High Court of Justice

Equitable Life Assurance Society

Summary Report of the Independent Expert in relation to the proposed Scheme of Arrangement under Part 26 of the Companies Act 2006

KPMG LLP

This summary report contains 33 pages including appendices.

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1 Introduction

1.1 Introduction

In order to ensure continuing solvency, the Society must hold back assets in order to meet its statutory capital requirements. Since the Society is in *run-off*, the requirement to hold these assets back means that it will become difficult to distribute assets fairly and quickly amongst the with-profits policyholders over time. In addition, as the number of policies reduce, it becomes difficult to reduce expenses in line with how policies *run-off*, and expenses per policy could rise.

Equitable Life Assurance Society ('ELAS' or 'the Society' or 'Equitable Life') has therefore proposed a Scheme of Arrangement ('the *Scheme*') under Part 26 of the Companies Act 2006 to convert the UK and Irish ELAS with-profits policies into unit-linked policies. Additionally, ELAS has proposed that Utmost Life and Pensions becomes the sole *Member* of ELAS via a change in the articles of association, and that almost all of the policies in ELAS will be transferred to Utmost Life and Pensions via a *Part VII Transfer* under the Financial Services and Markets Act 2000. This transfer is considered by another Independent Expert, and does not form part of my scope. Irish law governed and German law governed policies are excluded from the *Part VII Transfer* and will remain in ELAS.

In return for giving up their right to a future claim on with-profits assets and any valuable *Investment Guarantees,* and being converted to unit-linked, with-profits *Scheme Policyholders* will receive an uplift to their policy. Note that throughout this report, when 3.5% Guaranteed Investment Return ('GIR') policies are referred to in the text, those references also relate to the few 2.5% GIR policies that exist.

If the required majorities of *Scheme Creditors* vote in favour of the *Scheme*, and *Members* vote to change the articles of association, and the transfer goes ahead, then it would have the following impacts on:

UK, Irish and International with-profits policyholders:

— *Investment Guarantees*, including any guaranteed increases, will be removed

— some guarantees (e.g. Guaranteed Minimum Pensions) will be maintained

— policies will be converted to unit-linked

— *Members* of the Society will, as a result of the conversion to unit-linked policies and the change in the articles of association, lose all membership rights

— the unit-linked policies will have a value reflecting the value of their policy enhanced by a fair share of assets available for distribution

— policyholders will be offered a choice of investment options for their new unit-linked policies

— Utmost Life and Pensions will become the sole *Member* of ELAS

— UK and international business (i.e. polices written for residents of Guernsey, Jersey and other countries outside of the UK, Germany and Ireland) will be transferred to Utmost Life and Pensions under the *Part VII Transfer.*

German UK-style with-profits policyholders (not part of the Scheme):

These policies are German with-profits policies which are issued under German law with benefits and rights to participate in the profits and losses of ELAS in a similar way to UK with-profits policies in-force as at the *Implementation Date*.

Although not part of the *Scheme*, if the *Scheme* goes ahead, ELAS will change how it manages the German UK-style with-profits policies as follows:

— the value of with-profits policies will be uplifted to reflect a fair share of with-profits assets available for distribution

— *Investment Guarantees* will be maintained as will any other guarantees

— *Members* of the Society will, as a result of the change in the articles of association, lose all membership rights

— market returns with no material smoothing will be applied to the policies in the future

— Utmost Life and Pensions will become the sole *Member* of ELAS.

ELAS has confirmed that the other German with-profits policies (German-style with profits policies) are not entitled to the uplift, and their benefits are unaffected by the *Scheme*. As a result of their policy terms, these contracts are effectively managed as if they were non with-profits policies, in accordance with a business plan agreed with German regulators.

The *Scheme* would have no impact on all other non with-profits policies.

The *Scheme* and the *Part VII Transfer* are expected to be implemented as at 1 January 2020.

ELAS has appointed me, with the approval of the Financial Conduct Authority ('FCA'), as the Policyholder Independent Expert ('PIE'), and my role covers the impact of the *Scheme* on its policyholders. My role includes consideration of the fairness of the whole *Scheme* for all with-profits policyholders of Conventional With-Profits ('CWP') policies and Recurrent Single Premium ('RSP') policies, including members of the Free Standing Additional Voluntary Contributions ('FSAVC') scheme, life RSP policies and individual and group RSP pensions. It also includes the impact of the *Scheme* on those policyholders who are excluded from the *Scheme* (i.e. German with-profits policies, unit–linked policies and non-profit policies).

My Independent Expert's report is primarily addressed to the High Court, in order to give the High Court my opinion as PIE on the effects of the *Scheme* on the ELAS policyholders. I recognise that the High Court will use this report in connection with the discharge of its statutory functions concerning the *Scheme*.

This summary of my Independent Expert's report is for inclusion in the documentation to be distributed or otherwise made available to policyholders, as envisaged in SUP 18.2.48G.

I will also produce a *supplementary report*, to be issued in advance of the *Sanction Hearing*. My *supplementary report* is a report produced after this report, and before the *Implementation Date*, to consider the impact of events or decisions that have occurred subsequent to the release of this report.

1.2 Independence and qualifications

I am a Fellow of the Institute and Faculty of Actuaries in the UK and have over 28 years of experience of working in the life insurance industry. I am the holder of a Chief Actuary (Life) practising certificate issued by the Institute and Faculty of Actuaries which permits me to carry out certain reserved actuarial functions relating to life insurance business in the UK.

I have carried out this work as a Partner of KPMG LLP in the UK. Neither I nor any member of my family is a policyholder of Equitable Life. Neither I nor any member of my family has any other financial relationship with Equitable Life. KPMG LLP has carried out no other work for Equitable Life during the period covered by my work as the PIE for this *Scheme*.

Neither I nor any member of my family is a policyholder of Utmost Life and Pensions or any company of Utmost Group of Companies, the owner of Utmost Life and Pensions. Neither I nor any member of my family hold any shares or financial interest in any Utmost Group of Companies or Oaktree Capital Management, a firm that provides capital to Utmost Group of Companies. I utilise the Hargreaves Lansdown platform, but do not own any shares or other interests in Hargreaves Lansdown. Neither I nor any member of my family holds any shares or financial interest in Jardine Lloyd Thompson, who will be providing guidance and support to Equitable policyholders.

1.3 Reliance and limitations

In carrying out my work I have relied on the accuracy and completeness of information and data provided to me by the Society, both written and oral. I have considered the information for consistency and reasonableness based on my general knowledge of the life insurance industry but unless specifically stated I have not otherwise verified the information.

At the same time I have relied on the Society's internal systems and controls in place when producing the inputs for my analysis (data as at 31 December 2017 and 31 December 2018), and have not carried out a specific review of these.

I have also relied upon the governance structures of the Society, which includes the use of external independent reviews and internal peer reviews, along with formal sign offs, challenge at senior committee levels and second and third line of defence reviews. Specifically, I have relied on the fact that the Society has a Board of Directors, the majority of whom are independent of the Society with no financial interest in the outcome of the *Scheme* and who have specific regulatory and fiduciary responsibilities by being both company directors and approved persons under the insurance regulatory regime. The governance structure of the Society also includes a With-Profits Sub-Committee, with an independent actuary as a member, that considers matters affecting the with-profits policyholders, and provides a further check in terms of such matters. Finally I have also relied upon the fact that the executive management team has no financial incentive in relation to the outcome of the *Scheme*.

I am not an expert in legal matters and hold no qualifications in UK law (insurance regulations or otherwise). I am not therefore in a position to opine on legal matters. However given the nature of the role that I have been asked to perform, it is important that I understand the context of the Society's proposals. In order to ensure that I have an understanding of these legal issues, the options available to me are either to retain my own legal advisors to provide advice to me and carry out a legal review, or to utilise the advice of the Society's legal advisors, Freshfields Bruckhaus Deringer LLP ('Freshfields'), and the counsel that they consulted, on a strictly confidential basis and without any waiver of the Society's legal professions privilege in that advice.

For all relevant matters I considered each one individually but I did not consider that it was necessary for me to obtain independent legal advice for my role. I consider that it was appropriate for me to utilise the advice provided by Freshfields and the counsel consulted by the Society. My rationale for this is:

— Freshfields is a large international law firm and their staff and partners have deep experience in UK insurance law. This experience covers Schemes of Arrangement more generally as well as ones involving UK insurance companies. It is my opinion that they have appropriate qualifications and knowledge relevant to this proposed *Scheme*;

— The information from Freshfields that I have utilised is largely factual and, in particular, covers the terms and conditions of policies that are relevant to the structure of the *Scheme*. I am satisfied that the information and analysis provided by Freshfields is not materially different to the information and analysis that I would have received if I were to have retained my own legal advisors in respect of the proposed *Scheme*;

— The counsel consulted are experts in their fields and I am satisfied that the opinions they provided are not materially different to any opinion I would have obtained were I to have retained separate counsel in respect of the proposed *Scheme*.

It is important to note that Freshfields and the counsel consulted by the Society have not been retained by me and therefore have no liability to me for any information and analysis they have provided which has been made available to me.

I have consulted Freshfields in relation to the legal effect of the *Scheme* in England and other jurisdictions and the mechanisms for the approval of the Scheme.

Aspects of the financial position of the Society pre-*Scheme*, specifically the Best Estimate Liabilities and assumptions underlying these, have been subject to external audit. While other components of the financial projections that have been considered in the analysis in my report have not been subject to external audit, they have been subject to a formal review process within the Society. I am satisfied that it is reasonable to rely on the accuracy of these figures.

