Supplementary Report of the Chief Actuary of

The Prudential Assurance Company Limited

on the proposed transfer of an agreed portfolio of non-profit annuity business

of

The Prudential Assurance Company Limited

to

Rothesay Life Plc

pursuant to Part VII of the Financial Services and Markets Act 2000

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The Prudential Assurance Company Limited

17 May 2019

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SUPPLEMENTARY REPORT OF THE CHIEF ACTUARY OF THE PRUDENTIAL ASSURANCE COMPANY LIMITED

The following is the Supplementary Report by Jonathan Hughes, the Chief Actuary of The Prudential Assurance Company Limited (PAC), to the Directors of PAC on the proposed transfer of an agreed portfolio of non-profit annuity business to Rothesay Life Plc (RL). The proposed transfer will take place on 26 June 2019 (the Scheme Effective Date), or on such other date as may be agreed by PAC and RL and approved by the High Court of Justice of England and Wales (the Court).

1. INTRODUCTION

1.1 In my capacity as Chief Actuary of PAC, I produced a report dated 18 January 2019 for the Directors of PAC (the 'Main Report') in which I reviewed the proposed transfer of an agreed portfolio of non-profit annuity business to RL. A copy of the Main Report was provided to the Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) and was presented to the Court at the Directions Hearing which took place on 31 January 2019.

1.2 The details of the proposed transfer are set out in the Main Report, but in summary:

i) On 14 March 2018, PAC and RL entered into an agreement for the sale and transfer of a portfolio of c.400,000 non-profit annuity policies from PAC to RL. It was agreed that this sale would be implemented through an initial reinsurance arrangement to reinsure the agreed portfolio to RL and then to subsequently transfer the business to RL through a Part VII arrangement, which is the subject of this and the Main Report.

ii) The proposed transfer covers the majority of the policies reinsured to RL. A number of policies covered by the reinsurance to RL (c.10% as measured by the Solvency II best estimate liabilities) are excluded from the transferring portfolio due to legal and operational complexities that may arise on transfer. The excluded policies will remain subject to reinsurance from PAC to RL.

1.3 The purpose of this Supplementary Report is to review any developments that have occurred since the Main Report was produced and to consider whether any of the conclusions, as set out in the Main Report, would need to be changed as a result of those developments.

1.4 This report should be read in conjunction with the Main Report. The terms used in this Supplementary Report are as per the Main Report unless otherwise stated. Following the approach taken in the Main Report, in this Supplementary Report I have considered the impact of the transfer on the security of benefits, the reasonable benefit expectations and the service standards from the perspective of the following policyholders:

- The policyholders transferring to RL from PAC; and
- The policyholders remaining in PAC following the transfer.

For clarity, I have not considered the perspective of existing policyholders of RL and note that the Chief Actuary of RL has considered the transfer from the perspective of these policyholders in his report, as has the Independent Expert as part of his overarching review of the transfer (referenced in sections 1.8 and 1.9 below).

1.5 I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1996, and hold a Chief Actuary certificate issued by the Institute and Faculty of Actuaries.

I have been the PAC Chief Actuary since August 2018.

1.6 I am also a shareholder in PAC's ultimate owner, Prudential plc.

1.7 Peter Needleman, the With-Profits Actuary of PAC, has produced a Supplementary Report which confirms that the conclusions set out in his Main Report dated 18 January 2019 remain valid.

1.8 Simon Johnson, the Chief Actuary of RL, has produced a Supplementary Report which confirms that the conclusions set out in his Main Report dated 22 January 2019 remain valid.

1.9 Nick Dumbreck of Milliman has been retained by PAC and RL to produce reports on the terms of the Scheme in the capacity of Independent Expert, and his appointment has been approved by the PRA in consultation with the FCA. A copy of this report has been provided to Mr Dumbreck. Mr Dumbreck has produced a Supplementary Report which confirms that the conclusions set out in his Main Report dated 21 January 2019 remain valid.

1.10 This report is structured as follows:

- Section 2 sets out information on the current financial position of PAC, and considers the impact of the proposed transfer on that position.
- Section 3 sets out information on the current financial position of RL, and considers the impact of the proposed transfer on that position.
- Section 4 considers any material developments arising since the Main Report was produced together with any material points that have arisen from policyholders' responses to the proposed transfer.
- Section 5 sets out my conclusions.

