u>SCR</u> (N)	2,160.0
<u>Excess Own Funds</u> (O = M – N)	2,693.3
<u>Solvency coverage ratio</u> ( <u>Eligible Own Funds/SCR</u> ) (M/N)	225%

Source: Royal London's 2022 SFCR

(1) Adjustments in respect of ring-fenced funds (including MA portfolios)

(2) Adjustments in respect of subordinated liabilities and deferred tax asset

4.46. The "other liabilities" shown above is comprised of the following:

- £3,049.2m of derivatives,
- £1,762.8m of reinsurance payables,
- £1,210.1m of subordinated liabilities,
- £628.0m of insurance payables,

- £608.2m of other debts,
- £208.1m of trade payables,
- £63.3m of provisions, for example for accrued claims,
- £11.8m of deferred tax liabilities, and
- £6.5m of financial liabilities.

4.47. As discussed in paragraph 3.44, insurers are required to rank their Eligible Own Funds by quality of capital. Around £3,773.0m of the Eligible Own Funds included in **Figure 15** is Unrestricted Tier 1 Own Funds, which is the highest quality ranking capital and is made up of surplus funds and a reconciliation reserve (given Royal London's mutual status). The remaining £1,080.0m of Eligible Own Funds is Tier 2 Own Funds (which is lower ranking than Tier 1 Own Funds) and is made up of subordinated liabilities.

### Solvency II implementation

4.48. Appendix 6 describes the UK prudential regulatory regime.

4.49. Technically, Royal London calculates its SCR using a PIM, comprising an Internal Model for risks arising directly in the RLMF and the RL(CIS) Fund, aggregated with an SCR for RLI DAC (a subsidiary investment of the RLMF) which is determined using the Standard Formula. As RLI DAC's SCR is very small in the context of Royal London's overall SCR, and as Royal London typically refers to its PIM as an "Internal Model", I also do this throughout my report for consistency.

4.50. Royal London was granted regulatory approval to use an Internal Model in September 2019 and has reported on this basis since 31 December 2019. Under its Internal Model approach, the SCR is calculated by determining the amount that Royal London's Basic Own Funds could fall over the course of a year, such that the probability the fall in Basic Own Funds is greater than the SCR is 0.5%. This is consistent with the calibration standard applying to the Standard Formula.

4.51. Royal London has an Internal Model Governance policy in place which sets out the key roles and responsibilities relating to governance of the Internal Model. The key roles and responsibilities are discussed below.

- The **Royal London Board** approves all applications made to the PRA regarding major changes to the Internal Model and oversees the annual Internal Model review.
- The **Risk & Capital Committee** is responsible for performing the annual Internal Model review and presenting conclusions to the Royal London Board. It also oversees an annual Internal Model validation exercise and drives any resulting remedial actions.
- The **Royal London Group CRO** is responsible for the management of the Internal Model, (including its design, operation and validation) and ensuring that the Internal Model appropriately reflects Royal London's risk profile.
- The **Royal London Group CFO** has oversight of the financial and actuarial modelling used in the Internal Model, as well as all underlying systems feeding into the Internal Model output.

4.52. These roles are also supported by Internal Model specific committees responsible for more detailed design decisions, including reviewing the model, making model changes and approving documentation.

- 4.53. All risks outlined in **Figure 16** below are in scope of Royal London's Internal Model. The following risks, which are not allowed for in the Standard Formula, are allowed for in Royal London's Internal Model as they have been identified as being important to its business:
- movements in the spread between government bonds and risk-free swap yields;
  - implied volatilities for equity, property, and interest rate risk;
  - inflation risk;
  - guaranteed annuity option ("GAO") take-up rate risk and longevity risk (for annuities); and
  - longevity risks on the defined benefit staff pension schemes
- 4.54. Royal London's Internal Model does not allow for certain risks either because they cannot be quantified or because there are reasonable grounds not to hold additional capital, e.g. due to sufficiently robust risk management processes which mitigate the risk. Instead, these risks are captured as part of Royal London's annual ORSA process. Examples of such risks include climate change risk (paragraph 4.61 to 4.63) and liquidity risk (paragraph 4.70 to 4.72).
- 4.55. As part of its most recent annual validation exercise carried out in the first quarter of 2023, Royal London reaffirmed that it considers its Internal Model and its outputs to be appropriate for its business and compliant with regulation. In particular, Royal London is satisfied that the Internal Model operates properly and continues to reflect the risk profile of the firm.
- 4.56. Royal London has regulatory approval to use the TMTTP, which it has applied since the inception of Solvency II in January 2016. The purpose of the TMTTP is to smooth the transition from the previous insurance regulatory regime by phasing in the increased level of Technical Provisions over a 16-year period. Royal London's SFCR shows that, at 31 December 2022, the TMTTP reduced the Technical Provisions by c.£1,165m and increased Eligible Own Funds by c.£570m. Removing these benefits would together have resulted in a c.26 percentage point reduction to the regulatory solvency coverage ratio (from c.225% to c.198%), at that date.
- 4.57. Royal London has regulatory approval to use the VA to reduce the impact of short-term market volatility on its regulatory balance sheet. Royal London applies the VA in the valuation of all with-profits business and all non-profit in-payment annuity business which is not in the MA portfolio. Royal London's SFCR shows that, at 31 December 2022, the VA reduced the SCR by c.£90m and reduced Eligible Own Funds by c.£36m. Additionally removing these impacts would together have resulted in a further c.6 percentage point reduction to the regulatory solvency coverage ratio (from c.198% to c.192%), at that date.
- 4.58. Royal London also has regulatory approval to use the MA which has the effect of reducing the value of future liabilities on its regulatory balance sheet. This approval was effective from December 2021. Business in scope of the MA approval includes a subset of the annuity business within the RLMF. Royal London's SFCR shows that, at 31 December 2022, the MA reduced the SCR by c.£96m and increased Eligible Own Funds by c.£60m. Additionally removing these benefits would together have resulted in a further c.10 percentage point reduction to the regulatory solvency coverage ratio (from c.192% to c.182%), at that date.

## Risk profile

4.59. The most significant risks to which Royal London is exposed, as measured by the regulatory balance sheet, are persistency risk, longevity risk, equity risk and credit spread risk. This is shown in **Figure 16** below, which shows the components of Royal London's SCR (before diversification effects).

**Figure 16: Breakdown of Royal London's SCR (before diversification effects) as at 31 December 2022**

Risk	Capital requirement (£m)	Percentage of Total
<i>Mortality risk</i>	93.0	1.1%
<i>Longevity risk</i>	1,080.8	12.7%
<i>Morbidity risk</i>	77.6	0.9%
<i>Expense risk</i>	708.1	8.3%
<i>Persistency risk</i>	2,617.2	30.7%
<i>Catastrophe risk</i>	60.3	0.7%
<b>Total – Life Underwriting risk</b>	<b>4,636.9</b>	<b>54.4%</b>
<i>Interest rate risk</i>	709.3	8.3%
<i>Equity risk</i>	898.4	10.5%
<i>Property risk</i>	216.3	2.5%
<i>Credit <u>spread</u> risk</i>	861.3	10.1%
<i>Inflation risk</i>	142.5	1.7%
<i>Currency risk</i>	253.8	3.0%
<i>Other<sup>1</sup></i>	59.2	0.7%
<b>Total – Market risk</b>	<b>3,140.8</b>	<b>36.8%</b>
<b>Total – Counterparty Default risk</b>	<b>232.6</b>	<b>2.7%</b>
<b>Total – Operational risk</b>	<b>516.2</b>	<b>6.1%</b>
<b>Total <u>Undiversified</u> Components</b>	<b>8,526.6</b>	<b>100.0%</b>

Source: Royal London's 2022 SFCR

(1) Captures risk capital requirements related to the level and volatility in the price of commodities which are not quantified by other market risk components.

4.60. The risks included in **Figure 16** map to the definitions of risk outlined in **Figure 17** from Royal London's risk universe.

**Figure 17: Royal London's risk definitions**

Risk	Description of risk
Mortality risk	The risk that policyholders die sooner than expected. Mortality risk only applies to liabilities which increase under these circumstances.
Longevity risk	The risk that annuitants live longer than expected. Longevity risk only applies to liabilities which increase under these circumstances.
Morbidity risk	The risk that policyholders make morbidity related claims more frequently or for a longer period of time than expected.
Expense risk	The risk that the expense associated with investing in assets, or of administering pensions, insurance or <u>reinsurance</u> contracts held within the business is higher than expected.
Persistency risk	The risk that the rate of policy lapses, terminations, renewals, partial withdrawals and surrenders, or the number of policies converting to paid-up status, is different to that expected, resulting in an increase in liabilities.
Interest rate risk	The risk that changes to the term structure or volatility of interest rates adversely impact the value of <u>Own Funds</u> .
Equity risk	The risk that changes in the value of equities and derivatives or market expectations of the volatility of future equity returns adversely impact the value of <u>Own Funds</u> .
Property risk	The risk that changes in the value of property or market expectations of the volatility of future property returns adversely impact the value of <u>Own Funds</u> .
Credit <u>spread</u> risk	The risk that changes in current credit <u>spreads</u> or the market expectations of future credit <u>spread</u> volatility or downgrades and defaults adversely impact the value of <u>Own Funds</u> .
Other market risk	The risk that changes in the value of assets and liabilities not covered by other market risks adversely impact the value of <u>Own Funds</u> . This category includes currency risk, inflation risk, risks related to commodities, and concentration risk.
Counterparty default risk	The risk of loss if a counterparty fails to perform its obligations or fails to perform them in a timely fashion. Exposure to credit counterparty risk may arise in connection with a single transaction or an aggregation of transactions (not necessarily of the same type) with a single counterparty.
Operational risk	The risk of loss arising from inadequate or failed internal processes, people and systems, or from external events. This risk category covers the following components: <ul style="list-style-type: none"> <li>• <b>Conduct risk:</b> The risk of unfair outcomes to end customers.</li> </ul>

Risk	Description of risk
	<ul style="list-style-type: none"> <li>• <b>Processing risk:</b> The operational risk in the form of processes operated across Royal London</li> <li>• <b>Information security risk:</b> The operational risk associated with protecting Royal London's customer and management information, and information processing facilities, from threats.</li> <li>• <b>Third-party risk:</b> The operational risk arising from outsourcing processes to third-party providers.</li> <li>• <b>Change risk:</b> The operational risk arising from Royal London's change management processes and programmes.</li> <li>• <b>Resilience risk:</b> The operational risk associated with service resilience, business continuity management and disaster recovery processes and plans.</li> <li>• <b>Information technology risk:</b> The operational risk arising from development, delivery and maintenance activity for Royal London's IT infrastructure.</li> <li>• <b>Financial crime risk:</b> The operational risk that Royal London's customers or assets are subject to any kind of criminal conduct relating to money or to financial services.</li> <li>• <b>People risk:</b> The operational risk associated with Royal London's processes to attract and retain people with the right skills to deliver its strategy and maintain a values-based culture.</li> <li>• <b>Legal &amp; regulatory risk:</b> The risk of a poor level of compliance with law, regulation, or other obligations, and the materialising of breaches.</li> </ul>

Source: Royal London's 2022 ORSA

### Climate change risk

4.61. Royal London groups climate change risks into two categories:

- **Transition risks:** risks related to disorderly adjustments to markets as a result of the transition to a low-carbon economy. This category includes three sub-level risks including policy risks (e.g. carbon pricing, emission caps and subsidies), market risks (e.g. emergence of disruptive green technologies, changing consumer behaviours) and reputational risks.
- **Physical risks:** risks related to the physical impacts of climate change. This category includes both primary and secondary risks. Primary risks include damage to land, buildings, stock or infrastructure owing to physical effects of climate-related factors (such as heatwaves or flooding). Secondary risks include knock-on effects of physical risks, such as falling crop yields, resource shortages, supply chain disruption, as well as political instability or conflict.

4.62. As mentioned in paragraph 4.54, Royal London's Internal Model does not take climate risk into account when calculating the SCR. Instead, Royal London has incorporated climate risk management into its risk management framework, including a risk appetite statement and performing a number of qualitative and



quantitative assessments on its climate risk exposure as part of its annual ORSA process. The results from the 2022 ORSA process show that Royal London's main exposure is to a "failed transition" pathway where governments across the globe fail to enact sufficient policy responses to climate change, though the solvency coverage ratio remains within risk appetite. The impact under this scenario is driven by Royal London's unit-linked business which is adversely affected by severe market movements, particularly affecting equity markets.

4.63. Royal London's Executive Committee is responsible for the day-to-day management of climate change risks and opportunities across the Royal London Group. The Executive Committee is supported by the Royal London Group Sustainability Oversight Committee, which, in turn, is supported by the Royal London Group Sustainability and Stewardship function (established in January 2022).

## Capital, risk and liquidity management

### Capital management

4.64. Royal London considers capital management from two perspectives:

- **Investor view:** this considers the capital position of Royal London, including the RLMF (which is the primary source of capital for Royal London) along with its subsidiaries but excludes the closed ring-fenced RL(CIS) Fund.
- **Regulatory view:** this considers the capital position of Royal London at entity level. Under the regulatory view, Royal London is not able to take credit for surplus assets in the RL(CIS) Fund as these are ring-fenced for with-profits policyholders.

4.65. Under both the investor view and the regulatory view, Royal London aims to hold Eligible Own Funds in excess of the SCR within target ranges, in line with internal risk appetite standards, with different approaches being applied in the RLMF and in the RL(CIS) Fund. These targets consider Royal London Group's capital position on both the regulatory and investor views, with the latter being the principal basis by which Royal London manages its business. Royal London has an acceptable range for its investor view solvency coverage ratio, the lower end of which is 165%. In practice Royal London expects to operate with a larger solvency coverage ratio than this.

4.66. Should its capital position fall outside of the target ranges, Royal London will take management actions to rectify this, designed to manage risk, raise new capital, or remove capital inefficiencies. The severity of actions taken will depend on how far outside of the range Royal London is. Management actions available include increasing equity hedging, reviewing charges, raising subordinated debt, reviewing reinsurance arrangements, and expanding the application of the MA.

### Risk management

4.67. Royal London maintains a risk appetite framework which informs decision making and allows the business to identify and effectively manage emerging risks. This risk appetite framework consists of three components:

- **Risk strategy:** This sets out how Royal London approaches and manages the risks it is exposed to. The risk strategy includes a number of statements that are designed to clarify the types of risks to take or avoid in line with Royal London's strategy.
- **Risk appetite statements:** These explain how much risk Royal London is prepared to be exposed to, and why, in relation to each risk category outlined in the risk strategy.

- **Risk metrics:** These measure Royal London's exposure to each risk and how these compare to its risk appetite. These are designed to provide an early warning of when Royal London is approaching its risk appetite limits.

- 4.68. Royal London's risk appetite statements and metrics are constructed around core risk appetite categories: capital management, liquidity risk, business funding, insurance risk management, strategy, climate change risk and opportunities, and operational risks.
- 4.69. For each risk appetite category, Royal London's risk appetite statements classify each risk into one of the following risk preferences:
- Avoid – where there is no appetite for the risk;
  - Minimise – where there is limited appetite for the risk;
  - Manage – where there is some appetite for the risk but exposure should be appropriately managed; and
  - Seek – where there is high appetite for the risk and exposure should be sought where possible.

### Liquidity risk

- 4.70. Royal London defines liquidity risk as the risk that the Royal London Group, though solvent, either does not have sufficient financial resources available to meet its obligations as they fall due, or can only secure them at excessive cost.
- 4.71. As part of its risk management system, Royal London considers a number of scenarios that could create liquidity risk, including:
- a sharp and unexpected increase in death and/or surrender claims,
  - counterparty defaults and/or late payment of amounts due from reinsurers or linked fund investments,
  - the need to post significant amounts of margin or collateral under derivatives, reinsurance arrangements or other secured transactions,
  - operational and custodial banking counterparty disruption that would affect Royal London's ability to pay amounts when due, and
  - the need to pay claims on its unit-linked business, in particular early exit amounts, which may arise before assets in the fund can be realised.
- 4.72. Royal London manages liquidity risk in a number of ways:
- Holding an appropriate level of a Liquidity Buffer. The Liquidity Buffer is defined as the amount of liquid assets required to meet liabilities that may become due over the following twelve months. The assets held for the Liquidity Buffer must meet certain criteria, e.g. have a high credit quality. The Liquidity Buffer is set with consideration to both normal and stressed conditions, and is reviewed annually as part of the ORSA.
  - Monitoring liquidity risk, through the use of target liquidity coverage ratios and early warning indicators for liquidity issues, as well as maintaining a liquidity risk register.
  - Setting minimum amounts of cash and cash equivalent balances in each of its long-term funds. These are set by reference to recent and expected cash outflows and include a margin.

- Maintaining contingency funding and recovery plans. These include clear management action plans which outline an analysis of available financing options, regular and alternative sources of liquidity and an evaluation of a range of possible adverse liquidity scenarios.
- Appropriate matching of the maturities of assets and liabilities.
- Carrying out additional monitoring of unit-linked funds specifically, as these funds pose greater liquidity risk from holding a greater proportion of illiquid assets.

## 5. Outline of the Scheme

### Provisions of the Scheme

- 5.1. The parties propose that the Scheme should transfer the Transferring Policies to Royal London on the Transfer Date. Other than the four Guernsey policies mentioned in paragraph 1.5, no other policies within the individual protection book are expected to be excluded from the scope of the Scheme.
- 5.2. Following the Transfer Date, all of the assets, liabilities, rights and obligations under the Transferring Policies will move from SE plc to Royal London and the Transferring Policies will become business of Royal London.
- 5.3. The Scheme will move “Transferring Assets” to Royal London from SE plc on the Transfer Date. The “Transferring Assets” include:
  - the rights, benefits and property of SE plc relating to the Transferring Policies, and the reinsurance agreements on the Transferring Policies,
  - the rights, benefits and property relating to recovering clawback commission from independent financial advisers on Transferring Policies on or after 1 July 2022,
  - any defences, claims, counterclaims, and settlements relating to the Transferring Assets or to the Transferring Liabilities (see paragraph 5.4),
  - all intellectual property of SE plc that is used exclusively in the Transferring Policies,
  - all records relating to the Transferring Policies that are required for administrative and contractual purposes, and
  - any other assets agreed in writing by SE plc and Royal London prior to the Transfer Date.
- 5.4. The Scheme will also move “Transferring Liabilities” to Royal London from SE plc on the Transfer Date. The “Transferring Liabilities” are:
  - all liabilities relating to the Transferring Policies, including liabilities related to business contract breaches and historic administration errors,
  - all covenants, undertakings, or other forms compensation payments; and
  - any and all losses from any inability to recover amounts from HM Revenue & Customs (“HMRC”) in relation to the LPTR policies.
- 5.5. The rights and obligations of Transferring Policies will be unchanged by the Scheme. Some existing contracts with third parties relating to the Transferring Policies will transfer from SE plc to Royal London, including SE plc’s reinsurance contracts relating to the Transferring Policies. All references to SE plc, its board, its actuary or any other officers, employees or agents under such contracts and agreements will from the Transfer Date be read as references to Royal London and its equivalents. There will be no changes to policy terms and conditions, or to the terms of contracts with third parties including service level agreements, other than changing references from SE plc to Royal London. The Atos policy administration contract will not transfer but will instead be terminated and replaced on the Transfer Date by a new agreement between Atos and Royal London, which contains materially similar terms.

- 5.6. As noted in paragraph 1.3, a temporary reinsurance agreement was put in place between SE plc and Royal London to transfer all of the economic exposure from the individual protection business. This agreement will terminate on the Transfer Date.
- 5.7. The holders of Transferring Policies will not become members of Royal London and nor will they become eligible for ProfitShare distributions.
- 5.8. The Scheme makes provision for Residual Policies and the associated Residual Liabilities and Residual Assets, which include any policies, liabilities or assets which are intended to transfer under the Scheme, but which cannot be transferred on the Transfer Date for any reason. Any Residual Policies, Residual Liabilities and Residual Assets will be retained by SE plc until the impediment to their transfer has been removed, at which point they will be transferred to Royal London on a Subsequent Transfer Date. Other than as noted in 5.10, any Residual Policies will be fully reinsured to and administered by Royal London at the Transfer Date, under the "Residual Policies Reinsurance Arrangement", until such time as they are able to be transferred. The parties have advised me that they expect there to be no Residual Policies, Residual Liabilities or Residual Assets.
- 5.9. As noted in paragraph 1.5, there is a small number of Transferring Policies whose holders were resident in the Isle of Man, Jersey, or Guernsey at the time they took out their policies. It is intended that such policies held by customers in the Isle of Man and Jersey will be transferred as part of the Scheme, with no requirement for a separate scheme of transfer in those jurisdictions. For the four policies written in Guernsey, which are excluded from the scope of the Scheme, and for which a separate scheme would otherwise be needed, the parties intend to write directly to the customers with a view to novating their policies to Royal London. SE plc has had initial conversations with the holders of the four Guernsey policies, and no objections to this were raised. The working assumption is therefore that these policies will be novated. Should any of the policyholders not agree to the novation then the relevant policies would remain with SE plc. Consideration would then be given to either transferring the policies through a separate scheme presented to the Royal Court of Guernsey, or to the policies being permanently reinsured to and administered by Royal London for the remainder of their term. I will provide an update on this in my supplementary report.
- 5.10. SE plc has advised me that no holders of Transferring Policies were subject to UK political sanctions at the date of this report. This will continue to be monitored and should any of SE plc's holders of Transferring Policies become politically sanctioned prior to the Transfer Date, their policies would become Sanctioned Policies and would neither transfer to Royal London on the Transfer Date nor be included within the Residual Policies Reinsurance Arrangement. This is discussed further in paragraph 12.28.
- 5.11. The costs incurred in preparing and bringing into effect the Scheme will be met by SE plc and Royal London in accordance with the terms set out in the Framework Agreement between the two parties. This includes my fees, Court fees, Counsel's fees, and all other project costs.

#### **Planned actions following the Scheme**

- 5.12. Following the Scheme, both SE plc and Royal London will continue to operate in the UK insurance market, but SE plc will no longer provide individual protection business.
- 5.13. In due course following the completion of the transfer, Royal London intends to seek regulatory approval to apply the TMTP to the Transferring Policies, that were in force on 1 January 2016, in its regulatory balance sheet.
- 5.14. Royal London intends for policy administration in respect of the Transferring Policies to continue to be carried out by Atos immediately following the transfer, as set out in paragraph 5.5 above.

### Alternatives to the Scheme

5.15. In line with the Framework Agreement between the parties, SE plc and Royal London have always intended to pursue the proposed Scheme, which is necessary to transfer long-term insurance business between the parties in the manner envisaged. The parties have advised me that they have therefore not considered any alternatives to the Scheme, in which regard I note that I would not have expected them to do so in the circumstances.

### Contingency for the Scheme not proceeding

5.16. The parties have advised me that if the Scheme is not sanctioned, they would assess the impediments to it having been sanctioned and, if possible, seek to remove them with a view to implementing the Scheme at a future date.

5.17. In the event that the parties cannot or choose not to remove such impediments, the reinsurance agreement between SE plc and Royal London would be terminated and the transaction would be fully unwound. In that case, all Transferring Policies and their associated liabilities and risks would remain with SE plc, with their terms and conditions unchanged.

5.18. I consider the consequences of the Scheme not proceeding in Section 13.

## 6. Financial positions of SE plc and Royal London on the Transfer Date

### Pro-forma financial positions

6.1. **Figure 18** below sets out estimates of SE plc's and Royal London's financial positions as they would have been on 30 June 2023, had the Scheme been effective at that date. It also shows, for comparison, the "pre-Scheme" positions of both parties on that same date. For the avoidance of doubt, the "pre-Scheme" financial positions are as if the parties did not enter the Framework Agreement to work together to transfer the business, i.e. there is no allowance for the consideration paid for the business, the temporary reinsurance agreement, assets transferred as part of the Scheme, or impacts on capital requirements, though an allowance is made for costs incurred for the bid process. I am satisfied that the comparisons in **Figure 18** are appropriate for assessing the impact of the Scheme.

**Figure 18: Financial position pre- and post-Scheme**

As at 30 June 2023 (£m)	SE plc pre-Scheme <sup>1</sup>	SE plc post-Scheme <sup>1</sup>	Royal London pre-Scheme <sup>2</sup>	Royal London post-Scheme <sup>2</sup>
<u>Eligible Own Funds</u>	1,961.6	1,920.0	4,988.8	4,970.7
<u>SCR</u>	1,182.8	1,152.0	2,303.6	2,346.6
<u>Excess Own Funds</u>	778.8	768.0	2,685.2	2,624.1
<u>Solvency coverage ratio</u>	165.8%	166.7%	216.6%	211.8%

Source: (1) SE plc (2) Royal London

- 6.2. **Figure 18** does not show the full balance sheets. At the request of the parties some items have not been shown to ensure that the commercial details of the transaction, which would otherwise be able to be inferred, remain confidential to the parties. I have had access to and have reviewed the full balance sheets, and I have taken these into account in assessing the Scheme. I am satisfied that presenting the summary information in **Figure 18** does not mask any information which was material in my assessment of the Scheme.
- 6.3. Royal London prepares regulatory balance sheets on both a solo basis (i.e. for Royal London) and a group basis (i.e. for Royal London Group). As would be expected given that Royal London represents the majority of Royal London Group, the balance sheets are not dissimilar, with differences between the two being largely driven by the treatment of non-life insurance subsidiaries and the calculation of the SCR for RLI DAC. Royal London manages its business predominantly having regard to its group position on an investor view and **Figure 18** shows Royal London's position on that basis.
- 6.4. As described in paragraph 4.64, Royal London also considers its capital position on both a regulatory and an investor view. **Figure 15** outlined Royal London's capital position on a solo regulatory basis, being based on the regulatory balance sheet disclosed under Solvency II. Under the regulatory view, Royal London is unable to take credit for the Excess Own Funds in the RL(CIS) Fund, as these are required to be treated as being ring-fenced for the with-profits policyholders in that fund. However, as noted in paragraph 4.7, the assets in the RL(CIS) Fund may be used to provide capital support to the RLMF in extreme circumstances.
- 6.5. As the RL(CIS) Fund is strongly capitalised and very unlikely to need capital support from the RLMF, I consider it to be sufficient for my analysis of policyholder benefit security to focus on the financial position

of the RLMF – the fund into which the Transferring Policies will transfer – by considering the impact of the Scheme on Royal London’s group investor view capital position. As previously described, this is consistent with how Royal London manages its capital position and plans its business activities. It is also consistent with what Royal London’s Chief Actuary and With-Profits Actuary have considered in their reports on the Scheme.

- 6.6. Based on the analysis shown above, SE plc’s solvency coverage ratio is expected to increase by 0.9 percentage points to c.167% following the implementation of the Scheme, which is within SE plc’s target operating level.
- 6.7. Royal London’s solvency coverage ratio on an investor view basis would have reduced by c.5 percentage points, from c.217% to c.212%, at 30 June 2023, had the Scheme been effective at that date, while its solvency coverage ratio on a regulatory view would have reduced by c.4 percentage points to c.200%. These “post-Scheme” financial positions on the investor and regulatory views remain above Royal London’s target ranges.
- 6.8. The balance sheets underlying **Figure 18** assume that SE plc and Royal London retain all existing regulatory approvals as discussed in the “Solvency II implementation” sub-sections of Section 3 (from paragraph 3.45) for SE plc and of Section 4 (from paragraph 4.48) for Royal London. As noted in paragraph 5.13, Royal London intends in due course following completion of the Scheme to seek regulatory permission to apply TMTP in respect of the Transferring Policies that were in force at the inception of Solvency II. For the avoidance of doubt, that has not been allowed for in the financial positions shown in **Figure 18**.
- 6.9. Royal London’s Chief Actuary has advised that he expects the impact of the Scheme on the capital position of Royal London may reduce in time, owing to the following:
- Royal London has estimated that if TMTP was applied to eligible Transferring Policies, this would have increased Eligible Own Funds in its post-scheme regulatory balance sheet by c.£9m (which would have corresponded to a c.0.4 percentage point increase in the investor view solvency coverage ratio), and
  - the Scheme results in Royal London increasing its book of protection policies, in respect of which it expects that it may be able to create some expense synergies from economies of scale, which would improve the capital position,

neither of which is allowed for in the balance sheets underlying **Figure 18**.

### Capital management policies

- 6.10. A firm’s solvency coverage ratio is an indicator of its strength at a particular point in time. However, it should not be considered in isolation, not least as solvency coverage ratios can change for a number of reasons or be changed through deliberate management actions. It is therefore important to consider a firm’s solvency coverage ratio in the context of its overall risk framework, in particular its capital management policy.
- 6.11. As described in paragraphs 3.61 and 4.65, both SE plc and Royal London set targets for the ratio of Eligible Own Funds to SCR. SE plc targets a solvency coverage ratio of over 135% but expects to operate holding a solvency coverage ratio of around 150% under business as usual circumstances. As noted in paragraph 4.64, Royal London considers its capital management under an investor view and a regulatory view. Royal London has an acceptable range for its investor view solvency coverage ratio, the lower end of which is 165%. In practice Royal London expects to operate with a larger solvency coverage ratio than this. The key point to note for both firms, however, is that if the solvency coverage ratio were to



fall below the target level, management actions would be taken to return the capital position to the target level.