Where the transfer of assets to Utmost Life and Pensions and its related companies will take place post *Scheme*, I have relied on the governance arrangements at the Society and, in particular, the relevant independent reviews of any transfers of assets to ensure that they are in compliance with the *Part VII Scheme Document* that will be in place.

2 Executive summary and conclusions

2.1 Overall conclusions on the *Scheme*

I have reviewed the proposed *Scheme* and the corresponding voting arrangements, and I have considered all of the relevant aspects which may impact the policyholders of ELAS.

The *Scheme* ensures that all of the available assets for distribution are distributed amongst the eligible with-profits policyholders as soon as possible. This deals with the *tontine* effect which occurs with the *run-off* of closed with-profits funds, namely that increasing amounts of capital are distributed to policyholders staying for a longer duration, as assets are held back to cover the capital requirements.

Note that increasing amounts of capital may not necessarily be distributed to policyholders staying for a longer duration. Capital must be held in respect of the risks that the with-profits fund continues to face, but if those risks materialise the associated costs will have to be met by that capital and, in ELAS' case, any excess costs not met by that capital would have to be met by reducing policyholder benefits (through a reduction in the Capital Enhancement Factor in the first instance). The *Scheme* mitigates the risk of this happening.

Overall, I conclude that the *Scheme* is fair. I consider it appropriate that in order to fully distribute all of ELAS' available assets in the form of an uplift to the *Policy Value*, the removal of the *Investment Guarantees* (including any guaranteed annual increase) and switching rights is required. I consider that conversion to unit-linked is an appropriate solution.

My conclusions in respect of the effects of the *Scheme* on the *Scheme Policyholders* are summarised below:

— The Society has considered the likely relevant alternatives to the *Scheme*, including sale, merger, outsourcing, full wind-up, and conversion to non-profit, with a view to ensuring the most appropriate option is taken. Based on my analysis, which is outlined in my full report, I conclude that the *Scheme* is the most appropriate option for policyholders to consider against *run-off*.

— The Society currently distributes capital (the capital distribution) to with-profits policies via the Capital Enhancement Factor ('CEF'). The structure of the proposed uplift available under the proposed *Scheme* is consistent with the way the CEF is currently applied to *Policy Values*, and to CWP policies, and is a fair approach.

— I agree with the Society's reasons for not compromising the guarantees in respect of Guaranteed Minimum Pensions ('GMPs'), Guaranteed Annuity Rates ('GARs'), and certain insurance benefits, noting that it is not legally possible to compromise the GMPs. The impact on the uplift of not compromising the GARs and insurance benefits is not materially different from that if they were to be compromised.

— I have considered the differences in the extent to which different groups of policyholders could be better off under the *Scheme.* I conclude that the uplift is a fair outcome.

— I consider the approach to calculating the assets available for distribution to be appropriate.

- The assumptions and judgements used in the calculation of the uplift and *run-off* calculations are reasonable, and in particular I note there is no management bias in relation to treating one type of policyholder differently to another.
- The models used in the calculation of the uplift and fairness tests have been through appropriate checks and governance.
- For sterling based funds, the investment options and charges in place for the first six months after the *Implementation Date* are reasonable, and in line with market practice. After these six months, for pension policyholders that do not make an investment choice, the funds are assumed to transition to an age based investment in either a *Multi-Asset Moderate Fund*, *Multi-Asset Cautious Fund* or the *Money Market Fund*, over a further six months, which I consider to be reasonable. The charges on these funds are in line with what can be seen in the market.
- I have considered the default funds, and additional investment funds that are being developed, and believe these to adequately cover a range of potential risk appetites that policyholders may have, and in particular, I consider the broad asset mixes within the default funds to be appropriate.
- Euro and US dollar denominated *Scheme Policies* will have a limited choice of funds to choose from. Given the very small size of the relevant funds it is not economic for all ELAS policyholders to finance multiple funds being set up, and at the same time the ongoing costs of management which the Irish and Euro policyholders would have to bear in the fund would also become large and uncompetitive in such funds. In such a situation it seems sensible in my view to offer both a low risk option for the affected policyholders and an option that provides some potential for growth.
- The Irish *Scheme Policies* investing in the *Irish Managed Fund* will be exposed to more currency risk than currently. I understand the rationale for the choices that are offered, and confirm that *Scheme Policyholders* have had clear communications with regard to the limited choices and risks attached.
- Utmost Life and Pensions will guarantee that the charges on the *Secure Cash Investment Fund* will not exceed 50bps, and will not be higher than the return (i.e. the unit price will not decrease below that at the *Implementation Date)*. The annual management charges on the unit-linked funds will not exceed 100bps in any circumstances, and the charges will be no more than 75bps except under certain circumstances. I consider this to be fair.
- The criteria against which the Society checks the fairness of the uplift are reasonable, and consistent between groups of policyholders.
- The timelines and arrangements for voting are as I would expect.
- I have considered the analysis performed by Freshfields to determine that policyholders can form a single class, and I have not found any reason to regard this analysis and conclusion as inappropriate.
- I agree with the Society's analysis that the trustees of group schemes are the *Creditors* and *Members* of the Society. I also agree that it is impractical to allow each member of a group scheme (where the trustee is a policyholder) to vote. I note however that it is Equitable's intention to allow group policies to split their vote if they wish. This allows for a more accurate and fair representation of beneficiary views.
- In my view, the Society has spent an appropriate level of resource on trying to trace policyholders where it does not have valid addresses, and I consider the actions by the Society to be fair. In addition, the materiality of the dormant assets is currently low. Experience shows that customers contact the Society when they want to take their benefits.

I therefore consider it likely that the dormant assets will remain low, noting that this may not be the case. I consider the Society's approach to the treatment of these policies to be reasonable.

— Those policies which expire through death or mandatory contractual termination between the *Sanctions Hearing* (assuming the *Scheme* is approved) and the date that the uplift and other changes under the *Scheme* are implemented, when the policyholder is unable to change this situation, will receive the uplift. I consider the approach to these policies (*legacy policies*) to be fair.

— I consider it fair to apply the uplift to the premiums paid between 31 December 2014 and 31 December 2017. I also agree that those policyholders who are still paying premiums at the cut-off date of 31 December 2017 should be compensated for the potential future loss of GIRs on the premiums they may have carried on paying into the future.

— Parallel court schemes are being carried out in both Guernsey and Jersey to cover policies in those jurisdictions, and I consider it fair that the terms of the transfer are the same as that used for the *Scheme Policyholders*.

— I will conclude on the processes and governance surrounding the calculation of the uplift, and I will confirm whether they are adequate to ensure that the results are complete, accurate and consistent with the intended methodology, in my *supplementary report*.

My conclusions in respect of the effects of the *Scheme* on the German UK-style policyholders:

— The reasons for not bringing these policyholders into the *Scheme* are valid.

— The treatment of these policyholders is fair both in respect of these policyholders and on those who are in the *Scheme*. In particular, the allocation of assets to these German UK-style with-profits policyholders is fair.

— I consider that the draft Principles and Practices of Financial Management ('PPFM') provides adequate protection for policyholders.

My conclusions in respect of the effects of the *Scheme* on the German-style with-profits and non-profit, including unit-linked policyholders:

The Chief Actuary has confirmed that there is no material adverse impact on benefit expectations of the Society's non-profit policies, including unit-linked, and German-style with-profits policies, as a result of the *Scheme*. I have considered the report prepared by the Chief Actuary, and agree with his conclusions.

Other areas for consideration:

Assuming that the *Scheme* is approved by the Court and voted for by the policyholders, there is a risk that the uplift changes potentially materially for *Scheme Policyholders*, between the date of calculating the uplift disclosed to policyholders via their personal illustrations, and the *Implementation Date*. The timing of when policyholders voluntarily exit could also have an impact on the uplift; if fewer policyholders leave than expected, then the uplift will be spread over more policies and hence be lower (and vice versa). I consider that the *Scheme* will, however, still be fair and reasonable, and the expected likelihood of a material change in the uplift is low.

The risk that arises due to market fluctuations is largely mitigated as the assets are expected to all be in cash at that stage.

If the *Scheme* does not proceed for any reason, then I conclude that there will be no material effect on benefit expectations and that there will be no material effect on the security of benefits. However, the existing issues that exist currently under *run-off* will continue to exist.

Of the communications and personalised projections I have reviewed, the Society has incorporated my comments and I am satisfied that this communication is appropriate for policyholders and communicates information in an unbiased way.

I consider the level of support available in respect of guidance and advice to be appropriate, the subsidies available to be fair, and the costs involved to not be material in relation to the overall uplift.

2.2 The rationale for the *Scheme*

In order to ensure continuing solvency, the Society must hold back assets in order to meet its statutory capital requirements. It must also invest in lower risk investments which have a lower expected return, in order to avoid potential swings in solvency due to the more volatile returns that higher risk investments exhibit. Since the Society is in *run-off*, the requirement to hold these assets back means that it will become more difficult to distribute assets fairly and quickly amongst the with-profits policyholders over time. There is also a risk that more policyholders delay retirement, and the taking of their policy benefits, making the *Investment Guarantees* more onerous, thereby making it harder to distribute the assets fairly and quickly. The financial impact of this risk is higher when interest rates are low, as they are today, and where policies have longer to go. In addition, as the number of policies reduce, it becomes difficult to reduce expenses in line with the *run-off*, and expenses per policy could rise.

