Report of the Head of Actuarial Function of

Prudential International Assurance plc

on

The proposed transfer of the business of the Polish branch and certain other historic overseas business

of

The Prudential Assurance Company Limited

to

Prudential International Assurance plc

pursuant to

Part VII of the UK Financial Services and Markets Act 2000

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Contents

REPORT OF THE HEAD OF ACTUARIAL FUNCTION OF PRUDENTIAL INTERNATIONAL ASSURANCE PLC

The following is the report by Gemma O'Neill, the Head of Actuarial Function ('HoAF') of Prudential International Assurance plc ('PIA') to the Directors of PIA on the proposed transfer by The Prudential Assurance Company Limited ('PAC') of its local European life business to PIA, a subsidiary of PAC, which is domiciled and regulated in Ireland. The proposed transfer will take place on 1 January 2019, or on such other date as may be agreed by PAC and PIA and approved by the High Court of Justice of England and Wales (the 'Court').

1 INTRODUCTION

1.1 Following the decision of the UK government to trigger Article 50 of the Lisbon Treaty and leave the European Union ('EU'), Prudential has reviewed its business in the European Union. Currently Prudential's European operations are split across two companies PAC and PIA. The outcome of the review is that it is proposed to transfer all of PAC's long-term European business(excluding the UK) into PIA. This change streamlines Prudential's operating model and allows for simpler management structures. In addition it provides flexibility given that post-Brexit it might not be possible for PAC as a UK insurance company to operate in the same way it has done previously within the EU.At this stage, the final outcome of the negotiations on the exit of the United Kingdom from the European Union ('Brexit') is unknown.

1.2 PAC's presence in Europe is a consequence of businesses that PAC established in Europe, and as a by-product of acquisitions which PAC has made. In addition Prudential has established various non-insurance businesses in Europe to support its insurance business from both a management services perspective and from a distribution perspective. The business to be transferred includes business written by PAC in Poland, France and Malta as well as business written in Germany and Ireland that was transferred to PAC from the Equitable Life Assurance Society ('ELAS') in 2007.

1.3 PAC operates as the main insurance company in the UK and Europe business unit of the Prudential group (referred to as Prudential UK & Europe) and in August 2017, Prudential plc announced that it was combining two businesses within the Prudential group, Prudential UK & Europe and its asset manager, M&G, to form a combined business called M&G Prudential. In March 2018, it was also announced that M&G Prudential would demerge from the Prudential group, resulting in two separately listed companies.

1.4 PIA is a public limited company, the shares of which are 100% owned by PAC. PIA is an Irish regulated entity and is subject to the relevant requirements and guidelines of the Central Bank of Ireland ('CBI'). In October 2014, PIA established an overseas branch operation, Prudential International Assurance UK Branch ('PIA UK Branch'), in the United Kingdom.

1.5 PIA is a leading insurer in the offshore bond market. Its focus is the sale of multi-asset solutions to UK nationals resident in the UK and selected countries in continental Europe and the Crown Dependencies.

2 PURPOSE AND SCOPE

2.1 The purpose of this report is to review the proposed transfer of PAC's local European life business to PIA. The proposed transfer will take effect by means of an insurance business transfer scheme (the 'Scheme') under Part VII of the Financial Services and Markets Act 2000 (the 'FSMA'). This report should be read in conjunction with the Scheme.

2.2 In this report, I have considered the transfer from the perspective of existing policyholders of PIA. PIA Policyholders for this purpose include persons with certain rights, including contingent rights under PIA's policies. I have not considered the perspective of policyholders of the local European life business who will be transferred to PIA and the policyholders remaining in PAC following the transfer, and note that the Chief Actuary of PAC will consider the transfer from the perspective of these policyholders. I have reviewed the report produced by the Chief Actuary of PAC in relation to the position of the policyholders of the local European life business who will be transferred to PIA and the policyholders remaining in PAC following the transfer.

2.3 I am a Fellow of the Institute of Actuaries having qualified in 2007. I have 13 years' experience in the life assurance industry.

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

2.5 The financial information shown in this report has been prepared at 31st December 2017. The results have been reviewed and approved by PIA's Technical Committee.