1.11 This report is subject to, and complies with, all relevant Technical Actuarial Standards (TASs) published by the Financial Reporting Council (FRC) in the UK, in particular:

TAS 100: Principles for Technical Actuarial Work, and

TAS 200: Insurance.

The intended users of this report are the Board of Directors of PAC, the PAC With-Profits Actuary, the Independent Expert, the PRA and the FCA.

1.12 In accordance with Actuarial Profession Standards (APS) issued by the Institute and Faculty of Actuaries, APS X2: Review of Actuarial Work requires Members of the profession to consider whether to apply work review to actuarial work for which they are responsible, and whether it would be appropriate and proportionate for this work to be in the form of independent peer review.

I have produced this report in my capacity as the Chief Actuary of PAC, operating in the second line Risk function. The conclusions in section 5.1 are my own and I have sought independent peer review, due to the materiality and importance of these conclusions. Stewart Gracie, Director of Financial Strategy of M&G Prudential, has provided this review and my report incorporates his feedback. The proposed transfer is also subject to review by an Independent Expert.

1.13 I have relied on financial information provided to me by RL. I have not independently reviewed the accuracy of this information, other than a high-level review of its reasonableness.

1.14 This report is an abridged version of a fuller Supplementary Report on the proposed transfer. The full report includes information that is confidential to the companies and their regulators. Copies of the full report have been provided to the PAC Board Committee, the PAC With-Profits Actuary, the Independent Expert, the PRA and the FCA in order to assist their assessments of the company's proposals.

2. PAC - FINANCIAL IMPACT OF THE PROPOSED TRANSFER

2.1 30 June 2018 position

2.1.1 The Main Report set out the impact of the proposed transfer on PAC's Solvency II surplus assuming that the transfer had occurred on 30 June 2018. These results are summarised in Figure 2.1 below.

Figure 2.1 – PAC Solvency II valuation results before and after the transfer (as at 30 June 2018)

	Total PAC shareholder-backed business			**Total PAC With-Profits Fund(1)**			**Consolidated PAC balance sheet(2),(3)**		
	Pre-transfer £m	**Post-transfer £m**	**Impact £m**	**Pre-transfer £m**	**Post-transfer £m**	**Impact £m**	**Pre-transfer £m**	**Post-transfer £m**	**Impact £m**
Assets (net of other items)	72,545	60,782	(11,762)	127,025	127,025	-	212,834	201,072	(11,762)
Technical Provisions (including TMTP)	57,637	45,920	(11,717)	117,107	117,107	-	192,721	181,005	(11,717)
Own Funds	**14,907**	**14,862**	**(45)**	**9,918**	**9,918**	-	**20,112**	**20,067**	**(45)**
SCR	7,215	7,015	(200)	3,846	3,846	-	12,420	12,220	(200)
Surplus	**7,692**	**7,847**	**155**	**6,071**	**6,071**	-	**7,692**	**7,847**	**155**
Solvency ratio	207%	212%	5%	258%	258%	-	162%	164%	2%

Notes:

(1) This represents an economic view of the Solvency II balance sheet for the with-profits business. The presentation required by the Solvency II regulations excludes the liability (and associated capital requirements) related to the present value of the future shareholder transfers. Applying the regulatory presentation, the Solvency II surplus for total PAC With-Profits Fund, after the application of the TMTP, is c.£8.9bn and the corresponding solvency ratio is 332%.

(2) The consolidated PAC balance sheet allows for the PAC shareholder-backed business, the total PAC With-Profits Fund and the PHKL with-profits business.

(3) The consolidated PAC balance sheet recognises the ring-fenced nature of the PHKL with-profits business and the PAC With-Profits Fund. On aggregation, surplus in these funds can only be recognised to the level of the associated SCR with any excess surplus being eliminated as an explicit ring-fenced fund restriction.