- 6.12. The capital positions of both SE plc and Royal London shown in **Figure 18** were above their target levels at 30 June 2023. Had the Scheme been implemented on 30 June 2023, both firms would have remained above their target positions. More specifically:
- SE plc would have exceeded the target level of capital and continued to operate the business at the usual level, where no management actions are required to improve its capital position, and
  - Royal London also would have exceeded its target capital position on both an investor and regulatory view and therefore also would not have required management actions to improve its capital position.
- 6.13. I am therefore satisfied that the implementation of the Scheme will not impact either firm's ability to meet its capital policy.
- 6.14. At 30 June 2023, Royal London's solvency coverage ratio was higher than that of SE plc, as can be seen in **Figure 18**. However, I would not necessarily view that as implying that Royal London is financially stronger than SE plc.
- 6.15. The capital management policies for both parties have been set to reflect the different nature of their businesses. To draw out one key difference, SE plc and Royal London have different ownership structures. SE plc is a proprietary company, able to raise capital from its shareholders. Royal London, on the other hand, is a mutual insurance society, able to raise capital by issuing subordinated debt, but unable to raise equity capital as it has no shareholders. All else being equal, this is expected to make it more difficult, or more expensive, for Royal London to raise capital than SE plc, which in turn contributes to Royal London targeting a higher solvency coverage ratio than SE plc.
- 6.16. There are of course other differences between the parties, beyond ownership structure, for example relating to business plans and operating models. The key point to note is that the parties' capital management policies have been approved as being appropriate – by the parties' Boards– in the context of the nature of their business, the regulatory environment in which the parties operate, and the range and efficacy of the management actions available to the parties. I would therefore consider the two companies to be of approximately equal financial strength so long as they both complied with their capital management policies, which I note require each party to hold capital in excess of the regulatory minimum.
- 6.17. In relying on the protection afforded by the parties' capital management policies, I have considered the regulatory guidance that firms should not make changes to capital management policies solely to facilitate the payment of dividends or other business plans. Supervisory Statement SS4/18 "Financial management and planning by insurers" states that:

*"The PRA expects any significant change to an insurer's risk appetite only to be made by the board following an overall discussion on the risks and capital requirements of the business. Most insurers review their strategy and business plans on an annual basis, in the context of the insurer's risk profile, a process which inherently includes reviewing the risk appetite, and a review may also be appropriate following some major external event. The PRA does not however expect the risk appetite to be changed solely to justify, or regularise, particular actions, such as the assumption of a new risk, a change in investment policy, or a dividend payment."*

It should be noted that, when the PRA refers to "risk appetite" in the Supervisory Statement SS4/18, I take this to include the capital management policy, since the same Supervisory Statement says that "*The*

*insurer's risk appetite statement is expected to include the risk appetite for the levels of capital that are to be maintained in reasonably foreseeable market conditions."*

- 6.18. As discussed in paragraphs 3.62 and 4.65, SE plc and Royal London have a range of capital management actions available to them to improve their capital positions. For both parties these include raising capital, increasing market risk hedging, reviewing charging structures, and reviewing the use of reinsurance.
- 6.19. SE plc and Royal London have carried out analysis to assess the ongoing availability and efficacy of management actions after the implementation of the Scheme.
- SE plc has concluded that the majority of its key management actions are unaffected by the Scheme. It will still be able to manage its capital position through withholding dividends, or through support from its shareholders, and its ability to hedge market risks, or to change policy charges, is also unaffected by the Scheme. While SE plc notes that its potential to reduce capital requirements through the increased use of reinsurance may reduce from no longer having the Transferring Policies on its books, it also notes that proportion of risk reinsured on these was already high, such that there was limited capacity for SE plc to increase this further to improve its capital position.
  - Royal London has confirmed that its management actions relate to with-profits business, and that these are unaffected by the Scheme in terms of their range and efficacy.
- 6.20. I have considered the parties' comments and am satisfied that there will be no material adverse effect on the availability and efficacy of the management actions used by the parties to manage their capital positions.

### Risk profiles

- 6.21. **Figure 19** below shows the extent to which different risks contribute to the SCR, after the effects of diversification, as at 30 June 2023, for both SE plc and Royal London, compared to their post-Scheme balance sheets.

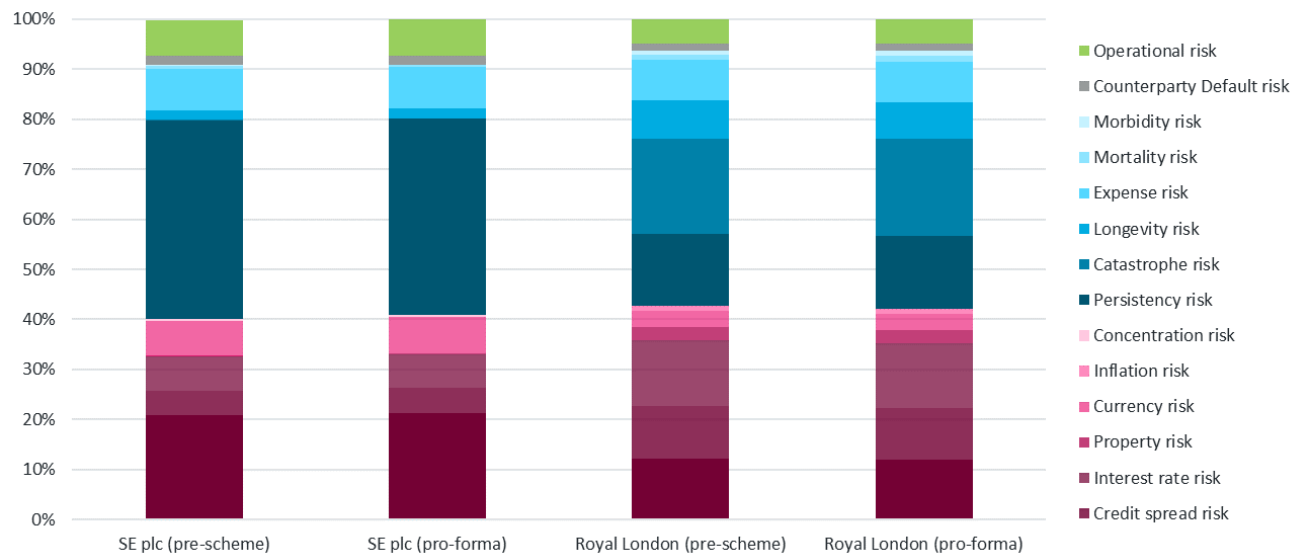
**Figure 19: Breakdown of SE plc and Royal London's SCRs including the impact of the Scheme as at 30 June 2023**

Risk	SE plc			Royal London			Difference between Aegon pre-Scheme and Royal London post-Scheme
	Pre-Scheme <sup>1</sup>	Post-Scheme <sup>1</sup>	<i>Difference between pre and post</i>	Pre-Scheme <sup>2</sup>	Post-Scheme <sup>2</sup>	<i>Difference between pre and post</i>	
Market risk	40.1%	40.8%	0.7%	42.6%	42.1%	(0.5)%	2.0%
Life underwriting risk	50.7%	50.0%	(0.6)%	51.1%	51.6%	0.5%	0.9%
Health underwriting risk	0.2%	0.0%	(0.2)%	0.0%	0.0%	0.0%	(0.2)%
Counterparty default risk	1.8%	1.7%	0.0%	1.3%	1.3%	0.0%	(0.4)%
Operational risk	7.3%	7.4%	0.2%	5.0%	5.0%	0.0%	(2.3)%

Source: (1) SE plc (2) Royal London

Figures in the table above have been rounded to 1 decimal place

- 6.22. **Figure 19** shows that there is expected to be an immaterial change to the breakdowns of SE plc and Royal London's SCRs following the implementation of the Scheme. **Figure 19** also shows that the risk breakdown of SE plc on 30 June 2023 is similar to that of Royal London, both before and after the implementation of the Scheme.
- 6.23. **Figure 20** below compares the total undiversified SCRs at 30 June 2023 for SE plc and Royal London, and the pro-forma undiversified SCRs assuming that the Scheme was effective at that date, broken down into the individual risk types.

**Figure 20: Breakdown of undiversified capital requirements by risk type**

Source: (1) SE plc (2) Royal London

- 6.24. In line with what was shown in **Figure 19**, **Figure 20** demonstrates that the Scheme is expected to have an immaterial impact on the breakdown of SE plc's risk exposure. A similar theme is observed for Royal London's risk exposure. The key transferring risks are mortality and morbidity risk, but the overall change in the breakdown of undiversified capital requirements by risk type is immaterial.
- 6.25. I have reviewed the parties' risk definitions and, other than some inevitable terminological differences, I consider them to be materially aligned for the most part, with some differences in respect of operational risk.
- 6.26. Both companies define operational risk as the risk of losses resulting from inadequate or failed internal processes, people and systems, or from external events. The parties consider many of the same risks within operational risk including legal, regulatory and conduct risk, information security risk, financial crime risk, processing risk and people risk. There are, however, some minor differences in the way the parties classify operational risk. For example, SE plc considers business risk in its own right whereas Royal London considers this to be a risk captured by other components of operational risk, including resilience risk and conduct risk. Conversely, Royal London considers third-party risk in its own right whereas SE plc captures this within processing risk. Royal London also does not consider tax risk as an operational risk given its mutual status.
- 6.27. These small differences in approach are ultimately methodological choices which give me no cause for concern. I also note that operational risk is a small portion of both parties' SCR.
- 6.28. I have reviewed the parties' strategic approaches to risk management, with each considering its risk exposure in high-level categories for the purpose of setting risk appetite statements and measuring exposure relative to the stated appetite. While the parties categorise these high-level risks somewhat differently, I do not consider that to be particularly material. For each risk within the high-level categories, both parties take a broadly similar approach of stating whether they have, for example, no appetite for the risk, limited appetite or some appetite. Furthermore, and most importantly in context, I consider the parties' risk definitions to be materially aligned for the most part, as discussed in paragraph 6.25.

- 6.29. I have reviewed the risk appetite statements and risk tolerance limits of both entities. Both parties have a similar risk appetite classification, with SE plc categorising into three groups, and Royal London into four, signifying the level of appetite. There are some differences in the risks each party seeks or looks to avoid.
- 6.30. I have reviewed the assessments carried out by the parties of how the Scheme is expected to affect their compliance with their risk tolerance limits as set out on their risk appetite frameworks.
- 6.31. SE plc has confirmed that it will not change its risk tolerance limits as a result of the Scheme and that it will continue to comply with these limits following the implementation of the Scheme.
- 6.32. For each risk, Royal London assesses its risk appetite position against risk tolerance limits, which depend on its appetite for the risks in question. As at 30 June 2023 Royal London was within its risk appetite for all risks and if the Scheme was effective on that date it would have continued to remain within its risk appetite. Royal London does not intend to make any changes to risk appetite statements or risk tolerance limits following the Scheme.
- 6.33. There are no material changes to the mix of risks of either party. All risks remain within each party's risk appetite. I am satisfied that there is therefore no material adverse effect to the benefit security for any group of policyholders as a result of the mix of risks.

### Regulatory approvals

#### Volatility Adjustment

- 6.34. As discussed in paragraphs 3.53 and 4.57, both SE plc and Royal London currently have regulatory approval to apply the VA in their valuation of certain liabilities. As set out in paragraph 6.8, the pro-forma positions shown in **Figure 18** assume that these approvals are retained and that the VA continues to be used within the valuation of the same liabilities.
- 6.35. SE plc currently applies the VA to certain business in the WPSF. The Transferring Policies are currently in SE plc's NPSF and the transfer is expected to have no impact on the assets, liabilities or management of the WPSF. I therefore do not expect that the Scheme will impact SE plc's ability to apply the VA.
- 6.36. Royal London currently applies the VA to with-profits business and in-payment non-profit annuity business which is not in the MA portfolio. The transfer is not expected to impact on the assets, liabilities or management of these policies, so I also do not expect the Scheme will impact Royal London's ability to apply the VA.

#### Matching Adjustment

- 6.37. As discussed in paragraphs 3.52 and 4.58, both SE plc and Royal London currently have regulatory approval to apply the MA in their valuation of certain annuity policy liabilities. As set out in paragraph 6.8, the pro-forma positions shown in **Figure 18** assume that these approvals are retained and that the MA continues to be used within the valuation of the same liabilities.
- 6.38. As the Scheme is not expected to impact on the assets, liabilities or management of these annuity policies in either SE plc or Royal London, I do not expect the Scheme will impact either party's ability to apply the MA.

#### TMTP

- 6.39. As discussed in paragraph 4.56, Royal London also has approval to apply the TMTP for business that was in force on 1 January 2016, when Solvency II was implemented. As the impact on its risk profile is small, as shown in **Figure 19** and **Figure 20**, I do not expect the transfer to lead to Royal London making an application to the PRA, under Supervisory Statement 6/16 'Maintenance of the transitional measure on technical provisions', to recalculate its TMTP.

6.40. While it intends in due course after the transfer to apply to extend TMTP to include the liabilities for Transferring Policies that were in force on 1 January 2016, the pro-forma balance sheet shown in **Figure 18** is presented on a prudent basis and does not allow for TMTP in connection with the Transferring Policies. If this were to be granted, that would increase Royal London's Eligible Own Funds by c.£9m, corresponding to a c.0.4 percentage point increase in the investor view solvency coverage ratio (as noted in paragraph 6.9), relative to that shown in **Figure 18**, all else being equal.

### SCR calculation

6.41. The financial positions shown in **Figure 18** assume that SE plc will continue to calculate its SCR using its PIM and that Royal London will continue to calculate its SCR using its Internal Model. I am satisfied that these will continue to remain appropriate for this purpose.

6.42. In reaching this conclusion:

- I have considered the standalone assessment of the appropriateness of its PIM carried out by SE plc, as discussed in paragraph 3.49,
- I have considered the standalone assessment of the appropriateness of its Internal Model carried out by Royal London, as discussed in paragraph 4.55, and
- I have assessed the change in risk profiles of SE plc and Royal London as a result of the Scheme in **Figure 19** and **Figure 20** above and in particular I note that no new risk categories are introduced.

6.43. As the Scheme is not expected to materially change the risk profiles of SE plc and Royal London, and as Royal London is not having risks transferred to it that are not already captured in its Internal Model, I am content that it is reasonable to consider that the parties' current approaches to calculating their SCRs will remain appropriate following the implementation of the Scheme.

### Climate Change

6.44. Both SE plc and Royal London have identified a number of areas in which they are exposed to climate change risks. These broadly consider similar risk categories including, operational, market, counterparty default, longevity, and mortality.

6.45. SE plc and Royal London have carried out qualitative and quantitative assessments of their climate risk exposures within their ORSAs. In particular, SE plc and Royal London have carried out climate scenario analyses to understand the impact of climate change risks on their solvency coverage ratios. To understand the relative exposure of each to climate change risk, I have reviewed the results of the scenarios provided in each entity's ORSA and compared the losses projected under a "disorderly transition" to the Paris Agreement. These show impacts of a broadly similar magnitude for each party.

6.46. As noted in paragraph 3.58, SE plc considers its main exposure in the short-term to be through transition risks, primarily stemming from the potential for SE plc's strategy for managing climate risk to lag behind its peers and not keep the pace with the wider industry. Quantitative assessments show that this risk will impact SE plc's unit-linked business more significantly than other parts of the business due to the impact of climate change risk on market prices of assets in these funds. Given SE plc's assessment of the sources of its climate change risk exposures, it does not consider there to be a material amount of climate change risk associated with the Transferring Policies, and so it does not expect the Scheme to have a material impact on its assessment of the sources of its exposure to climate change risk.

6.47. As noted in paragraph 4.62, Royal London considers its main exposure to be through a "failed transition" pathway whereby severe market movements cause significant adverse impacts to its unit-linked business in particular. Given this, Royal London also does not consider there to be a material amount of climate

change risk associated with the Transferring Policies, and so similarly does not expect the Scheme to lead to a material change in its exposure to climate change risk.

- 6.48. There is inevitably some climate change risk associated with the Transferring Policies, specifically there may be some additional mortality risk which could arise as a result of more extreme temperature and adverse weather events, but the book is heavily reinsured which will lessen any impact. I therefore agree with the parties' assessment that there is not a material amount of climate change risk associated with the Transferring Policies.
- 6.49. I am therefore content that the Scheme will not materially change the exposure of Transferring Policies, Remaining Policies, or Existing Policies to climate change risk.

### Quality of capital

- 6.50. The quality of Eligible Own Funds held by SE plc and Royal London is also relevant to the security of policyholder benefits. As discussed in paragraph 3.44, SE plc's Eligible Own Funds were of a high quality at 31 December 2022, and categorised as Unrestricted Tier 1 Own Funds. As noted in paragraph 4.47, c.80% of Royal London's Eligible Own Funds were categorised as Unrestricted Tier 1 Own Funds at 31 December 2022, with the rest being categorised as Tier 2 Own Funds. Royal London subsequently issued £350m of debt classified as Restricted Tier 1 Own Funds as well as redeeming £302m of debt classified as Tier 2 Own Funds. This resulted in Royal London's Eligible Own Funds comprising c.77% of Unrestricted Tier 1 Own Funds, c.7% of Restricted Tier 1 Own Funds and c.16% of Tier 2 Own Funds as at 30 June 2023.
- 6.51. Both parties have confirmed that the quality of Eligible Own Funds is expected to remain materially consistent with the position noted in paragraph 6.50 following the implementation of the Scheme. I am therefore satisfied that the Scheme should not have a material impact on the quality of Eligible Own Funds.

### Liquidity risk

- 6.52. I have reviewed both parties' approach to managing liquidity risk. As noted in paragraphs 3.69 to 3.71 and paragraphs 4.70 to 4.72, both SE plc and Royal London manage liquidity risk through holding a Liquidity Buffer. These are based on projections of liquidity requirements and each entity performs stress testing on these requirements.
- 6.53. Since both parties currently have regulatory approval to the use the MA and the VA, they are also required to maintain a liquidity plan which considers the risks that could increase liquidity requirements or reduce available liquidity. Both parties have analysed the expected liquidity position after implementation of the Scheme as part of their solvency projections. Results show no material risk to the liquidity position and no breaching of internal liquidity risk tolerance limits.
- 6.54. I am therefore content that the Scheme will not materially change the exposure of Transferring Policies, Remaining Policies, or Existing Policies to liquidity risk.

### Credit ratings

- 6.55. A credit rating is a formal, independent, forward-looking opinion of an organisation's ability to meet its obligations. Credit ratings can be a useful tool in assessing the financial strength and creditworthiness of a company. Credit ratings are predominantly provided by three main independent rating agencies, namely Standard & Poor's ("S&P"), Moody's, and Fitch, although there are others.
- 6.56. Although they may be called different names by different rating agencies, there are two main types of credit ratings:

- a “policyholder” or “insurer” financial strength rating, which is a forward-looking opinion on the firm’s ability to meet its insurance obligations to policyholders, and
- an “issuer” credit rating, which is a forward-looking opinion on a borrower’s ability to service its debt obligations, noting that these obligations are subordinate to insurance obligations.

6.57. As at the date of the report, the current credit ratings that SE plc and Royal London have been issued by the main rating agencies (see paragraph 6.55) are shown below.

**Figure 21: Ratings**

Company	Agency	Type	Rating	Date	Note
SE plc	S&P	Financial Strength Rating	A+	November 2023	(1)
	S&P	Issuer Credit Rating	A+	November 2023	(1)
Royal London	Moody’s	Insurance Financial Strength Rating	A	July 2023	(2)
	S&P	Issuer Credit Rating	A	August 2023	

Source: SE plc and Royal London

(1) These ratings have been given a negative outlook, which means they may be lowered in the future.

(2) This rating was provided by Moody’s, but has been expressed on the equivalent S&P rating scale for ease of comparison.

6.58. For “investment grade” credit, S&P’s credit rating scale is as follows:

- AAA, meaning that the issuer has an extremely strong capacity to meet financial commitments,
- AA, meaning that the issuer has a very strong capacity to meet financial commitments,
- A, meaning that the issuer has a strong capacity to meet financial commitments, but is somewhat susceptible to economic conditions and changes in circumstances, and
- BBB, meaning that the issuer has adequate capacity to meet financial commitments, but is more subject to adverse economic conditions.

Ratings of AA, A and BBB may also have a supplementary rating “+” or “-” notch representing a more granular forward-looking opinion on a borrower’s ability to service its debt obligations.

6.59. SE plc and Royal London have credit ratings of A, with the A+ (SE plc) and A (Royal London) ratings being only one notch apart. The credit ratings of SE plc and Royal London are therefore materially aligned.

### Events since 30 June 2023

6.60. The analysis shown in this section is based on data and market conditions as at 30 June 2023. The parties have provided me with their more recent financial positions, including estimated solvency coverage ratios, at 30 September 2023. Both parties continued to comply with their capital management policies at that date.

6.61. Since 30 September 2023, markets have moved slightly. For example, the 10-year gilt yield has fallen from 4.44% to 3.79% at 31 January 2024. The FTSE 100 was 7,608.1 on 30 September 2023 and increased slightly to 7,630.6 at 31 January 2024. In their 2022 SFCRs, both parties disclosed how their solvency coverage ratios would change if interest rates decreased by one percentage point. Both



estimated that this would have an immaterial impact on their solvency coverage ratios, which would have increased by around one percentage point. As at the date of this report the parties are still finalising their year-end balance sheets, but they have advised me that they are still operating comfortably within their capital management policies.

- 6.62. Some changes to the UK prudential regulatory regime came into force on 31 December 2023. These are discussed in paragraphs 12.1 to 12.15.
- 6.63. On 5 February 2024, Atos SE, the parent company of Atos, announced that it was in formal discussions with its lending banks to agree a plan to refinance its debts. Following these discussions, Atos SE requested that a process called a “mandat ad hoc” be initiated. This is a procedure that allows negotiations to be carried out between parties within a confidential framework. Under this process, an independent third party (called a “mandataire ad hoc”) is appointed by a French court to assist Atos SE in these discussions and help Atos SE find a financial solution as soon as possible. Since this announcement there have been a number of articles in the press about the financial position of Atos SE and its subsidiaries (the “Atos Group”). This is discussed further in paragraphs 7.43 to 7.47.

## 7. Impact of the Scheme on Transferring Policies

7.1. In this section I consider the likely effects of the Scheme on the holders of Transferring Policies, specifically with reference to benefit security, benefit expectations, service standards, and the expected impacts on changes to governance and management arising from Transferring Policies moving from SE plc to Royal London.

### Benefit security

7.2. The effect of the Scheme on the security of benefits for Transferring Policies can be assessed by considering the relative financial strength of the providers of the benefits. I do this by considering the differences between the capital management policies of the two firms, whether Royal London is expected to continue to comply with its capital management policy following the implementation of the Scheme, the risks to which the Transferring Policies are exposed, and the quality of capital held by the provider in respect of the risks.

### Capital management policy

- 7.3. As discussed in paragraph 6.12, the capital positions of SE plc and Royal London shown in **Figure 18** were respectively above their operating and target levels at 30 June 2023 and, had the Scheme been implemented on 30 June 2023, the firms would have remained there. For the reasons set out in paragraph 6.16, I therefore consider that SE plc and Royal London were of approximately equal financial strength on 30 June 2023, and that this would not have been changed had the Scheme been implemented on that date.
- 7.4. As discussed in paragraph 6.19, I do not consider that the Scheme will have a material adverse effect on the availability and efficacy of Royal London's management actions and therefore on the benefit security of holders of Transferring Policies.
- 7.5. As discussed in paragraphs 6.41 to 6.43, I am satisfied that Royal London's Internal Model will remain appropriate for use in these assessments.
- 7.6. As well as considering Royal London's pro-forma solvency position immediately after the implementation of the Scheme, I have also considered how the position is expected to evolve over time. Analysis prepared by Royal London as part of its business planning shows that its solvency coverage ratio is expected to remain within or above its target range to 2027, its business planning horizon. The implementation of the Scheme is not expected to affect this, with solvency projections expected to return to the pre-Scheme level by 2027, and to remain within or above the target range over this period.
- 7.7. As discussed in paragraph 6.9, Royal London also expects the impact of the Scheme on its capital position may reduce in time through a combination of it seeking to extend its application of the TMTTP to the Transferring Policies and through potential expense synergies from a growing in-force book. While these are not allowed for in the analysis presented in **Figure 18**, and so are not material to my assessment of the Scheme, I am satisfied that Royal London's expectations in this regard are reasonable.

### Balance of risks

#### Components of the SCR

7.8. **Figure 20** compares the total undiversified SCR as at 30 June 2023 for SE plc and Royal London and their pro-forma undiversified SCR assuming that the Scheme was effective at that date, broken down by risk types. To assess the significance of the changes in risks to which holders of Transferring Policies are exposed, the relevant comparison is of the risk profile of SE plc before the implementation of the Scheme to that of Royal London after its implementation. The largest changes are an increase in mortality and

morbidity risk but these are small components of Royal London's undiversified SCR. Other components have relatively minor changes. As set out in paragraph 6.24, and noting my comments at paragraph 6.28, I am satisfied that the change in balance of risks will not have a material adverse effect on the benefit security of Transferring Policies.

### **Fund-level considerations**

- 7.9. The Transferring Policies currently sit within SE plc's NPSF which does not contain any with-profits policies, although the assets in the NPSF may be used to support policies in SE plc's ring-fenced WPSF should its assets be insufficient to meet liabilities. The Scheme will move the Transferring Policies into the RLMF which includes both non-profit and with-profits business. While this more directly exposes the Transferring Policies to risks from with-profits business, in the sense that they are not ring-fenced from other with-profits business, this is unavoidable in the context of Royal London's mutual society structure and is the same as all of Royal London's other non-profit business. I do not consider this to constitute a material risk to the benefit security of the Transferring Policies given Royal London's expected compliance with its capital management policy following the implementation of the Scheme and the range and efficacy of management actions available to it should the capital position fall outside the target range.
- 7.10. While the RL(CIS) Fund is ring-fenced, any burn-through cost would fall to the RLMF. Royal London considers this in its ORSA. Given the capital strength of the RL(CIS) Fund and the management actions available to it under stress (including reducing bonuses, reducing equity investment in the fund, and removing past miscellaneous surplus), Royal London considers it to be highly unlikely that any burn-through cost would fall to the RLMF. Having considered the range of management actions available in the context of the strength of the RL(CIS) Fund, I am satisfied that the burn-through risk from the RL(CIS) Fund does not represent a material adverse effect on Transferring Policies.

### **Assets**

- 7.11. **Figure 22** below provides a high-level comparison of the assets held by SE plc and Royal London as at 31 December 2022.

Figure 22: Assets held by SE plc and Royal London as at 31 December 2022

Asset Category	SE plc		Royal London	
	Asset Value (£m)	% of Total	Asset Value (£m)	% of Total
<u>Deferred tax asset</u>	-	-	33.4	0.0%
Pension benefit surplus	-	-	206.6	0.2%
Property, plant & equipment held for own use	68.2	0.1%	-	-
Property (other than for own use)	106.9	0.1%	127.9	0.1%
Holdings in related undertakings, including participations <sup>1</sup>	846.2	1.0%	13,884.3	12.5%
Equities	889.3	1.1%	6,053.7	5.5%
Government bonds	794.7	1.0%	3,483.0	3.1%
Corporate bonds	708.6	0.9%	6,224.3	5.6%
<u>Structured notes</u>	0.0	0.0%	48.7	0.0%
<u>Collateralised securities</u>	156.3	0.2%	284.7	0.3%
<u>Collective investment undertakings</u>	14.8	0.0%	1,206.4	1.1%
Derivatives	32.9	0.0%	1,835.2	1.7%
Deposits other than cash equivalents	242.8	0.3%	605.3	0.5%
Assets held for <u>index-linked</u> and <u>unit-linked</u> contracts	70,051.1	86.0%	70,839.9	64.0%
Loans and mortgages	0.0	0.0%	91.6	0.1%
<u>Reinsurance recoverables</u>	6,409.9	7.9%	2,969.8	2.7%
Insurance and intermediaries receivables <sup>2</sup>	38.9	0.0%	48.2	0.0%
<u>Reinsurance receivables</u>	47.0	0.1%	183.7	0.2%
Receivables (trade, not insurance) <sup>3</sup>	993.0	1.2%	2,199.7	2.0%
Cash and cash equivalents	53.0	0.1%	431.6	0.4%
Other assets <sup>4</sup>	1.1	0.0%	-	-
<b>Total</b>	<b>81,454.8</b>	<b>100.0%</b>	<b>110,758.2</b>	<b>100.0%</b>

Sources: SE plc SFCR 2022; Royal London SFCR 31 December 2022

(1) Refers to the non-insurance subsidiaries

(2) Includes debtors arising out of direct insurance operations

(3) Relates to other debtors not captured elsewhere on the balance sheet

(4) Includes other assets not captured elsewhere on the balance sheet, e.g. dividends receivable

- 7.12. SE plc has confirmed that the Transferring Assets are reinsurance 'assets' together with some net current assets. These are small in the context of the asset holdings of Royal London. There are no planned changes to the existing assets backing Royal London's business, so the information in **Figure 20** is useful for providing high level comparisons between the asset holdings of the entities after the implementation of the Scheme.
- 7.13. Royal London classifies a significant proportion of its assets (12.5%) as non-insurance subsidiaries, whereas SE plc's holding of such assets is much lower (1%). For Royal London, this constitutes a broad range of businesses including unit trusts, Open-Ended Investment Companies (OEICs), and other investment funds. The RLMF estate receives profits (excluding investment profits) and bears the risks on these businesses, and the profits are eligible for distribution as ProfitShare to eligible Royal London policies. Given Royal London's capital management policy and noting that these are allowed for in Royal London's projections in its ORSA, I do not consider this difference in asset profile to constitute a material adverse effect on the benefit security of the Transferring Policies.
- 7.14. It is inevitable that there will be differences between the other asset holdings of the parties. As can be seen, the majority of the assets held by both SE plc and Royal London are those held to back unit-linked and index-linked contracts, although this comprises a larger proportion of SE plc's assets relative to Royal London's. Royal London holds relatively more equities, corporate bonds, and government bonds than SE plc due to having a relatively higher proportion of with-profits business, although I do not consider the differences ultimately to be of significance as both parties hold the majority of their assets in liquid, market traded instruments. SE plc has a higher proportion of reinsurance recoverables, the consequences of which I discuss in paragraphs 7.15 and 7.16.