2.6 To the best of my knowledge, I have taken account of all material facts in assessing the impact of the Scheme and in preparing my report. My report is focussed on commenting on the proposed Scheme and is not concerned with possible alternatives to the Scheme. As noted above, my report considers the impact of the proposed Scheme on the policyholders of PIA both from the point of view of the Scheme proceeding and not proceeding.

2.7 Oliver Gillespie of Milliman LLP has been retained by PAC and PIA to produce a report on the terms of the Scheme in the capacity of Independent Expert, and his appointment has been approved by the Prudential Regulation Authority ('PRA'). A copy of this report, together with the reports of the PAC With-Profits Actuary and the PAC Chief Actuary, has been provided to Mr. Gillespie, who has had the opportunity to review various drafts of it.

2.8 The report is structured as follows:

- Sections 3 and 4 provide information on PIA's current operations and risk profile
- Section 5 outlines the proposed Scheme of transfer and its operational, reinsurance and other implications
- Section 6 provides information on PIA's financial position and risk profile taking into account the Scheme of transfer
- Section 7 provides a summary of the impact of the proposed transfer on the security of policyholders' benefits and their reasonable expectations
- Section 8 provides my conclusions on the Scheme from the perspective of PIA's policyholders

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

- TAS 100: Principles of Technical Actuarial Work, and
- TAS 200: Insurance

The intended users of this report are the Court, the Board of Directors of PIA (the 'Board'), the PAC With-Profits Committee, the PAC With-Profits Actuary, the PAC Chief Actuary, the Independent Expert, the PRA, the Financial Conduct Authority ('FCA') and the CBI.

A version of this report has also been reviewed by our legal advisors.

2.10 The Actuarial Profession Standard ('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 HoAF of PIA. As HoAF, I am responsible for the financial information presented in this report which may give rise to a potential conflict of interest or the appearance of conflicts of interest. In light of this and the materiality and importance of my conclusions, I have sought independent peer review from the PIA Chief Risk Officer, Mr Bruce Gunn.

3 INFORMATION ON PRUDENTIAL INTERNATIONAL ASSURANCE PLC

3.1 Background

3.1.1 PIA is a public limited company, the shares of which are 100% owned by PAC. As an Irish regulated entity, PIA is subject to the Solvency II regulatory regime, applicable to all EU entities, as well as to the relevant requirements and guidelines of the CBI. In October 2014, PIA established an overseas branch operation, Prudential International Assurance UK Branch ('PIA UK Branch'), in the United Kingdom.

3.1.2 PIA is a leading insurer in the offshore bond market. Its focus is the sale of multi-asset solutions to UK nationals resident in the UK and selected countries in continental Europe and the Crown Dependencies.

3.1.3 PIA's current markets outside of the UK include France, Spain, Malta, Cyprus, Gibraltar and the Crown Dependencies (Isle of Man, Jersey, and Guernsey). PIA has two lines of business: unit-linked insurance and insurance with-profit participation. Insurance with-profit participation business comprises all single premium investment products that are invested in the PAC With-Profits funds via a reinsurance arrangement further detailed in section 3.5.

3.1.4 The PIA UK Branch was established in the UK in October 2014 under the EU freedom of establishment rules. PIA UK Branch policies are distributed through third party platform providers and through a distribution company owned by PAC. The branch has an address in Craigforth (where the branch manager and assistant branch manager are located) and a registered office in London.

3.1.5 The onshore product is an open architecture bond allowing customers to have access to a number of funds offered by external fund managers. The business sells single premium insurance bonds and targets high net worth individuals seeking the tax and estate planning advantages offered by an onshore bond.

3.1.6 In recent years, PIA has undergone significant changes. In particular, it has restructured its expense model to reduce costs and it has improved its sales in the offshore bond market through having a better support structure for sales staff and an improved product offering through PruFund. It has also significantly invested in a digitisation strategy to update the information technology infrastructures supporting its operating model.

3.2 Risk Appetite

3.2.1 The Board is collectively responsible for the long-term success of the company and for providing leadership within a framework of effective controls. The Board maintains and approves risk appetite statements and limits that inform decision making, reflect the company's business model and are compatible with Prudential group-wide risk limits with materiality taken into consideration. PIA's risk appetite enables it to implement its strategy and achieve its business plan objectives whilst continuing to ensure it operates within the confines of the tolerances and limits defined by the Board.