Part of these assets are distributed through the capital distribution which is applied when the policyholder takes their benefits.

The capital distribution is set by ELAS such that there is an acceptably low risk of having to cut future distributions in order to protect the interests of policyholders taking benefits in the longer-term. However, judgement is required to avoid the development of any *tontine.* Setting a capital distribution at too low a level works against the interests of policyholders taking benefits in the short-term by withholding capital from leavers and exacerbates the development of a *tontine*.

There is, therefore, an inevitable tension between achieving a stable level of capital distribution, and distributing capital as soon as possible.

The *Scheme* aims to deal with these issues, as the assets which cannot currently be distributed will be allocated to the with-profits policies, which will then immediately convert to unit-linked policies. When a policyholder chooses to take their benefits after the *Implementation Date*, these amounts will form part of their benefits. For all with-profits policies, this increased benefit if taken as at the *Implementation Date,* is higher than they would receive if the *Scheme* did not go ahead (based on the current level of capital distribution).

Additionally, under the *Scheme*, policyholders can choose an investment fund appropriate to their needs, with the potential of earning additional returns by investing in higher risk assets than are currently invested in by the with-profits fund. For example, equities are expected to earn higher returns than bonds over the longer term, but equity returns are more volatile with a higher likelihood of going down in value. Such investments, with the possibility of achieving higher returns, are not held by the Society for its with-profits business due to the capital that would have to be retained to protect the *Investment Guarantees* against the chance that asset values might fall.

I consider it appropriate that in order to fully distribute all of ELAS' available assets in the form of an uplift to the Policy Value, the removal of the Investment Guarantees (including any guaranteed annual increase) and switching rights is required. I consider that conversion to unit-linked is an appropriate solution.

Further detail can be found in section 6.1 of my full report, and my analysis can be found in section 10 of my full report.

2.3 Process and timelines

In order for the Court to be able to sanction the *Scheme*, ELAS must determine whether policyholders affected by the *Scheme* constitute a single class or multiple classes. The Society has proposed that all policyholders who will be subject to the *Scheme* can form a single class of *Creditors*. The relevant legal test requires that a class must be *"confined to those persons whose rights are not so dissimilar as to make it impossible for them to consult together with a view to their common interest"*, having regard to how those legal rights are treated under the *Scheme*.

For group pension schemes, in most cases it will be the trustees of the group schemes who have the legal right to vote on the *Scheme* rather than the scheme members. Group scheme trustees are able to split their vote in a way that represents the preferences of their members.

There are two parts to the *Proposal*:

Part one is:
- to increase with-profits *Policy Values* with an immediate one-off amount
- to remove any *Investment Guarantees* and switching rights
- to convert with-profits policies to unit-linked policies.

Part two is to transfer almost all of the Equitable's business to Utmost Life and Pensions.

This would happen through three separate processes which are expected to occur simultaneously:

1. The Scheme of Arrangement

The *Scheme* is an agreement between the Equitable and its *Scheme Policyholders.* It is a legal process, supervised by the Court, which can only go ahead if it is approved by a vote of the *Scheme Policyholders*, the change to the articles of association is approved by eligible *Members* (see below) and the *Scheme* and *Part VII Transfer* are approved by the Court.

2. Change to the articles of association

Eligible *Members* will be asked to vote, at an Extraordinary General Meeting ('EGM'), on the proposal to make Utmost Life and Pensions the sole *Member* of the Society, following the conversion of the non-German with-profits *Members* to unit-linked.

3. *Part VII Transfer* of the Society and almost all its policies to Utmost Life and Pensions

The Transfer is a legal process which will need approval from the Court before it can go ahead. The *Scheme* will not go ahead if the Court does not approve the *Part VII Transfer*. Under the *Part VII Transfer*, UK *Scheme Policies* will be transferred to Utmost Life and Pensions immediately after conversion to unit-linked policies. Almost all other ELAS policies will also transfer to Utmost Life and Pensions at the same time under the *Part VII Transfer*.

The voting arrangements, and timelines are set out below:

Date	Target Milestone
22 July 2019 (Jersey w/c 29 July 2019)	*Convening Hearing (first court hearing)*
30 September 2019	*Calculation Date*
1 November 2019	*Policyholders' Meeting*
1 November 2019	EGM
22 and 25 November 2019	*Sanction Hearing (second court hearing)*
Week commencing 25 November 2019	*Scheme Effective Date*
1 January 2020	*Implementation Date*

The ***Convening Hearing*** - the Society will ask the Court for:

- (i) permission to call a meeting of the *Scheme Policyholders* (the *Policyholders' Meeting*)
- (ii) confirmation of the class analysis, i.e. that the *Scheme Policyholders* can vote as one class and
- (iii) approval of the proposed method of notifying *Scheme Policyholders* of that meeting.

The policyholder *Decision Pack*, including a personalised illustration and the voting form, will be issued after the *Convening Hearing*, along with a detailed explanation of the terms of the *Scheme* and details of the *Policyholders' Meeting*.

The ***Calculation Date***

— The *Secondary Percentage Uplifts* (the additional uplift percentage applied above the *Primary Percentage Uplift* to reflect the policyholders' *residual value of guarantees* which are being given up) and fairness adjustments are fixed as at the *Calculation Date.*

The ***Policyholders' Meeting***

— If the *Scheme Policyholders* vote in favour (in the requisite majorities) at the *Policyholders' Meeting* and the conditions of the *Scheme* are met, the *Scheme* needs to be subsequently approved at the second court hearing (the *Sanction Hearing*).

— There will be an EGM vote held immediately after the *Scheme* vote, in the same location, to approve the changes to the articles of association. This must be passed in order for the *Scheme* to go ahead.

— Group scheme trustees will have a single vote at the *Policyholders' Meeting*, but they have the option to split the value of that vote by percentage in a way that represents the preferences of their scheme members. Regarding the vote on the articles of association, group schemes can have up to 10 votes (one vote per £1,000 sum assured up to a maximum of 10), which they can split in favour or against the change to the articles of association, however they cannot split their vote if they only have one vote.

— Group scheme trustees are entitled to split the element of their vote in any proportion that they see fit, in order to best reflect the underlying beneficial interests of the members. The voting mechanics implicitly allow for this. Where group trustees split their vote, then for the vote count their single vote will be counted twice, once for and once against the Scheme, whilst their Voting Value will be split in the chosen proportions.

The *Scheme Effective Date*

The date on which the *Scheme* order is delivered to the Registrar of Companies in England and Wales for registration in accordance with the *Scheme*.

The ***Implementation Date*** will be

— (a) the date on which the substantive aspects of the *Scheme* (uplift, *Scheme Policies* become unit-linked, and the removal of *Investment Guarantees* and switching rights) come into effect;

— (b) the date the change to the Equitable's Articles of Association becomes effective;

— (c) the date the *Part VII Transfer* becomes effective; and

— (d) the date on which the *Primary Percentage Uplifts* (the minimum level initial percentage uplift that each *Scheme Policyholder* would receive) are fixed.

2.4 Impact of the *Scheme* on with-profits policyholders

The effect of the *Scheme* for *Scheme Policyholders* is to remove *Investment Guarantees* and convert the with-profits policies to unit-linked policies. The aim is to create a fairer and more equitable distribution of assets. A necessary step to achieve that is the removal of the *Investment Guarantees*. *Members* of the Society will, as a result of the change in the articles of association, lose all membership rights.

The outcome for policyholders will depend on the expected date that they will take their benefits (which may depend on age), and the type of policy and benefit. For example, death benefits on CWP policies cannot be reduced from the benefit available immediately pre-*Scheme*, and RSP policies with valuable *Investment Guarantees* will be compensated for giving up these *Investment Guarantees*. The outcomes are discussed in more detail below, and further detail can be found in section 6.3 of my full report and my analysis can be found in section 10.2 of my full report.

2.4.1 RSP and CWP policies

In return for giving up rights to a future claim on with-profits assets and for giving up *Investment Guarantees*, all assets available for distribution (less costs) will be distributed to *Scheme Policyholders* in the form of an uplift to their current *Policy Value* for RSP policies, and surrender value for CWP policies.

For CWP policies the minimum death benefit is maintained at the level immediately pre-*Scheme*, and does not change over time, even if the value of the unit-linked policy reduces to zero, as long as the policyholder continues paying the current contractual premiums.

There are many considerations, both positive and negative, to take into account when considering the impact on the potential benefits. Although the *Scheme* does address the issues around the *tontine*, it does mean that with-profits policyholders will be giving up their *Investment Guarantees*, and it is possible that, in some instances, they could get back less than they would have done under *run-off*.

In concluding whether the *Scheme* was fair in the round, I considered the following impacts on *Scheme Policyholders*:

— Those policyholders who expect to maintain their policy for longer, and who may have benefitted more from the *tontine* effect, such that in the longer-term they may potentially be better off under *run-off*, are exposed to significant uncertainty as to the value that will be received under *run-off*. There is also a risk that more policyholders may defer taking their benefits, and as such there would be less to distribute, so that policyholders remaining longer may not benefit as much from the *tontine* as they may have anticipated.

— If the *Scheme* does not go ahead, the Society will have to address the developing *tontine*, and there is uncertainty in relation to:

  — when any actions to address the *tontine* will occur

  — what form any actions to address the *tontine* will take

  — the impact of any expense levels on the fund

  — whether any future buyer for the Society would be found, and what it would charge for providing the capital support.