### Reinsurance

- 7.15. SE plc's existing reinsurance arrangements on individual protection business will be transferred to Royal London under the terms of the Scheme, and the terms of the arrangements will not change. The parties have engaged with the reinsurers who provide the reinsurance on the Transferring Policies. There are no concerns about transferring the reinsurance agreements to Royal London and no known barriers to doing so. Transferring Policies will therefore continue to be protected by the existing reinsurance arrangements following implementation of the Scheme.
- 7.16. As discussed in paragraphs 4.40 to 4.43, Royal London has a number of existing reinsurance arrangements. These will also be unchanged following implementation of the Scheme. While these will not apply directly to the Transferring Policies, following implementation of the Scheme they will gain an exposure to risks arising from Royal London's existing reinsurance arrangements, including the risk of reinsurer default and the operational and reputational risks arising from the arrangements. Royal London's overall reinsurance exposure is proportionately less than that of SE plc, meaning that the Transferring Policies' proportionate exposure when in Royal London will reduce as a result of the Scheme.
- 7.17. Royal London considers exposure to counterparties relative to its risk appetite at a parent company level, i.e. instead of considering various entities within a reinsurance group separately, exposures are combined and compared to the risk appetite for each reinsurance group as a whole. As noted in paragraph 4.43, Royal London sets its risk appetite based on its relative exposure to each counterparty (taking account of the credit-risk-mitigating effects of any collateral arrangements), as a proportion of Eligible Own Funds and the reinsurance counterparties' credit ratings. I am satisfied that the implementation of the Scheme leaves reinsurance exposures relative to their risk appetite materially unchanged.

### Valuation methods

7.18. Based on due diligence carried out as part of the acquisition of the Transferring Policies from SE plc, Royal London has confirmed that it expects to make no material changes as a result of the Scheme to the methodology used to value the Transferring Policies relative to that used by SE plc.

### Climate change risk

7.19. As discussed in paragraphs 6.44 to 6.48, I have reviewed both parties' assessments of climate change risk. For the reasons set out there, I am satisfied that the Scheme does not materially change the exposure to climate change risk of the holders of Transferring Policies.

### Quality of capital

7.20. As discussed in paragraph 6.50, the quality of the parties' Eligible Own Funds is expected to be materially unchanged following the Scheme. While Royal London's Eligible Own Funds are of a slightly lower quality, on average, than SE plc's, I do not consider this to represent a material adverse effect to benefit security for Transferring Policies as Royal London complies with regulatory requirements in this regard.

### Liquidity risk

7.21. As discussed in paragraphs 6.52 to 6.54, I have reviewed both parties' assessments of liquidity risk. For the reasons set out there, I am satisfied that the Scheme does not materially change the exposure to liquidity risk of the holders of Transferring Policies.

### Credit ratings

7.22. While not identical, the credit ratings of SE plc and Royal London are materially aligned, and so do not raise any concerns about the benefit security of Transferring Policies.

### Business plans

7.23. Royal London expects to continue to operate in the UK insurance market following the Scheme. I have discussed with management their plans in general terms, which are unchanged by the Scheme. Any new business will be written into the RLMF where the Transferring Policies will then reside. Any new policies to be written, or potential future acquisitions of business, should be expected to increase Royal London's exposure to market and insurance risks, the details of which would depend on the amount of business written. They may also increase Royal London's exposure to operational and expense risks. Business transfers may result in slight reductions to the solvency coverage ratio, but any reductions would be expected to be short term.

7.24. However, and notwithstanding these points, any such new business policies or acquisitions should be expected to increase capital generation within Royal London. I note that decisions about new business and potential acquisitions will be subject to Royal London's risk appetite framework and capital management policy.

7.25. Finally, I note that any future transfers of insurance business into Royal London would be subject to the safeguards set out in Part VII of FSMA. These safeguards include the requirement for an Independent Expert to opine on whether the transfer is expected to have a material adverse effect on any group of policyholders which, if Royal London were to acquire a further block of business after this Scheme was implemented, would include the policyholders to be transferred by this Scheme.

7.26. Given these considerations, I am satisfied that Royal London's business plans are not expected to give rise to any risks that would have a material adverse effect on benefit security of the Transferring Policies.

### Conclusion in respect of benefit security

7.27. Having considered the capital management policies, the balance of risks, exposure to climate change risk, the quality of capital, liquidity risk, and the business plans of Royal London, I am satisfied that the Scheme will not have a material adverse effect on benefit security for Transferring Policies.

### Benefit expectations

#### Terms and conditions

7.28. The Transferring Policies are entitled to benefits on claim, subject to their terms and conditions, which will not change as a result of the Scheme, other than changing references from SE plc to Royal London.

### The application of discretion

7.29. SE plc has identified six areas of discretion it currently applies in managing certain aspects of the Transferring Policies, as outlined in paragraph 3.23. These could influence the payouts to the holders of Transferring Policies. For example, claims underwriting processes could influence the likelihood of a claim being paid, and potentially the amount and timing, while premium reviews could lead to higher or lower premiums having to be paid by policyholders.

7.30. Royal London has reviewed each of the areas of discretion, with the following outcomes:

- **Claims underwriting:** Royal London has reviewed SE plc's underwriting process, and the results of historical claims audits by reinsurers, and is satisfied that SE plc's claims underwriting approach is consistent with its own and that there will therefore be no material difference in claims underwriting standards as a result of the Scheme. Royal London also intends to implement claims monitoring to identify any material changes in claim payouts following the Scheme.
- **Reviewable premiums:** As discussed in paragraph 3.23, a different approach to premium reviews is taken depending on when the policy was sold, with SE plc performing the reviews for policies sold from September 2005 and the reinsurers performing the reviews on behalf of SE plc for policies sold before September 2005. Royal London has reviewed SE plc's process for reviewing premiums for policies sold from September 2005 and has committed to continuing with these reviews in line with the approach carried out by SE plc (which Royal London notes is also consistent with the process carried out on some blocks of its Existing Policies). To facilitate this, Royal London will require access to historical pricing factors from SE plc, which SE plc has agreed to provide in advance of the Transfer Date. Royal London has also committed to maintain the current process for policies sold before September 2005 where reinsurance rates drive the premium reviews. As noted in paragraph 7.15, Royal London has engaged with all reinsurers that will be transferring across as part of the Scheme, with no concerns being raised.
- **Benefit commutation:** As discussed in paragraph 3.23, this is not a contractual option and it is currently only offered at the discretion of SE plc. Royal London currently offers commutation on some of its Existing Policies and has therefore committed to continue offering this discretionary option using its existing calculation methodology, which, similar to SE plc, is performed on a cost-neutral basis using current economic conditions.
- **Guaranteed Insurability Option and Renewal Option:** Royal London has committed to continue offering this option to Transferring Policies using its own pricing basis effective from the Transfer Date. As discussed in paragraph 3.23, SE plc has historically priced this option using its current new business basis. Royal London's commitment is consistent with this.
- **Change of smoker status:** Royal London offers this option to some of its Existing Policies and has committed to continue offering it to Transferring Policies. The option is currently administered by Atos for SE plc, which will continue after the Scheme.

7.31. Royal London has also committed to continuing to communicate the options available to customers in the same way as SE plc currently does. Noting that Royal London will continue to apply discretion to the Transferring Policies using principles consistent with SE plc's approach, I am satisfied that the benefit expectations of Transferring Policies will not be materially adversely affected by the Scheme.

### ProfitShare

7.32. The Transferring Policies are non-profit protection policies and so do not share in the profits of SE plc. Consistent with Royal London's existing non-profit protection policies, which similarly do not share in Royal London's profits, the Transferring Policies will not become eligible for ProfitShare after the transfer.

### Tax

7.33. As discussed in paragraph 3.31, the Transferring Policies include c.4,000 LPTR policies, which were sold alongside pension policies and therefore benefit from tax relief on the life insurance policy premiums. The Scheme will transfer only the life insurance policies, while the pension policies will be retained within SE plc. The parties intend to seek an ancillary order from the Court to the effect that from the Transfer Date the LPTR policies can be treated for tax purposes as continuing to meet the criteria necessary to constitute "protected policies" that qualify for such tax relief under paragraph 5 of Schedule 18 of the Finance Act 2007, notwithstanding their transfer from SE plc to Royal London.

7.34. Historically, SE plc has been able to claim tax relief from HMRC on the premiums paid on LPTR policies. Royal London has engaged with HMRC to inform them of the Scheme and of the intention to continue to claim tax relief on the LPTR policies in line with the ancillary order referred to in paragraph 7.33, and Royal London has advised me that HMRC has raised no objections. However, should HMRC not allow Royal London to continue to claim tax relief, it will meet on the policyholders' behalf the costs of the lost tax relief on premiums. The value of the tax relief over the remaining run-off of the LPTR policies is immaterial in the context of Royal London's overall business. I am therefore satisfied that should Royal London be unable to claim tax relief, meeting the costs of the lost tax relief on premiums will not materially impact Royal London's financial position.

7.35. Royal London has confirmed that it does not expect the Scheme to result in any changes more generally to the taxation treatment of the Transferring Policies, including in the hands of policyholders.

7.36. I am therefore content that the benefit expectations of Transferring Policies will not be materially adversely affected by the Scheme.

### Conclusion in respect of benefit expectations

7.37. Having considered the expected effect of the Scheme on the terms and conditions of Transferring Policies, the application of discretion in managing them, and Royal London's assurances in respect of the tax treatment of LPTR policies, I am satisfied that the Scheme will not have a material adverse effect on the benefit expectations of the Transferring Policies.

### Service standards

#### Outsourced administration

7.38. Atos currently provides administration services for the Transferring Policies on behalf of SE plc. From the Transfer Date, Atos will continue to provide policy administration under a new contract with Royal London.

7.39. Royal London has set out for me a comparison of the target service levels in its contract with Atos against those in SE plc's existing contract with Atos. The agreements are materially aligned, with the targets being unchanged except for two areas – relating to the target time to answer policyholder calls and the acceptable proportion of policyholders who abandon their call before it is answered – where the targets



will increase slightly. The table below outlines these under SE plc's existing contract with Atos and also under Royal London's contract with Atos. Under SE plc's current agreement, targets vary depending on whether the contact relates to claims, to general servicing, or is from financial advisers.

**Figure 23: Service level targets under Atos contracts**

Agreement	SE plc / Atos			Royal London / Atos
	Claims	Servicing	Financial advisers	
Calls abandoned	No more than 4.5%	No more than 2%	No more than 2.5%	No more than 6%
Time to answer calls	82% within 20 seconds	81% within 45 seconds	85% within 45 seconds	80% within 150 seconds

- 7.40. Moving the administration of Transferring Policies to the new agreement will therefore have an adverse effect on the holders of Transferring Policies, or their financial advisers, in these two specific areas. I have considered the service level targets against the industry average (based on data from a widely-used UK call centre benchmarking survey), as well as against Royal London's targets for its Existing Policies. I have also considered how these service levels may be affected by increased demands, for example where there is an unexpectedly large number of customers getting in contact with Atos. I am satisfied that Atos take appropriate steps to estimate the resource required to maintain service levels and can take suitable actions (such as utilising employees from other departments) to respond to changes in demand.
- 7.41. Based on the considerations set out above, I do not consider the change in service standards to represent a material adverse effect for the holders of Transferring Policies (or where relevant their financial advisers). In forming my views on the impacts on policyholders, I am mindful that this is an area of judgement, and I am content that Royal London has considered the balance between providing good service levels for customers on one hand and the commercial implications of exceeding those levels on the other. I also note that Royal London's agreement with Atos will trigger remedial action more quickly than SE plc's existing agreement with Atos if Atos fall below the agreed service level targets. This introduces additional safeguards for policyholders in upholding the service level targets.
- 7.42. I therefore do not expect there to be a material adverse effect on service standards for Transferring Policies as a result of the Scheme.
- 7.43. As mentioned in paragraph 6.63, there has recently been some press commentary on the financial position of Atos Group. I firstly note that businesses do, from time to time, enter into discussions with their creditors with a view to managing their financial position. It is not certain when Atos SE's ongoing formal discussions with lenders will conclude or what the outcome of these discussions will be. It also remains to be seen whether the financial position of the Atos Group will deteriorate in such a way that it impacts the ability of Atos to administer and service the Transferring Policies, although that is a possibility.
- 7.44. The Scheme will not create a material new exposure for the holders of Transferring Policies to Atos, on the basis that Atos currently provides third-party services in respect of those policies. For the avoidance of doubt, this would not be my view if Atos did not currently provide outsourced administration services to the holders of Transferring Policies. However, in the specific circumstances of the Scheme as proposed, I remain content that the Scheme is not likely to create a material adverse effect for holders of Transferring Policies, in the sense that it will not create a significant new reliance on Atos, provided that the parties' contingency plans to address the failure of Atos are appropriate and continue to support this conclusion.
- 7.45. In respect of contingency planning, I consider there to be two relevant areas of focus:

- SE plc's existing contingency plans for Transferring Policies for the potential servicing failure and forced exit from Atos; and
- Royal London's contingency plans in the short and longer term. These plans consider the short-term possibility of a servicing failure of Atos during the period from now up to the Transfer Date to ensure a smooth transition from SE plc at the Transfer Date. These plans also consider the possibility of Atos failure in the longer term, after the Transfer Date.

7.46. In Section 11, I consider the parties' approach to policyholder communications, both generally and also specifically in relation to any communication requirements in respect of the Atos Group. For clarity, I comment on this situation in my summary report to policyholders, as described in paragraph 1.27.

7.47. I am currently content that the conclusion drawn in paragraph 7.42 remains appropriate and unchanged in light of the situation with Atos SE, but I will report further on this – including the relative merits of the parties' contingency plans in respect of Atos – in my supplementary report for the Sanction Hearing. I will monitor the situation actively ahead of then and discuss with the parties and the PRA and FCA anything that may cause my views to change.

#### **In-house administration**

7.48. In the longer term, Royal London intends to bring the administration of Transferring Policies in-house. While plans to do this have not been finalised, Royal London currently expects that if the Transferring Policies' administration was brought in-house it would seek to align the service standards for them with those for its existing internally-administered business. With that in mind, Royal London has set out for me a comparison of the service standards for the Transferring Policies in its new agreement with Atos with those currently applying to its internally-administered business. While there are some differences, I am satisfied that these are not material. Should the administration of the Transferring Policies be brought in-house, Royal London has committed to undertaking an assessment at that point to ensure there is no resulting material adverse effect on service standards.

7.49. I therefore do not expect there to be a material adverse effect on service standards for Transferring Policies as a result of the Scheme.

#### **Additional services**

7.50. The Transferring Policies currently have access to "Policy Plus" which offers policyholders a range of additional health and wellbeing support services provided by a series of third-party providers. Royal London has confirmed that this arrangement will be novated with effect on the Transfer Date and maintained for the holders of Transferring Policies following the transfer.

7.51. The Barclays Bank Account referred to in paragraph 3.6, currently used by SE plc to manage cash flows relating to its individual protection business, will be novated to Royal London with effect on Transfer Date. The terms of this agreement will be unaffected.

7.52. I am therefore satisfied that the Scheme will not have a material adverse effect on service standards for Transferring Policies.

#### **Governance and management**

7.53. As noted in paragraphs 3.16 and 4.19, Royal London's governance structure is similar to SE plc's. Both entities have Board committees for Audit, Remuneration, Nominations, Investment, Risk & Capital, With-Profits and Independent Governance, all with similar high-level remits. Royal London additionally has a Disclosures Committee responsible for approving Solvency II financial disclosures for submission to the PRA.

- 7.54. As noted in paragraphs 3.15 and 4.20, the SE plc and Royal London Executive Committees are comprised of individuals holding a similar set of roles including CEOs, CFOs and CROs, among others. There are some differences in the compositions of the Executive Committees – for example Royal London does not operate with a specific Chief Technology Officer or Chief Distribution Officer. However, Royal London has confirmed that the technology role falls to its Chief Operating Officer and the distribution responsibilities are covered by its Chief Commercial Officer. I am satisfied that the relevant responsibilities remain covered.
- 7.55. As mentioned in paragraphs 3.17 and 4.21, both entities also maintain internal governance functions as prescribed by the Solvency II framework (Internal Audit Function, Actuarial Function, Risk Management Function and Compliance Function).
- 7.56. I therefore consider that the governance and management of Royal London is broadly comparable to that of SE plc and as such I do not expect the Scheme to have a material adverse effect on the governance and management of the Transferring Policies.

### **Eligibility for the Financial Services Compensation Scheme and the Financial Ombudsman Service**

- 7.57. Policies held with a firm authorised by the PRA are currently protected by the Financial Services Compensation Scheme (“FSCS”) if that firm should suffer an insolvency event. Like SE plc, Royal London is an insurer authorised by the PRA. The transfer of a long-term insurance policy from SE plc to Royal London will therefore not affect that contract’s eligibility for FSCS compensation. The level of compensation received will also be unaffected, including for any holders of Transferring Policies who also hold other contracts of insurance with Royal London.
- 7.58. The holders of Transferring Policies that were sold in the UK are currently able to bring complaints against SE plc to the Financial Ombudsman Service (“FOS”). Following the implementation of the Scheme, the holders of the Transferring Policies sold in the UK will be able to bring complaints against Royal London to the FOS. I note that any complaints made to the FOS by holders of the Transferring Policies that are outstanding at the Transfer Date will be transferred to Royal London and handled and settled by Royal London under the terms of the Scheme.
- 7.59. Based on legal advice commissioned by SE plc, which I have considered and am comfortable with, it is my understanding that the holders of Transferring Policies who were resident in the Channel Islands or in the Isle of Man at the commencement of their policy cannot currently bring complaints against SE plc to a financial ombudsman in these jurisdictions. Any such complaints are taken to FOS in the UK instead, and this will continue to be the case following the implementation of the Scheme. I also note that any complaints made to FOS by the holders of such Transferring Policies that are outstanding at the Transfer Date will be transferred to Royal London and be handled and settled by Royal London under the terms of the Scheme.
- 7.60. I am therefore satisfied that the eligibility of the Transferring Policies to financial services compensation and to make representations to a financial ombudsman will be unchanged as a result of the transfer.

## 8. Impact of the Scheme on SE plc's Remaining Policies

### Benefit security

8.1. Consistent with my approach in Section 7 in relation to the Transferring Policies, I assess the likely effect of the Scheme on the security of benefits for the holders of SE plc's Remaining Policies by considering its impact on SE plc's financial strength. Specifically, I consider whether SE plc is expected to comply with its capital management policy following the implementation of the Scheme, the risks to which the firm is exposed, and the quality of capital held.

### Capital management policy

8.2. SE plc's capital management policy will not change as a result of the Scheme. As discussed in paragraphs 6.35 and 6.37, I do not expect that the Scheme will result in SE plc losing its regulatory approvals to apply the MA and the VA and, as discussed in paragraph 6.41, I am satisfied that SE plc's PIM will remain appropriate for calculating its SCR and assessing compliance with its capital management policy after the Scheme is implemented. As shown in **Figure 18**, SE plc's solvency coverage ratio would have increased slightly, and exceeded both the target level and the operating level, had the Scheme become effective on 30 June 2023. I am therefore content that the Scheme will not lead to a material adverse effect on the benefit security of Remaining Policies.

8.3. As well as considering SE plc's pro-forma solvency position immediately after the implementation of the Scheme, I have also considered how the position is expected to evolve over time. Projections over a three-year time horizon provided by SE plc show that SE plc's solvency coverage ratio is expected to be a little over one percentage point higher over this time period than would be the case without the implementation of the Scheme. These projections allow for future new business in line with SE plc's plan. This analysis indicates that SE plc will continue to comply with its capital management policy in the years immediately following the Scheme.

### Balance of risks

#### Components of the SCR

8.4. **Figure 20** compares the total undiversified SCR as at 30 June 2023 for SE plc and Royal London and their pro-forma undiversified SCR assuming that the Scheme was effective at that date, broken down by risk types. To assess the significance of the changes in risks to which the holders of Remaining Policies are exposed, the relevant comparison is of the risk profile of SE plc before and after the implementation of the Scheme.

8.5. Underlying **Figure 20** are small reductions in mortality, morbidity and catastrophe risks, with small changes in other components of the SCR. For example, there is a small overall reduction in expense risk, notwithstanding that the Scheme otherwise increases SE plc's exposure in respect of overhead costs which will be reallocated from Transferring Policies across the Remaining Policies. The Scheme also removes SE plc's exposure to the counterparty default risk on the transferring reinsurance treaties. Ultimately, though, the Scheme is expected to have an immaterial impact on the breakdown of SE plc's risk exposure, as shown in **Figure 20**.

#### Fund-level considerations

8.6. The Scheme will not change SE plc's existing fund structure and the Remaining Policies will continue to sit in the NPSF or the ring-fenced WPSF (as the case may be) after its implementation. Additionally, the shareholder fund and NPSF will continue to be available to support the WPSF if needed.

8.7. Given my assessment in paragraphs 8.2 and 8.3, I am satisfied that the Scheme does not lead to a material adverse effect on the capital support available to SE plc's Remaining Policies.

### Assets

8.8. SE plc has advised me that there are no expected changes to assets backing the Remaining Policies as a result of the Scheme. I therefore do not expect any material adverse effect on benefit security for the Remaining Policies to arise from changes in asset risk exposures following implementation of the Scheme.

### Reinsurance

8.9. As discussed in paragraph 5.5, the reinsurance agreements that SE plc has in place for the individual protection policies will transfer to Royal London as part of the Scheme. There will be no changes to the remaining reinsurance agreement, namely the reinsurance agreement in place for annuity business, and SE plc has no plans to enter into any new reinsurance agreements as a consequence of the Scheme.

### Valuation methods

8.10. SE plc has confirmed that there will be no changes to how it values Remaining Policies as a result of the Scheme.

### Climate change risk

8.11. As discussed in paragraphs 6.44 to 6.48, I have reviewed SE plc's assessment of climate change risk. For the reasons set out there, I am satisfied that the Scheme does not materially change the exposure to climate change risk of the holders of Remaining Policies.

### Quality of capital

8.12. As discussed in paragraph 6.50, the quality of SE plc's Eligible Own Funds following the Scheme is expected to be equivalent to the quality of SE plc's Eligible Own Funds prior to the Scheme, continuing to consist entirely of Unrestricted Tier 1 Own Funds. I am therefore satisfied that there will be no material adverse effect to the benefit security of the Remaining Policies in relation to the quality of capital held after implementation of the Scheme.

### Liquidity risk

8.13. As discussed in paragraphs 6.52 to 6.54, I have reviewed SE plc's assessment of liquidity risk. For the reasons set out there, I am satisfied that the Scheme does not materially change the exposure to liquidity risk of the holders of the Remaining Policies.

### Credit ratings

8.14. As the transfer is expected to have an immaterial impact on the financial position of SE plc, and as SE plc is expected to continue to comply with its capital management policy, and noting that this is a matter for the ratings agencies rather than me, I would not expect the transfer to result in any changes to SE plc's credit ratings, and indeed I note that the latest ratings were awarded after the parties entered into the Framework Agreement.

### Business plans

8.15. While SE plc is now closed to new individual protection business, it continues to write significant volumes of new savings and pensions business, and these plans are not changed by the Scheme. I have discussed with management their business plans in general terms, which are unchanged by the Scheme. As the ability to continue to write new business in SE plc will be subject to continued compliance with its capital management policy, which is also not changed by the Scheme, I am satisfied that the Scheme will not lead to a material adverse effect on the benefit security of the Remaining Policies in terms of SE plc's business plans.

### Conclusion in respect of benefit security

8.16. Having considered the capital management policies, the balance of risks, exposure to climate change risk, the quality of capital, liquidity risk, and SE plc's business plans, I am satisfied that the Scheme will not have a material adverse effect on the benefit security of the Remaining Policies.

### Benefit expectations

#### Unit-linked policies

8.17. The Scheme will not change the terms and conditions of the unit-linked Remaining Policies. Similarly the Scheme will not change, and SE plc has confirmed that it does not plan to change as a result of the Scheme, any of the following:

- the way in which it manages its unit-linked business,
- the charges applying to that business,
- its unit-linked PPFM, and
- the range of unit-linked funds available to policyholders, including the funds' investment aims.

8.18. I am therefore satisfied that the benefit expectations of holders of unit-linked Remaining Policies will not be materially adversely affected by the Scheme.

#### Non-profit policies

8.19. The premiums payable and benefits due under non-profit policies are codified in the policy terms and conditions, which will not be altered by the Scheme. Following the Scheme, there will be some non-profit Remaining Policies – specifically the group protection policies noted in paragraph 3.24 – where there is possible discretion over commutation of ongoing benefit payments. SE plc's management has confirmed that there are no plans to change the approach to applying any such discretion following the implementation of the Scheme. Furthermore, as the Scheme will not change the way in which management apply such discretion, I am therefore satisfied that there will be no material adverse effect on the benefit expectations of the holders of non-profit Remaining Policies following implementation of the Scheme.

#### With-profits policies

8.20. The Scheme will not change the terms and conditions of the with-profits Remaining Policies. Similarly, the Scheme will not change, and SE plc has confirmed that it does not plan to change as a result of the Scheme, the management of the with-profits business in the WPSF, including the application of discretion required to manage that business, e.g. investment strategy, the allocation of expenses, setting surrender values, and setting bonus rates. For the avoidance of doubt, SE plc does not intend to change the PPFM for the WPSF as a result of the Scheme.

8.21. For the avoidance of doubt, SE plc does not intend to change its with-profits PPFMs as a result of the Scheme. In the absence of specific provisions in the Scheme, SE plc considers its PPFMs to continue to provide appropriate safeguards in relation to the management of with-profits policies. I agree with this assessment.

8.22. I am therefore satisfied that there will be no material adverse effect on the benefit expectations of the holders of with-profits Remaining Policies following implementation of the Scheme.

#### Costs associated with the Scheme

8.23. SE plc's agreed share of the costs of the Scheme will be borne by its shareholders. As discussed in the preceding paragraphs the costs will have no impact on Remaining Policies.

## Tax

- 8.24. As discussed in paragraph 3.32, SE plc's Remaining Policies are taxed on a BLAGAB basis or on the basis of trading profits, depending on the nature of the business. SE plc has confirmed that the Scheme does not lead to any changes in the taxation of Remaining Policies, including on policyholders' personal taxation. I am therefore satisfied that there will be no material adverse effect on the tax treatment of the Remaining Policies.
- 8.25. SE plc has received tax advice on the Scheme, which states that it is unlikely that HMRC will apply anti-avoidance rules (which would mean that SE plc would be unable to take tax benefits associated with the Scheme and Transferring Policies). Paraphrasing, the advice states that should SE plc request clearance from these rules it is likely to be granted.

## Conclusion in respect of benefit expectations

- 8.26. Having considered the expected effect of the Scheme on the terms and conditions of Remaining Policies, and the application of discretion in managing them, I am satisfied that the Scheme will not have a material adverse effect on the benefit expectations of the Remaining Policies.

## Service standards

- 8.27. As discussed in paragraph 3.8, a small book of group protection policies currently falls under the scope of the outsourced administration agreement with Atos that covers the Transferring Policies. SE plc intends to incorporate the administration of these policies to a different, existing arrangement with Atos that covers the administration of SE plc's unit-linked pensions and investment bond business, with the terms and service standards for group protection policies to be unchanged. The contractual changes are expected to be in place by 31 March 2024. If the intended approach ultimately proves not to be possible, SE plc intends to bring group protection policy administration in-house. As the group protection policies represent a small book of business that does not require claims experts for their administration, SE plc does not anticipate any resourcing skills gaps or deterioration in service standards should the administration need to be brought in-house. I am satisfied with SE plc's position here and will provide an update in my supplementary report.
- 8.28. As noted above, Atos also currently provides administration services for some unit-linked pensions and investment bond business. There are no planned changes to this arrangement as part of the Scheme, other than the migration onto the Sapiens platform, as mentioned in paragraph 3.8. This migration will happen regardless of whether or not the Scheme is implemented.
- 8.29. There are no other changes to policy administration as a result of the Scheme. I am therefore satisfied that there is no material adverse effect on service standards for the Remaining Policies as a result of the Scheme.
- 8.30. As discussed in paragraphs 6.63 and 7.43 to 7.47, there has recently been some press commentary on the financial position of Atos Group. I am satisfied that the Scheme will not change the exposure to Atos of the holders of Remaining Policies, on the basis that Atos currently provides third-party services to these policies and will continue to do so following the Scheme. I also note that SE plc has a contingency plan (for the potential servicing failure and forced exit from Atos) specifically for Remaining Policies. I am therefore currently satisfied that the conclusion drawn in paragraph 8.29 remains appropriate and unchanged in light of the situation with Atos SE, but I will report further on this in my supplementary report.

## Governance and management

- 8.31. SE plc's management has confirmed that there are no intended changes to the firm's management or governance structures as a result of the Scheme, including the various terms of reference.

8.32. As such, I am content therefore satisfied that the Scheme will not have a material adverse effect on the governance and management of Remaining Policies.



## 9. Impact of the Scheme on Royal London's Existing Policies

### Benefit security

9.1. Consistent with my approach in Sections 7 and 8 in relation to the Transferring Policies and the Remaining Policies respectively, I assess the likely effect of the Scheme on the security of benefits for the holders of Royal London's Existing Policies by considering its impact on Royal London's financial strength. Specifically, I consider whether Royal London is expected to comply with its capital management policy following the implementation of the Scheme, the risks to which the firm is exposed, and the quality of capital held.

### Capital management policy

9.2. Royal London's capital management policy will not change as a result of the Scheme. As discussed in paragraphs 6.36 and 6.38, I do not expect that the Scheme will impact Royal London's ability to apply the MA and the VA. As discussed in paragraph 6.39, I do not expect the transfer to lead to Royal London making an application to the PRA to recalculate its TMT. As discussed in paragraph 6.41, I am satisfied that Royal London's Internal Model will remain appropriate for use in calculating its SCR and assessing compliance with its capital management policy after the Scheme is implemented.