2.1.2 It also was noted in the Main Report that the legal ownership of PAC's Hong Kong subsidiaries was transferred to Prudential Corporation Asia Limited (PCA) in December 2018. Assuming that the transfer to PCA had occurred at 30 June 2018, the surplus of PAC's shareholder-backed business would have been c.£3.0bn with a coverage ratio of 150% prior to the proposed Part VII transfer and c.£3.1bn with a coverage ratio of c.155% post transfer (with the corresponding solvency ratios for the consolidated PAC balance sheet being 130% pre-transfer and 133% post transfer).

2.2 31 December 2018 position

2.2.1 The impact of the proposed transfer on PAC's Solvency II surplus has now been assessed using the latest reported results as at 31 December 2018 (assuming that the transfer had occurred at that date). These results reflect a recalculation of the TMTP as at 31 December 2018. They also reflect the transfer of legal ownership of PAC's Hong Kong subsidiaries to PCA, resulting in a reduction in surplus of c.£4bn for the PAC shareholder-backed business, as discussed in section 2.1.2. The results are summarised in Figure 2.2 below.

Figure 2.2 – PAC Solvency II valuation results before and after the transfer (as at 31 December 2018)

	Total PAC shareholder-backed business			Total PAC With-Profits Fund[1]			Consolidated PAC balance sheet[2],[3]		
	Pre-transfer £m	Post-transfer £m	Impact £m	Pre-transfer £m	Post-transfer £m	Impact £m	Pre-transfer £m	Post-transfer £m	Impact £m
Assets (net of other items)	60,740	49,537	(11,203)	125,257	125,257	-	176,823	165,621	(11,203)
Technical Provisions (including TMTP)	51,918	40,716	(11,203)	115,620	115,620	-	163,823	152,620	(11,203)
Own Funds	**8,822**	**8,822**	-	**9,637**	**9,637**	-	**13,001**	**13,001**	-
SCR	5,130	5,030	(100)	4,179	4,179	-	9,309	9,209	(100)
Surplus	**3,691**	**3,791**	**100**	**5,458**	**5,458**	-	**3,691**	**3,791**	**100**
Solvency ratio	172%	175%	3%	231%	231%	-	140%	141%	1%

Notes:

(1) This represents an economic view of the Solvency II balance sheet for the with-profits business. The presentation required by the Solvency II regulations excludes the liability (and associated capital requirements) related to the present value of the future shareholder transfers. Applying the regulatory presentation, the Solvency II surplus for total PAC With-Profits Fund, after the application of the TMTP, is c.£8.0bn and the corresponding solvency ratio is 293%.

(2) The consolidated PAC balance sheet allows for the PAC shareholder-backed business and the total PAC With-Profits Fund.

(3) The consolidated PAC balance sheet recognises the ring-fenced nature of the total PAC With-Profits Fund. On aggregation, surplus in these funds can only be recognised to the level of the associated SCR with any excess surplus being eliminated as an explicit ring-fenced fund restriction.

2.2.2 Figures 2.1 and 2.2 above illustrate that the proposed transfer is expected to result in an improvement in surplus of £100m for PAC's shareholder backed business. This is as a result of releasing the reinsurance counterparty default risk capital held in relation to the reinsurance arrangement between PAC and RL for the Transferring Business (£50m of counterparty default risk capital is assumed to remain in respect of the non-transferring business in the sale portfolio which will continue to be reinsured).

The 30 June 2018 post-transfer results reflected a further improvement of £55m in PAC surplus relative to the reported position. This reflected an agreed settlement for a reinsurance premium true-up together with a corresponding release of capital held by PAC against this true-up. This settlement is reflected in the reported 31 December 2018 results so does not feature as a difference between the pre- and post-transfer results.

2.2.3 Overall, PAC's shareholder-backed business and the total PAC With-Profits Fund remained well capitalised as at 31 December 2018 and are expected to remain so after allowing for the proposed transfer.

2.3 Latest estimated solvency position (30 April 2019)

2.3.1 Overall, PAC's financial position has remained relatively stable from 31 December 2018 to 30 April 2019. The change in solvency position from 31 December 2018 to 30 April 2019 does not impact the conclusions reached in this report.