— With-profits policyholders will be giving up their *Investment Guarantees*, and it is possible, under some instances, they could get back less than they would have done under *run-off*. This depends on, amongst other things, the investment decisions they make, and returns achieved post *Scheme*. Although there are scenarios where policyholders may get back less than they would have done under *run-off*, the Society has used fairness indicators to assess that the allocation of the uplift is fair. My views on these can be found in section 11.4 of my full report. ***In my view the Secondary Uplift is fair compensation for giving up the Investment Guarantees, and it reflects the reserves that the Society would itself hold in respect of the potential claims.***

— Policyholders who have maintained their premium paying status will lose any *Investment Guarantees* they might have received on future premiums. Premiums paid between 31 December 2014 and 31 December 2017 receive no capital distribution, but the uplift will apply to these premiums. The uplift on premiums paid between 31 December 2014 and 31 December 2017 materially covers the value of lost *Investment Guarantees* on the expected future premiums and, in the few cases where it does not, the Society will include an addition to the *Secondary Uplift* to compensate for this.

— Policyholders will have more control over the way the uplifted value of their policy is invested, and this uplift is significantly more than the current 35% CEF (i.e. the capital distribution) available now. Part of the uplift will be given in exchange for the value of the *Investment Guarantees* that the policyholder is giving up, and as such, a risk averse policyholder could choose to invest in less risky assets to better match their risk appetite and maintain more certainty around the benefits they receive, but gain the flexibility of when the value can be taken. In the normal course (i.e. without the *Scheme*) the *Investment*

Guarantee is available once pension policyholders reach a specified age (on or after this date), on specified dates for life policies, or on death or maturity for CWP policies. It should be noted that a less risky asset strategy could result in low returns which could be less than inflation.

— The CEF is variable and is not guaranteed, so there is no certainty that it would be paid in time, or at what level, if the Society continued in *run-off*.

— Policyholders whose market consistent value of *Investment Guarantees* after the *Primary Percentage Uplift* is higher than the uplifted *Policy Value* (i.e. they have a *residual value of guarantees*), gain by getting this value with effect from the *Implementation Date,* and the funds will be available immediately (or after age 55 for pensions policies). In the normal course (i.e. without the *Scheme*) the *Investment Guarantee* is available once pension policyholders reach a specified age (on or after this date), on specified dates for life policies, or on death or maturity for CWP policies. A further benefit is that the *Investment Guarantees* are valued at a time of historically low interest rates.

— Policyholders who have no *residual value of guarantees* will benefit from getting an uplift which is significantly more than is likely to be received in the short to medium term (around 5 – 10 years) under the existing *run-off* plan.

— Similarly, policyholders who are expected to take their benefits in the near future (under 5 years), whether by choice or due to retirement or maturity, are expected to be better off as the CEF is unlikely to reach the level of the uplift in the next 12 years.

— Overall, the current asset mix of the with-profits fund has a low expected return due to being comprised of mainly gilts and some corporate bonds. As a result of the *Scheme*, policyholders will have the option of investing in assets with a higher potential return, but with the risk of higher volatility.

2.4.2 GARs, GMPs and certain insurance benefits

Guaranteed Minimum Pensions (‘GMPs’), Guaranteed Annuity Rates (‘GARs’), and certain insurance benefits, including CWP death benefits, are not being compromised. However, the *Investment Guarantees* on these policies will be compromised and, in exchange for giving up these *Investment Guarantees*, these policyholders will receive an immediate uplift to *Policy Values*.

The Society has decided not to compromise GARs, which will apply to the unit value in the same way that it applied to the *Policy Value* pre-*Scheme*. The CWP death benefit will be the greater of the death benefit as at the *Implementation Date*, and the *Policy Value*.

The Society has decided not to compromise insurance benefits, which remain materially the same as pre-*Scheme*. For CWP policies the minimum death benefit is maintained at the level immediately pre-*Scheme*, and does not change over time, even if the value of the unit-linked policy reduces to zero, as long as the policyholder continues paying the current contractual premiums.

GMP benefits cannot be compromised, and would continue to apply to the policies post *Implementation Date* and transfer to Utmost Life and Pensions

I agree with the Society’s reasons for not compromising the guarantees in respect of Guaranteed Minimum Pensions (‘GMPs’), Guaranteed Annuity Rates (‘GARs’), and certain insurance benefits, noting that it is not legally possible to compromise the GMPs.

The impact on the uplift of not compromising the GARS and insurance benefits is not materially different from that if they were to be compromised.

2.4.3 German UK-style with-profits policies

The Society considers that, under German law, German policyholders would not be able to be the subject of a Scheme of Arrangement. Instead the German UK-style with-profits policies will remain in a separate ring-fenced with-profits fund within the ELAS legal entity.

All German UK-style with-profits policies in force at *Implementation Date*, that had a claim on the surplus in the ELAS with-profits fund as at 31 December 2017, will be allocated their share of assets, their *Policy Values* will increase by an amount equivalent to the *Primary Uplift*, and their guarantees will be maintained. The German UK-style with-profits policies will remain in an ELAS with-profits sub-fund, and inter-fund reinsurance arrangements will be put in place to ensure the assets are notionally ring-fenced. This is because policyholders are entitled to the assets specifically backing their policies but not the general surplus within ELAS post-*Scheme*. Only the German UK-style with-profits policies are entitled to share in the assets in that notional ring-fenced fund so that they are not exposed to any of the liabilities and risks of ELAS outside that notional ring-fenced fund.

The assets backing GARs, the *Investment Guarantees* and the German-style with-profits policies will also be held in the ELAS with-profits fund, and the ELAS main fund bears the risks associated with these liabilities via an inter-fund reinsurance arrangement.

It is noted that German policies do not have switching rights.

My conclusions in relation to the approach to the German UK-style business, are as follows:

1. ***I agree that this business should not be part of the Scheme.***

2. ***I consider that the valuation of this business in respect of the impact on the assets available for distribution is reasonable.***

3. ***I consider the approach to determining the benefits on this business post Scheme to be fair.***

4. ***The allocation of capital to UK-style German with-profits is done via an enhancement to Policy Values (equivalent to the Primary Percentage Uplift) and these assets are allocated to a notionally ring-fenced fund in the ELAS with-profits sub-fund. Any assets held to meet the residual value of guarantees are used to cover the Investment Guarantees, and as such are not used to enhance Policy Values. I consider this to be fair.***

5. ***I consider that the draft PPFM provides adequate protection for policyholders.***

2.4.4 Investment options and charges

From now up until the *Implementation Date*, the Society will continue to adopt a cautious investment approach. At the *Implementation Date* UK unit-linked policyholders will be given a range of fund choices, based on the Society's current range of unit-linked funds plus at least four new funds.

All policyholders will have their funds invested in the *Secure Cash Investment Fund* before or at the *Implementation Date*. Policyholders who do not select an investment fund at the *Implementation Date*, will have their funds invested in the *Secure Cash Investment Fund* for the first six months. The *Secure Cash Investment Fund* will consist of a cash fund with a maximum annual management charge of 50bps, under which the unit price is guaranteed not to reduce below the price on the *Implementation Date* until the funds are transferred out of that fund. This will provide policyholders sufficient time to consider where their investments should be in the long term, without the risk of losing money. With-profits policyholders who make no fund choice within six months, will be gradually moved over the next six months into a default strategy constructed from one or more of the new funds or the *Money Market Fund*.

For these policyholders who do not select an investment fund at *Implementation Date*, Utmost Life and Pensions shall provide sufficient information in respect of the alternative funds the policyholder can invest in to allow them to elect an alternative fund should policyholders wish to do so. As such, Utmost Life and Pensions shall agree a policyholder communication strategy with the Society which will include communication with the policyholders at least twice during the first six months. I will comment on this agreement within my *supplementary report*.

The annual management charges on the unit-linked funds will not exceed 100bps in any circumstances. These charges will be no more than 75bps unless one of the following applies:

— The charge on the existing unit-linked fund at the *Implementation Date* is more than 75bps

— Utmost Life and Pensions' costs increase materially due to regulatory action that also results in other life companies increasing their annual management charges

I note that there are some risks associated with the proposed arrangements for implementing the investment choices of policyholders immediately following the *Implementation Date*. In particular, I note that policyholders could lose out from dilution because of the large scale purchases of unit funds (and hence underlying assets), though ELAS is taking steps to minimise or prevent any such losses.

ELAS considered reducing the uplift to pay for the effect of dilution, but decided that this would be unfair since such estimated costs would have a prudence margin in them. Therefore, it is proposed that the policies incur any dilution as and when they occur post *Scheme*. When calculating the amounts required to pass the fairness indicators, a best estimate allowance will be made for these costs.

I note that the investment proposition has also been developed to ensure that the assets can be invested over a period of time, with the aim of minimising the likely impact. Policies invested in the default options remain in the *Secure Cash Investment Fund* for six months and are then transferred over a six month period to the automatic investment option funds. Policyholders will have the option to transition into their chosen investment fund over a shorter period.

For one group scheme (NHS), the trustees have given ELAS authority to take investment requests directly from members. However, for other 'trust-based' schemes the contract is with the '*Creditor*' who is the trustee and that is generally the employer. Therefore, ELAS can only act on investment choices provided by the trustees. I note that the trustee can specify investment choice at the scheme member level.

I consider this to be fair. It allows those policyholders who require time to consider their options to maintain their funds, with the certainty that the price will not reduce below the price on the Implementation Date. Clearly a different time period could have been chosen which may also be considered fair, but I consider that whilst interest rates are currently low, greater than nine months (the average period for transition) may be too long to be invested in a cash fund.