9.3. As noted in paragraph 6.7, Royal London's solvency coverage ratio – under both the investor and regulatory views – would have fallen only slightly had the Scheme become effective on 30 June 2023, and in particular would have remained above its target ranges for both.

9.4. As discussed in paragraph 6.19, I do not consider that the Scheme will have a material adverse effect on the availability and efficacy of Royal London's management actions and therefore on the benefit security of holders of Existing Policies.

9.5. Additionally, as described in paragraph 7.6, Royal London's solvency coverage ratio is expected to remain within or above its target range based on projections to 2027. I am therefore content that the Scheme will not lead to a material adverse effect on the benefit security of the Existing Policies.

### Balance of risks

#### Components of the SCR

9.6. **Figure 20** compared the total undiversified SCR as at 30 June 2023 for SE plc and Royal London, and the pro-forma undiversified SCR assuming that the Scheme was effective at that date, broken down by risk types. To assess the significance of the changes in risks to which holders of Existing Policies are exposed, the relevant comparison is of the risk profile of Royal London before the implementation of the Scheme to that of Royal London after its implementation. As described in paragraph 6.24, the Scheme is expected to have a very small impact on the breakdown of Royal London's risk exposure with no material change in its risk profile.

9.7. Royal London is already exposed to operational risk on individual protection business through its existing protection policies. The operational risk component of the SCR will therefore remain materially unchanged as a result of the Scheme.

9.8. The transfer inevitably brings with it an element of operational risk in relation to moving business from SE plc to Royal London. A dedicated project manager has been assigned to lead on the initial transfer activities, which will receive the same scrutiny and oversight as any other change project in Royal London. I am therefore comfortable that the transfer does not expose Existing Policies to a material additional amount of operational risk.

9.9. As set out in paragraphs 6.21 to 6.33, I am satisfied that the change in the balance of risks will not have a material adverse effect on the benefit security of Royal London's Existing Policies.

### Fund-level considerations

- 9.10. As noted in paragraph 4.7, the RLMF estate is available to provide capital support to the RL(CIS) Fund in extreme circumstances, and vice versa. This arrangement will not change as a result of the Scheme.
- 9.11. By effectively increasing the proportion of guaranteed benefits payable from the RLMF, albeit by increasing the amount of non-profit protection business in it, the implementation of the Scheme slightly increases the likelihood of Royal London needing to take management actions to manage its overall financial position. However, and as noted in paragraph 9.3, Royal London's regulatory view of the solvency coverage ratio would have fallen only slightly, from c.204% to c.200%, had the Scheme become effective on 30 June 2023 and this remains within the capital management policy. I therefore do not consider this aspect to represent a material adverse effect on the Existing Policies in the RLMF.
- 9.12. For the reasons discussed in the previous paragraph, that is by effectively increasing the proportion of guaranteed benefits payable from the RLMF, the proposed transfer is expected to very slightly increase burn-through risk to the RL(CIS) Fund. However, given the RLMF's compliance with its capital policy after the transfer, I consider this additional risk to be very small indeed. Specifically, the Scheme is expected to reduce Royal London's solvency coverage ratio based on its investor view by c.5 percentage points, from c.217% to c.212%, at 30 June 2023, had the Scheme been effective at that date. That remains within the target range of the investor view capital management policy which governs the RLMF.
- 9.13. Furthermore, since the RL(CIS) Fund is ring-fenced and the Transferring Policies will transfer into the RLMF, the Scheme does not increase the likelihood of the RLMF having to support the RL(CIS) Fund, nor does it affect the ability of the RL(CIS) Fund to support the RLMF if needed.
- 9.14. I therefore do not consider there to be a material adverse effect on the capital support available to Royal London's Existing Policies.

### Assets

- 9.15. As noted in paragraph 7.12, the Transferring Assets are reinsurance 'assets' together with some net current assets. These will not introduce any new material asset exposures to Royal London and so I do not expect any material adverse effect on expected benefit levels or benefit security of Existing Policies to arise from changes in their asset risk exposures following implementation of the Scheme.

### Reinsurance

- 9.16. As noted in paragraph 7.15, SE plc's reinsurance arrangements relating to the Transferring Policies will transfer to Royal London as part of the Scheme. As noted in paragraph 7.17, Royal London considers its exposure to reinsurers at a parent company level and already has existing reinsurance arrangements with all of the counterparties at a parent company level.
- 9.17. As noted in paragraph 4.43, Royal London sets its risk appetite based on its relative exposure to each counterparty (taking account of the credit-risk-mitigating effects of any collateral arrangements) as a proportion of Eligible Own Funds and the reinsurance counterparties' credit ratings. I have had access to and have reviewed the full reinsurance exposures and Royal London's counterparty risk appetite tolerance limits.
- 9.18. Royal London considers its risk appetite at a fund level, and so also considers the RLMF and RL(CIS) Fund in turn. The reinsurance risk appetite position of the RL(CIS) Fund is unchanged by the Scheme and exposure to each counterparty continues to be within appetite.
- 9.19. The RLMF's exposure to all but one reinsurance counterparty is currently classified as within risk appetite. Royal London currently accepts this position, having considered options such as recapturing the risk ceded to the reinsurer which is outside of risk appetite. This remains unchanged by the

implementation of the Scheme. Although the absolute monetary exposures are affected by the Scheme, all counterparties currently classed as within risk appetite are expected to remain so after the transfer.

9.20. As the Scheme does not change the exposures relative to risk appetite tolerances I am therefore satisfied that the transfer of reinsurance treaties attaching to the Transferring Policies will not lead to a material adverse effect for the holders of Existing Policies.

#### Valuation methods

9.21. Royal London has confirmed there will be no changes to how it values Existing Policies as a result of the Scheme.

#### Climate change risk

9.22. As discussed in paragraphs 6.44 to 6.49, I have reviewed Royal London's assessment of climate change risk. For the reasons set out there, I am satisfied that the Scheme does not materially change the exposure to climate change risk of the holders of Existing Policies.

#### Quality of capital

9.23. As discussed in paragraph 6.50, the quality of Royal London's Eligible Own Funds following the Scheme is not expected to change materially compared to the quality of Royal London's Eligible Own Funds prior to the Scheme, where the majority of Eligible Own Funds is classified as Unrestricted Tier 1 Own Funds, with the remainder classified as Tier 2 Own Funds. I am therefore satisfied that there will be no material adverse effect to the benefit security of Existing Policies in relation to the quality of capital held after implementation of the Scheme.

#### Liquidity risk

9.24. As discussed in paragraphs 6.52 to 6.54, I have reviewed Royal London's assessment of liquidity risk. For the reasons set out there, I am satisfied that the Scheme does not materially change the exposure to liquidity risk of the holders of Existing Policies.

#### Credit ratings

9.25. Consistent with my comments in paragraph 8.14 in connection with SE plc, I would not expect the transfer to result in any changes to Royal London's credit ratings.

#### Business plans

9.26. I discussed Royal London's business plans in paragraph 7.23. As these are unchanged by the Scheme, and for the same reasons set out in paragraphs 7.24 and 7.25, I am satisfied that the Scheme will not lead to a material adverse effect on the benefit security of Existing Policies in terms of Royal London's business plans.

#### Conclusion in respect of benefit security

9.27. Having considered the capital management policies, the balance of risks, exposure to climate change risk, the quality of capital, liquidity risk, and the business plans of Royal London, I am satisfied that the Scheme will not have a material adverse effect on the benefit security of the Existing Policies.

#### Benefit expectations

##### Unit-linked policies

9.28. The Scheme will not change the terms and conditions of Royal London's existing unit-linked policies. Similarly, the Scheme will not change, and Royal London has confirmed that it does not plan to change as a result of the Scheme, any of the following in the RLMF:

- the way in which it manages its unit-linked business, including the application of discretion as discussed in paragraph 4.31 ,

- the charges applying to that business, and
- the range of unit-linked funds available to policyholders, including the funds' investment aims.

9.29. I am therefore satisfied that the benefit expectations of Royal London's unit-linked Existing Policyholders will not be materially adversely affected by the Scheme.

### Non-profit policies

9.30. As discussed in paragraphs 4.25 and 4.27, Royal London has some non-profit business where there is management discretion over areas such as claims underwriting, reviewable premiums and renewal options. Management has confirmed that they do not plan to change their approach to applying such discretion following the implementation of the Scheme. The Scheme will not change the terms and conditions of Royal London's existing non-profit policies.

9.31. I am therefore satisfied that there will be no material adverse effect on the benefit expectations of Royal London's non-profit Existing Policyholders following implementation of the Scheme.

### With-profits policies

9.32. SE plc's business will be transferred into the RLMF. The Scheme will not change the terms and conditions of Royal London's existing with-profits policies in either the RLMF or RL(CIS) Fund. Similarly, the Scheme will not change, and Royal London has confirmed that it does not plan to change as a result of the Scheme, the management of with-profits business as described in paragraphs 4.28 to 4.30, including the application of discretion required to manage that business, e.g. investment strategy, the allocation of expenses, setting surrender values, and setting bonus rates.

9.33. For the avoidance of doubt, Royal London does not intend to change its with-profits PPFMs as a result of the Scheme. In the absence of specific provisions in the Scheme, Royal London considers its PPFMs to continue to provide appropriate safeguards in relation to the management of with-profits policies. I agree with this assessment.

9.34. I am therefore satisfied that there will be no material adverse effect on the benefit expectations of Royal London's with-profits Existing Policyholders following implementation of the Scheme.

9.35. Chapter 20 of the FCA's Conduct of Business Sourcebook COBS sets out various rules and guidance applying to insurers with with-profits business. Chapter 20.2 relates to treating with-profits policyholders fairly, and rule 20.2.28R specifically outlines steps that insurers must take when writing new business into a with-profits fund (which the Transferring Policies will constitute in connection with the RLMF), to ensure that the new business is likely to have no adverse effect on the interests of the with-profits policyholders already in that fund. While strictly beyond my scope, I have at the FCA's request reviewed Royal London's analysis and assessment of this, and discuss some points of note below.

9.36. **Figure 18** showed that at 30 June 2023, the Scheme was expected to result in a small reduction in Royal London's Eligible Own Funds. However, as noted in paragraph 6.8, this does not allow for the TMTF benefit that Royal London expects it will be able to apply to this business, and nor does it allow for the changes to the calculation of the Risk Margin which took effect on 31 December 2023 (discussed in more detail in paragraphs 12.4 and 12.12). If these were allowed for in the analysis in **Figure 18**, it is expected there would be a small increase in the Eligible Own Funds, of the order of £4m at that date.

9.37. Additionally, as noted in paragraph 7.48, Royal London intends in the longer term to bring the administration of Transferring Policies in-house, which is expected to create expense synergies and further improve the financial position. The capital requirements associated with the Transferring Policies will also be released over time as the business runs off, which will also improve Royal London's financial

position. I am therefore comfortable with Royal London's conclusion that the Scheme is likely to have no adverse effect on existing with-profits policyholders. I note that the conclusion of this assessment differs to the assessment that I am required to make.

### Membership

9.38. As the holders of Transferring Policies will not become members of Royal London I am satisfied that the Scheme will not lead to any loss or dilution of the rights of Royal London's existing members.

### ProfitShare

9.39. As noted in paragraph 4.32, Royal London awards eligible policies a share of its profits each year via a scheme called ProfitShare. As payment of ProfitShare is discretionary and not guaranteed, Royal London does not view its award as forming part of the benefit expectations of eligible members, and its communications to eligible members support this position.

9.40. Noting also that the holders of Transferring Policies will not become eligible for ProfitShare awards, and having discussed with management in broad terms how it operates the ProfitShare scheme, I am satisfied that the Scheme will have no material adverse effect on the benefit expectations of Royal London's members who are eligible to awards of ProfitShare.

### Costs associated with the Scheme

9.41. Royal London's agreed share of the costs of the Scheme will be met from the RLMF estate. Royal London has advised that these costs have been allowed for within the pricing of the acquisition to ensure that members are expected to achieve an appropriate return from the investment. As discussed in the preceding paragraphs the costs will have no impact on Existing Policies.

### Tax

9.42. As discussed in paragraph 4.34, Royal London's Existing Policies are taxed on a BLAGAB basis or on the basis of trading profits, depending on the nature of the business. Royal London has confirmed that it does not expect the Scheme to lead to any changes in the taxation of Existing Policies, including on policyholders' personal taxation. I am therefore satisfied that there will be no material adverse effect on the tax treatment of the Existing Policies.

### Conclusion in respect of benefit expectations

9.43. Having considered the expected effect of the Scheme on the terms and conditions of Existing Policies, and the application of discretion in managing them, I am satisfied that the Scheme will not have a material adverse effect on the benefit expectations of the Existing Policies.

### Service standards

9.44. There are no changes to the administration of Existing Policies as a result of the Scheme.

9.45. Additionally, the "Helping Hand" services, which are provided to holders of Existing Policies who were sold protection insurance policies through independent financial advisors (see paragraph 4.13), will continue to be offered to those policyholders, with no changes as a result of the Scheme.

9.46. I am therefore satisfied that there is no material adverse effect on service standards for the Existing Policies as a result of the Scheme.

### Governance and management

9.47. Royal London's management has confirmed that there are no intended changes to the firm's management or governance structures as a result of the Scheme, including the various terms of reference.

9.48. As such, I am therefore satisfied that the Scheme will not have a material adverse effect on the governance and management of the Existing Policies.

## 10. Other Stakeholders

### Reinsurers

10.1. Reinsurers may be exposed to the risk of default by cedants, for example if the present value of future premiums to be paid by the cedants exceeds the present value of the claim payments that are expected to be made to the cedant under the reinsurance agreement.

### SE plc's reinsurers

- 10.2. As discussed in paragraph 3.37, SE plc has 25 arrangements with nine reinsurers to manage mortality and morbidity risk on the Transferring Policies. As discussed in paragraph 5.5 these arrangements will be transferred to Royal London as part of the Scheme. Following the transfer, SE plc will therefore have an agreement in place with only one reinsurer (the "remaining reinsurer"), as discussed in paragraph 3.38.
- 10.3. As also discussed in paragraph 3.38, SE plc has a negative exposure to its remaining reinsurer as at 30 June 2023, meaning the remaining reinsurer is exposed to the risk of SE plc not meeting its obligations under the agreement were SE plc to become insolvent. However, this exposure is relatively small, accounting for less than 0.1% of SE plc's Eligible Own Funds at 30 June 2023. Additionally, as the Scheme is expected to have only a small impact on the solvency position of SE plc which is still expected to comply with capital management targets, I am satisfied that the Scheme will not materially adversely affect SE plc's ability to pay premiums under its agreement with its remaining reinsurer.
- 10.4. Noting the above, together with the analyses set out in Section 6 in relation to SE plc's financial strength, capital management policies, risk profile, and governance arrangements – which applies equally to SE plc's remaining reinsurer as they do to holders of Remaining Policies – I am satisfied that the Scheme will not have a material adverse effect on SE plc's remaining reinsurer.
- 10.5. SE plc has advised me that it has notified the remaining reinsurer about the Scheme and the reinsurer has not raised any concerns.
- 10.6. The other nine reinsurers whose treaties will transfer to Royal London as part of the Scheme are already reinsurance counterparties of Royal London, either with the specific reinsurance entity or at its parent company level, so I consider the impact of the Scheme on them, along with Royal London's other reinsurers, below.

### Royal London's reinsurers

- 10.7. SE plc's reinsurance agreements associated with the Transferring Policies will transfer to Royal London as part of the Scheme. Royal London has existing relationships with all nine of these reinsurers, either with the specific reinsurance entity or at its parent company level, meaning that their exposure to Royal London will change as a result of the Scheme. As noted in paragraph 7.17, Royal London considers its exposure to reinsurers at a parent company level. The paragraphs that follow therefore focus on seven reinsurers rather than nine, as four of SE plc's reinsurance arrangements on the Transferring Policies span across two parent companies.
- 10.8. I have considered those reinsurers' current exposures to Royal London, compared to their expected exposures following the implementation of the Scheme, by considering the reinsurer's portion of the BEL, before and after the Scheme, net of any collateral arrangements in place. This analysis shows that:
- exposure to Royal London for three out of the seven reinsurers remains largely unchanged as a result of the Scheme,
  - for one reinsurer, the exposure is expected to move from positive before transfer to negative after it,

- the exposure becomes less positive for another reinsurer, and
- for the final two reinsurers, their exposure to Royal London remains negative but becomes even more negative after the transfer.

10.9. For clarity of interpretation, a negative exposure to Royal London means that the reinsurer will have a net total payment due to Royal London, with the opposite being true for a positive exposure.

10.10. There will be no change to the terms and conditions, exercise of discretion and overall benefit expectations for the Transferring Policies as a result of the Scheme, as discussed in paragraph 7.30.

10.11. There will also be no change to the exposure for Royal London's six remaining reinsurers, covering its Existing Policies, as a result of the transfer. I am therefore satisfied that Royal London's reinsurers are not materially more exposed to additional business risk associated with the Transferring Policies as a result of the Scheme.

10.12. Noting the above, together with the analyses set out in Section 6 in relation to Royal London's financial strength, capital management policies, risk profile, and governance arrangements – which apply equally to Royal London's current reinsurers as they do to holders of Existing Policies – I am satisfied that the Scheme will not have a material adverse effect on Royal London's reinsurers.

10.13. Additionally, Royal London has advised me that its reinsurers have been notified about the Scheme and have confirmed that they have no concerns about the impact of the Scheme on their counterparty exposures and risk profile.

### Outsourced service providers

10.14. As discussed throughout my report, the outsourced administration agreement between SE plc and Atos in respect of the Transferring Policies will be terminated and replaced with a new agreement between Royal London and Atos. As discussed in paragraph 7.38, the terms of Royal London's new agreement with Atos are materially similar to SE plc's current agreement with Atos.

10.15. The Policy Plus services provided to all Transferring Policies through SE plc's contracts with Health Assured Ltd, FPSG Connect Ltd and Red Arc Assured Limited will be novated to Royal London with effect on the Transfer Date, for the ongoing benefit of the holders of Transferring Policies. There will be no changes to the terms of the contracts with Health Assured Ltd, FPSG Connect Ltd and Red Arc Assured Limited as a result of the transfer.

10.16. The Barclays Bank Account referred to in paragraph 3.6, currently used by SE plc to manage cash flows related to the individual protection business, will also be novated to Royal London with effect on Transfer Date. The terms of this agreement with Barclays will be unaffected.

10.17. As discussed in paragraph 3.7, a small book of group protection policies, which does not form part of the book of Transferring Policies, currently falls in scope of SE plc's outsourcing arrangement with Atos for the Transferring Policies. As discussed in paragraph 10.14, this administration agreement will be terminated as part of implementing the Scheme, meaning that an alternative arrangement is needed for SE plc's group protection policies. SE plc intends to incorporate the administration of those policies into a different, existing arrangement with Atos that covers the administration of SE plc's unit-linked pensions and investment bond business, with the terms and service standards for group protection policies to be unchanged. Atos is therefore expected to continue to administer the group protection business.

10.18. SE plc and Royal London have confirmed that there will be no other changes to existing outsourcing arrangements as part of the Scheme. The parties have also advised me that all outsourced service providers have been consulted regarding the Scheme and have not raised any concerns or objections.



10.19. Based on all of the above, I am satisfied that the Scheme will not have a material adverse effect on the parties' outsourced service providers.

### Defined benefit pension schemes

#### SE plc

10.20. As noted in paragraph 3.34, SE plc is Aegon UK's main source of funding for the Aegon UK Staff Retirement and Death Benefit Scheme. As SE plc is still expected to comply with its capital management policy after the transfer, I consider that the Scheme is expected to have no material impact on the strength of Aegon UK's employer covenant. SE plc has also advised me that it has engaged with the trustees of the pension scheme and they have noted no concerns with the Scheme. I am therefore satisfied that the Scheme will not have a material adverse effect on the members of the Aegon UK Staff Retirement and Death Benefit Scheme.

#### Royal London

10.21. As discussed in paragraph 4.35, Royal London is responsible for funding three defined benefit pension schemes.

10.22. As Royal London is still expected to comply with its capital management policy after the transfer, I consider that the Scheme is expected to have no material impact on the strength of Royal London's employer covenant. Royal London has also advised me that it has engaged with the trustees of the pension schemes and they have noted no concerns with the Scheme. I am therefore satisfied that the Scheme will not have a material adverse effect on the members of Royal London's defined benefit pension schemes.

### Creditors

10.23. As shown in **Figure 15**, Royal London had c.£1,210m of subordinated liabilities on its regulatory balance sheet as at 31 December 2022. Since 31 December 2022, Royal London has issued £350m Restricted Tier 1 debt and has redeemed £302m of existing Tier 2 debt. Repayments on debt are an ongoing cost for Royal London. Should the Scheme result in a material deterioration in Royal London's capital position, it may increase the risk of Royal London defaulting on these repayments.

10.24. However, as discussed in paragraph 6.6, the Scheme is expected to result in only a small reduction in Royal London's solvency coverage ratio and Royal London is still expected to comply with its capital management policy targets. Noting this, and the range of management actions that Royal London has at its disposal to manage its capital position, I am satisfied that the Scheme will not have a material adverse effect on the holders of this debt.

10.25. Royal London does not intend to individually notify all bondholders, which I consider to be reasonable given the modest impact of the Scheme on Royal London's capital position.

### Insurance subsidiaries

10.26. As discussed in paragraph 4.8, RLI DAC is an insurance subsidiary of the RLMF.

10.27. RLI DAC fully reinsures the business of its closed funds to Royal London via a collateralised quota share reinsurance agreement, as described in paragraph 4.38. There will be no changes to these arrangements, or to RLI DAC's internal capital support arrangements, also described in paragraph 4.38, as a result of the Scheme.

10.28. As discussed in paragraph 6.6, the Scheme is only expected to result in a small reduction in Royal London's solvency coverage ratio and Royal London is still expected to comply with its capital management policy targets. RLI DAC's Board has been notified of the transfer and no concerns were raised.

10.29. I am therefore satisfied that the Scheme will not have a material adverse effect on Royal London's ability to meet its reinsurance obligations to RLI DAC.

## 11. Policyholder communications

### SE plc's approach

#### Structure and content

11.1. SE plc intends to issue a notification pack to holders of Transferring Policies shortly after the Directions Hearing, which is scheduled to be held on 28 February 2024. That pack will include:

- a cover letter,
- an explanatory booklet (the "Transfer Guide") containing an introduction to the transfer, a summary of the Scheme, a notice (the "Legal Notice") stating that the application for the Scheme has been made in the appropriate form, answers to common questions that policyholders may have, information on the legal process, and information on how to raise any objections, and
- a summary of my Scheme Report, included within the Transfer Guide.

11.2. I have reviewed the notification pack that will be sent to holders of Transferring Policies and the information to be posted on SE plc's website. I consider these to convey the information I would typically expect policyholders to receive in connection with the proposed Scheme. I also believe that the language used is appropriate for the intended audience. I am therefore comfortable with the content of the proposed communications.

#### Wider publication

11.3. SE plc and Royal London have jointly developed a communication plan which sets out how the parties intends to meet the wider notification requirements of FSMA. In particular, the parties will publish the Legal Notice in each of the London, Edinburgh and Belfast Gazettes, as well as in The Times, The Daily Mail, The Sun, and the international edition of the Financial Times, this notice having first been approved by the PRA in consultation with the FCA.

11.4. In addition to the notification pack being issued to holders of Transferring Policies and the media publications noted above in paragraph 11.3, SE plc will also publish the following items on their website and make paper copies available on request without charge:

- the policyholder cover letter,
- the full Scheme document,
- the Transfer Guide, including the additional items set out in paragraph 11.1,
- SE plc's Chief Actuary's report on the Scheme,
- SE plc's With-Profits Actuary's report on the Scheme, and
- this report in full, together with a summarised version of it.

Once available, my supplementary report and the Chief Actuary's and With-Profits Actuary's supplementary reports will also be made available on SE plc's website.

#### Policyholder support

11.5. The notification pack identifies a number of ways in which policyholders can receive support from SE plc in relation to the proposed transfer. Specifically, further information or support in answering questions will be available from various sources, namely:

- on written request to the postal or email address detailed in the Legal Notice,

- through contacting a trained, dedicated team – on freephone telephone numbers provided in the notification pack – who will deal with all requests and queries in relation to this transfer, and
- on SE plc’s website.

11.6. To ensure vulnerable customers’ needs are allowed for, SE plc has reviewed communications: (i) against Aegon’s “Brand and Tone of Voice” standards, which require all communications to be accessible and easy to understand; and (ii) to ensure the layout, terminology and readability are appropriate for the intended audience, and that the specific needs of vulnerable customers are considered. Atos staff are trained in identifying and supporting the needs of vulnerable customers. SE plc will also offer customers the option to receive communications in larger print, Braille, or audio versions. I am therefore satisfied that suitable steps have been taken to ensure the appropriate treatment of vulnerable customers.

### Policyholder queries

11.7. A ring-fenced team of additional Atos staff will be established to deal with policyholder queries during the transfer process. Tailored training will be provided to ensure the team are able to deal with standard queries, and a manager will also be appointed to deal with any technical queries. Processes will also be established to refer any technical queries that are unrelated to the Scheme to the appropriate teams.

11.8. A weekly management information report will be produced, which will contain details of the mailing process, level and nature of customer calls, performance against target service levels, and any complaints or objections received. This information will be shared with the PRA, with the FCA, and with me. I will also receive copies of SE plc’s responses to any objections. I will review and comment on the key areas of feedback received from policyholders in my supplementary report.

### Waivers sought

11.9. The Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001 (as amended) (the “Communication Regulations”) sets out notification requirements (the “Notification Requirements”) in relation to the transfer of insurance business. Under the Communication Regulations, an insurer may seek sanction from the High Court pursuant to Regulation 4(2) for waivers in respect of some of the Notification Requirements, and this is common practice for firms undertaking a transfer of insurance business.

11.10. Precedent has been established in the courts for firms seeking waivers from the High Court. Precedent dictates several factors (the “Aviva Factors”) that would be relevant to an application for waivers. The Aviva Factors are:

- the impossibility of contacting policyholders,
- the practicality of contacting policyholders,
- the utility of contacting policyholders,
- the availability of other information channels through which notice of the application can be made available,
- the proportionality of strict compliance,
- the impact of collateral commercial concerns, and
- the object of the transfer itself and its likely impact on policyholders.

11.11. SE plc plans to seek waivers, or otherwise not make direct notification of the proposed transfer, in the following situations:

- to holders of Remaining Policies,
- to “gone-away” policyholders, i.e. those for whom SE plc does not hold the policyholder’s up-to-date address, identified through SE plc’s gone-away tracing process,
- to trustees of policies written under trust, other than the Principal Trustee,
- to beneficiaries of policies written under trust,
- to trustees-in-bankruptcy, receivers and administrative receivers of insolvent policyholders, where they are not named on the policyholder database,
- to policyholders who have in place attorneys with a power of attorney arrangement where the attorney’s address has specifically been notified,
- to executors and personal representatives of deceased policyholders, where the claims are still in progress, and
- to sensitive policyholders, where contact is made through financial advisors.

11.12. Notwithstanding SE plc’s intention to contact all policyholders, other than where waivers are sought, it is inevitable that some policyholders will not be able to be contacted, for example where policyholders have changed address but have not informed the parties. These policyholders are discussed further below in paragraphs 11.18 to 11.20.

11.13. I have considered the Notification Requirements and the Aviva Factors when assessing the proposed communication plan and the waivers being sought. I discuss below each waiver being sought.

### **Holders of Remaining Policies**

11.14. SE plc intends to seek a waiver from communicating directly with the holders of Remaining Policies. SE plc does not expect the transfer to have a material adverse effect on benefit security, benefit expectations, or service standards for these policies, and so it considers there to be limited utility in notifying those policyholders. SE plc also believes that notifying them is likely to lead to adverse customer experience and potential confusion, which it wishes to avoid.

11.15. SE plc estimates that the cost of notifying the holders of Remaining Policies, which make up c.89% of SE plc’s business by policy count, to be c.£1.9m, which it considers to be disproportionate having regard to the expected limited utility in notifying holders of Remaining Policies.

11.16. Additionally, as noted in paragraphs 11.3 and 11.4 SE plc will publish information on the Scheme on its website, and in a number of national newspapers.

11.17. I am supportive of this waiver request on the grounds that there is limited utility to the holders of Remaining Policies, the disproportionate cost of a potential mailing, and the availability of information via other channels.

### **Gone-away policyholders**

11.18. I have been advised by the parties that the known gone-away policyholders represented c.0.6% of the Transferring Policies as at May 2023. Recognising that some policyholders will have changed address without notifying them, SE plc conducted an additional gone-away tracing exercise with a view to identifying the correct address for the policyholders in the scope of the transfer. Around 433,000

policyholder records were sent to a tracing agency which indicated that c.353,000 policyholder records were of good quality but that c.76,000 may have changed address. For a further c.1,400 policies, the address details were found to be of poor quality, but it is not expected that a more reliable address could be found through further tracing. There also remain the c.2,500 known gone-away policies, which represented c.0.6% of the Transferring Policies as at May 2023.

- 11.19. Further activity was carried out to try to identify up-to-date addresses for the c.76,000 records that may have changed address. For c.17,000 of them, the current addresses on record were found to be the best matches for those policyholders; these addresses will therefore remain unchanged. For c.56,000 records, the tracing agency was able to reliably identify new addresses, which SE plc will use for all contact going forward, including the mailing relating to the transfer. For the remaining c.3,000 records, the tracing exercise suggested that these policyholders may have changed their address and a possible new address has been identified. Ahead of sending out the notification packs, SE plc will write to policyholders at these possible new addresses with a view to confirming them to be correct. Where policyholders provide confirmation, these new addresses will be used going forward, but if no confirmation is forthcoming, the existing addresses will be used. While I have not performed an assurance review of the tracing exercise, I am comfortable that SE plc's approach is reasonable.
- 11.20. SE plc intends to seek a waiver from notifying any policyholders for whom up-to-date contact details cannot be obtained. I support this application on the grounds that I consider it to be impossible to notify any policyholders whose contact details are unknown. I also note that the current known proportion of the Transferring Policies which are gone-away is immaterial. I also note that the Scheme will be publicised on the parties' websites and in the press.