3. RL - FINANCIAL IMPACT OF THE PROPOSED TRANSFER

3.1 30 June 2018 position

3.1.1 The Main Report set out the impact of the proposed transfer on RL's Solvency II surplus assuming that the transfer occurred on 30 June 2018. These results are summarised in Figure 3.1 below.

Figure 3.1 – RL Solvency II valuation results before and after the transfer (as at 30 June 2018)

	Pre-transfer £m	Post-transfer £m	Impact £m
Assets	36,315	36,315	-
Technical Provisions	32,157	32,157	-
Own Funds	**4,158**	**4,158**	-
SCR	2,351	2,351	-
Surplus	**1,807**	**1,807**	-
Solvency ratio	177%	177%	-

3.2 31 December 2018 position

3.2.1 The impact of the proposed transfer on RL's Solvency II surplus has been assessed using the latest reported results as at 31 December 2018 (assuming the transfer occurred on this date). These results reflect a recalculation of the TMTP as at 31 December 2018. The results are summarised in Figure 3.2 below.

Figure 3.2 – RL Solvency II valuation results before and after the transfer (as at 31 December 2018)

	Pre-transfer £m	Post-transfer £m	Impact £m
Assets	36,089	36,089	-
Technical Provisions	32,195	32,195	-
Own Funds	**3,895**	**3,895**	-
SCR	2,163	2,163	-
Surplus	**1,731**	**1,731**	-
Solvency ratio	180%	180%	-

3.2.2 Figures 3.1 and 3.2 above illustrate the following:

(i) RL's solvency ratio has improved between 30 June 2018 and 31 December 2018.

This was partly due to the impact from adopting RL's partial internal model, which was approved by the PRA in December.

(ii) There is no change in the solvency position of RL as a result of the proposed transfer as the Transferring Business was already reinsured to RL as part of the reinsurance agreement between PAC and RL and a portfolio of assets representing the agreed premium was already transferred to RL shortly after 14 March 2018 as part of this arrangement.

3.2.3 Overall, RL remained well capitalised as at 31 December 2018 and is expected to remain so after allowing for the proposed transfer.

3.3 Latest estimated solvency position (30 April 2019)

3.3.1 Overall, RL's financial position has remained relatively stable from 31 December 2018 to 30 April 2019. The change in RL's solvency position from 31 December 2018 to 30 April 2019 does not impact the conclusions reached in this report.

3.4 Balance sheet sensitivity

3.4.1 As discussed in the Main Report, RL is exposed to a narrower range of risks but benefits from a lower level of risk diversification when compared to PAC. RL manages these risks through reinsuring longevity risk and adopting a relatively low risk investment strategy.

3.4.2 The Main Report included an assessment of the resilience of RL's solvency position as at 30 June 2018 against a selection of scenarios determined by stressing the main assumptions RL is exposed to.

3.4.3 RL have subsequently performed a similar assessment as at 31 December 2018. The results indicate that RL would continue to be able to withstand a range of market and non-market stress conditions whilst maintaining a strong solvency position.

4 OTHER CONSIDERATIONS

4.1 Policyholder enquiries

4.1.1 I have been provided with a summary of the objections and enquiries that arose from PAC policyholders over the period 8 February 2019 to 15 May 2019 inclusive following the issue of the Policyholder Information booklet to transferring PAC policyholders.

4.1.2 4,966 phone calls or letters have been received from PAC policyholders (as at 15 May 2019) in relation to the proposed transfer. An analysis of the calls and letters indicated that the majority were asking for further information about the proposed transfer.

4.1.3 As of 15 May 2019, 983 objections to the transfer have been received from PAC policyholders. Most of the objections relate to one or more of the following:

- Policyholders who have loyalty with the Prudential brand;
- Policyholders who do not want to be transferred to a provider that they view as newer and less well-known; and
- Policyholders who will have one or more annuity policy transferring to RL and one or more annuity policy remaining with PAC.

4.1.4 Written responses are being drafted for all objections. Summaries of the objections have been passed to the Independent Expert who has taken a sample for further review. All objections have been or will be passed to the PRA and the FCA for their information, and will also be passed to the Court. The issues raised by the objections, where they are within the scope of my report, have been considered. I am satisfied that none of the issues raised by any of the objections alter the conclusions as set out in the Main Report.