I have considered the default strategies, and additional investment funds that are being developed, and believe these to adequately cover a range of potential risk appetites that policyholders may have. In particular, I consider the broad asset mixes within the default strategies to be appropriate.

I note that there is limited fund choice for the euro and USD denominated funds. This is due to the low volumes, and I consider this to be reasonable under the circumstances.

I consider the approach of allowing for a best estimate of any potential impact of dilution within the fairness indicator tests to be appropriate. I consider that the Society has taken appropriate steps to develop the investment proposition with the aim of minimising the risk of loss from any potential impact of dilution, in particular, the availability of a transition period for fund switching.

Utmost Life and Pensions will guarantee that the charges on the Secure Cash Investment Fund will not exceed 50bps, and will not be higher than the return (i.e. the fund price will not decrease below that at the Implementation Date). The annual management charges on the unit-linked funds will not exceed 100bps in any circumstances, and the charges will be no more than 75bps except under certain circumstances. I consider this to be fair.

2.5 Calculation of uplift

2.5.1 Assets available for distribution

The first step in determining the uplift involves calculating the total assets that are available for distribution.

I have considered the approach used to derive the assets available to be distributed. There are few areas of judgement within this calculation which I have considered, and I consider the judgements to be appropriate and the approach to be reasonable and as I would expect.

Further detail can be found in section 7.1 of my full report and my analysis can be found in section 11.1 of my full report.

2.5.2 Structure of the uplift

The Society has decided to apply the uplift to the *Policy Value* as at the *Implementation Date*. For CWP policies the surrender value is used as a proxy for a *Policy Value*.

The total assets available for distribution are allocated to the policyholders in the form of a *Primary Percentage Uplift* plus compensation for the *residual value of guarantees* (the *Secondary Uplift*). The *Primary Percentage Uplift* represents compensation for giving up a right to a claim on the with-profits assets (this is approximately 90% - 95% of the distribution). The

Secondary Uplift represents *residual value of guarantees* plus any fairness adjustments. A set of fairness criteria are then tested, and a small adjustment is made across all policyholders to ensure the criteria are met.

Secondary Uplifts and fairness adjustments will be calculated as at the *Calculation Date* (30 September 2019) – *Primary Uplifts* will be calculated as at the *Implementation Date* (1 January 2020).

The expected uplifts based on data as at 31 December 2018, by each age band and broad product type, as proposed by the Society are:

— 72% for life RSP and 0% GIR policies,

— 72% in over 95% of CWP cases, and the range goes up to 167%.

— ranging from 72% to 135% for those policyholders with 3.5% GIRs, depending on the level of the residual guarantee, with younger policyholders generally having higher uplifts reflecting the fact that they are giving up future GIRs over a longer period.

It should be noted that the actual *Primary Uplift* as at 31 December 2019 could be more or less than 72% depending on the investment returns over 2019. More recent policyholder communications set out an expected range of 60% to 70%, and 68% is now closer to the expected value. The main reason for the value being lower than that as derived from 31 December 2018 data is that *Policy Values* have increased by 2% over the period.

For RSP policies, allocating the uplift using the Policy Value as a base is consistent with how the CEF is allocated. I consider the approach to be appropriate, and do not consider there to be a viable alternative for the allocation of the uplift.

I have discussed the consistency between RSP *Policy Values* and CWP surrender values at length with the Society. ***I conclude that the CWP surrender basis is materially aligned to the calculation of Policy Values for RSP business, and as such is an appropriate proxy to the RSP Policy Value.***

Overall I conclude that the uplift, as determined, is the most appropriate option for the policyholders to consider against run-off.

I consider it fair to apply the uplift to the premiums paid between 31 December 2014 and 31 December 2017. I also agree that those policyholders who are still paying premiums at the cut-off date of 31 December 2017 should be compensated for the potential future loss of GIRs on the premiums they may have carried on paying into the future. This compensation is mostly covered by the uplift on the premiums paid between 31 December 2014 and 31 December 2017 (the CEF is not payable on premiums paid after 31 December 2014). Any shortfall will be compensated for via the Secondary Uplift.

Further detail can be found in section 7.2 of my full report and my analysis can be found in section 11.2 of my full report.

2.5.3 Key assumptions and judgements

There are two key areas in relation to the *Scheme* where calculations using judgement are performed. The first is the calculation of the uplift, and the second is in the analysis which compares the benefits which may have been achieved under *run-off*, with those which may be achieved under the *Scheme*.

The Society uses an approach that is consistent with generally accepted actuarial practice when calculating the value of a guarantee (sometimes known as an embedded option).

The cost of residual guarantees makes an allowance for when the policyholder is expected to take their benefits. The surrender and retirement assumptions used are based on the Society's most recent (pre-*Scheme* announcement) experience, and reflect the different experience between group and individual business. No allowance has been made for future changes to policyholder behaviour, but smoothing is used to ensure that uplifts are consistent between ages.

I consider the approach taken to calculating the cost of residual guarantees to be appropriate. I have also been given access to the most recent experience data and consider the assumptions to be appropriate.

I conclude that I support the use of the 35% CEF as the starting level of CEF in the projections since this is the CEF which is currently being applied, and there is no evidence to suggest that an alternative would result in a different uplift structure.

My review has not identified any areas which would lead me to conclude that the models are not appropriate for use. Further detail can be found in section 7.3 of my full report and my analysis can be found in section 11.3 of my full report.

2.5.4 Governance around the calculation of the uplift.

In practice, some items within the calculation of the uplift are calculated at a different date to the *Implementation Date*, and there are some approximations within the calculation. In addition, the methodology used to calculate the assets available for distribution as at the *Implementation Date* is not derived straight from the *Solvency II* own funds. This is because the own funds amounts are not available in time.

I have had extensive discussions around the methodology for calculating the uplift and the governance around the calculations, including the extensive independent reviews being carried out on the processes in place, but this work is still ongoing.

I will conclude on the processes and governance surrounding the calculation of the uplift, and I will confirm whether they are adequate to ensure that the results are complete, accurate and consistent with the intended methodology, in my supplementary report.

2.6 Fairness assessment

In order to determine whether the allocation of the uplift amongst policyholders is fair, the Society has set out six fairness indicators against which it has assessed the uplift. Three of the indicators pass by virtue of the way the uplifts are derived. Should the other fairness criteria fail, the *Secondary Uplift* is adjusted accordingly to cover the cost of meeting the fairness criteria. Some of the fairness tests require testing the projected benefits forgone against those that are estimated to be received under the *Scheme*.

I have considered the fairness indicators set out by the Society (listed in section 2.6.1). In addition to these, I have considered further significant analysis to assess fairness.

My fairness analysis is based on uplifts as at 31 December 2018 (see section 11 of my full report) and 31 December 2017 (see Appendix 1 of my full report). I do not expect my conclusions to change between 31 December 2018 and the *Implementation Date* but I will confirm this in my *supplementary report*.

Further detail can be found in section 7.4 of my full report, and my analysis of fairness can be found in section 11 and Appendix 1 in my full report.

2.6.1 ***ELAS' fairness criteria***

2.6.1.1 ***RSP policies***

The Society has set out the following six indicators to assess the fairness of the allocation of the uplift:

i. At the *Implementation Date*, all policyholders have an uplifted value in excess of the higher of *Policy Value* including CEF and the underlying guarantee.

ii. The present value of a policyholder's GIR is the minimum level payable at the *Implementation Date*.

iii. Using a *medium risk* managed fund post *Scheme* uplift, all policyholders should be better off on a best estimate basis at specific future dates.

iv. All policyholders who invest their uplifted policy in assets which earned a rate of return of 0% per annum will still have a value in excess of their GIR in 5 years' time.

v. All policyholders who invest their uplifted value in assets which earned a rate of return of 1.5% per annum would have a value in excess of their GIR after 10 years, or the expected date of claim, if earlier.

vi. For policyholders who do not specifically choose a fund link post *Implementation Date*, the value of their investment is guaranteed for six months.

2.6.1.2 ***CWP policies***

Fairness indicators may need to be interpreted in different ways for CWP policies. I have set out below any deviations from indicators i to vi for CWP policies:

i. At the *Implementation Date*, all policyholders have an uplifted value in excess of the surrender value they would have received under *run-off*.

ii. The present value of future guaranteed benefits (less future premiums) under *run-off* is the minimum level payable at the *Implementation Date*.

iii. For endowments, using a *medium risk* managed fund post uplift, all policyholders should be better off on a best estimate basis at maturity date. For whole of life and Flexible Savings Plans ('FSP'), the death benefits for all policyholders should be greater on a best estimate basis at expected date of death than under *run-off*.

iv. For endowments, all policyholders who invest their uplifted *Policy Value* in assets assumed to earn 0% per annum, whose policies mature within the next 5 years, will at maturity have a value in excess of the total of their sum assured and declared *reversionary bonus* under *run-off*. For whole of life and FSP, all policyholders who invest in assets assumed to earn 0% per annum, and who die within 5 years, will receive a value at least as high as the sum assured plus declared *reversionary bonus* under *run-off*.

v. For endowments, all policyholders whose policies mature between 5 and 10 years' time will, assuming a rate of return of 1.5% per annum, at maturity have a value in excess of the total of their sum assured and declared *reversionary bonus* under *run-off*. For whole of life and FSP, all policyholders who die within 10 years will, assuming 1.5% per annum return, receive a value at least as high as the sum assured plus declared *reversionary bonus* under *run-off.*

vi. For policyholders who do not specifically choose a fund link post *Implementation Date*, the value of their investment is guaranteed for six months.