### **Trustees**

- 11.21. SE plc also intends to seek a waiver from notifying all trustees on policies written under trust, other than the Principal Trustee. I am supportive of this application on the grounds that the utility of writing separately to multiple trustees of the same policy is likely to be limited and sending correspondence directly to the Principal Trustee is SE plc's common practice.

### **Beneficiaries in trust**

- 11.22. SE plc also intends to seek a waiver from notifying any beneficiary of a policy written in trust. For these policies, SE plc typically holds contact details only for the legal owner, i.e. the trustee, and is not required to capture the contact details for all parties with a beneficial interest in the policy. For many of these policies the beneficiary may not yet be known or exist, for example policies where it is at the trustee's discretion who receives the proceeds of the policy, or policies where beneficiaries do not yet exist, e.g. a first-born child.
- 11.23. SE plc has advised me there may be some policies for which it has contact details for the beneficiaries, although in the majority of such cases these beneficiaries would not have granted permission to use their personal data in this way. SE plc's proposed approach will be to always communicate with the trustee rather than the beneficiary, in line with business-as-usual processes.
- 11.24. SE plc therefore intends to send the notification pack to the trustees, who (where relevant) will be asked to pass the notification pack to beneficiaries. I consider this approach to be appropriate given the impossibility of contacting individuals for whom no contact details are held. In light of the availability of information via other channels, I consider this to be a suitably cautious approach where there is doubt over whether the beneficiaries have granted permission for their personal data to be used in this way.

### **Trustees-in-bankruptcy, receivers and administrative receivers**

11.25. SE plc intends to seek a waiver from contacting the trustees-in-bankruptcy, receivers and administrative receivers with an interest in policies held by insolvent policyholders. SE plc's policyholder databases often continue to show details of insolvent policyholders but details of trustees-in-bankruptcy, receivers and administrative receivers are not maintained and would need to be gathered through a manual search of records. SE plc propose to send the notification pack to the insolvent policyholder.

11.26. I am supportive of this approach and consider it to be appropriate as obtaining contact details for these parties would be time-consuming and costly, while the utility of contacting them is likely to be limited.

### **Attorneys**

11.27. Where the policyholder has a power of attorney agreement in place, and the application of the power of attorney included instructing SE plc to direct all future correspondence to the attorney, SE plc proposes to notify the attorney rather than the policyholder. Where there is no such instruction, the notification pack will be sent to the policyholder. This is in line with SE plc's normal communication approach in such circumstances.

11.28. I consider this approach to be appropriate in order to comply with the instructions under the application of the power of attorney. For policyholders with this instruction in place, SE plc is seeking a waiver from notifying the policyholder directly, which I support on the grounds that the utility of additionally contacting these policyholders is likely to be limited.

### **Executors and personal representatives of deceased policyholders**

11.29. SE plc expects to have settled by the Transfer Date all death claims that have been notified to it by the mailing date. However, where such claims are in progress on the mailing date, SE plc will not send the notification pack to executors and personal representatives of the deceased to avoid causing additional distress.

11.30. As the benefits payable under these policies will not be affected by the Scheme, and taking into account the SE plc's wishes to avoid causing undue distress, I support these proposals.

### **Sensitive customers**

11.31. SE plc has two Transferring Policies which are held by policyholders who are categorised as "sensitive customers". SE plc is contractually required to send all correspondence for these policyholders via their financial advisers so SE plc proposes to adopt this approach for the notification pack. As this is in line with the communication requirements for these policyholders, I support this proposal.

## **Royal London's approach**

### **Structure and content**

11.32. Royal London does not intend to directly notify the holders of Existing Policies and is seeking a waiver in respect of this, which is discussed further below. Rather, Royal London intends to rely on wider communication, through the media and on its website.

11.33. As noted in paragraph 11.3, the Legal Notice will be published in the London, Edinburgh and Belfast Gazettes, as well as in The Times, The Daily Mail, The Sun and the international edition of the Financial Times.

11.34. Royal London will also publish the following items on its website and make paper copies available on request without charge:

- the full Scheme document and a summary of the Scheme document,
- Royal London's Chief Actuary's report on the Scheme,

- Royal London's With-Profits Actuary's report on the Scheme, and
- this report in full, together with a summarised version of it.

Once available, my supplementary report and the Chief Actuary's and With-Profits Actuary's supplementary reports will also be made available on Royal London's website.

11.35. I have reviewed the information to be posted on Royal London's website and consider it to convey the information I would typically expect to be provided in connection with the proposed Scheme. I also believe that the language used is appropriate for the intended readers and I am therefore comfortable with the content of the proposed communications.

11.36. The holders of Transferring Policies will also receive a direct communication shortly after the Transfer Date, welcoming them to Royal London, including among other things confirmation of there being no change to their policy terms and conditions, other than changing references from SE plc to Royal London.

### Policyholder support

11.37. Royal London's website will encourage holders of Existing Policies to contact Royal London to discuss any questions or concerns that they have. Staff will be trained to respond to policyholder queries and will be provided with a "question and answer" document to help them to answer questions.

### Policyholder queries

11.38. Royal London will set up a helpline for policyholders to respond to any queries or objections in connection with the transfer. Responses or objections received, and the information sent to policyholders in response, will be tracked by Royal London. Details will be shared with the PRA, with the FCA, and with me, on a weekly basis. I will also receive copies of Royal London's responses to any objections received. I will review and comment on the key areas of feedback received from policyholders in my supplementary report.

### Waiver being sought

11.39. As mentioned in paragraph 11.32, Royal London intends to seek a waiver from communicating directly with any of the holders of Existing Policies. Its principal rationale for making this waiver request is on the grounds that:

- The transfer is not expected to materially affect the holders of Existing Policies in that there will be no changes to terms and conditions and no material adverse effect on benefit security, benefit expectations, or service standards. Therefore, Royal London considers there to be limited utility in notifying its policyholders.
- It estimates the costs of notification to be c.£4.9m, which it considers to be disproportionate, having regard to the expected limited utility in notifying policyholders.
- Information will be made available to holders of Existing Policies through Royal London's website and in the Legal Notice published in the various newspapers and gazettes.

11.40. On balance, given the limited utility to policyholders, the disproportionate cost of a potential mailing, and the availability of information via other channels, I agree that seeking the waiver from directly contacting the holders of Existing Policies is reasonable.

### Communication of recent events

11.41. As discussed in paragraphs 6.63, 7.43 to 7.47 and 8.30, Atos SE announced on 5 February 2024 that it was in formal discussions with its lending banks to agree a plan to refinance its debts, which has led to some subsequent press commentary on the financial position of Atos Group. I have considered whether



this situation should be reflected in policyholder communications, and I am satisfied that it is not necessary at this stage for the parties to materially amend their planned communications approaches. To do so would seem to be somewhat speculative, potentially commenting on a scenario which may or may not happen. However, I note that the parties have updated call centre question and answer scripts, as well as the relevant question and answer sections on their websites, to support policyholder queries on the matter. Further, I comment on the matter in my summary report to policyholders, which is included in SE plc's Transfer Guide. I consider this overall approach to be appropriate at this moment in time.

### Conclusion

11.42. For the reasons set out in this section, I am content with the overall approach to communications, including:

- the proposed approach to communicating with the holders of Transferring Policies,
- the parties' wider communication strategy,
- the waivers being sought, including from contacting the holders of Remaining Policies and the holders of Existing Policies, and
- the support to be offered to policyholders.

## 12. Other considerations arising from the Scheme

### Proposed changes to the UK prudential regulatory regime

12.1. The Solvency II regulatory regime came into effect in the European Union in 2016, and its provisions were later incorporated into UK law in preparation for the UK's decision to withdraw from the European Union. In October 2020, HM Treasury ("HMT") announced a review of Solvency II, noting that, since it had been developed to apply across the European Union, there were certain areas of it that could better reflect the particular structures, products and business models of the UK insurance sector. The new prudential regime for insurers in the UK will eventually be known as "Solvency UK" but – consistent with the PRA's stance at this stage – I have continued to use the phrase "Solvency II" throughout my report.

12.2. HMT's stated objectives of the review are:

- "to spur a vibrant, innovative, and internationally competitive insurance sector,"
- "to protect policyholders and ensure the safety and soundness of firms," and
- "to support insurance firms to provide long-term capital to underpin growth, including investment in infrastructure, venture capital and growth equity, and other long-term productive assets, as well as investment consistent with the Government's climate change objectives."

12.3. **Figure 24** shows the progress of the review so far.

**Figure 24: Key milestones in HMT's review of Solvency II**

Date	Development
October 2020	HMT published call for evidence on the major areas of the review.
July 2021	HMT published its response to the call for evidence. It stated that the Government had asked the PRA to model different options to better understand which combination of reforms would best meet the Government's objectives and what the aggregate impact would be.
July 2021	The PRA announced a quantitative impact study that was intended to assist its analysis of potential reform options.
April 2022	HMT published a consultation in which it stated that in some areas of reform the way forward seemed clear. The consultation sought evidence on the likely impact of those reforms to help determine the precise form that they needed to take.
April 2022	The PRA published a discussion paper on the detail of particular reforms.
November 2022	HMT published a more detailed package of reform proposals following the results of its April 2022 consultation, with some of the earlier proposals having been amended following feedback from the industry.
February 2023	The PRA announced that consultations on the proposed reforms will take place in June and September 2023.

Date	Development
June 2023	HMT published draft regulations outlining proposed changes.  The PRA published the first of the two consultation papers (CP 12/23) covering proposed reforms.
September 2023	The PRA published its second consultation paper (CP 19/23) on the proposed reforms, with a particular focus on <u>MA</u> reforms.
December 2023	Regulations to give effect to the change in calculation of the <u>Risk Margin</u> were laid before parliament, as were regulations to empower the PRA to make rules in connection with the <u>MA</u> .  The PRA published a statement outlining considerations for 2023 year-end reporting, in particular commenting on simplifications to regulatory reporting and the calculation of <u>TMTP</u> .

### HMT regulations

12.4. Key reforms included in the draft regulations published by HMT in June 2023 included:

- (i) changing the calculation of the Risk Margin, including reducing the cost of capital rate from 6% to 4%, and
- (ii) making it easier to include a wider range of assets in MA portfolios.

12.5. The regulations to give effect to the change in the calculation of the Risk Margin were laid before the UK parliament on 8 December 2023, with no changes to the proposals that were consulted on. The changes came into force on 31 December 2023.

12.6. Regulations to empower the PRA to make rules relating to the MA were also laid before parliament on 8 December 2023, and will come into force on 1 April 2024.

12.7. The proposals published by HMT in November 2022 referred to “reforming reporting and administrative requirements to reduce EU-derived burdens”. While the reporting reform was not mentioned in the draft regulation published by HMT in June 2023, I expect there may well be further updates from HMT in this area.

### PRA consultations

12.8. The PRA’s June 2023 consultation paper (CP 12/23 – Review of Solvency II: Adapting to the UK insurance market) outlined a number of key reforms, expected to be implemented from 31 December 2024, including:

- changes to the calculation of TMTP, which largely came into force 31 December 2023 as noted in paragraph 12.10;
- changes to the Solvency II Internal Model framework, including a new capital add-on to facilitate Internal Model permissions;
- allowing insurance groups greater flexibility in the methods available to calculate the group SCR;

- removal of branch capital requirements and the branch Risk Margin for the purposes of ongoing supervision of third-country branches;
- streamlining of certain reporting requirements to better reflect the composition and activities of the UK insurance market;
- the introduction of an optional mobilisation stage for new insurers under which they can operate, albeit with restrictions, while completing the final aspects of their development;
- an increase to the thresholds below which small insurers do not need to operate within the Solvency II regime; and
- various currency redenominations (from EUR to GBP), notably in relation to absolute floor of the minimum capital requirement within the PRA Rulebook.

12.9. CP 12/23 was open for industry feedback until 1 September 2023. While the PRA has yet to publish final policy following this consultation, it announced on 8 December 2023 certain simplifications to regulatory reporting that it was content to permit from 31 December 2023 to 30 December 2024, pending finalising its longer-term policy. The simplifications affecting the parties relate to dispensing with the need to complete certain reporting templates, which does not affect my assessment of the Scheme.

12.10. The PRA initially proposed in CP 12/23 to remove the “Financial Resources Requirement” (“FRR”) test from the calculation of TMTP from 31 December 2024. However, in response to industry feedback, the PRA decided to use its discretion to remove this test (or where firms were required to limit the TMTP due to the FRR test at their last recalculation before 31 December 2023, to consider on a case-by-case basis removing this test) from 31 December 2023. This coincided with the PRA’s invitation to firms to apply for permission to recalculate the TMTP at 31 December 2023, which the PRA expects to take account of the effect of the Risk Margin reforms described in paragraphs 12.4 and 12.5.

12.11. The PRA’s September 2023 consultation paper (CP19/23 – Review of Solvency II: Reform of the Matching Adjustment) outlined a number of other key reforms relating to the MA. The proposals, which may be refined following a period of industry consultation which closed on 5 January 2024, are expected to be implemented from 30 June 2024. They include:

- extending asset eligibility requirements to allow assets with “highly predictable” cash flows, subject to a number of constraints and requirements;
- the proposed reforms increase the granularity at which the credit quality of assets is reflected in the calculation of the MA;
- removing features of the existing regime that disincentivise investment in sub-investment grade assets;
- introducing an annual MA appropriateness attestation requirement;
- expanding the types of insurance business to which insurers may apply the MA; and
- increasing efficiency in the MA application process by streamlining the application process with less stringent treatment of unintended MA compliance breaches.

### Reform impacts

12.12. Both parties currently comply with their capital management policies and are expected to continue to do so following the implementation of the Scheme. The reforms to the Risk Margin – which are expected to

decrease the size of the Risk Margins held on the regulatory balance sheets of SE plc and Royal London, and so increase the Eligible Own Funds for both parties – are expected to make it more likely that each firm will comply with its capital management policy both before and after the Transfer Date, all else being equal.

- 12.13. Both SE plc and Royal London have regulatory approval to the use the MA in valuing certain non-profit annuity liabilities. Neither party expects that the proposed changes to the MA will materially change the way in which the MA is calculated or the level of MA benefit they receive. SE plc's MA portfolio is small and both parties' portfolios are largely made up of simple, high-quality assets such as investment-grade corporate bonds, with neither having any immediate plans to take advantage of the increased asset eligibility requirements referred to in paragraph 12.11. For the relatively small amount of assets in its portfolio which lead to a larger MA benefit, Royal London has assessed whether the attestation requirement referred to in paragraph 12.11 might have a material impact on the MA it can achieve for these assets; this analysis suggests that this will not be the case.
- 12.14. Both parties expect that the Risk Margin reforms will improve their financial position and that the proposed changes to the MA will have an immaterial impact on their financial position. Overall, I therefore expect the reforms to be beneficial for both parties' financial positions and so I do not expect them to affect my conclusion that the Scheme will not have a material adverse effect on the security of benefits for any group of policyholders. I will provide further commentary on these matters in the Supplementary Report as the outcome of the MA proposals become more certain.
- 12.15. Royal London has permission to apply the TMTP, but SE plc does not. At Royal London's last recalculation of the TMTP the FRR test did not bite and was not close to doing so. The changes to streamline the TMTP calculation will therefore not affect Royal London's financial position, all else being equal. This therefore does not affect my assessment of the Scheme.

### Operational resilience

- 12.16. On 29 March 2021, the FCA published policy statement PS21/3 "Building operational resilience", containing new rules and guidance on requirements to strengthen the operational resilience of the financial services sector. These came into force on 31 March 2022, and require firms to perform mapping and scenario testing of their operational resilience as soon as possible after the March 2022 implementation date, and by no later than 31 March 2025. "Mapping" refers to identifying and documenting the people, processes, technology, facilities and information that support important business services. "Scenario testing" refers to testing their robustness in a range of severe but plausible scenarios inside and outside of a firm's control.
- 12.17. SE plc and Royal London have business continuity plans which are reviewed and tested on a regular basis. The plans consider a range of scenarios including loss of data, loss of key people, unavailability of premises, loss of IT (including threats to IT and information security), and loss of a key supplier/third party.
- 12.18. Additionally, SE plc and Royal London are both undertaking wider operational resilience programmes in line with the regulatory guidance, to identify business critical services and put in place contingency arrangements.
- 12.19. As part of its programme, SE plc has developed a framework for operational resilience which is centred around six strategic pillars, consistent with those outlined in paragraph 12.17. Each pillar has an agreed impact tolerance mapped to it, which is set to reflect the point in time where SE plc may cause intolerable harm to consumers and/or market integrity, threaten the viability of firms and/or cause instability in the financial system. Operational resilience vulnerabilities are also being identified through scenario testing

and work to address these vulnerabilities is underway in advance of the 2025 regulatory deadline. SE plc's operational resilience framework is commissioned by a dedicated operational resilience team and the framework is reviewed on an annual basis, with oversight provided by SE plc's Risk Function.

12.20. Royal London has also developed a framework for operational resilience as part of its programme, driven by a dedicated team, similar to that adopted by SE plc. Royal London's framework includes many of the same features SE plc's framework, including the mapping and scenario testing requirements outlined in paragraph 12.16, defining impact tolerances, and identifying vulnerabilities in operational resilience. As part of this framework Royal London also produces reports on resilience and remediation. This programme has now largely been embedded in "business as usual" processes, with the exception of cyber resilience, where work continues to address some outstanding findings.

12.21. I therefore do not expect the parties' approach to operational resilience to affect my conclusion on the Scheme as I consider both parties' to have made similar levels of progress against the regulatory requirements, with operational resilience programmes underway and structured in a broadly consistent way.

### Consumer Duty requirements

12.22. In July 2022, the FCA published policy statement PS22/9 "A new Consumer Duty" setting out final rules and guidance which are intended to strengthen consumer protection by ensuring that firms act to deliver good outcomes for customers. The Consumer Duty already applies to products that are open to new business and will become effective on 31 July 2024 for products that are closed to new business.

12.23. Both parties have established Consumer Duty programmes to implement the Duty's requirements. Although the Transferring Policies are technically a closed book in SE plc, SE plc continued to treat them as if they were "open", and so applied the Duty's requirements to them from 31 July 2023. Royal London has reviewed SE plc's Consumer Duty programme and has confirmed it is satisfied that SE plc's interpretation of the Duty is in line with its own. The book is therefore expected to be compliant with Royal London's interpretation of the Duty at the point of transfer, ahead of the formal closed book deadline of 31 July 2024.

12.24. SE plc performed a gap analysis of the Consumer Duty requirements against its individual protection business and identified key actions. These actions included Consumer Duty training for SE plc and Atos staff, introducing additional reporting to monitor customer outcomes, reviewing and updating policyholder letters, carrying out a review of the protection product lifecycle and assessing whether customers receive fair value.

12.25. SE plc has also reviewed Royal London's Consumer Duty programme and is satisfied that Royal London's interpretation of the Duty is in line with its own such that the treatment of the Transferring Policies under Consumer Duty will not change materially as a result of the Scheme.

12.26. Taking into account all of the above, I consider the firms' interpretations of Consumer Duty and their associated programmes to be materially aligned such that any differences are not material. I therefore do not expect any Consumer Duty considerations to give cause for concern or mean that it is inappropriate for the Scheme to proceed.

### Political sanctions

12.27. The UK's Sanctions and Anti-Money Laundering Act 2018 creates the UK's regime for financial, trade, immigration, aircraft, and shipping sanctions, while the Export Controls Act 2002 creates the UK's export control regime. The parties are required to comply with these regimes.

12.28. While it is largely a legal matter, and therefore not directly within my scope, I am satisfied that the Scheme should not give rise to any concerns from the perspective of the UK's sanctions regime:

- As discussed in paragraph 5.10, no holders of Transferring Policies were subject to political sanctions at the date of this report. SE plc continues to monitor sanctioned policyholders on a daily basis, as part of its standard processes. No policies held by individuals subject to UK political sanctions will be transferred under the Scheme.
- As discussed in paragraph 7.12, the only assets transferring as part of the Scheme are reinsurance assets and some net current assets, which consist of payments due from reinsurers and claims due to policyholders. In particular, the Scheme does not involve the transfer of assets domiciled in Russia or Belarus, i.e. which may fall into scope of the Russia (Sanctions) (EU Exit) Regulations 2019 or the Republic of Belarus (Sanctions) (EU Exit) Regulations 2019.

12.29. There remains the question of whether the transfer will materially alter the exposure of Transferring Policies, Remaining Policies or Existing Policies to assets which may be subject to restrictions from political sanctions, which on grounds of the size of its economy are most likely to be domiciled in Russia. On the basis of the exposure analysis and approach to risk management described in paragraphs 12.31 to 12.36, this does not give me any cause for concern.

12.30. A holder of one the Transferring Policies (who is a UK resident) is subject to a Turkish political sanction, which requires a freeze on assets in Turkey under Article 7 of Law No. 6415 on the Prevention of the Financing of Terrorism. SE plc considered the terms of this sanction and did not consider it to be necessary to seek external legal advice on the matter as it has no impact on assets held outside of Turkey. In particular the policy is unaffected by the sanction – premiums continue to be collected by SE plc, the level of cover is unaffected, and the policy is operated by SE plc as normal in line with its terms and conditions. Noting again that this is ultimately a legal matter, and noting also the parties' requirements to comply with the UK political sanctions regimes as discussed in paragraph 12.27, I have no cause for concern in relation to this policy transferring under the Scheme.

### Exposure to the war in Ukraine

12.31. SE plc does not have any direct exposure to assets held in Ukraine or Russia. It does not consider itself to have direct exposures to the Russia/Ukraine conflict and so allows for macroeconomic risks from the conflict (e.g. increases in inflation) through its existing stress and scenario testing included in the ORSA, i.e. rather than performing a distinct set of scenario testing. The results show that SE plc's solvency coverage ratio remains above the target operating level without the need for any management actions.

12.32. SE plc has a c.£210m indirect asset exposure through assets held in unit linked funds which are domiciled in Russia and Ukraine. However, not all of these assets are subject to political sanctions, for example c.£20m is domiciled in Ukraine. Around £155m is also listed equity. These assets represent c.0.2% of SE plc's assets at 31 December 2022 and none of these assets are transferring as part of the Scheme.

12.33. Royal London does have some direct exposure to assets held in Russia. However, in valuations it considers the value of these assets to be zero, to remove its exposure to the risk associated with these assets.

12.34. Royal London also has some indirect exposure to assets in Russia and Ukraine through assets which are domiciled in Russia and Ukraine held in unit linked funds. Following the start of the war between Russia and Ukraine, RLAM sought to sell these assets where possible, with any remaining assets given zero value in valuations. Royal London also monitors potential indirect asset exposures to companies that

have high sales to Russia, to oil and gas companies, and to commodities companies. I therefore do not have any concerns about Royal London's indirect asset exposure to Russia and Ukraine.

12.35. Royal London has incorporated risks from the Russia/Ukraine conflict into its annual ORSA process, quantifying the financial impact under three different scenarios:

- (i) the conflict between Russia and Ukraine is limited to military conflict between the two countries,
- (ii) the crisis escalates from (i) with further cyber warfare between the two countries, and
- (iii) other nations become involved in the conflict, including the UK.

12.36. Results from this exercise show that Royal London is most exposed to scenario (iii), the financial impacts of which are driven by supply issues from the conflict, sharp rises in unit costs from inflationary pressures, a mass lapse event due to an increase in the number of deaths, and sharp falls in interest rates allied to other volatility in the investment markets. Royal London has identified numerous management actions in this scenario to keep the solvency coverage ratio within the target range, which do not affect benefits payable on the Transferring Policies.

### IFRS 17

12.37. Following many years of development, the International Accounting Standards Board's new insurance accounting standard, International Financial Reporting Standard 17 ("IFRS 17") became effective from 1 January 2023.

12.38. SE plc published its first set of IFRS 17 results on 12 July 2023. SE plc does not expect IFRS 17 to impact the way in which it is managed, including its capital management policies. Royal London does not report on an IFRS 17 basis, as it considers UK GAAP – on which basis it has reported since 1 January 2020 – to be more suitable for a UK mutual insurer. IFRS 17 therefore does not impact the way in which Royal London is managed, including its capital management policies.

12.39. I therefore do not expect the implementation of IFRS 17 to affect my conclusion that the Scheme will not have a material adverse effect on the security of benefits for any group of policyholders.

### Future operation of the Scheme

12.40. The provisions of the Scheme deal largely with the transfer of the Transferring Policies rather than placing requirements on how Royal London manages its business (including the Transferring Policies) after the Transfer Date. If the Scheme is sanctioned by the Court the parties will be legally obliged to implement it, and their directors will be responsible for ensuring that this happens.

12.41. For practical purposes, the Scheme provides that the parties may amend it for the following reasons:

- to reflect "minor or technical" differences (including those to correct manifest errors);
- to allow for any changes in law or regulation;
- to reflect any amendments due to a change in the generally accepted actuarial practices relating to the Transferring Policies; and
- to capture any changes that are required to protect the rights and reasonable expectations of the holders of Transferring Policies.

12.42. The PRA and FCA have the right to object to any amendment noted above, and the parties must give them 30 days' notice. Other types of amendment to the Scheme can be made only through an application to the Court. The PRA and FCA must be given at least 30 days' notice, and would have the right to be



heard by the Court. Such an application would need to be accompanied by a report from me or another independent actuary certifying that the proposed amendment was not expected to materially adversely affect the holders of the Transferring Policies, SE plc's remaining policyholders or Royal London's existing policyholders.

12.43. Overall, I am satisfied that the Scheme contains sufficient safeguards to ensure that it operates as intended.

## 13. Consequences of the Scheme not completing

- 13.1. As part of my assessment of the Scheme, I have considered the consequences of it not completing as planned. The parties have informed me that if this were to happen then they would seek to understand the impediments to it and, if possible and appropriate, seek to remove them and subsequently re-present the Scheme, amended as appropriate, for approval at a later date.
- 13.2. There are provisions in the Framework Agreement between the parties that allow for the temporary reinsurance agreement between SE plc and Royal London in respect of the Transferring Policies to be terminated should the Scheme not complete. However, the parties may also extend this reinsurance agreement, which they have informed me that they expect to do unless the barriers to the Scheme completing are insurmountable.
- 13.3. Should the parties decide not to re-present the Scheme for approval then the temporary reinsurance agreement will be terminated in accordance with its provisions, and the Transferring Policies will remain policies of SE plc. The effects of the reinsurance agreement between the parties will be unwound and – other than incurred project costs – the financial position of each party will then be materially as if the Scheme had not been contemplated at all. In particular, both parties are expected to remain in compliance with their capital policy.
- 13.4. Should the Scheme not be sanctioned, none of the Transferring Policies or associated contracts, including reinsurance contracts and outsourcing contracts, will be transferred from SE plc to Royal London. The Policy Plus contracts and the Barclays Bank Account would also not be novated.
- 13.5. Should the Scheme not complete, SE plc's current arrangements with Atos will continue. The notice being served with Atos is contingent upon the Scheme completing.

## 14. Summary of conclusions

- 14.1. I am satisfied that the Scheme will not have a material adverse effect on the benefit security of any group of policies.
- 14.2. I am satisfied that the Scheme will not have a material adverse effect on the benefit expectations of any group of policyholders.
- 14.3. I do not expect the Scheme to result in any changes to the standards of service for, or the management and governance of, any group of policies.
- 14.4. I am therefore satisfied that the Scheme is equitable to all classes and generations of SE plc's and Royal London's policyholders.
- 14.5. I am satisfied that the Scheme will not have a material adverse effect on SE plc's reinsurers whose contracts will be transferred to Royal London, or on Royal London's existing reinsurers.
- 14.6. I am also satisfied that the Scheme will not have a material adverse effect on any of the parties' outsourced service providers, pension schemes, creditors or insurance subsidiaries.

## 15. Certificate of compliance

- 15.1. I understand that my duty in preparing the Scheme Report is to help the Court on all matters within my expertise and that this duty overrides any obligation I have to those instructing me and/or paying my fees. I have complied with this duty.
- 15.2. I am aware of the requirements applicable to experts as set out in Part 35 of the Civil Procedure Rules, Practice Direction 35, and the related Guidance for the instruction of experts in civil claims. I understand my duty to the Court.
- 15.3. I confirm that I have made clear which facts and matters referred to in this report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions that I have expressed represent my true and complete professional opinions on the matters to which they refer.
- 15.4. I understand that proceedings for contempt of court may be brought against anyone who makes, or causes to be made, a false statement in a document verified by a statement of truth without an honest belief in its truth.



**Stephen Makin FFA CERA**  
**Independent Expert**

**For and on behalf of Hymans Robertson LLP**

**22 February 2024**

# Independent Expert's summary report for policyholders

## Introduction

1. Scottish Equitable plc, which I refer to as SE plc, and The Royal London Mutual Insurance Society Limited, which I refer to as Royal London, wish to transfer SE plc's individual protection business to Royal London. To do this, they must make an application to the High Court of Justice in England and Wales. The application must include a report by an Independent Expert on the terms of the transfer. I have been instructed jointly by SE plc and Royal London to fulfil this role, and my appointment has been approved by the UK's insurance regulators. I am a Fellow of the Institute and Faculty of Actuaries, and a partner of Hymans Robertson LLP, an actuarial consultancy firm.
2. This is my report for the policyholders of SE plc and Royal London in connection with the proposed transfer. It is a summary of my full report to the Court, which is available on both firms' websites or from either firm on request. That report sets out the detailed scope of my work, the standards applying to it, and the information I have used in preparing it. Nothing in that report and this summary is, and nor should it be viewed as being, investment, accounting, legal or tax advice, including to SE plc, to Royal London, or to their policyholders.
3. The main focus of my work is to consider whether the proposed transfer is likely to affect the benefits paid to any group of policyholders, or to significantly reduce either the security of those benefits or the standards of service provided to policyholders. I have considered the likely effect of the proposed transfer on SE plc's current policyholders whose policies will be transferred to Royal London, on SE plc's current policyholders whose policies will not be transferred to Royal London, and on Royal London's existing policyholders. I refer to these groups of policies and policyholders as "transferring", "remaining" and "existing" policies and policyholders, respectively.