3.2.2 The key risks to which PIA is exposed are market risk, lapse risk and expense risk. These risks relate to:

(i) market performance being lower than expected, resulting in lower policyholder fund values and lower charges being received than assumed, contributing to a lower present value of future profits (PVFP),

(ii) a higher level of lapses than expected, which will reduce the value of assets under management resulting in lower charges and lower PVFP, and
(iii) higher expenses than expected, which will result in a lower PVFP.

3.3 Capital management

3.3.1 The Prudential group's preferred approach to capital management is, insofar as is possible, to hold surplus shareholder capital in excess of its subsidiaries' regulatory capital requirements at Prudential group level and to provide additional capital support to its subsidiaries, as required, to write new business and/or to maintain solvency in the event of adverse experience.

3.3.2 PIA's current solvency ratio (as at YE17) is 157%.

3.3.3 PIA is a wholly owned subsidiary of PAC, and in adverse scenarios would reasonably expect to rely on further funding from PAC. However, PIA does not have any formal capital support arrangements in place with PAC and is a separate subsidiary, regulated by the CBI with its own Board responsible for ensuring its ongoing solvency as a separate entity.

3.3.4 In this context, PIA's Board makes decisions in relation to the management of PIA's capital through the Own Risk and Solvency Assessment ('ORSA') process. The ORSA process provides the PIA Board with the information it needs to make forward looking decisions on capital management in the context of its business strategy, such as requesting capital from PAC and/or paying up dividends to PAC and/or undertaking projects which release capital within its existing business. In particular, the ORSA process considers PIA's solvency and capital position in the context of the business PIA is expected to write, any strategic or operational initiatives and other management actions it is expecting to take over its business planning horizon.

3.4 Investment management

3.4.1 The PIA Board is responsible for setting PIA's investment strategy which it does through PIA's investment policy. The investment policy sets out the framework for the management and oversight of investment performance and investment related risk for internally and externally managed funds, both policyholder and shareholder.

3.4.2 Investments are made in accordance with PIA's investment policy which is set in line with its risk appetite from an investment and credit risk exposure perspective and is reviewed annually. PIA monitors its exposures on an ongoing basis, highlighting deviations from its risk appetite through its escalation processes.

3.4.3 For policyholder liabilities, PIA typically matches its policyholder liabilities with relevant assets. For other long-dated liabilities, it seeks to match these with government bonds of the same / similar duration. Remaining shareholder assets are typically invested in short dated cash, near cash instruments or government bonds. In addition, credit risk on all investments is managed through appropriate diversification and monitoring of credit rating updates and other market information.

3.4.4 It is worth noting that while PIA has policyholder with profits products, a reinsurance arrangement with PAC transfers all risks, in particular guarantee and option risks, on these funds to PAC. Consequently, all investment risk on PIA's insurance with profit participation business is managed by PAC. A general explanation of how PAC manages it's with profits business is provided in the publicly available document, "Principles and Practices of Financial Management", published on the website, www.pru.co.uk.

3.4.5 Constraints are placed on the credit quality of PIA's assets, and reserves are held to protect the company against the risk of adverse credit experience.

3.5 Reinsurance arrangements

3.5.1 PIA has a reinsurance arrangement in place with PAC in respect of its insurance with profit participation business. This business comprises all single premium investment products invested in PAC's with profits funds, with these funds accessed through a reinsurance arrangement. The reinsurance arrangement in place between PIA and PAC is such that all of the with profits benefits provided by the policies are wholly reinsured to PAC.

3.5.2 As a result, PIA has a policyholder liability for insurance with profit participation business which is backed by a corresponding reinsurance asset (due from PAC) of the same size. PIA assumes that the credit risk associated with the reinsurance arrangement with PAC is negligible because the PAC with-profits fund is managed to a AAA standard, which leads to a very low expected probability of default. PIA therefore does not hold any capital against this risk. In addition to the reinsurance arrangements being set up, PAC will grant PIA a 'pari passu' charge on the assets of PAC such that in the event of PAC becoming insolvent, PIA would rank alongside the direct written policies of PAC.