The *Scheme* has been designed so that indicators i, ii and vi of the above six fairness indicators always pass for all policies in scope of the *Scheme*. The remaining three fairness indicators (i.e. iii, iv and v) are hence used to ensure that policyholders receive a fair outcome from the *Scheme*.

It is worth noting that for RSP life policies which have review dates, fairness indicators iii, iv, and v above may be tested on a very short projection, depending on the review date. Given that these policies have 0% GIRs (and as such, are uplifted only by the *Primary Uplift*), I have satisfied myself that these tests would be passed at longer durations. In addition the policies can be repriced at review dates, and as such it makes little sense to project past these dates.

At the review date, the uplifted *Policy Value* instead of the *Policy Value* with CEF will be used to determine whether any re-pricing is required. The policyholder may be able to either maintain the same level of cover while reducing their premiums or increase the level of cover and maintain the same level of future premiums. However, since future returns are uncertain and depend upon the investment performance of the selected fund there is an element of uncertainty impacting future reviews.

I have considered the above fairness indicators and conclude that I consider them to be appropriate. I have seen the results of the fairness tests, and can confirm that where any group of policyholders failed any of the tests (iii, iv and v), the Society has allocated an additional uplift such that the test is passed.

Clearly some of the indicators used are artificial, for example it is not possible to achieve a return of exactly 1.5% over 10 years, as tested in indicator v. It is important to consider that the key purpose of the fairness indicators is to adjust the uplift in the event that one or more of these indicators fail. Setting different tests would reallocate the uplift between policyholders as there is only one pot of money. In coming to my conclusion I bore in mind that there are a range of tests which could be considered reasonable, and as such there is a range of different *Secondary Uplifts* which may also be reasonable. The indicators set by the Society are in my view reasonable and practical.

2.6.2 Additional fairness criteria that I have considered

In addition to the Society's fairness criteria, I performed further detailed analysis on the extent to which RSP pension and CWP policyholders may be better off post *Scheme*.

The *Extent Better Off* is the percentage difference between (i) the projected benefits that a policyholder might achieve through the unit-linked investment if the *Scheme* is implemented and (ii) the projected benefits if the *Scheme* is not effected and future experience follows best estimate assumptions for the *run-off* of the fund.

I have excluded the RSP life business in my analysis as these policies are only modelled to the next review date, which may be a very short projection. As such, I consider any analysis would not add much value to my additional tests. I would expect RSP life business to have similar results to RSP pensions (0%) with short durations, and these show that the expectation is that policyholders are expected to be better off under the *Scheme*.

For my additional analysis, I have considered the extent by which groups of RSP pension policyholders are better off at the following dates:

— Ages at retirement (55, 60, 65, 70, 75)

— Retirement age (now), i.e. exit at 31 December 2017 or 2018, and immediate termination as if contractual terms apply.

For CWP policies, the dates taken were the maturity date, or the expected date of death (or 30 years if earlier) for whole of life policies.

The analysis performed for the data as at 31 December **2017** projected forward the uplifted *Policy Value*, using three different investment choices:

1 The Society's best estimate assumptions for post *Scheme* investments are based on a *medium risk* managed fund (Equity 55%, Property 10%, Fixed Interest 30% (split 20/80 between gilts and corporate bonds), and Cash 5%) and annual management charges of 0.75%

2 Cautious – 30% Gilts, 30% Bonds – A rated, 30% Equities, 10% Cash and annual management charge 0.75%

3 Cash – 100% cash investment mix and annual management charge 0.5% - this is materially similar to the *Money Market Fund*, except the guarantee of no reduction in the value on the Implementation Date in the first six months is not modelled.

Two different *run-off* projections are considered:

1 Base Scenario – In this scenario the *run-off comparator* assumes full *run-off* for 30-years and the remaining assets at that point are then fully distributed to the in-force policies.

2 Scenario 1 – In this scenario the *run-off comparator* assumes full *run-off* for 30-years and the remaining assets at that point are not distributed fully but will continue to be run off, i.e. this scenario ignores the *tontine* effect to some degree.

For 31 December **2018** data, ELAS provided *Extent Better Off* results for the following investment choices:

— *Medium risk* managed fund (Equity 55%, Property 10%, Fixed Interest 30% (split 20/80 between gilts and corporate bonds), and Cash 5%) and annual management charge 0.75%.

— *Age Related Transition* as set out below:

All business is invested in a cash fund for the first year of the projection. UK and International Sterling pension RSP policyholders are then invested based on an age related asset mix, as set out below:

Age	*Medium Risk* Fund	Cautious Fund	Cash Fund
55 years and under	100%	0%	0%
Over 55 years up to 65 years	gradual reduction from 100% to 0%	gradual increase from 0% to 100%	0%
Over 65 years up to 75 years	0%	100%	0%
Over 75 years up to 85 years	0%	gradual reduction from 100% to 0%	gradual increase from 0% to 100%
Over 85 years	0%	0%	100%
Asset mix	equity 55%, property 10%, fixed interest 30% (split 20/80 between gilts and corporate bonds), and cash 5%	30% gilts, 30% bonds, 30% equities, 10% cash	100% cash
Annual management charge	0.75%	0.75%	0.5%

Source: ELAS

I have not repeated my analysis for 2018 data for the base scenario *run-off* projection, i.e. the scenario where the remaining assets at that point are distributed fully. The messages from this run are similar to the run without the distribution except it highlighted the distortion of the *tontine* happening at once, in 30 years' time, and as such I consider it adequate to show the results of this for the 2017 data only.

The full results of my additional fairness tests are shown in section 11.5 of my full report, and I have summarised my considerations and conclusions below.

2.6.3 **Results of my analysis assuming benefits are taken straight away (the 'now' scenario)**

I have considered the various with-profits policy types, policyholder ages, *Extent Better Off* results, and uplifts. My conclusions are as follows:

The differences in the Extent Better Off reflect the nature of the relationship between run-off and the Scheme and are not due to any inherent unfairness in the uplift approach.

Overall, based on the explanations as to the differences between the Extent Better Off results, I consider the uplifts to be fair.

2.6.4 Results of my analysis assuming benefits are taken at age 55, 60, 65, 70, 75

I have considered the various with-profits policy types, policyholder ages, *Extent Better Off* results, and uplifts. My conclusions are as follows:

I consider it fair that the individual pensions business appears slightly better off under the Scheme, compared with run-off, than group policyholders.

This reflects the fact that the value of the residual guarantees are higher for individual pensions due to the fact that they are expected to take their benefits later, and the uplift allows for this. The *Extent Better Off* projections do not make this distinction.

Assuming policyholders invest in the same investment choice, younger policyholders with 3.5% guarantees have higher *Extent Better Off* results under the *Scheme* than those with 0% guarantee. No account is taken within the uplift of the fact that the 0% GIRs are losing out more over time on potential increases in CEF compared to 3.5% GIRs. ***Given that this situation is part of the same issue as the tontine, I do not consider that it would be fair to compensate for this. For ages over 51 the differences are not material (5% and under). I consider this to be a fair outcome.***

For very young ages (under 40), policyholders mainly have higher *Extent Better Off* results under the *Scheme* than the next age up in the age brackets. This is because the investments are invested in higher yielding assets for longer which outweighs the potential projected benefits from the *tontine*. As noted previously, I do not consider this to be unfair as I do not consider the *tontine* to be fair, however clearly policyholders need to consider carefully their own position before deciding how to vote and what investment choices to make.

The *Extent Better Off* results for older policyholders are higher than for many younger policyholders when invested in both investment choices, the *medium risk* managed fund and the *Age Related Transition*.

The differences between the Extent Better Off results by age are a function of many things. In particular the results for younger ages are volatile and depend heavily on the investment return assumptions and the projected release of the CEF under run-off. This was highlighted by the relationship between the ages changing between the December 2017 analysis and the December 2018 analysis. I do not consider these features to be due to any unfairness in the way the uplift is calculated.

Policyholders should consider the asset mix post *Scheme*, which reflects their appetite for risk and their expected term to taking their benefits.

Even though the Society has ensured there are some safeguards in its fairness indicators, there are still some scenarios (e.g. depending on how they choose to invest) where policyholders appear worse off after the *Scheme*.

The biggest negatives are for the *Age Related Transition* risk strategy for ages 46-60 retiring at 70 and 75.

The older policyholders have less time to be impacted by lower investment returns in the *Age Related Transition* strategy, and are also unlikely to benefit from the *tontine* under the projected *run-off*. As such they remain better off under the *Scheme*. The 46-60 year olds are investing for around 15-35 years, and under *run-off* they would benefit from the projected *tontine* (the release of CEF).

Under the *Age Related Transition* strategy (see section 2.6.2 above), the under 40s are invested in higher yielding assets for longer and this outweighs the potential of benefitting from the *tontine*.

I conclude that some younger policyholders being potentially worse off under the Scheme, in comparison to run-off, allowing for the tontine effect, does not result in the proposed distribution being an unfair outcome. In addition, the Scheme provides more certainty against the risk of many policyholders with valuable guarantees deferring taking retirement benefits, thereby reducing available capital. Younger policyholders also need to consider their own circumstances, and the fact that they may exit prior to the tontine effect, or indeed, in reality the tontine may not be there at the time they take their benefits.

2.7 Policyholder communications

Of the communication I have reviewed, the Society has incorporated my comments and I am satisfied that this communication is appropriate for policyholders and communicates information in an unbiased way.