## The impact of the transfer on benefits expected to be paid to policyholders

### Policyholders transferring from SE plc to Royal London

4. There will be no changes to the terms and conditions of transferring policies, except to refer to Royal London rather than SE plc. In particular, there will be no changes to premiums payable by transferring policyholders, or to benefits due to them in accordance with their terms and conditions. While SE plc does have some areas of discretion in its management of the transferring policies, I am satisfied that these areas will continue to be managed in materially the same way by Royal London.
5. I therefore do not expect the transfer to result in any change to the benefits paid to or premiums required from any of the transferring policyholders.

### SE plc's policyholders not transferring to Royal London and Royal London's existing policyholders

6. There will be no changes to the terms and conditions of SE plc's remaining policies or to those of Royal London's existing policies. There will also be no changes to the way in which any of these policies are managed, including premiums, charges, expenses, investment strategy, and the range of funds available where relevant. The transfer will also not affect or dilute policyholders' rights to share in certain profits arising in their firm, where relevant.
7. I therefore do not expect the transfer to result in any changes to the benefits paid to or the premiums required from any of SE plc's remaining policyholders or any of Royal London's existing policyholders.

## The security of policyholder benefits

### Policyholders transferring from SE plc to Royal London

8. SE plc and Royal London have different ownership structures, business plans, and operating models, and both companies maintain internal policies which govern the financial resources retained in each firm to provide security to their policyholders. These policies inevitably differ to some extent, but they have been approved as being appropriate by the parties' Boards, in the context of their businesses, the regulatory environment in which the parties operate, and the options available to them to manage their financial

positions. These policies require both SE plc and Royal London to hold capital in excess of the regulatory minimum.

9. In that context, I view SE plc and Royal London as being of approximately equal financial strength provided that they both comply with their capital management policies, which they currently do, and which is expected to be the case after the transfer.
10. Furthermore, both SE plc and Royal London, which have similar management and governance arrangements, hold similar types of insurance policies and are exposed to similar risks. I have considered the risks faced by both SE plc and Royal London, and I am satisfied that the transfer should not materially change the risks faced by transferring policyholders.
11. I have also considered how Royal London's financial position is expected to change in the years following the transfer, and I am satisfied that the company's financial position is expected to continue to meet the targets set out in its financial resources policy.
12. I therefore do not expect the transfer to have a material adverse effect on the security of benefits for policyholders transferring from SE plc to Royal London.

#### **SE plc's policyholders not transferring to Royal London and Royal London's existing policyholders**

13. SE plc has confirmed that the transfer will not result in any changes to its internal policy governing the level of financial resources that it holds, and Royal London has confirmed similarly. I am satisfied that the level of financial resources that each expects to hold following the transfer will comply with its policy. I have also examined the likely effect of the transfer on the risks faced by SE plc and by Royal London, and I am satisfied that I do not expect there to be a material impact on each company's risk profile.
14. I therefore do not expect the transfer to have a material adverse effect on the security of benefits for SE plc's remaining policyholders or Royal London's existing policyholders.

#### **Service standards**

##### **Policyholders transferring from SE plc to Royal London**

15. The administration of the transferring policies is currently outsourced by SE plc to Atos BPS Limited, who I refer to as Atos, a specialist third-party provider of insurance policy administration. SE plc's contract with Atos will be cancelled, with Royal London entering into a new contract with Atos on materially similar terms. Target service levels will remain unchanged for the vast majority of servicing activities (such as processing claims, complaints and other mail), although there will be a slight reduction in call handling service levels. In deciding whether I consider the proposals to represent a material adverse effect on service standards, I considered them against industry averages and the proposals compare favourably to these. Given this, and given that the administration will continue to be carried out by Atos, and on the same systems, I do not expect there to be a material adverse effect on the standards of service received by the transferring policyholders.
16. Atos SE, the parent company of Atos, announced on 5 February 2024 that it was in formal discussions with its banks to agree a plan to refinance its debts. Since then there have been a number of articles in the press about the financial position of Atos SE and its subsidiaries. As Atos currently provides third-party services for the transferring policies, I am satisfied that the Scheme will not create a significant new reliance on Atos for the transferring policyholders. I also note that Atos's ability to administer and service the transferring policies is not currently impacted. Should this change, either before or after the proposed transfer, SE plc and Royal London both have back-up plans in place to ensure that continuity of service is maintained for transferring policies. I am therefore currently satisfied that the conclusions of my report remain appropriate and unchanged in light of this, provided that these back-up plans are appropriate and continue to support these conclusions. I will report further on the situation, including on the ongoing appropriateness of the parties' back-up plans, in my supplementary report.

17. In the longer term, Royal London intends to bring the administration of transferring policies in-house. While plans to do this have not been finalised, Royal London currently expects that if the transferring policies' administration was brought in-house it would seek to align the service standards for them with those for its existing internally-administered business. While there are some differences between the service standards for the transferring policies under Royal London's new agreement with Atos compared to those currently applying to its internally-administered business, I am satisfied that these are not material and that the service standards are generally comparable. Should the administration of the transferring policies be brought in-house, Royal London has committed to undertaking an assessment at that point to ensure there is no resulting material adverse effect on service standards.

#### **SE plc's policyholders not transferring to Royal London and Royal London's existing policyholders**

18. Some of SE plc's remaining policies are currently administered by Atos under the same arrangement referred to in paragraph 15. As that arrangement is to be cancelled, SE plc intends to bring the administration of the relevant remaining policies into the scope of another (separate) agreement it has with Atos, and on identical terms. There are no other changes to the administration of SE plc's remaining policies. I therefore do not expect there to be a material adverse effect on the standards of service received by SE plc's remaining policyholders.

19. As discussed in paragraph 16, there have recently been some articles in the press about the financial position of Atos SE and its subsidiaries. As Atos currently provides third-party services for SE plc's remaining policies, and will continue to do so following the transfer, I am satisfied that the Scheme does not change the reliance on Atos for SE plc's remaining policies. Atos's ability to administer and service these policies is not currently impacted. Should this change, SE plc has a back-up plan in place to ensure that continuity of service is maintained for remaining policies. I am therefore currently satisfied that the conclusions of my report remain appropriate and unchanged in light of this, provided that these back-up plans are appropriate. I will report further on the situation, including on the ongoing appropriateness of SE plc's back-up plan, in my supplementary report.

20. The transfer will not affect the administration of Royal London's existing policies.

#### **Conclusion**

21. I therefore conclude that the proposed transfer is not expected to have a material adverse effect on the benefits expected to be paid to any group of policyholders, or to significantly reduce the security of those benefits, or the standards of service received by policyholders.

22. Before the final Court hearing, expected to be held on 14 June 2024, at which the Court will decide whether the transfer may proceed, I will prepare a further report discussing any significant developments that have occurred since my full report was finalised, commenting on whether these developments cause me to change my conclusions.

## Appendix 1: Glossary

Term	Definition
Accepted reinsurance	Refers to insurance business where the insurer acts as the <u>reinsurer</u> .
Annuity	A contract of insurance under which an insurer pays a regular income, usually until the death of the insured.
Asset Share	This is a term applicable to <u>with-profits</u> business and, in its simplest form, represents the share of an insurer's assets that are attributable to a policy which is used to determine the pay-outs allocated to that policy. Each insurer has its own methodology for calculating the <u>asset share</u> , which will generally be outlined in its <u>PPFM</u> . The calculation is generally formulaic in nature, taking into account premiums paid, investment returns earned on these premiums, benefits paid, as well as other allocations such as expenses, taxation, and cost of capital.
Attestation requirement	An expected requirement from the <u>Solvency II</u> reforms (see Section 12) where specified individuals at firms (nominated senior managers with formal regulatory responsibilities) will be required to attest to the PRA whether or not the level of <u>MA</u> taken credit for appropriately reflects the risks retained from the firm's <u>MA</u> eligible assets.
Aviva Factors	A number of factors which precedent dictates to be relevant to an application for waivers from the <u>Notification Requirements</u> .
Barclays Bank Account	A bank account with Barclays used by SE plc to manage cash flows in respect of its individual <u>protection</u> business, for example receiving direct debit premiums and paying policyholder claims.
Basic Own Funds	<u>Basic Own Funds</u> are typically defined as an insurer's total assets, less <u>Technical Provisions</u> , less any assets which the insurer cannot take credit for in its solvency assessment, for example assets in ring-fenced <u>with-profits</u> funds.
Best Estimate Liabilities	In <u>Solvency II</u> , the best-estimate valuation of liabilities refers to the discounted value (i.e. in today's terms) of expected future obligations that an insurer expects to have to pay. The cash flows underlying the valuation are "best-estimate" in the sense of being "expected". They may therefore be considered to be neither pessimistic nor optimistic. Further information is given in Appendix 6.
BLAGAB	In the context of taxation, this refers to a method of taxation applied to certain types of long-term insurance business. This business is "Basic Life Assurance and General Annuity Business" (which gives rise to the term BLAGAB), and it is taxed on an 'I-E' business where 'I' denotes investment income (including chargeable gains) and 'E' denotes expenses. Eligibility for this form of taxation depends on the nature of the insurance contracts, the details of which can be found in UK tax legislation.

Term	Definition
Bonus	In the context of a <u>with-profits</u> policy, this is an addition to the policy's value, which may be declared throughout a policy's term, as a <u>regular bonus</u> , or the point of claim, as a <u>final bonus</u> . Once declared, bonuses become part of the policy's guaranteed benefits.
Bonus rates	Refers to the way in which bonuses are expressed for the purposes of adding them to a policy's value. For example, bonus rates are often expressed as a percentage uplift to the policy's guaranteed benefits, but other approaches can be taken.
Burn-through	Any excess of the value of guaranteed benefits on <u>with-profits</u> policies in a <u>with-profits</u> fund over the value of assets in the fund.
Claims-in-payment	Refers to insurance policies where the policyholder is currently claiming benefits on the policy. This is a term generally used for policies where a series of benefits may be payable by the insurer once a claim is accepted, rather than where a lump sum would be due on claim. Typically claims-in-payment arise from health insurance and <u>income protection</u> policies.
Collateral	In the context of a loan, an asset that a lender accepts as security for providing a loan. In the context of <u>reinsurance</u> , assets put up to cover the potential claims that could arise from the <u>reinsurance</u> contract which the <u>reinsurer</u> may not be able to meet if it were to become insolvent.
Collateral calls	Refers to the situation where a lender requests additional collateral from a counterparty to maintain an appropriate level of security in relation to the loan. Collateral calls can often arise following market movements which affect the value of the collateral relative to the value of the loan.
Collateralised securities	Securities (including bonds, shares or options) which are secured against assets.
Collective investment undertakings	Funds managed by professional managers which invest in a range of underlying assets. Individual investors buy (or are allocated) shares (or units) in the fund, with their money being pooled together with that of other investors, and spread over all of the assets held in the fund.
Conventional with-profits	A <u>conventional with-profits</u> policy has a guaranteed cash benefit (or sum assured) which is payable to the policyholder on a fixed date or event (e.g. death). This guaranteed cash benefit may be increased by the addition of bonuses.
Critical illness	A form of, or benefit on a, life insurance product that usually pays a lump sum amount to the policyholder upon diagnosis of certain (and usually serious) illnesses, disabilities, or diseases. The illnesses, disabilities and diseases covered will be set out in policy terms and conditions.
Deferred tax asset	Items on a company's balance sheet that may be used for tax relief purposes in the future.



Term	Definition
Deferred tax liability	Items on a company's balance sheet that record taxed owed but not due to be paid until a future date.
Defined benefit	In the context of an employer sponsored pension plan, this refers to the situation where benefits are calculated using a formula considering length of service, accrual rate and salary history. The employer is responsible for investment and the risks of the plan.
Defined contribution	In the context of an occupational pension scheme, this refers to the situation where employee and employer contributions are invested into a "money purchase" pot, the proceeds from which can be used to buy a pension or other benefits at retirement. The employee bears all of the risks associated with the arrangement.
Demutualisation	Demutualisation is the process by which a member-owned company changes its structure to become a company owned by shareholders.
Diversification	The reduction in risk (and therefore capital requirements) that results from an expectation that adverse outcomes from one risk can be offset by more favourable outcomes from others. This arises from not all risks being expected to occur at the same time.
Eligible Own Funds	<u>Own Funds</u> that an insurer is permitted to use to cover its <u>SCR</u> .  The regulations categorise various <u>Own Funds</u> items into tiers according to their loss absorbency, degree of subordination, and term. The regulations also specify limits on the amount of <u>Own Funds</u> in each tier that may be used to cover the <u>SCR</u> . Further information is given in Appendix 6.
Estate	The financial resources available to an insurance company to cover its obligations. This comprises the assets, liabilities and any surplus or shareholders' equity.
Excess Own Funds	An insurer's <u>Eligible Own Funds</u> less its <u>SCR</u>
Existing Policies	Policies insured by Royal London that were already written (or transferred to) Royal London prior to the <u>Transfer Date</u> .
Family Income Benefit	An insurance policy which pays regular income to specified family members if the insured life dies.
Final bonus	A bonus which is added to a <u>with-profits</u> policy value at the point of claim.
Financial Resources Requirement test	Under Solvency II, firms must restrict their use of <u>TMTP</u> to ensure that their total "financial resources requirement" (generally taken to mean the sum of the <u>technical provisions</u> , other liabilities and capital requirements) is no less under <u>Solvency II</u> than it would have been under the previous regulatory regime.
Gift Inter Vivos	Insurance policies used to cover the inheritance tax liability that may arise when an individual gifts to another person while they are alive and so are potentially liable to inheritance tax for the next 7 years.

Term	Definition
Gone-away	Refers to those policyholders for whom SE plc does not hold an up-to-date address.
Guaranteed Annuity Option	The option on a policy under which the insurer must convert the policyholder's accumulated policy value into an annuity at a pre-determined and guaranteed rate if requested to do so by the policyholder.
Income protection	An insurance policy that provides the policyholder with a regular income if they become unable to work due to illness or injury. The conditions for the commencement of payments will be defined in the policy terms and conditions, but broadly cover scenarios where the individual is no longer able to carry out the responsibilities of defined types of employment due to illness or injury.
Index-linked	Policies under which the benefits are wholly or partly determined by reference to the value of or fluctuations in an index.
Interest rate swaps	This is an agreement between two parties, in which one party pays a stream of fixed interest payments, in exchange for variable interest rate payments from the other party.
Internal Model	Internal Models are developed by insurers to calculate their <u>SCR</u> , in line with the <u>Solvency II</u> requirements. Subject to regulatory approval, Internal Models may be used instead of the <u>Standard Formula</u> , with the intention of better-capturing certain risks to which a given insurer is exposed.
Investment bond	Under an investment bond a policyholder invests a lump sum for a period of time. The value of their investment will change over time depending on market conditions.
Level Life Term Insurance	An insurance policy which pays out of the death of the insured life, if they die within the specified term. The amount which is payable on death is constant throughout that term.
Life Insurance with Critical Illness	An insurance policy which pays out on the death of the insured life and also offers <u>critical illness</u> cover.
Life Protection with Tax Relief	These are insurance policies which pay out on the death of the insured life. They were sold alongside pension policies, and policyholders benefit from tax relief on the premiums paid.
Liquidity Buffer	An amount of liquid capital held in addition to the assets required to meet expected outflows, such that SE plc or Royal London is expected to be able to meet all cash flows over the next year under pre-determined stresses.
Market value reduction	An adjustment that may be deducted from the value of a <u>with-profits</u> policy value at the point of claim.
Mass lapse	A scenario where there is a significant and instantaneous fall in the number of in-force policies due to extreme scenarios, e.g. natural disaster or pandemic event.

Term	Definition
Matching Adjustment	<p>When determining the <u>BEL</u>, the standard approach is to discount future liability cash flows using the “basic risk-free rate”, which is a prescribed discount rate based on swap yields.</p> <p>For certain lines of business, a Matching Adjustment may be added to the basic risk-free rate when the insurer has regulatory approval to do so. The value of the Matching Adjustment is derived from the <u>spread</u> on the assets held by the insurer to back the relevant business. Further information is given in Appendix 6.</p>
Non-profit	Insurance products where the premiums and benefits are prescribed in the policy terms and conditions. Non-profit policies do not participate in the insurer’s profits.
Non-Profit Sub-Fund	A sub-fund of SE plc’s long-term insurance fund that contains all insurance business, including all new business written since 2013, not included in the <u>With-Profits Sub-Fund</u> .
Notification Requirements	The notification requirements set out in the Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001.
Open-ended investment companies	Pooled investment funds based in the UK which are structured as company in their own right.
Ordinary share capital	Capital raised by a company by issuing ordinary shares. Ordinary shares are the most common type of shares and the only type of shares that SE plc had on its balance sheet at 31 December 2022.
Own Funds	<p>The total of:</p> <ul style="list-style-type: none"> <li>the excess of assets over liabilities, according to the <u>regulatory balance sheet</u>, less the amount of own shares held by the insurer, and</li> <li>subordinated liabilities</li> </ul> <p>Further information is given in Appendix 6.</p>
Own Risk and Solvency Assessment	A process that insurers are required by regulation to carry out on a regular basis to identify and assess the risks to which they are exposed, and the capital required to support their risk profiles, approved <u>risk tolerance limits</u> , and their business strategies.
Paris Agreement	An international treaty among 194 parties, focused on reducing climate change. A key focus of the Paris Agreement is to reduce greenhouse gas emissions to limit the increase in global temperature this century to two degrees Celsius.
Partial Internal Model	Where an insurer uses the <u>Standard Formula</u> to calculate its <u>SCR</u> for some risks, and an <u>Internal Model</u> to calculate its <u>SCR</u> for other risks.
Power of attorney	A power of attorney is a legal document appointing a dedicated person (the attorney) to make decisions on another person’s behalf.

Term	Definition
Principles and Practices of Financial Management	A document which sets out the high-level principles and lower-level practices employed by an insurer in managing a particular type of fund or business.
Protection	Insurance designed to provide cover for the policyholder and their loved ones in the event of an insured person's death or illness.
Quota share	A type of <u>reinsurance</u> contract under which the <u>reinsurer</u> is entitled to receive a specified proportion of all premiums received by the cedant from a portfolio of insurance contracts, in exchange for the <u>reinsurer</u> paying the same proportion of all claims incurred on the portfolio.
Reducing Life Term Insurance	An insurance policy which pays out of the death of the insured life if they die within the policy's term. The amount which is payable on death reduces throughout that term.
Regular bonus	This is bonus which is declared regularly throughout a <u>with-profits</u> policy's term, often annually. Once declared, the regular bonus becomes part of the <u>with-profits</u> policy's guaranteed benefits.
Regulatory balance sheet	A balance sheet showing assets and liabilities recognised and valued in accordance with the <u>Solvency II</u> regulations.
Reinsurance	Insurance protection taken out by an insurer to manage its exposure to risks on its balance sheet, usually those arising from direct insurance contracts.
Reinsurance asset	A term used interchangeably with <u>reinsurance BEL</u> . It represents the benefit that an insurer is able to recognise on the asset side of its <u>Solvency II</u> balance sheet as a result of having <u>reinsurance</u> arrangements in place on its insurance business.
Reinsurer	The entity providing <u>reinsurance</u> .
Remaining Policies	SE plc's policies that are not <u>Transferring Policies</u> , and which will continue to be insured by SE plc following implementation of the Scheme.
Residual Assets	This term is defined fully in the Scheme, but in essence it means any assets which are intended to transfer under the Scheme but which cannot be transferred on the <u>Transfer Date</u> for any reason.
Residual Liabilities	This term is defined fully in the Scheme, but in essence it means any liabilities which are intended to transfer under the Scheme but which cannot be transferred on the <u>Transfer Date</u> for any reason.
Residual Policies	This term is defined fully in the Scheme, but in essence it means any policies which are intended to transfer under the Scheme but which cannot be transferred on the <u>Transfer Date</u> for any reason.
Residual Policies Reinsurance Arrangement	The reinsurance agreement to be implemented in respect of any <u>Residual Policies</u> such that Royal London reinsures and administers these policies achieving the same economic effect as if they had been transferred.

Term	Definition
Restricted Tier 1 Own Funds	A subset of <u>Tier 1 Own Funds</u> that is subject to restrictions in terms of how much can be used to cover an entity's SCR. This class of <u>Tier 1 Own Funds</u> is lower ranking than <u>Unrestricted Tier 1 Own Funds</u> . Further information is given in Appendix 6.
Risk appetite	For different risks, an insurer may wish to increase exposure, maintain exposure, decrease exposure, or eliminate exposure entirely, depending on its appetite for such risks.
Risk appetite framework	A framework used by an insurers within which its makes decisions and takes actions to manage its risk profile.
Risk Margin	This is an addition to the <u>Solvency II best-estimate liabilities</u> . Its calculation is prescribed by the <u>Solvency II</u> rules, and it is intended to represent the amount in excess of the <u>best-estimate liabilities</u> that would have to be paid to another insurer in order for it to agree to take on the underlying insurance obligations. Further information is given in Appendix 6.
Risk tolerance limits	Quantitative target levels of risk against which SE plc's or Royal London's current risk exposures are measured.
Sanctioned Policies	Those <u>Transferring Policies</u> that may become politically sanctioned prior to the <u>Transfer Date</u> which would therefore neither transfer to Royal London on the <u>Transfer Date</u> nor be included within the <u>Residual Policies Reinsurance Arrangement</u> .
Scheme of Demutualisation	The legal document outlining the terms of Scottish Equitable Life Assurance Society's demutualisation.
Share premium account	The share premium account is the difference between the value of the company's shares and the amount it received for the sale of those shares.
Smoothing	A management framework which imposes limits on how much with-profits policy payouts can change at each review of bonus rates.
Solvency II	<p>The name given to the regulatory regime in the UK. The regime is very similar to that with which insurers in the EU are required to comply, the EU legislation having initially been written directly into UK law after Brexit. There have been subsequent changes in the UK, as described in Section 12 and Appendix 6, with further changes being consulted upon.</p> <p>Solvency II imposes quantitative requirements on insurers, for example relating to how assets and liabilities are measured, and how much capital insurers are required to hold.</p> <p>Solvency II imposes qualitative requirements, for example relating to governance and risk management processes and controls.</p> <p>Solvency II also places disclosure requirements on insurers, relating to what and to whom insurers must report on their financial health.</p>

Term	Definition
Solvency Capital Requirement	Under <u>Solvency II</u> , insurers are required to hold a Solvency Capital Requirement. The Solvency Capital Requirement is specific to each insurer and is calculated based on the risks that each insurer faces. It aims to ensure that an insurer holds enough <u>Own Funds</u> to withstand certain stress events. Further information is given in Appendix 6.
Solvency coverage ratio	This is a measure of financial strength of an insurer, calculated as the value of its <u>Eligible Own Funds</u> divided by its <u>Solvency Capital Requirement</u> .
Spread	The difference between two prices, rates, or yields. For example credit spread refers to the difference in yield between two debt instruments with the same maturity and different credit qualities.
Standard Formula	A prescribed approach to calculating the <u>Solvency Capital Requirement</u> which insurers must use unless they have regulatory approval to use their own internal model. Further information is given in Appendix 6.
Structured notes	Hybrid securities that combine the features of multiple financial products into one. They combine elements of traditional bonds with stocks or derivatives.
Subordinated debt	A debt owed to an unsecured creditor that in the event of a liquidation can only be paid after the claims of secured creditors have been met.
Subordinated liabilities	A term used interchangeably with <u>subordinated debt</u> .
Subsequent Transfer Date	This term is fully defined in the Scheme, but in essence it refers to the date, following the <u>Transfer Date</u> , at which point any <u>Residual Assets</u> , <u>Residual Liabilities</u> and <u>Residual Policies</u> will be transferred to Royal London.
Risk-free swap yields	See definition for <u>interest rate swaps</u> . Investments are considered risk-free when there is theoretically zero risk of the counterparty defaulting.
Technical Provisions	Liabilities held on the <u>regulatory balance sheet</u> in respect of future benefit payments under contracts of insurance and the expenses of administering those contracts. Usually calculated as the sum of the <u>Best Estimate Liabilities</u> and the <u>Risk Margin</u> . Further information is given in Appendix 6.
Technical Provisions Calculated as a Whole	This represents Royal London's liability for <u>unit-linked</u> business. Royal London calculates the liability for its <u>unit-linked</u> business as a whole, rather than separately calculating a <u>BEL</u> and adding a <u>Risk Margin</u> .
Tier 1 Own Funds	The highest two qualities of the four categories of <u>Own Funds</u> . May be either unrestricted or restricted. Further information is given in Appendix 6.
Tier 2 Own Funds	The third highest quality of the four categories of <u>Own Funds</u> . Further information is given in Appendix 6.
Transfer Date	The date on which the Scheme will take effect, which is expected to be 1 July 2024.

Term	Definition
Transferring Assets	This term is fully defined in the Scheme, but in essence it means all of SE plc's assets relating to the <u>Transferring Policies</u> , including the <u>reinsurance agreements on the Transferring Policies</u> , at the <u>Transfer Date</u> , excluding any <u>Residual Assets</u> and assets relating to <u>Residual Policies</u> .
Transferring Liabilities	This term is fully defined in the Scheme, but in essence it means all of SE plc's liabilities relating to the <u>Transferring Policies</u> , at the <u>Transfer Date</u> , excluding any <u>Residual Liabilities</u> and liabilities relating to <u>Residual Policies</u> .
Transferring Policies	This term is fully defined in the Scheme, but in essence it means all of SE plc's policies in scope of the transfer that remain in force at the <u>Transfer Date</u> , other than <u>Residual Policies</u> .
Transitional Measure on Technical Provisions	A deduction from the <u>Technical Provisions</u> for insurance contracts written before <u>Solvency II</u> came into effect, based on the difference between the <u>Technical Provisions</u> calculated in accordance with <u>Solvency II</u> and those calculated in accordance with the previous regulatory regime. Further information is given in Appendix 6.
Undiversified	Before allowing for <u>diversification</u> .
Unitised with-profits	A form of <u>with-profits</u> fund where the investor buys units which increase in value in line with any declared regular bonuses and to which a final bonus may be added when the units are cashed in.
Unit-linked	A type of insurance product where the policy value is linked to the value of the units held in underlying assets or investment funds.
Unrestricted Tier 1 Own Funds	The highest quality of the four categories of <u>Own Funds</u> . Further information is given in Appendix 6.
Volatility Adjustment	When determining the <u>BEL</u> , the standard approach is to discount future liability cash flows using the so-called "basic risk-free rate", this being a prescribed discount rate based on swap yields. Insurers may apply for regulatory approval to add a Volatility Adjustment to the basic risk-free rate. Further information is given in Appendix 6.
Whole of Life	A type of life insurance policy that provides defined cover, usually against death, for the lifetime of the policyholder.
With-profits	Insurance products which give policyholders the right to participate in certain profits of the insurance company, usually applied as <u>bonuses</u> . Other common features include guarantees and the smoothing of investment returns.
With-Profits Sub-Fund	A sub-fund of SE plc's long-term insurance fund that contains <u>conventional with-profits policies</u> , <u>unitised with-profits policies</u> , and all <u>annuity policies</u> that were in force at the date of <u>demutualisation</u> .