3.5.3 With respect to its unit-linked insurance line of business, where such business has significant death and/or disability benefits, PIA has a reinsurance arrangement in place with external reinsurers where at least 75% of the mortality and morbidity risks on such products are reinsured. An allowance for the risk of default of external reinsurers is allowed for from a capital perspective; this allowance is negligible due to the high credit rating quality of the reinsurers. Following the proposed transfer there will be no change to these reinsurance arrangements.

3.5.4 The HoAF is required to express an opinion to PIA's Board on the adequacy of PIA's reinsurance arrangements on an annual basis. This opinion identifies any deficiencies and provides recommendations. The opinion of the previous HoAF Olive Gaughan, as of 5th December 2017, identified no material deficiencies or recommendations. To the best of my knowledge, no material changes in the business have been effected since that date to invalidate that opinion.

4 FINANCIAL POSITION AND RISK PROFILE OF PIA BEFORE TRANSFER

4.1 Background

4.1.1 With effect from 1 January 2016, PIA is required to adopt Solvency II as its capital regime. Solvency II is the maximum harmonisation regulatory regime applicable to all insurance companies within the EU.

4.1.2 Under Solvency II and other relevant and applicable CBI regulations, PIA is required to hold sufficient capital to meet its best estimate liabilities ('BEL') plus risk margin ('RM') plus SCR. The SCR determines the amount of capital needed to withstand a 1-in-200 year risk event over a one year time horizon. The SCR is shown net of risk mitigation actions, for example, reinsurance. PIA has been granted approval by the CBI to calculate its SCR based on its internal model.

4.1.3 In calculating PIA's current financial position, Solvency II calculations were performed using appropriate assumptions and methodologies, determined and applied in accordance with the Solvency II regulations. The assumptions and methodologies used as well as the application of these to generate the numbers shown in the table below have been through a governance, review and sign-off process within PIA, including the ultimate sign-off and approval of them by the PIA Board.

4.1.4 The HoAF is required to provide an annual opinion in relation to technical provisions to the Board of PIA and the CBI, supported by a report to the Board which may be provided to the CBI upon request. My opinion at year-end 2017 stated *'In my opinion, the technical provisions of Prudential International Assurance (PIA) as at 31/12/2017 identified above by line of business, gross and net of reinsurance, comply in all material respects with all relevant Solvency II requirements.'*

4.1.5 The results shown in this report are as at 31st December 2017.

4.1.6 The HoAF is also required to provide an opinion to the PIA Board on the ORSA process which considers the range of risks and adequacy of the stress scenarios considered as part of the ORSA process, the appropriateness of the financial projections included within the ORSA process and whether PIA is continuously complying with requirements regarding the calculation of technical provisions and potential risks arising from the uncertainties connected to this calculation. The opinion of the previous HoAF on the 2016 ORSA process did not include any significant issues or recommendations.

4.2 Current solvency position

4.2.1 PIA's solvency ratio as at 31 December 2017 was 157%. This reflected the actual solvency position at this date and was determined on the basis of the SCR calculated using PIA's internal model which was approved for use by the CBI. PIA's solvency position at 31 December 2016 and 31 December 2017 is shown below.

	Actual	
	YE2016	**YE2017**
Own Funds	205	203
SCR	109	130
Surplus	96	74
Solvency ratio	189%	157%

4.3 Current risk profile

4.3.1 PIA's current risk profile in terms of its SCR by risk category is shown in the table below.

Components description (£m)	**2017 actual**
Interest rate risk	10.5
Equity Risk	95.6
Property Risk	13.2
Spread Risk	18.2
Currency Risk	20.0
Mortality Risk	13.0
Disability-morbidity risk	0.2
Lapse risk	115.3
Expense risk	62.4
Operational risk	22.7
Loss-absorbency capacity of deferred tax	-18.4
Other adjustments	-34.9
Sum of SCR by Risk	317.9
Diversification	-188.4
SCR (Diversified across all Risks)	129.5