Some communications are still being developed, and I will comment on any further communications I review in my *supplementary report*.

In particular, in my view, the individual projections showing the potential benefits under run-off reflect a reasonably likely scenario in relation to the potential projected CEF. I agree that the projections should not allow for the potential tontine as I consider that this could be misleading. The wording accompanying the illustrations clearly conveys the fact that the projections may not be borne out in the future, highlighting the key areas that the results are sensitive to.

I consider the Society's strategy with regards to the method of communication (direct mail, websites and the use of newspapers) to be appropriate.

The expertise provided by Jardine Lloyd Thompson has ensured that the communications have been developed in a concise, and timely way, and that they contain all the relevant information. ***I consider the use of Jardine Lloyd Thompson to assist with developing the communications to be an appropriate use of policyholder assets.***

I consider the communications to group trustees, with regards to the vote and where to find information, to be clear.

With regard to the production of the personal projections, I have considered the governance around the process for calculating the projections, including the testing plans and sign-off processes. ***I consider the governance and checks around the process to be adequate to ensure that the calculations are produced in line with the documented methodology and assumptions.***

I have reviewed the wording which is included in the illustrations and consider that it makes it clear that the actual uplift could be different to that used in the projections.

Further detail can be found in section 8 of my full report, and my analysis can be found in section 12 of my full report.

2.8 Guidance and advice

Guidance is given to policyholders in order to help them understand the *Scheme*, and the subsequent *Part VII Transfer*, the implications for their policy and to assist in making their decision as to how to vote on the *Scheme*. This is highly dependent on their individual circumstances, including the value of their policy and the *Investment Guarantees* they are giving up. This differs from advice, which aims to provide a recommendation to policyholders about how to vote and/or which funds to invest their unit-linked policy in if the *Scheme* goes ahead.

Although it is expected that a significant proportion of policyholders will be able to form their view on the vote and/or investment decisions without any help, the offer of guidance and advice is available to all *Scheme Policyholders*, and ***I consider it fair that guidance and advice is provided.***

Advice on the vote is to be subsidised, and it is a matter of judgement as to whether advice on the vote should be subsidised, given the free guidance that will be made available. There are advantages and disadvantages to subsidising this advice, and in my view it would be acceptable for the Society to not subsidise this advice as any costs would impact the assets available for distribution, and hence the uplift. ***The Society has decided to provide some subsidy towards advice on the vote, and I understand the reasoning for this and consider this an appropriate approach since the costs involved do not have a material impact on the uplift.***

I have considered whether it is fair to all policyholders to use policyholder assets to pay for guidance and advice. In coming to my conclusion, I have taken account of the results of surveys conducted by the Society which suggest that some policyholders will want either guidance or advice or possibly both. Given the immaterial impact to the uplift and the results of the survey, ***I consider it fair to use policyholder assets to pay for guidance and advice.***

The services to be provided with regards to the investment advice are:

— Web based (Type 1) advises the policyholders on a restricted unit-linked investment fund choice with Utmost Life and Pensions.

— Telephone advice (Type 2) advises the policyholders on a restricted unit-linked investment fund choice with Utmost Life and Pensions.

— Full advice on investments held with the Society and other providers (Type 3).

I consider the spectrum of advice to be appropriate. Different policyholders will have different needs depending on the size of their Policy Value compared to the rest of their wealth.

I have considered whether the guidance and advice package, overall, provides sufficient support to policyholders, and is accessible to policyholders. In coming to my conclusions, I have taken account of experienced third party input into the development of the guidance (Jardine Lloyd Thompson) and on advice to be given (Jardine Lloyd Thompson for advice on the vote, and Hargreaves Lansdown on investment advice). I consider the guidance and advice to be informative, providing a full picture of the Society's proposals, including key information which is tailored and presented to the policyholders in a way that is most relevant to them.

Based on the draft documents I have reviewed, I consider the overall guidance and advice package to be comprehensive, informative, and not misleading.

I have also taken account of the testing performed on the communications, which involved policyholder feedback on draft communications. In addition, I have considered how the availability of guidance and advice has been communicated to policyholders, via the various policyholder communications. ***In my view, the overall guidance and advice package provides appropriate support to policyholders, and the options are clearly presented to policyholders.***

I have considered the timing for which the advice period runs, and have taken account of restrictions due to specific dates within the process. ***I agree that the window for the advice period should run from the date that the Decision Pack is issued. This is because policyholders need to have read the content to be able to then fully understand the guidance. It is not practical for the advice to continue after the Implementation Date as the cost would need to be provided for out of the assets to be distributed, and any difference between the actual and expected costs would eventually fall to Utmost Life and Pensions which would be unfair.***

In relation to investment advice being provided by Hargreaves Lansdown, there are a number of financial advisors who could have been chosen to give advice. The Society took me through its selection process, and I considered the criteria that it used to choose the advisor. I consider the approach taken to be reasonable, and in particular, I considered how the choice would be viewed by policyholders. I would expect the majority of policyholders to know of Hargreaves Lansdown, which is in my view a well-known FTSE 350 reputable firm with a wealth of experience***. I consider the appointment of Hargreaves Lansdown as the advice provider to be an acceptable choice.***

In relation to the Scheme vote, Jardine Lloyd Thompson had already been engaged to assist with the guidance, as it has previous experience in this area. I consider it appropriate and cost effective to utilise Jardine Lloyd Thompson to provide both guidance and to give advice on the Scheme vote since it will have access to all relevant information, and will have already considered the key aspects as part of the guidance work.

The cost to the Society across all the advice and guidance is expected to be in the region of £12 million to £15 million.

The expected total cost of advice translates to around 0.8% of the uplift. I consider this to be a reasonable contribution and not in aggregate material enough to impact my assessment of fairness in relation to all with-profits policyholders.

If advice is to be subsidised, and made available, it is my view that it should be accessible for all *Scheme Policyholders;* which it is. However, I also think that the cost should not be material to the amount of the uplift available under the *Scheme*. The fact that the non-vulnerable policyholders have to contribute as well should avoid any policyholders taking the advice just for the sake of it. ***I agree that the non-vulnerable Scheme Policyholders should pay towards the cost of advice if taken.***

A summary of the policyholder charges and subsidies is set out below:

	Paid by policyholder	Paid by the Society	Total Cost
	£	£	£
Jardine Lloyd Thompson – Voting Advice	95	based on fixed contract	N/A
Financial Advisor ('FA') – Existing	Policyholder pays FA direct less subsidy	Up to £355	FA fee
Hargreaves Lansdown – Online Type 1	50	150	200
Hargreaves Lansdown – Telephone Type 2	95	355	450
Hargreaves Lansdown – Type 3* - Full Advice	345*	450	795

Source: ELAS

*1% of the *Policy Value* with a minimum of £795, less the subsidy of £450

In order to maintain fairness between those taking advice and those not, I consider it fair that the subsidy for Type 3 advice is proportionately lower than for Types 1 and 2.

For *Scheme* voting advice provided by Jardine Lloyd Thompson, the amount payable by the policyholder is £95. ***I consider this to be a relatively low cost for obtaining advice. However, I note that the cost to the Society of subsidising this advice is also relatively low (at around £2.3 million of the total expected cost of £12 million to £15 million). I consider this to be fair subsidy to make. The take-up rate for this advice is expected to be low and related to vulnerable customers, who will not have to pay. I note that the £2.3 million costs will have taken the low expected take-up rate into account.***

I agree with the Society's reasons for not giving customers choosing to use new FAs a subsidy. Those customers who want to take advice from their existing FAs receive a subsidy of £355 which I consider to be fair.

As part of the guidance call flow, Jardine Lloyd Thompson has built in controls and trigger points to identify vulnerability during the call and at the end of the call, to test if a policyholder understands the proposals. If, at any stage, it considers that the policyholder is vulnerable, advice on the vote and investment advice will be offered without charge.

I have reviewed the approach taken by the Society to vulnerable customers, and I consider it to be appropriate.

I have reviewed the approach taken by the Society to customers living outside the UK, and I consider it to be appropriate. Non-UK based policyholders account for

approximately 3% of in-force with-profits policyholders, hence the risk of a poor customer outcome by choosing an unregulated non-UK FA to provide advice is limited.

I note that the Society is not providing the same financial assistance to group schemes as it is to individual policyholders as it considers that most group schemes have employee benefit consultants or advisors, and would expect these advisors to provide trustees with professional advice if required. However, telephone support via Jardine Lloyd Thompson will be provided. ***I have reviewed the transcript of the guidance call and consider it to be appropriate.*** Group trustees will be provided with support from ELAS on a range of areas they may require assistance on, including support with developing a template they may want to use to send details of illustrations to their members.

The *Proposal* presents a risk of policyholders becoming the target of scammers, fraudulent activity via criminal means or immoral FA behaviours. The Society includes a leaflet within the *Investment Choice Pack* warning policyholders of the risks when making important decisions and they also plan to include the warnings on their website. ***I have reviewed this leaflet and I consider that it provides sufficient information to warn the policyholders against scams and frauds, including how to spot a scam and what to do if the policyholder suspects they are being scammed.*** In addition, I agree with the Society that the guidance package should reduce the number of policyholders who feel they need to seek advice before making their choices, therefore reducing the risk of immoral FAs becoming involved.