## Appendix 2: Abbreviations

Abbreviation	Definition
Aegon	Aegon UK plc
Atos	Atos BPS Limited
BEL	<u>Best Estimate Liabilities</u>
Capita	Capita Life and Pensions Regulated Services Limited
CEO	Chief Executive Officer
CFO	Chief Financial Officer
Communication Regulations	The Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001
Court	The High Court of Justice in England and Wales
CRO	Chief Risk Officer
FCA	Financial Conduct Authority
FOS	Financial Ombudsman Service
Framework Agreement	The agreement entered into on 4 April 2023 by the parties under which SE plc agreed to transfer its individual <u>protection</u> book of business to Royal London
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000
GAO	<u>Guaranteed Annuity Option</u>
HMRC	HM Revenue & Customs
HMT	HM Treasury
Hymans Robertson	Hymans Robertson LLP
IFoA	Institute and Faculty of Actuaries
IFRS17	International Financial Reporting Standard 17
IGC	Independent Governance Committee
Independent Expert	The person responsible for preparing the Scheme Report in accordance with Section 109(2) of FSMA
LPTR	<u>Life Protection with Tax Relief</u>
MA	<u>Matching Adjustment</u>
MVRs	<u>Market Value Reductions</u>
NPSF	<u>Non-Profit Sub-Fund</u>



Abbreviation	Definition
OEICs	<u>Open-ended Investment Companies</u>
ORSA	<u>Own Risk and Solvency Assessment</u>
PIM	<u>Partial Internal Model</u>
PPFM	<u>Principles and Practices of Financial Management</u>
PRA	Prudential Regulation Authority
RL(CIS) Fund	Royal London Co-operative Insurance Society Fund
RLGPS	Royal London Group Pension Scheme
RLI DAC	Royal London Insurance designated Activity Company
RLMF	Royal London Main Fund
Royal London	The Royal London Mutual Insurance Society Limited
Sapiens	Sapiens International Corp NV
Scheme	The proposed scheme of transfer, the terms of which I have been instructed to report on in the capacity of Independent Expert
Scheme Report	The report on the terms of the Scheme required under section 109(1) of FSMA
SCR	<u>Solvency Capital Requirement</u>
SE plc	Scottish Equitable plc
SEPT	Scottish Equitable Policyholders' Trust
SUP 18	Chapter 18 of the Supervision Manual of the FCA Handbook
TCS	Tata Consultancy Services Limited
TMTF	<u>Transitional Measure on Technical Provisions</u>
UK	United Kingdom
VA	<u>Volatility Adjustment</u>
WPSF	<u>With-Profits Sub-Fund</u>

## Appendix 3: Compliance with terms of reference

### Material adverse effect

Requirement	Section of the Scheme Report
<p>I will assess the expected impact of the Scheme on each of the following groups:</p> <ul style="list-style-type: none"> <li>• Holders of SE plc's <u>Transferring Policies</u>, noting that those holding a <u>protection</u> insurance policy (in scope of the transfer) will be transferred to Royal London as part of the Scheme,</li> </ul>	Section 7
<ul style="list-style-type: none"> <li>• Holders of SE plc's <u>Remaining Policies</u>, to the extent that they are impacted by the transfer of the portfolio of <u>protection</u> business to Royal London,</li> </ul>	Section 8
<ul style="list-style-type: none"> <li>• Holders of Royal London's <u>Existing Policies</u>,</li> </ul>	Section 9
<ul style="list-style-type: none"> <li>• Any of SE plc's <u>reinsurers</u> whose contracts of <u>reinsurance</u> will be transferred to Royal London as part of the Scheme,</li> </ul>	Paragraphs 10.2 to 10.6
<ul style="list-style-type: none"> <li>• Royal London's <u>reinsurers</u>, and</li> </ul>	Paragraphs 10.7 to 10.13
<ul style="list-style-type: none"> <li>• Any other interested parties.</li> </ul>	<p><b>Outsourced service providers:</b> Paragraphs 10.14 to 10.19</p> <p><b>SE plc's pension schemes:</b> Paragraph 10.20</p> <p><b>Royal London's pension schemes:</b> Paragraphs 10.21 to 10.22</p> <p><b>Royal London's creditors:</b> Paragraphs 10.23 to 10.25</p> <p><b>Royal London's insurance subsidiaries:</b> Paragraphs 10.26 to 10.29</p>
<p>As part of this assessment, I will consider whether the Scheme is expected to have a similar impact on all policyholders/<u>reinsurers</u> within each of these groups, or whether there are any sub-groups – for example, different groups or different generations of policyholders – for which the Scheme is expected to have a greater impact. In particular, I will assess whether the Scheme is expected to have a material adverse effect on any group of policyholders or <u>reinsurers</u>.</p>	<p>I have considered the impact on each of these groups across all main classes of business, i.e. <u>unit-linked</u>, other <u>non-profit</u>, and <u>with-profit</u> contracts, through-out Sections 7, 8 and 9.</p>

Requirement	Section of the Scheme Report
The Scheme report will set out my definition of “material adverse” effect. This definition will encompass both the impact of the Scheme on benefit security and its impact on benefit expectations.	Paragraphs 1.14 to 1.18

### Benefit security

Requirement	Section of the Scheme Report
As part of the assessment of the expected impact of the Scheme on policyholder benefit security, I will consider the current financial positions of SE plc and Royal London – as measured by their <u>Solvency II</u> Pillar 1 balance sheets – and how these are expected to change following the implementation of the Scheme.	<p>In paragraphs 6.1 to 6.9 I consider the financial impacts of the Scheme as at 30 June 2023.</p> <p>In paragraphs 6.60 to 6.62 I consider any events since 30 June 2023 that may affect my conclusions in the sections noted above.</p> <p>I have also considered projections of the parties’ future solvency positions in paragraphs 7.6 and 8.3.</p>
I will also compare the capital management policies (or equivalent) of the two parties and consider whether any differences have implications for the benefit security of the holders of <u>Transferring Policies</u> . I will consider the management actions that may be taken following the implementation of the Scheme, according to the capital management policies, and the implications for different groups of interested parties.	<p>I have compared the capital management policies of SE plc and Royal London, including the management actions available, in paragraphs 6.10 to 6.19.</p> <p>I have then considered the impact on benefit security for holders of <u>Transferring Policies</u> in paragraphs 7.3 to 7.7.</p>
If appropriate, I will consider the financial strengths of the parties on other bases, such as those used for <u>ORSA</u> s. This might be relevant if, for example, the capital management policies refer to bases other than <u>Solvency II</u> Pillar 1.	Confirmed
As part of assessing the impact of the Scheme on the <u>Solvency II</u> Pillar 1 balance sheets, I will consider its potential impact on the parties’ <u>Solvency II</u> approvals.	Paragraphs 6.34 to 6.40
SE plc and Royal London currently use the <u>Solvency II Partial Internal Model</u> and <u>Internal Model</u> , respectively, to calculate their Pillar 1 capital	Paragraphs 6.41 to 6.43

Requirement	Section of the Scheme Report
<p>requirements. I will consider each party's assessment of whether and why their respective <u>PIM/Internal Model</u> will continue to remain appropriate following the implementation of the Scheme.</p>	
<p>I will consider the impact of the Scheme on the risks faced by different groups of interested parties. For these purposes I will consider the capital held against different risks under <u>Solvency II</u> Pillar 1, as well as the parties' assessments of the risks faced in their <u>ORSAs</u>. This assessment will consider any risks not captured by the <u>Solvency II</u> Pillar 1 capital requirements, such as those which may emerge after the first year.</p>	<p>In paragraphs 6.21 to 6.33 I consider, for each of the parties, the impact of the Scheme on:</p> <ul style="list-style-type: none"> <li>• The capital held against different risks under <u>Solvency II</u> Pillar 1,</li> <li>• <u>risk appetite frameworks</u>, and</li> <li>• associated impacts to <u>risk tolerance limits</u>.</li> </ul> <p>I consider any impacts from this assessment on holders of <u>Transferring Policies</u>, <u>Existing Policies</u> and <u>Remaining Policies</u> in paragraphs 7.8 to 7.17, 8.4 to 8.9 and 9.6 to 9.20.</p> <p>In paragraphs 6.50 to 6.51 (as well as in paragraphs 7.20, 8.12 and 9.23) I consider the impact of the Scheme on the quality of capital held by both parties.</p> <p>I further consider the impact of the Scheme on climate change risk and liquidity risk respectively in paragraphs 6.44 to 6.49 (as well as in 7.19, 8.11, 9.22) and 6.52 to 6.54 (as well as in 7.21, 8.13, 9.24).</p> <p>In paragraphs 7.23, 8.15 and 9.26 I also consider the future business plans for both parties' and how this</p>

Requirement	Section of the Scheme Report
	<p>may affect different groups of policyholders.</p> <p>I have also considered projections of the parties' future solvency positions in paragraphs 7.6 and 8.3.</p>
<p>When assessing the expected financial positions and risk profiles of the parties before and after the implementation of the Scheme, I will consider the implications of any changes in investment strategy that result from the implementation of the Scheme. I will also consider Royal London's ability to manage any assets transferred as part of the Scheme and to identify, measure, manage, monitor and mitigate any risks posed by these assets.</p>	<p>Paragraphs 7.11 to 7.14, 8.8, 9.15.</p>

### Benefit expectations

Requirement	Section of the Scheme Report
<p>I will consider the impact of any changes to policy terms and conditions needed to allow the Scheme to be effected.</p>	<p>I have considered the impact to policy terms and conditions across all main classes of business, i.e. <u>unit-linked</u>, other <u>non-profit</u>, and <u>with-profit</u> contracts. This is covered in paragraphs 7.28, 8.17 to 8.20, 9.28 to 9.32.</p>
<p>I will consider whether SE plc and/or Royal London have discretion over the benefits paid under certain policies. If this is true for the <u>Transferring Policies</u> then I will consider whether Royal London would be expected to exercise this discretion in a different way to how SE plc has exercised it in the past. If it applied to Royal London's <u>Existing Policies</u> then I will consider whether the transfer is expected to impact the way in which Royal London exercises this discretion. Particular examples might include reviewable premiums or charges, or non-contractual options that are currently offered to policyholders.</p>	<p>I have considered areas of discretion (and the application of it) across all main classes of business, i.e. <u>unit-linked</u>, other <u>non-profit</u>, and <u>with-profit</u> contracts. This is covered for holders of <u>Transferring Policies</u>, <u>Remaining Policies</u> and <u>Existing Policies</u> in paragraphs 7.29 to 7.31, 8.17 to 8.22, 9.28 to 9.40, respectively.</p>
<p>I will consider any tax consequences of the Scheme insofar as they affect holders of <u>Transferring Policies</u>.</p>	<p>I consider the tax implications from the Scheme on holders of <u>Transferring Policies</u> in paragraphs 7.33 to 7.36.</p>

### Service standards

Requirement	Section of the Scheme Report
I will consider how the <u>Transferring Policies</u> will be administered following the implementation of the Scheme, and whether this is expected to affect the standard of service experienced by policyholders.	I consider any impact to service standards on holders of <u>Transferring Policies</u> in paragraphs 7.38 to 7.52.

### Communications to policyholders

Requirement	Section of the Scheme Report
I will consider the accuracy, completeness and transparency of the communications that will be sent to policyholders advising them of the parties' intention to implement the Scheme. This will include consideration of whether the communications provide sufficiently clear and accurate information in relation to policyholders' rights under the Scheme, such as the right to object to the Scheme and have that objection heard by the Court.	Paragraphs 11.1 to 11.4, 11.32 to 11.36, and 11.42
I will review and comment upon the parties' wider communication plans, and related preparations, including: <ul style="list-style-type: none"> <li>the support in place for policyholders in light of the Scheme, for example arrangements for policyholders to ask questions or raise concerns, and arrangements for vulnerable policyholders,</li> </ul>	Paragraphs 11.5 to 11.8, and 11.37 to 11.38.
<ul style="list-style-type: none"> <li>specific arrangements for "gone-away" policyholders,</li> </ul>	Paragraphs 11.18 to 11.20.
<ul style="list-style-type: none"> <li>any applications made by the parties to waive the requirement to send communications to particular groups of policyholders, and</li> </ul>	Paragraphs 11.9 to 11.29, and 11.39 to 11.40.
<ul style="list-style-type: none"> <li>the parties' plans in relation to wider notification of the Scheme including press advertisements.</li> </ul>	Paragraphs 11.3 to 11.4.
I will prepare a summary of my report for inclusion in the communications to be sent to policyholders.	Included at the end of the Scheme Report

### Governance

Requirement	Section of the Scheme Report
I will compare SE plc's governance arrangements, Royal London's current governance arrangements, and how Royal London's governance arrangements are expected to change as a result of the implementation of the Scheme. I will then assess any implications for particular groups of policyholders.	Paragraphs 7.53 to 7.56, 8.31 to 8.32, and 9.47 to 9.48.

**Consequences of not implementing the Scheme**

Requirement	Section of the Scheme Report
I will consider the likely effects on policyholders if the Scheme is not implemented. I will also determine whether the parties have considered any alternatives to implementing the Scheme and, if so, why these were not proceeded with.	Section 13

## Appendix 4: Documents considered

The principal documents reviewed in preparing the Scheme Report were:

- advanced draft of the Scheme,
- Royal London Chief Actuary's report on the Scheme,
- Royal London With-Profits Actuary's report on the Scheme,
- SE plc Chief Actuary's report on the Scheme,
- SE plc With-Profits Actuary's report on the Scheme,
- the first and second witness statements of Daniel Sebastian Cazeaux (Royal London's CFO),
- the first and second witness statements of James Ewing (SE plc's CFO),
- Royal London's Solvency and Financial Condition Report as at 31 December 2022,
- SE plc's Solvency and Financial Condition Report as at 31 December 2022,
- Royal London's 2022 Own Risk and Solvency Assessments,
- SE plc's 2022 Own Risk and Solvency Assessments,
- SE plc's addendum to its 2022 Own Risk and Solvency Assessments (covering the impacts from implementing the Scheme),
- Royal London's 2022 annual report and accounts,
- SE plc's 2022 annual report and accounts,
- Sample policy terms and conditions from both Royal London and SE plc,
- Royal London's Principles and Practices of Financial Management,
- SE plc's Principles and Practices of Financial Management,
- Terms of reference for Royal London's management and governance committees,
- Terms of reference for SE plc's management and governance committees,
- Documents from both parties containing responses to my questions.
- Royal London's solvency projections following implementation of the Scheme,
- SE plc's solvency projections following implementation of the Scheme,
- Detailed financial results and analyses, pre-Scheme and post-Scheme, provided by both parties, including detailed SCR breakdowns, detailed BEL breakdowns, detailed analyses of Own Funds,
- Details of Royal London's reinsurance contracts, including risk appetite for reinsurance,
- Details of SE plc's reinsurance contracts,
- Royal London's material outsourcing arrangements,
- Royal London's Internal Model validation report,
- SE plc's Partial Internal Model validation report,
- Documentation detailing SE plc's approach for Guernsey policies, and
- Documents outlining the approach to and content of SE plc's and Royal London's communications in relation to the Scheme.



## Appendix 5: Compliance with regulatory rules and guidance

### FCA Handbook (Supervision chapter)

Rule	Requirement from SUP 18.2	Section of the Scheme Report
18.2.31	A scheme report must accompany an application to the court to approve an insurance business transfer scheme. This report must be made in a form approved by the appropriate regulator.	The form of this Scheme Report has been approved by the PRA in consultation with the FCA.
18.2.31A	When the appropriate regulator has approved the form of a scheme report, the scheme promoter may expect to receive written confirmation to that effect from that regulator.	Information only, no requirements
18.2.32	There may be matters relating to the scheme or the parties to the transfer that the regulators wish to draw to the attention of the independent expert. The regulators may also wish the report to address particular issues. The independent expert should therefore contact the regulators at an early stage to establish whether there are such matters or issues. The independent expert should form his own opinion on such issues, which may differ from the opinion of the regulators.	Confirmed
18.2.33	The scheme report should comply with the applicable rules on expert evidence and contain the following information:	1.9, 1.11
	(1) who appointed the independent expert and who is bearing the costs of that appointment;	
	(2) confirmation that the independent expert has been approved or nominated by the appropriate regulator;	1.9
	(3) a statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role;	1.19, 1.20
	(4) whether the independent expert has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest;	1.21
	(5) the scope of the report;	1.12 to 1.18
	(6) the purpose of the scheme;	1.1, 1.2
(7) a summary of the terms of the scheme in so far as they are relevant to the report;	Section 5	

Rule	Requirement from SUP 18.2	Section of the Scheme Report
	(8) what documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided;	1.25, Appendix 4: Documents considered
	(9) the extent to which the independent expert has relied on: (a) information provided by others; and	1.22, 1.25, 1.26
	(b) the judgment of others;	1.5, 8.25 The parties have provided me with the legal and tax advice that they have received.
	(10) the people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable;	1.25
	(11) his opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders;	Section 7
	(b) policyholders of the transferor whose contracts will not be transferred; and	Section 8
	(c) policyholders of the transferee;	Section 9
	(11A) his opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme;	10.1 to 10.12
	(12) what matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the scheme; and	Not applicable
	(13) for each opinion that the independent expert expresses in the report, an outline of his reasons.	Accompanying each opinion
18.2.34	The purpose of the scheme report is to inform the court and the independent expert, therefore, has a duty to the court. However reliance will also be placed on it by policyholders, by reinsurers, by others affected by the scheme and by the regulators. The amount of detail that it is appropriate to include will depend on the complexity of the scheme, the materiality of the details themselves and the circumstances.	Throughout the report.

Rule	Requirement from SUP 18.2	Section of the Scheme Report
18.2.35	The summary of the terms of the scheme should include:  (1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme; and	3.37, 5.3
	(2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred.	3.38, 10.1 to 10.6
18.2.36	The independent expert's opinion of the likely effects of the scheme on policyholders should:  (1) include a comparison of the likely effects if it is or is not implemented;	Sections 7, 8 and 9. Section 13 discusses consequences of the scheme not completing.
	(2) state whether he considered alternative arrangements and, if so, what;	5.15
	(3) where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders; and	As required in Sections 7, 8 and 9
	(4) include his views on:	7.2 to 7.27
	(a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;	8.1 to 8.16 9.1 to 9.27
	(b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:	7.2 to 7.27 8.1 to 8.16
	(i) the security of policyholders' contractual rights;	9.1 to 9.27
	(ii) levels of service provided to policyholders; or	7.38 to 7.52 8.27 to 8.29 9.44 to 9.46
(iii) for long-term insurance business, the reasonable expectations of policyholders; and	7.28 to 7.37 8.17 to 8.26 9.28 to 9.43	

Rule	Requirement from SUP 18.2	Section of the Scheme Report
	(c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations.	7.33 to 7.36 8.24 to 8.25 9.42
18.2.37	The independent expert is not expected to comment on the likely effects on new policyholders, that is, those whose contracts are entered into after the effective date of the transfer.	No requirements, only clarification.
18.2.38	For any mutual company involved in the scheme, the report should: <ul style="list-style-type: none"> <li>(1) describe the effect of the scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes which could affect their entitlements as policyholders;</li> <li>(2) state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights; and</li> <li>(3) comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without.</li> </ul>	9.38
18.2.39	For a scheme involving long-term insurance business, the report should:	8.20 to 8.22
	(1) describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits;	9.32 to 9.34
	(2) if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;	Rights will not be diluted
	(3) describe the likely effect of the scheme on the approach used to determine:	8.20 to 8.22
	(a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and	9.32 to 9.34
	(b) the levels of any discretionary charges;	8.20 to 8.22 9.32 to 9.34
	(4) describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm;	8.21, 9.33

Rule	Requirement from SUP 18.2	Section of the Scheme Report
	(5) include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders;	Sections 2 and 14
	(6) state whether the independent expert is satisfied that for each firm the scheme is equitable to all classes and generations of its policyholders; and	Section 14
	(7) state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented.	8.21, 9.33
18.2.40	Where the transfer forms part of a wider chain of events or corporate restructuring, it may not be appropriate to consider the transfer in isolation and the independent expert should seek sufficient explanations on corporate plans to enable him to understand the wider picture. Likewise he will need information on the operational plans of the transferee and, if only part of the business of the transferor is transferred, of the transferor. These will need to have sufficient detail to allow him to understand in broad terms how the business will be run.	Not applicable
18.2.41	A transfer may provide for benefits to be reduced for some or all of the policies being transferred. This might happen if the transferor is in financial difficulties. If there is such a proposal, the independent expert should report on what reductions he considers ought to be made, unless either:  (1) the information required is not available and will not become available in time for his report, for instance it might depend on future events; or  (2) otherwise, he is unable to report on this aspect in the time available.	Not applicable

Source: <https://www.handbook.fca.org.uk/handbook/SUP/18/?view=chapter>

## Statement of Policy: The PRA's approach to insurance business transfers

Paragraph	Requirement from PS1/22	Section of the Scheme Report
2.27	Under section 109 of FSMA, a scheme report must accompany an application to the court to approve an insurance business transfer scheme. This report must be made in a form approved by the PRA (following consultation with the FCA).	Appendix 3 sets out my terms of reference and how I have fulfilled them.
2.27A	The PRA's assessment of whether to approve the form of the scheme report considers if the report is in an appropriate form to be submitted to the court to assist its assessment of the scheme. The PRA expects to take into consideration whether the report:  (1) covers in sufficient detail all the issues that appear to the PRA to be relevant; and  (2) incorporates appropriate reasoning.	The form of this Scheme Report has been approved by the PRA in consultation with the FCA.
2.27B	The PRA would generally expect a scheme report to contain at least the information specified in 2.30 and 2.32–2.33 below before it would be able to consider approving the form of the report.	
2.28	When the PRA has approved the form of a scheme report, the scheme promoter(s) may expect to receive written confirmation to that effect.	Information only, no requirements.
2.29	There may be matters relating to the scheme or the parties to the transfer that the regulators wish to draw to the attention of the independent expert. The regulators may also wish the report to address particular issues. The independent expert would therefore be expected to contact the regulators at an early stage to establish whether there are such matters or issues. The independent expert should form their own opinion on such issues, which may differ from the opinion of the regulators.	Confirmed
2.30	The scheme report should comply with the applicable rules on expert evidence and contain the following information:  (1) who appointed the independent expert and who is bearing the costs of that appointment;	1.9, 1.11
	(2) confirmation that the independent expert has been approved or nominated by the PRA;	1.9

Paragraph	Requirement from PS1/22	Section of the Scheme Report
	(3) a statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role;	1.20
	(4) whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest;	1.21
	(5) the scope of the report;	1.12 to 1.18
	(6) the purpose of the scheme;	1.1, 1.2
	(7) a summary of the terms of the scheme in so far as they are relevant to the report;	Section 5
	(8) what documents, reports and other material information the independent expert has considered in preparing the report, whether they have identified any material issues with the information provided and whether any information that they requested has not been provided;	1.25, Appendix 4
	(8A) any firm-specific information the independent expert considers should be included, where the applicant(s) consider it inappropriate to disclose such information, then the independent expert should explain this and the reasons why disclosure has not been possible;	2.6, 6.2, 6.11
	(9) the extent to which the independent expert has relied on:  (a) information provided by others; and	1.25
	(b) the judgement of others;	The parties have provided me with the legal and tax advice that they have received.  1.5, 8.25
	(10) the people the independent expert has relied on and why, in their opinion, such reliance is reasonable;	1.25
	(11) Their opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between:  (a) transferring policyholders;	Section 7

Paragraph	Requirement from PS1/22	Section of the Scheme Report
	(b) policyholders of the transferor whose contracts will not be transferred; and	Section 8
	(c) policyholders of the transferee;	Section 9
	(d) any other relevant policyholder groupings within the above that the independent expert has identified.	8.17 to 8.22 9.28 to 9.40
	(12) Their opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme;	10.1 to 10.13
	(12A) their definition of 'material adverse' effect;	1.16 to 1.18
	(13) what matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in their opinion, be relevant to policyholders' consideration of the scheme; and	Not applicable
	(14) for each opinion that the independent expert expresses in the report, an outline of their reasons.	Accompanying each conclusion
	(15) an outline of permutations if a scheme has concurrent or linked schemes, and analysis of the likely effects of the permutations on policyholders.	Not applicable
2.31	The purpose of the scheme report is to inform the court and the independent expert, therefore, has a duty to the court. However reliance will also be placed on it by policyholders, reinsurers, and others affected by the scheme and by the regulators. The amount of detail that it is appropriate to include will depend on the complexity of the scheme, the materiality of the details themselves and the circumstances.	Throughout
2.31A	The independent expert is ultimately responsible and accountable for the opinions and conclusions expressed in the scheme report, including where reliance has been placed on others. Therefore where the independent expert has placed reliance on others, they must be clear why they are content to do so.	1.25 Appendix 4
2.32	The summary of the terms of the scheme should include:  (1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme; and	3.37, 5.3



Paragraph	Requirement from PS1/22	Section of the Scheme Report
	(2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred.	3.38, 10.1 to 10.6
2.33	The independent expert's opinion of the likely effects of the scheme should be assessed at both firm and policyholder level and should:	Sections 6, 7, 8 and 9. Section 13 also discusses consequences of the Scheme not completing.
	(1) include a comparison of the likely effects if it is or is not implemented;	
	(2) state whether the firm(s) considered alternative arrangements and, if so, what were the arrangements and why were they not proceeded with;	5.15
	(2A) analyse and conclude on how groups of policyholders are affected differently by the scheme, and whether such effects are material in the independent expert's opinion. Where the independent expert considers such effects to be material, they should explain how this affects their overall opinion;	As required in sections 7, 8 and 9.
	(3) include their views on:	7.2 to 7.27
	(a) the likely effect of the scheme at firm and policyholder level on the ongoing security of policyholders' contractual rights, including an assessment of the stress and scenario testing carried out by the firm(s) and of the potentially available management actions that have been considered by the board of the firm(s) and the likelihood and potential effects of the insolvency of the transferor(s) and transferee(s). The independent expert should also consider whether it is necessary to conduct their own stress and scenario testing or to request the firm(s) to conduct further stress and scenario testing;	8.1 to 8.16 9.1 to 9.27
	(aa) the transferor's and transferee's respective abilities to measure, monitor, and manage risk and to conduct their business prudently. This includes their ability to take corrective action in the event there is a material deterioration of their balance sheets;	6.10 to 6.33
	(aaa) the likely effects of the scheme, in relation to the likelihood of future claims being paid, with consideration of not only the regulatory capital regime, but also any other risks not falling within the regime. This would include those likely to emerge after the first year or that are not fully captured by the regulatory capital requirements;	7.2 to 7.27 8.1 to 8.16 9.1 to 9.27

Paragraph	Requirement from PS1/22	Section of the Scheme Report
	(aaaa) whether the transferee'(s') existing (or proposed, where applicable) capital model would remain appropriate following the scheme;	6.41 to 6.43
	(b) the likely effects of the scheme on matters such as investment management, capital management, new business strategy, claims reserving, administration, claims handling, expense levels and valuation bases for both transferor(s) and transferee(s) in relation to:  (i) the security of policyholders' contractual rights;	7.2 to 7.27 8.1 to 8.16 9.1 to 9.27
	(ii) levels of service provided to policyholders; or	7.38 to 7.52 8.27 to 8.29 9.44 to 9.46
	(iii) for long-term insurance business, the reasonable expectations of policyholders; and	7.28 to 7.37 8.17 to 8.26 9.28 to 9.43
	(c) the likely cost and tax effects of the scheme, in relation to how they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations; and	7.33 to 7.36 8.24 to 8.25 9.42
	(d) the likely effects at firm and policyholder level due to any change in risk profiles and/or exposures resulting from the scheme or related transactions.	6.21 to 6.33 7.8 to 7.17 8.4 to 8.9 9.6 to 9.20
2.34	The independent expert is not expected to comment on the likely effects on new policyholders, that is those whose contracts are entered into after the effective date of the transfer.	No requirements, only clarification.