4.3.2 Each line reflects the capital required in respect of a given risk if a 1-in-200 year event for that risk were to occur in isolation. If all of these risk events happened simultaneously, the impact would be lower than the sum of all of the individual risk events (for example, the impact of a combined lapse and equity stress is lower than the sum of the individual stresses as the equity stress would reduce the value of future profits which results in a lower impact from the lapse stress). This is reflected in the line item "Other Adjustments" and is also referred to as "Interaction effects". As these events result in the loss of value (future profits) to the company, there is a reduction in the associated deferred tax liability. The item "Loss absorbing capacity of deferred tax" reflects the extent of this for PIA. The total of these items is reflected in the row "Sum of SCR by Risk". The row "SCR (Diversified across all Risks") reflects the overall impact of a 1-in-200 year event for the company. The item "Diversification" reflects the extent to which this is less than the Sum of SCR by Risk.

4.3.3 The table below indicates the relative materiality of PIA's risks, based on the individual line items in the table above.

	2017 actual
Lapse Risk	31%
Equity Risk	26%
Expense Risk	17%
Other Market Risks (IR, Credit, Currency, Property)	17%
Other Insurance risks	4%
Operational Risk	6%
	100%

4.3.4 PIA's current risk profile shows that it is significantly exposed to underwriting risk, in particular lapse risk because of the reduction in the value to the business of the future fund charges expected to be earned; and to expense risk because of the risk actual expenses differ from the operational and investment expenses assumed. PIA is also significantly exposed to market risk. This risk arises from two sources:

- indirect exposure through fees earned: the management fees earned by PIA depend on the value of policyholder assets under management. Therefore, there is a risk that adverse movements in the value of the assets in which policyholders are invested results in a reduction in the level of management fees earned by PIA;
- direct exposure through shareholder's investments: PIA faces the risk of adverse movements in the value of assets in which PIA's shareholder funds are invested.

4.3.5 As described in Section 3.2, PIA is also exposed to other material risks which are not quantified. PIA manages these risks through the risk policies it has in place and its risk appetite which sets tolerances for these risks.

5 THE PROPOSED TRANSFER

5.1 Proposed transfer

5.1.1 It is proposed that all of the local European life insurance business of PAC, as specified below in sub-sections 5.2, should be transferred to PIA. The proposed transfer will take effect by means of an insurance business transfer scheme (the Scheme) under Part VII of the Financial Services and Markets Act 2000. This report should be read in conjunction with the Scheme.

5.1.2 Following the transfer, it is expected that PAC Poland, PAC France and PAC Malta will cease to transact insurance business. PAC Poland may not be closed as it may be necessary for it to remain open as a shared services centre.

5.1.3 PIA proposes to pay for the transferred business through the issue of one or more additional shares in PIA to PAC, subject to the terms of a subscription agreement entered into between PIA and PAC that will take effect on the transfer date.

5.2 Business to be transferred

5.2.1 The business to be transferred from PAC to PIA under the Scheme comprises (figures are as at 31 December 2017):

i. The with-profits business from PAC Poland with asset shares of c.£3m.

ii. The non-profit business from PAC Poland, which has a negative liability of c.£21m[1] (reflecting the fact that the value of future charges exceeds expenses).

   There are approximately 18,000 with-profits policyholders and 27,000 non-profit policyholders in PAC Poland.

iii. All of the business from PAC France, comprising approximately 769 policies and liabilities of c.£44m.

iv. All of the business of PAC Malta, comprising 21 policyholders and liabilities of c.£3m.

v. The policyholders of business written by ELAS in Germany and Ireland:

   1. 237 policyholders holding with-profits annuity contracts originally written in Ireland, with a liability of c.£11m.

   2. 439 policyholders holding with-profits annuity contracts originally written in Germany, with a liability of c.£13m.

5.3 Rationale for the transfer

5.3.1 Currently Prudential's European operations are split across two companies, PAC and PIA. Prudential has decided to consolidate all of its long-term European business (excluding the UK) into one entity, PIA, which is based in Ireland.

5.3.2 This change will allow Prudential to operate more efficiently and simplify how these policies

[1] *This will be offset by a risk margin of £6m, a deferred tax liability of £5m and an SCR of £15m.*

are managed. In addition, it will also ensure that these policies can continue to run smoothly given that post-Brexit it might not be possible for PAC as a UK insurance company to operate in the same way it has done previously within the EU.