4.2 Feedback from other regulators

4.2.1 Regulators in all EEA countries have been notified of the proposed transfer. As of 15 May 2019, responses have been received from 22 of the regulators. At the time of writing, there is ongoing dialogue with the regulators but no objections have been raised against the proposed transfer.

4.3 Prudential restructuring

4.3.1 It was noted in the Main Report that in March 2018, Prudential plc announced its intention to demerge M&G Prudential from Prudential plc. Work is underway in relation to this and it is not expected that the restructuring activities would affect the conclusions from the Main Report.

4.4 Review of the commutation basis

4.4.1 Under certain circumstances, annuities can give rise to lump sum payments determined using commutation terms (for example, tax free cash commutation for deferred annuities, and ill health and trivial commutation for annuities in payment). The terms of commutation for the transferring policyholders are currently determined using PAC's standard basis in force at the time. Following the proposed transfer, commutation terms will be set by RL. The commutation bases are not guaranteed and may change over time; the ultimate commutation benefits offered to the transferring policyholders will be dependent on the prevailing basis at the time of commutation.

4.4.2 Within the Main Report, I considered RL's commutation approach in comparison to PAC's and concluded that the principles applied in determining the basis are not unreasonable and that the basis is subject to appropriate governance through approval at RL's Customer and Conduct committee.

4.4.3 Analysis performed at the time of the Main Report suggested that RL's commutation basis resulted in lower commuted values relative to PAC's. In light of this, I noted that it was important to recognise that the commutation bases are not guaranteed and may change over time and that most of the deferred annuities (where commutation or transfer payments are most likely to take place and are most likely to be material to the policyholder) have been excluded from the proposed transfer.

4.4.4 RL and PAC have since both reviewed their commutation bases. Under the revised bases, RL's and PAC's commutation terms for the transferring policyholders are more aligned, with no systematic increase or decrease in commuted values expected as a result of the transfer (based on analysis of a representative sample of policies).

4.4.5 As a result of these changes to the commutation bases, my view on policyholder benefit expectations is unchanged from that expressed in the Main Report. It is expected that RL will be able to meet the reasonable benefit expectations of the policyholders with a high degree of confidence.

4.5 Sale of Irish business by RL

4.5.1 On 1 April 2019, it was announced that, subject to regulatory approval, RL had entered into an agreement with Monument Re to sell a portfolio of Irish annuities worth approximately €140 million. The sale has been structured initially as reinsurance to Monument Re and is expected to be followed by a transfer of the portfolio to Laguna Life d.a.c., subject to regulatory and court approvals.

The transaction is expected to have a minimal impact on RL's financial position and none of the Transferring Business from PAC is to be transferred to Monument Re.

5 CONCLUSIONS

5.1 The Main Report reviewed the proposed transfer and concluded that as part of the prudent management of PAC and its subsidiaries it is not inappropriate to transfer the agreed portfolio of annuity business to RL.

The Main Report also reviewed the impact of the proposed transfer from the perspective of the transferring and remaining PAC policyholders and concluded that:

(a) the security of PAC's transferring policyholders will not be materially adversely affected by the transfer,

(b) the reasonable benefit expectations of PAC's transferring policyholders will not be materially adversely affected by the transfer,

(c) the service standards of PAC's transferring policyholders will not be materially adversely affected by the transfer,

(d) the security of PAC's remaining policyholders (in all sub-funds) will not be materially adversely affected by the transfer,

(e) the reasonable benefit expectations of PAC's remaining policyholders (in all sub-funds) will not be materially adversely affected by the transfer,

(f) the service standards of PAC's remaining policyholders (in all sub-funds) will not be materially adversely affected by the transfer.

5.2 I have reviewed the Main Report and considered the changes in the financial position of PAC and RL since the Main Report was produced, together with any other developments such as the responses from policyholders to the proposed transfer and other considerations.

Based on the considerations as set out in this Supplementary Report, it is my view that the conclusions set out in the Main Report and as set-out in section 5.1 above, are reasonable and remain valid.

Jonathan Hughes

17 May 2019