Paragraph	Requirement from PS1/22	Section of the Scheme Report
2.35	<p>For any mutual company involved in the scheme, the report should:</p> <p>(1) describe the effect of the scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes which could affect their entitlements as policyholders;</p> <p>(2) state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights; and</p> <p>(3) comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without</p>	9.38
2.36	<p>For a scheme involving long-term insurance business, the report should:</p> <p>(1) describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits;</p>	8.20 to 8.22 9.32 to 9.40
	<p>(2) if any such rights will be diluted by the scheme, describe how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;</p>	Rights will not be diluted
	<p>(3) describe the likely effect of the scheme on the approach used to determine:</p> <p>(a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and</p>	8.20 to 8.22 9.32 to 9.34
	<p>(b) the levels of any discretionary charges;</p>	8.20, 9.32
	<p>(4) describe what safeguards are provided by the scheme against a subsequent change of approach to these matters (in 2.36(1)–(3)) that could act to the detriment of existing policyholders of either firm;</p>	8.21, 9.33
	<p>(5) include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders;</p>	Section 14

Paragraph	Requirement from PS1/22	Section of the Scheme Report
	(6) state whether the independent expert is satisfied that for each firm, the scheme is equitable to all classes and generations of its policyholders; and	Section 14
	(7) state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented.	8.21, 9.33
2.37	Where the transfer forms part of a wider chain of events or corporate restructuring, it may not be appropriate to consider the transfer in isolation and the independent expert should seek sufficient explanations on corporate plans to enable them to understand the wider picture. Likewise, the independent expert will also need information on the operational plans of the transferee and, if only part of the business of the transferor is transferred, of the transferor. These will need to have sufficient detail to allow them to understand in broad terms how the business will be run. The PRA expects the independent expert to comment on how any such plans (including other insurance business transfers involving the parties to the scheme) would impact the likely effects of the scheme at firm and policyholder level.	Not applicable
2.38	<p>A transfer may provide for benefits to be reduced for some or all of the policies being transferred. This might happen if the transferor is in financial difficulties. If there is such a proposal, the independent expert should report on what reductions they consider ought to be made, unless:</p> <p>(1) the information required is not available and will not become available in time for their report, for instance it might depend on future events; or</p> <p>(2) they are unable to report on this aspect in the time available.</p> <p>Under such circumstances, the transfer might be urgent and it might be appropriate for the reduction in benefits to take place after the event, by means of an order under section 112 of FSMA. The PRA considers any such reductions having regard to its statutory objectives. Section 113 of FSMA allows the court, on the application of the PRA, to appoint an independent actuary to report on any such post-transfer reduction in benefits.</p>	No such proposal

Paragraph	Requirement from PS1/22	Section of the Scheme Report
2.39	The PRA expects the independent expert to provide a supplementary report for the final court hearing. Any supplementary reports will form part of the scheme report required to be produced under section 109 of FSMA and must also comply with 2.30-2.37.	I have undertaken to provide this in 1.31.
2.40	The purpose of the supplementary report is for the independent expert to provide an update on any relevant new information or events that have occurred since the date of the scheme report and to provide an opinion on whether they have affected the transfer. Matters that should be considered include, but are not limited to: <p>(1) the most recent audited and unaudited available financial information in respect of the transferor and transferee, which the PRA would expect to have been internally validated;</p> <p>(2) any recent economic, financial or regulatory developments; and</p> <p>(3) any representations made by policyholders or affected persons that raise issues not previously considered in the scheme report.</p>	I have undertaken to provide this in 1.31.
2.40A	In circumstances where there has been a duration between the directions hearing and the final court hearing of six months or more, it may be appropriate for the independent expert to produce an updated scheme report rather than a supplementary report. The PRA would assess this report as set out in 2.27A.	Not applicable

Source: <https://www.bankofengland.co.uk/prudential-regulation/publication/2015/the-pras-approach-to-insurance-business-transfers>

**Finalised Guidance FG22/1: The FCA's approach to the review of Part VII insurance business transfers**

Paragraph	Guidance from FG22/1	Section of the Scheme Report
6.1	The PRA is responsible for approving the form of the IE's report but it must consult us before doing so. Our review will not just be limited to a high-level check of whether the report covers the appropriate topics (see SUP 18 for details). It also aims to ensure that there has been detailed analysis and challenge of the Applicants' position, so we can be satisfied that it is appropriate for the Court to rely on the conclusions.	Information only, no requirements
6.2	The IE report should be easy to read and understandable by all its users and for the IE to pay attention to the following:	Throughout
	• Technical terms and acronyms should be defined on first use.	
	• There should be an executive summary that explains, at least in outline, the proposed transfer and the IE's conclusions.	Section 2
	• The business to be transferred should be described early in the report.	1.1 to 1.5
	• The detail given should be proportionate to the issues being discussed and the materiality of the transfer when seen as a whole. While all material issues must be discussed, IEs should try to avoid presenting reports that are disproportionately long.	Throughout
	• IEs should prepare their reports in a way that makes it possible for non-technically qualified readers to understand.	Throughout
6.3	IE reports should consider and compare:	7.28 to 7.37
		8.17 to 8.26
		9.28 to 9.43
	• type and level of service.	7.38 to 7.52
		8.27 to 8.29
		9.44 to 9.46
	• management, administration and governance arrangements	7.38 to 7.56
8.27 to 8.32		
9.44 to 9.48		
• where the scheme includes Employers' Liability/ Public Liability claimants and Run Off Claims, we expect the IE to include their view of the quality of the firms' Employers' Liability tracing arrangements	Not applicable	
• where there are significant changes during the process, for example due to pandemic or economic fluctuations, we expect the IE to have adequately reflected on these in the supplementary report or for firms to consider whether the proposal has materially altered and needs a fuller reconsideration or delay to the process	To be addressed, if appropriate, in my Supplementary Report	
6.4	We also sometimes see an imbalance between factual description and supporting analysis. IE reports often include a very detailed description of the transaction and background but much less analysis of the effect on each Policyholder group's reasonable expectations. Our concern here is that the IE often uses the detailed description of the background to compensate for the lack of analysis and challenge of the Applicants.	Sections 6 to 9

Paragraph	Guidance from FG22/1	Section of the Scheme Report
The level of reliance on the Applicants assessments and assertions		
6.6	IE should demonstrate that they have questioned the adequacy of the assessments. We may also expect the IE to have asked the Applicants to undertake additional work or provide more evidence to support their assertions to ensure that the IE can be satisfied on a specific point.	Throughout
6.7	We expect the IE to explain any challenges they made to the Applicants about such underlying information and the outcome in their report, rather than just stating the final position.	Throughout
6.8	Where conclusions are supported solely or largely by statements like 'I have discussed with the firm's management, and they tell me that...' followed by 'I have no reason to doubt what they have told me...' In these circumstances: <ul style="list-style-type: none"> <li>• Where a feature of the proposed transfer forms a significant part of the IE's own assessment of the scheme's impact, we will ask the IE to review relevant underlying material. We do not expect them to just rely on the Applicants' analysis of the material and subsequent assertions.</li> <li>• If there are concerns about matters that fall outside the IE's sphere of expertise, like legal issues, we expect the Applicants to give the IE any advice that they have received. If the issue is significant or remains uncertain, we expect the IE to make sure the Applicants obtained appropriate advice from a suitably qualified independent subject matter expert.</li> </ul>	The parties have provided me with the legal and tax advice that they have received.
6.9	We also expect the IE to challenge calculations carried out by the Applicants if there is cause for doubt on review of the scheme and supporting documents. As a minimum, we will expect the IE to: <ul style="list-style-type: none"> <li>• review the methodology used and any assumptions made, to satisfy themselves that the information is likely to be accurate and to challenge it where appropriate</li> <li>• challenge the factual accuracy of matters that, on the face of the documents or considering the IE's knowledge and experience, appear inconsistent, confusing or incomplete</li> </ul>	Section 6
6.10	We also expect the IE to challenge the Applicants where the documents provided contain an insufficient level of detail or analysis.	Additional information has been requested when necessary
Balanced judgements and sufficient reasoning		
6.11	IEs will sometimes state that they are satisfied by referencing certain features of the scheme ... In these circumstances we will expect to see both the evidence and the IE's reasoning that led to their conclusion.	Throughout

Paragraph	Guidance from FG22/1	Section of the Scheme Report
6.12	<p>We have also seen many examples of schemes where the Applicants have stated that there will be no material adverse impact to Policyholders. However, from the report it is unclear whether the IE is certain that there will most likely not be an adverse impact or whether it is their best judgement but lacks certainty. In these instances, we expect IEs to consider the following:</p> <ul style="list-style-type: none"> <li>• Where the IE takes the view that there is probably no material adverse impact, we expect the IE to challenge the Applicants about further work they could undertake to enable the IE to be satisfied to a greater degree.</li> <li>• We accept that it is not the IE's role to suggest a different scheme or propose changes to a scheme (unless it is to propose mitigations against possible harm). However, we believe that they should be able to challenge the Applicants to be confident that their report's conclusions are robust. Applicants and IEs should know that they will need to consider how any proposed changes/mitigations will affect all Policyholder groups.</li> </ul>	Throughout
6.13	When finalising their report, we expect the IE to have checked that the documents they are relying, and forming judgements, on are the most up-to-date available.	Confirmed
6.14	Market conditions may have changed significantly since the IE's analysis was carried out and they formed their judgement. In these cases, we will expect the Applicants to discuss any changes with the IE and for the IE to update their report as necessary.	No significant changes.
Sufficient regard to relevant considerations affecting Policyholders		
6.15	<p>We will expect to see IE consideration of all relevant issues for each individual group of Policyholders in all firms involved, as well as how an issue may affect each group. Our expectations of the IE when giving their opinion include the:</p> <ul style="list-style-type: none"> <li>• current and proposed future position of each Policyholder group</li> <li>• potential effects of the transfer on each of the different Policyholder groups</li> <li>• potential material adverse impacts that may affect each group of Policyholders, how these impacts are inter-related and how they will be mitigated</li> </ul>	Sections 7, 8 and 9
6.16	To support this, we will expect the IE to consider whether the groups of affected Policyholders have been identified appropriately. For example, this could include instances where certain Policyholder groups' services are provided by an outsourced function which is changing, but other Policyholder groups do not.	Sections 7, 8 and 9
6.17	We will also expect the IE to review and give their opinion on administrative changes affecting Policyholders and claimants.	7.38, 8.27 to 8.29 and 9.44
6.18	Where the transferring business involves employers' liability policies the IE should consider the quality of the firms' tracing procedures.	Not applicable
6.19	IEs should also review and give their opinion on all relevant issues for all Policyholder groups where reinsurance was entered into in anticipation of a transfer.	5.6, 6.1, Section 13



Paragraph	Guidance from FG22/1	Section of the Scheme Report
6.20	The IE may identify particular sub-groups of Policyholders whose benefits, without other compensating factors, are likely to be adversely affected. Here we will want to see the IE take into account the Transferor's obligations under Principle 6 (Customers' interests) of our Principles for Businesses.	No such sub-groups.
6.21	When a loss is expected for a subgroup of Policyholders, we will expect to see IE consideration and analysis of alternatives, even if the IE does not consider this loss to be material.	No such sub-groups.
6.22	We will expect to see this analysis even if the IE is able to conclude that the Policyholder group as a whole is not likely to suffer material adverse impact, even if a minority may. For example, we will expect to see this analysis where: <ul style="list-style-type: none"> <li>• some Policyholders within a group/sub-group will suffer higher charges post-transfer because the Transferee has a different charging structure</li> <li>• some Policyholders within a group/sub-group had free access to helplines that will no longer be available or have a significantly altered service after the transfer</li> </ul>	Not applicable
6.23	When an IE is assessing the potential material adverse impacts on various groups of Policyholders, we may feel they have reached their conclusion based on the balance of probabilities and without adequately considering the possible impact on all affected Policyholder groups.	Information only, no requirements
6.24	As a specific example, we might consider the right of Policyholders to make a claim on the FSCS following a cross-border general insurance transfer	Information only, no requirements
6.25	In summary, we expect to see the consideration, evidence of challenge, and reasoning to support the IE's opinion that a change due to the Part VII transfer will not materially and negatively affect a group of Policyholders.	Throughout
Commercially sensitive or confidential information		
6.26	Often the IE will need to consider commercially sensitive or confidential information as part of their decision-making process. In these circumstances, we remind IEs of their duty as an independent expert to consider Policyholder interests, as this information will not be publicly available. Examples include: <ul style="list-style-type: none"> <li>• where 'whistle-blower' information relevant to the scheme received is forwarded to the IE by the firm</li> <li>• where we are aware of enforcement action in progress with one of the Applicants</li> </ul>	Additional information may be provided to the regulators as required.
6.27	In these situations, we expect to see the analysis and the information that is relied on and require it to be sent separately from the IE Report. It is also possible that the Court may want to see this information without it being publicly disclosed. The IE may wish to consider sending a separate document with further details, solely for the Court's use and not for public disclosure. Please note that this is at the Court's discretion.	

Paragraph	Guidance from FG22/1	Section of the Scheme Report
The level of reliance on the work of other experts		
6.28	For large scale and complex insurance business transfers we accept that the IE may rely on the analytical work of other qualified professionals, often to prevent their own work becoming disproportionately time consuming. However, we will still expect the IE to have carried out their own review of this analysis to ensure they have confidence in, and can place informed reliance on, the opinions they draw from another professional's work.	The parties have provided me with the legal and tax advice that they have received.
6.29	We expect the IE to have obtained a copy of relevant significant legal advice given to the Applicants, subject to appropriate arrangements to safeguard any legal professional privilege. This should be in writing or transcribed, and approved by the advisor. It should also be in a final form for the IE to review and rely on it. The IE should reflect this review, and the opinions drawn from the advice, within their report.	Confirmed
6.30	The IE may refer to factors that are outside their sphere of expertise and rely on advice received by the Applicants. They should consider whether or not to get their own independent advice on the relevant issue. This situation occurs most often with legal advice, and we discuss our expectations in further detail below.	1.26
6.31	We accept that it is not necessary for IEs to get separate independent legal advice in all cases. However, we do expect that the IE will have given due consideration to whether or not they need to get their own advice	
6.32	The IE's key consideration is whether it is reasonable for them to rely on the advice and whether their independence is compromised by doing so. Whether or not the legal advisor has acknowledged that it owes a duty of care to the IE will be relevant to this consideration. We may challenge IEs who rely on the Applicants' legal advice and merely state they have no reason to doubt the advice and/or that it is consistent with their understanding of the position or experience of similar business transfers. Our decision to challenge will depend on how complex the legal issue is	These factors have been taken into consideration when reaching the conclusion in 1.26
6.33	In deciding whether to get independent legal advice, we will expect the IE to consider, amongst other things, the following: <ul style="list-style-type: none"> <li>• The significance of the issue and the degree of potential adverse effect on Policyholders if the position turns out to be different from what the legal advice considers likely.</li> <li>• How much the IE relies on the legal advice to reach their conclusions. Also, if they did not rely on the legal advice, will the report contain too little information to justify the view that there is no material adverse impact?</li> <li>• The difficulty, novelty or peculiarity of the issue to the Applicants' own circumstances.</li> <li>• Applicants' proposals to explain to Policyholders in communication documents the issues involved, any uncertainty, and any residual risks.</li> </ul>	
6.34	Alternatively, the IE may need to explain why they consider that they do not need to get independent advice to be adequately satisfied on a point	1.26

Paragraph	Guidance from FG22/1	Section of the Scheme Report
6.35	Finally, the IE should consider the Applicant's contingency plans if the risks identified in the legal advice occur and whether this may create negative consequences for Policyholders. This could require further legal advice to explain how Policyholders may be affected or additional proposals to mitigate the risks.	Not applicable
Ambiguous language or a lack of clarity		
6.42	At the start of the document, the IE should provide a description of where they propose to rely on information provided by the Applicants. We will look for any overly general reliance, as it indicates a lack of critical assessment or challenge	1.22, 1.25
6.43	<p>Some examples we have seen and challenged IEs on include:</p> <ul style="list-style-type: none"> <li>• Where a conclusion in the report is that the IE 'takes comfort' from certain matters, as opposed to 'being satisfied' having taken various matters into account.</li> <li>• Where the conclusion is uncertain. For example, 'I am satisfied that there is no material adverse effect. However...' but it is unclear how the qualification affects or undermines the conclusion.</li> <li>• Where the conclusions are caveated, we will review whether these are reasonable in the circumstances. If the caveats involve areas that the IE has not considered, we will consider if it is reasonable for them not to do further work to satisfy themselves and remove the caveat.</li> <li>• It is also important that the caveat does not undermine the report or the IE's ability to be satisfied on the relevant point. For example, the conclusion may be caveated by 'on the basis of information provided to me'. In these cases, we may ask if the IE should be carrying out their own analysis of the underlying documentation or if they require further information or documentation to be satisfied without making a qualification.</li> </ul>	Information only, no requirements
6.44	<p>In summary, where the report does not seem to reach a clear conclusion, either generally or on a specific issue, the IE report should state clearly:</p> <ul style="list-style-type: none"> <li>• That the IE has considered and is satisfied about the likely level of impact on a specific point. Where uncertainty remains, the IE report needs to include details of, and reasons for, this uncertainty. It should also include any further steps the IE has taken to get clarification, such as seeking further advice from a subject matter expert.</li> <li>• How the IE satisfied themselves about the uncertainty they have identified and how they have formed an opinion on any potential impact.</li> </ul>	Not applicable

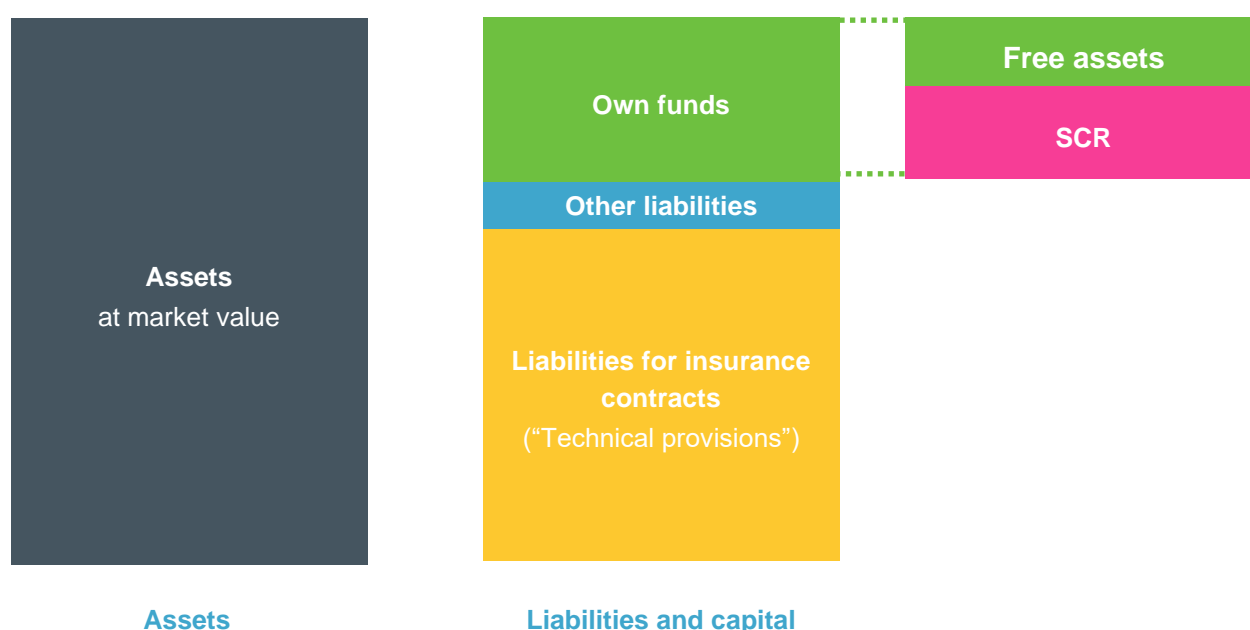
Paragraph	Guidance from FG22/1	Section of the Scheme Report
<b>Demonstrating challenge</b>		
6.45	To ensure the IE report is complete, thorough and considered we expect to see challenge from all involved parties. This includes evidence that Applicants have made appropriate challenges, especially where they believe there are issues the IE has not fully addressed. It is in Applicants' interests to make sure that the Court, regulators and Policyholders can rely on the IE report, taking into account the IE's disclaimers. We consider that Applicants can make these challenges without compromising the IE's independence. We expect a confirmation that the near-final version of the IE's report had the relevant challenge at the time it was submitted.	The parties and their legal advisers have reviewed drafts of the Scheme Report
6.46	To ensure effective two-way challenge we will expect the IE to engage with FCA or PRA- approved senior management function holders at the Applicant firm. This can be senior actuaries, including possibly the Chief Actuary, the CFO or Senior Underwriters.	Engagement through regular meetings and sharing drafts
6.47	The Applicants should also check the draft IE report before submission to the regulators and make sure it is accurate.	Confirmed
<b>Technical actuarial guidance</b>		
6.48	We expect IEs who are both qualified and unqualified members of the Institute & Faculty of Actuaries to pay proper regard to the Technical Actuarial Standards (TAS) published by the Financial Reporting Council, especially those for compiling actuarial reports.	1.32 to 1.34
6.49	The revised versions of the TAS which came into force with effect from 1 July 2017 (TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance) specifically applies to technical actuarial work to support Part VII transfers.	1.32 to 1.34
6.50	It is important to note paragraph 5 of TAS 100 states that actuarial communications should be 'clear, comprehensive and comprehensible so that users are able to make informed decisions understanding the matters relevant to the actuarial information'. We also highlight paragraph 5.2 of TAS 100 which states that 'the style, structure and content of communications shall be suited to the skills, understanding and levels of relevant technical knowledge of users'.	1.32 to 1.34
6.51	Qualified IEs and peer reviewers should also note the Actuaries' Code and Actuarial Profession Standards documents APS X2: Review of Actuarial Work and APS L1: Duties and Responsibilities of Life Assurance Actuaries. IEs and peer reviewers should adhere to the required standards of their professional body at the time when they do the work	1.32 to 1.34
<b>Review of the communications strategy</b>		
7.3	We expect IEs to include consideration of the proposed communications strategy and any supporting requests for dispensations from the Transfer Regulations in their report. We also expect to see evidence that the IE has challenged proposed communications that are not clear and fair and do not adequately explain the transfer and the potential effect on Policyholders and how this is addressed.	Section 11

Source: <https://www.fca.org.uk/publications/finalised-guidance/fg22-1-fcas-approach-review-part-vii-insurance-business-transfers>

## Appendix 6: UK prudential regulatory regime

- A6.1. In this Appendix, we explain in general simplified terms some of the key elements of the current solvency regime for UK-based insurance companies, which is termed “Solvency II”. The regime, which will eventually be known as “Solvency UK”, is currently very similar to that with which insurers in the European Union are required to comply, the EU legislation having initially been written directly into UK law after Brexit. There have been subsequent changes in the UK, as described in Section 12. This Appendix outlines the regime in-force from 31 December 2023, which is expected to evolve further over time, as also noted in Section 12.
- A6.2. An insurer is required to hold assets the value of which exceeds the value of its liabilities, where both assets and liabilities are valued in accordance with the regulations. The regulatory value of assets is generally based on market values while the regulatory value of liabilities is generally assessed on a best estimate market-consistent basis.
- A6.3. In addition to holding assets sufficient assets to cover the value of its liabilities, an insurer must maintain a certain amount of excess assets over and above the value of its liabilities. This works by first calculating the amount of “Own Funds” an insurer has, broadly defined as the value of its assets less the total value of its liabilities. This is then compared to the amount of Own Funds that the insurer is required to have, referred to as the “Solvency Capital Requirement” (“SCR”). I discuss Own Funds in more detail in paragraphs A6.22 to A6.25.

**Figure A6.1 Illustrative insurance company balance sheet**



### Balance sheet liability

- A6.4. Life insurers are required to establish reserves for future benefit payments and expenses, referred to as “Technical Provisions”. Technical Provisions are intended to represent the amount that the insurer would need to pay to immediately discharge its obligations by transferring the business to another insurer in an arm’s length transaction. Since the price of such a transaction is not readily observable in the financial markets, a theoretical transfer value is determined, equal to a Best Estimate Liability plus a component called the “Risk Margin”. The basic tenet of the balance sheet presentation is that it is

market consistent: assets are valued at the values achievable in the market and the Technical Provisions are derived using inputs from financial markets.

### Best estimate liability

A6.5. The Best Estimate Liability (“BEL”) is typically calculated by projecting future cash flows using assumptions that are neither optimistic nor pessimistic. The discount rate that is used to place a present value on these cash flows is equal to the risk-free interest rate, with the basic risk-free rate being based on swap yields. Other methods may be used for certain types of business – for example asset shares are often used in the context of with-profits business.

### Risk Margin

A6.6. The Risk Margin is the amount added to the BEL to bring the Technical Provisions up to the theoretical transfer value. It is calculated based on the idea that, as well as the expected cost of paying the benefits and expenses, the hypothetical insurer taking on the business would also incur the cost of holding capital against those risks that it cannot hedge. The Risk Margin is the present value, using the basic risk-free curve, of the cost, mandated by regulation, associated with holding this capital.

A6.7. “Non-hedgeable” risks primarily relate to insurance risks such as mortality, longevity, persistency and expenses. In practice of course, insurers can take steps to hedge their exposure to these risks by, for example, using reinsurance. The regulations are based on the assumption that the markets for transferring these risks are not sufficiently deep, liquid and/or transparent for the risks to be classed as “hedgeable”. (For the avoidance of doubt, the phrases “hedgeable risks” and “non-hedgeable risks” are not used in the regulations. I used them here only to aid my explanation.)

### Adjustments permitted to the basic approach for calculating Technical Provisions

A6.8. Insurers can apply to the PRA for permission to use a number of adjustments which are allowed under Solvency II, the purpose typically being to ensure a more stable balance sheet position or to smooth in the implementation of Solvency II. The main adjustments include a “Matching Adjustment” and a “Volatility Adjustment”, both of which are adjustments to the risk-free rate used to value certain classes of business, and the Transitional Measure on Technical provisions (“TMTP”).

### Matching Adjustment

A6.9. As described above, the standard approach when determining the BEL is to discount future liability cash flows using the so-called “basic risk-free rate”, this being a prescribed discount rate based on swap yields.

A6.10. For certain lines of business, a Matching Adjustment may be added to the basic risk-free rate when the insurer has regulatory approval to do so. The quantum of the Matching Adjustment is derived from the spread on the assets held by the insurer to back the relevant business.

A6.11. The Matching Adjustment is typically used in the valuation of annuities in payment and deferred annuities. As noted in paragraph 12.11, the PRA is currently consulting on expanding the types of insurance business to which insurers may apply the Matching Adjustment under Solvency UK.

A6.12. Insurers must meet a number of requirements in order to receive regulatory approval to apply the Matching Adjustment.

### Volatility Adjustment

A6.13. For lines of business where the Matching Adjustment is not incorporated in the liability discount rate, insurers may apply for regulatory approval to incorporate a Volatility Adjustment in the discount rate instead.

- A6.14. Like the Matching Adjustment, the Volatility Adjustment is an addition to the basic risk-free rate, although the magnitude of this addition is generally lower for Volatility Adjustment than for the Matching Adjustment.
- A6.15. The requirements for obtaining regulatory approval to use the Volatility Adjustment are generally less onerous than the requirements relating to the Matching Adjustment.
- A6.16. The Volatility Adjustment is most commonly used in the valuation of annuities in payment and deferred annuities (other than those for which the Matching Adjustment is used); certain with-profits liabilities including guarantees, and protection business.

### Transitional Measure on Technical Provisions

- A6.17. Insurers may apply for regulatory approval to use the TMTP in the valuation of business written before Solvency II came into force.
- A6.18. TMTP is a deduction from the Solvency II Technical Provisions. The size of this deduction was initially calculated when Solvency II came into force on 1 January 2016. At this date, the maximum value of the deduction was equal to the difference between the Solvency II Technical Provisions and the Technical Provisions calculated in accordance with the previous regulatory regime.
- A6.19. The size of the deduction was capped so the total FRR under Solvency II, after TMTP had been taken into account, was no lower than the equivalent measure under the previous regulatory regime. The FRR is generally taken to mean the sum of the Technical Provisions, other liabilities and capital requirements. As noted in paragraph 12.10, the PRA intends to remove the FRR test entirely from 31 December 2024, noting that it has been removed on a discretionary basis for some firms recalculating their TMTP at 31 December 2023.
- A6.20. Having established the size of the TMTP on 1 January 2016, insurers are required to linearly reduce its value over the 16-year period from 1 January 2016 to 1 January 2032.
- A6.21. In addition to this gradual reduction, insurers may also apply for regulatory approval to recalculate the value of TMTP to reflect changes in their business, in the financial markets, or other operating conditions. These recalculations generally occur every two years from the start of Solvency II, or following a material change in a firm's risk profile.

### Own Funds

- A6.22. Basic Own Funds are broadly defined as assets less liabilities, less any assets which the insurer cannot take credit for in its solvency assessment, for example assets in ring-fenced with-profits funds. Further adjustments may then be made to an insurer's Basic Own Funds to calculate its Eligible Own Funds, for example removing subordinated debt which doesn't meet certain requirements.
- A6.23. Solvency II ranks Basic Own Funds according to quality based on three properties:
- Loss absorbency: higher quality Basic Own Funds (such as share capital) can absorb losses while the insurer is still a going concern.
  - Subordination: the more subordinated the Basic Own Funds, the higher its quality.
  - Term: longer-dated obligations are higher quality than shorter dated ones.
- A6.24. Based on these properties, the regulations rank Basic Own Funds into four "tiers" as shown in Figure A6.2 below.

Figure A6.2 Tiering of Basic Own Funds

Tier	Typical examples
<u>Unrestricted Tier 1 Own Funds</u> (highest quality)	Share capital, retained earnings
<u>Restricted Tier 1 Own Funds</u>	Perpetual subordinated debt that meets certain criteria, including the ability to absorb losses while the insurer is still a going concern (e.g. by being written down if the firm suffers a stress event)
<u>Tier 2 Own Funds</u>	Dated subordinated debt
<u>Tier 3 Own Funds</u>	Deferred tax assets. Insurers are permitted to include deferred tax assets on their <u>regulatory balance sheets</u> . This increases the excess of assets over liabilities and thus increases <u>Basic Own Funds</u> . However, these <u>Own Basic Funds</u> are considered only to be of <u>Tier 3</u> quality.

A6.25. There are limits around how much Restricted Tier 1 Own Funds, Tier 2 Own Funds and Tier 3 Own Funds may be counted when determining an insurer's solvency. Basic Own Funds that satisfy these limits are referred to as "Eligible Own Funds". The limits are:

- the total amount of Tier 2 Own Funds and Tier 3 Own Funds can be no more than half of the amount of the SCR,
- the total amount of Tier 3 Own Funds can be no more than 15% of the amount of the SCR, and
- No more than 20% of the total Tier 1 Own Funds can be made up of Restricted Tier 1 Own Funds items (any Restricted Tier 1 Own Funds above this amount are re-categorised as Tier 2 Own Funds).

### Solvency Capital Requirement

A6.26. The regulations require an insurer to maintain a level of capital in excess of its Technical Provisions, this being referred to as the "Solvency Capital Requirement" ("SCR"). It is calculated by determining the amount by which the insurer's Basic Own Funds could fall over the course of one year such that the probability that the fall in Basic Own Funds exceeds the SCR is 0.5%. The SCR is sometimes described as the amount by which Basic Own Funds would fall following a "1-in-200 one-year event".

### Standard Formula

A6.27. The SCR may be determined using either a standard model (referred to in Solvency II as the "Standard Formula"), the firm's own Internal Model, or a mixture of the two, referred to as a Partial Internal Model. References below to Internal Models also include Partial Internal Models.

A6.28. The Standard Formula sets out prescribed stresses to each of the main risk categories which impact either the BEL or the value of the assets. Each prescribed stress represents a 1-in-200 one-year event but, since it is unlikely that all of the stresses will occur to this extent at the same time, a process (called "diversification") is applied to produce a lower capital requirement than the amount arrived at by simply adding up the individual capital components.

### Internal Model

A6.29. Since the Standard Formula is intended to be generally appropriate, if firms consider that it does not adequately reflect the nature of the risks to which they are exposed in the context of the controls that they operate, then they may develop an Internal Model to provide a better fit. Using an Internal Model



allows firms to capture a broader range of risks and to carry out more sophisticated modelling to calculate its capital requirements for those risks. The insurer must apply to the PRA for approval to use an Internal Model. The regulations impose tests and standards on a firm's Internal Model and the PRA must consider whether these have been met before granting approval. The Internal Model is not simply about the risk calibration and the capital calculation, but a wider-ranging model of risk governance and management.

### Minimum Capital Requirement

A6.30. As well as the SCR, the regulations also require an insurer to maintain a Minimum Capital Requirement ("MCR") which is typically lower than the SCR. The MCR is calculated as the sum of various components, each of which is a percentage of a particular metric relating to the firm in question such as Technical Provisions, written premiums and administration expenses incurred. This amount is then subject to a floor of 25% of the SCR and a cap of 45% of the SCR, all the while subject to an absolute minimum value of €4.0m (equivalent to c.£3.4m as at 31 December 2022).

### Regulatory intervention

A6.31. If an insurer's Eligible Own Funds fall below the value of its SCR, then it must submit a recovery plan to the PRA within two months which sets out the measures that the insurer intends to take to restore compliance with the SCR within a period of six months.

A6.32. If an insurer's Eligible Own Funds fall below the value of its MCR then it must submit a short-term finance scheme to the PRA within one month which must restore compliance with the MCR within a period of three months. If the PRA regards the finance scheme as being "manifestly inadequate", or if it subsequently transpires that the finance scheme fails to restore compliance with the MCR within the three-month period, then the PRA will withdraw authorisation to carry on insurance business.



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