Trevor Jones
Fellow of the Institute of Actuaries
Partner, KPMG LLP

3 Appendix 1 – Abbreviations

Abbreviation	Meaning
bps	Basis Points (100bps = 1%)
CEF	Capital Enhancement Factor
CWP	Conventional With-Profits
EGM	Extraordinary General Meeting
ELAS	Equitable Life Assurance Society
FA	Financial Advisor
FCA	Financial Conduct Authority
FSAVC	Free Standing Additional Voluntary Contributions
FSP	Flexible Savings Plans
GAR	Guaranteed Annuity Rate
GIR	Guaranteed Investment Return
GMP	Guaranteed Minimum Pensions
PIE	Policyholder Independent Expert
PPFM	Principles and Practices of Financial Management
RSP	Recurrent single premium policies. Note that any reference in the report to Regular Savings Plans is in full, and not abbreviated

4 Appendix 2 – Glossary

Term	Meaning
Age Related Transition	A UK investment strategy under which policyholders are invested in an asset mix which is dependent on their age. *Age Related Transition* will occur automatically for pension policies if the policyholder does not specify their investment choice within 6 months of *Implementation Date*.
Calculation Date	The date before the *Implementation Date* when some of the calculations for the *Scheme* are carried out. The *Secondary Uplift*s are fixed as at this date. This date is expected to be 30 September 2019.
Convening Hearing	The first court hearing for the *Scheme*. If the court is satisfied with the initial *Proposals*, such as the proposed classes, permission is given to proceed with the next stages of the process.
Creditors	The *Creditors* hold *Scheme Policies*. This includes the Trustees and individual policyholders. It also includes individuals to whom a policy has been assigned and members of the FSAVC scheme, where the Society is the trustee.
Decision Pack	Communication sent out to policyholders containing: - cover letter - explanatory booklet A, which will highlight the key features of the *Proposal* and details of where they can go to get help and support - explanatory booklet B, which provides technical information on the *Scheme*, including summaries of: the terms of the *Scheme*, the Transfer and the Independent Expert reports - voting pack – including voting forms and notice of the EGM - personal illustration containing the potential uplift amount and projections indicating what the future could look like with and without the *Proposal*
Extent Better Off	The percentage difference between (i) the projected benefits that a policyholder might achieve through unit-linked investment if the *Scheme* is implemented and (ii) the projected benefits if the *Scheme* is not effected and future experience follows best estimate assumptions for the *run-off* of the fund.
Guaranteed Fund	The *Guaranteed Fund* on Recurrent Single Premium contracts is the accumulation of premiums paid less charges plus any declared regular bonuses, increased by the GIR.
Implementation Date	The date at which: (a) the key aspects of the *Scheme* (*Policy Value*s are uplifted, With-Profits policies become unit-linked policies, and *Investment Guarantees* are removed) would be implemented; (b) the change to the Equitable's Articles of Association will become effective; (c) the Transfer will be implemented. This is expected to be 1 January 2020.

Term	Meaning
Investment Choice Pack	Policyholder communication pack which sets out information to help policyholders: — understand the different investment options available to them from *Implementation Date*, and the range of unit-linked funds available — understand the different risks and charges — assess their risk appetite — understand who Utmost Life and Pensions are and their relationship with JPMorgan — details on where to get further guidance and support, including advice on the unit-linked investments — an investment choice form to document and inform the Society of what funds they have chosen
Investment Guarantee	The Equitable's obligation under a *Scheme Policy* to pay benefits determined by amounts which have been paid in premiums and when they were paid. *Investment Guarantees* do not include benefits which are payable only on the occurrence of specified life events (such as death or survival, or being diagnosed with a particular medical condition, or undergoing specified hospital surgery). *Investment Guarantees* do not include GARs or GMPs.
Irish Managed Fund	A unit-linked fund option for Irish *Scheme Polices* after the *Implementation Date* that invests in shares (including European and global equities) and fixed interest securities (bonds) and has higher potential risk and reward than the *Irish Money Market fund*. This fund is primarily invested in sterling, and as such it has significant foreign exchange rate risk.
Irish Money Market Fund	A unit-linked fund option for Irish *Scheme* Polices after the *Implementation Date* that invests in assets with a very short maturity, usually issued by governments, financial institutions or large companies, providing a high level of capital security and liquidity.
Money Market Fund	A new unit-linked fund option for unit-linked policies after the *Implementation Date* that invests in securities with a very short maturity, usually issued by governments, financial institutions or large companies
medium risk	The Society's best estimate assumption for the post *Scheme* investment fund mix, at the point that analysis was carried out.
Member	The *Members* of the Society are its owners. Membership is linked to having a with-profits policy in force. This includes trustees of group policies. Trustees are both the *Member* and the policyholder on policies which provide benefits to underlying beneficiaries.
Multi-Asset Cautious Fund	A new unit-linked fund option for unit-linked policies after the *Implementation Date* that invests across a wide range of equity and bond markets (and other assets) providing investors with a high level of diversification, and with lower risk/potential return (around 30% in shares).
Multi-Asset Moderate Fund	A new unit-linked fund option for unit-linked policies after the *Implementation Date* that invests across a wide range of equity and bond markets (and other assets) providing investors with a high level of diversification, and with moderate risk/potential return (around 60% in shares).
Part VII Scheme Document	The document setting out the terms of the *Part VII Transfer.*
Part VII Transfer	A transfer of policies from one insurer to another effected under *Part VII* of Financial Services and Markets Act 2000 (FSMA) or equivalent legislation in other jurisdictions as appropriate.

Term	Meaning
Policy Value	For RSP with-profits policies, *Policy Values* reflect premiums paid less charges and the investment return on underlying assets. They increase with a smoothed return, which has been 2% per annum for several years. Conventional with-profits policies do not have a *Policy Value*, but an equivalent measure is used. References to *Policy Value* in this report include the equivalent measure used for this business.
Policyholders' Meeting	A meeting held for *Scheme Policyholders* where they will vote on the *Scheme*.
Primary Percentage Uplift	The minimum level initial percentage uplift to with-profits *Policy Values* that each *Scheme Policyholder* would receive.
Primary Uplift	The base uplift applied to the qualifying *Policy Values* of all *Scheme Policies* under the *Scheme*. This is expected to be between 60% and 70% of qualifying *Policy Values*.
Proposal	The proposed transfer of all of the Society's business and associated assets from the Society to Utmost Life and Pensions under the Part VII.
residual value of guarantees	The difference, where applicable, between the total market consistent value of guarantees and the uplifted value post *Scheme*.
reversionary bonus	Regular bonuses that can be declared on a discretionary basis to increase the *Guaranteed Fund* on Recurrent Single Premium contracts or the sum assured on conventional with-profits contracts. No *reversionary bonus* has been declared by the Society since 1999.
run-off	A process by which an insurance company no longer enters into new policies, but continues to meet its obligations under existing policies.
run-off comparator	The basis used by the Society to project benefits assuming no *Scheme* occurred.
Sanction Hearing	The second court hearing for the court to consider whether to sanction the *Scheme*. This is expected to take place on 22 and 25 November 2019. *Creditors* have a right to make representations to this hearing.
Scheme	The Scheme of Arrangement, made in accordance with Part 26 of the Companies Act 2006.
Scheme Effective Date	The date at which the *Scheme* order is delivered to the Registrar of Companies in England and Wales for registration in accordance with the *Scheme*. The *Scheme* will not become effective unless the *Scheme* is approved by a vote of the *Scheme Policyholders* at the *Policyholders' Meeting*, the Court sanctions the *Scheme*, the change to the Equitable's Articles of Association is approved by a vote of the *Members* at the EGM and change in control approval is obtained by Utmost Life and Pensions. The Equitable currently expects the *Scheme Effective Date* to be week commencing 25 November 2019.
Scheme Policies	These are policies within the scope of the *Scheme.* They are all policies with rights to share general surplus of the Society except German with-profits policies. This includes some policies that currently only have unit-linked investments but have a contingent right to share general surplus of the Society through a right to switch into a with-profits investment.
Scheme Policyholders	The holders of *Scheme Policies.*

Term	Meaning
Secondary Percentage Uplift	The additional percentage uplift above the *Primary Percentage Uplift* that a *Scheme Policyholder* would receive to reflect the *residual value of guarantees*. For some policies this percentage will be zero. This is calculated as at the *Calculation Date*.
Secondary Uplift	The additional uplift applied above the *Primary Uplift* to reflect the policyholders' *residual value of guarantees*, where applicable. The same approach is used to calculate these for all *Scheme Policies,* and for some *Scheme Policies* the *Secondary Uplift* will be zero.
Secure Cash Investment Fund	This is a temporary cash fund that all policies will be invested in when converted from with-profits to unit-linked, and transferred to Utmost Life and Pensions. Policyholder savings will gradually transition to their chosen investments in the timeline they have selected. If *Scheme policyholders* do not make an investment choice, their unit-fund will be invested in the secure cash investment for six months, and then gradually transition over the next six months to the automatic investment option. Whilst savings are in the secure cash investment, the unit price is guaranteed not to decrease below the price on the *Implementation Date*, although its value is unlikely to keep pace with inflation.
Solvency II	Directive 2009/138/EC of the European Parliament and of the Council on the taking-up and pursuit of the business of Insurance and Reinsurance or such other legislation as shall from time to time enact the equivalent provisions in the United Kingdom.
supplementary report	A report produced after this report, and before the *Implementation Date*, to consider the impact of events or decisions that have occurred subsequent to the release of this report.
Tontine	Occurs with the *run-off* of closed with-profits funds when increasing amounts of capital are distributed to policyholders staying for a longer duration, as assets are held back to cover the capital requirements.