5.4 Effective date of transfer

5.4.1 If the Scheme is sanctioned by the Court, the transferring policies (along with the associated assets and liabilities) and the surplus assets will transfer from PAC to PIA at 00.01am GMT/01:01 CET on [1 January 2019], or such other time and date as may be agreed by PAC and PIA and approved by the Court.

5.5 Overview of business to be transferred from PAC Poland to PIA Poland

5.6.1 The Scheme proposes to transfer all of the business of PAC Poland to PIA Poland to be on a freedom of establishment basis and, post transfer, to de-authorise PAC Poland.

5.6.2 PAC Poland was set up in 2012 as a local Polish branch of PAC under the EU freedom of establishment rules. Its full name is The Prudential Assurance Company Limited Sp. z o.o. Oddział w Polsce and it is entered in the register of entrepreneurs maintained by the District Court in Warsaw, XIII Division of National Court Register, under registered number 0000437638.

5.6.3 The branch's business comprises conventional with-profits regular premium endowments, protection rider benefits and standalone term assurance plus riders.

5.6.4 The branch has 4 distribution channels for its business as follows:

- tied agent channel comprising around 933 agents across 22 sales offices as at 31st December 2017, under Prudential Polska Sp. z o. o. which is a fully-owned subsidiary of Prudential Financial Services Ltd which is turn is a fully owned subsidiary of Prudential plc;
- multi-agency channel which sells a variety of products from various insurers;
- bancassurance channel with a relationship currently in situ with one bank and with further agreements in the pipeline by way of tender and/or leads;
- affinity channel where products are sold via phone to customers of partners such as telecommunications companies.

5.6.5 The conventional with-profits (WP) business comprises two different products - an endowment plan without a surrender guarantee which is closed to new business (End1) and one which has a surrender guarantee (End2) and is open to new business. Both products are available with different fund asset mixes (Low EBR and Mid EBR). The WP endowments receive discretionary increases in benefits by way of regular renewal bonuses and a terminal bonus at the point of payout. Both products access PAC's with-profits sub-fund ('WPSF') which is a 90:10 WP fund. Standalone non-profit riders (which are optional), encompassing serious illness, accidental death, disability, total and permanent disablement and waiver of premium are sold in conjunction with the WP business. WP policies are sold via all channels except the Affinity channel.

5.6.6 The non-profit ('NP') business comprises different products sold by each distribution channel. A standalone protection term product with a compulsory death benefit and optional riders is sold by the tied agent, multi-agency and bancassurance channels. The standalone term product offers a guaranteed rate for the policy term. The riders are subject to 5 year reviews but with no further individual risk assessment undertaken. The NP business sold by the Affinity channel comprises death, accidental death and cancer illness cover. There are no periodical payment covers, such as income protection or hospital cash sold currently.

5.6.7 From a strategic perspective, the business plans for the Polish branch project very strong growth through offering variants of their existing product range and the development of a new single premium WP product via a broader distribution channel base (including a significant increase in the number of tied agents).

5.5 Operational implications of transfer from PAC Poland to PIA Poland

5.6.8 PAC Poland currently operates with broad autonomy in terms of day to day management with a local management team supported by a full suite of locally staffed functional areas. This local management team is responsible for the full range of operations of the Polish branch including finance, actuarial, change, operations and human resources. No change is expected in the local management team structure nor in the operations.

5.6.9 PIA's governance framework will largely remain the same but changes will be made to accommodate the new PIA Poland branch expected to be authorised by the CBI. In addition to the creation of a branch structure of PIA, these changes will also include the creation of a new management committee for Poland ('Polish SMT') as well as ensuring PIA's existing advisory committees include appropriate Polish representation. The additional governance and oversight which will be required in PIA is expected to be absorbed by existing staff.

5.6.10 PAC Poland currently has a series of servicing agreements in place for the administration and servicing of certain aspects of its business, although the majority of its administration and servicing is managed internally within PAC Poland. An outsourcing arrangement for some IT services is currently provided to PAC Poland by another Prudential entity (Prudential Global Data Services or PGDS). PIA obtains IT services from PGDS though a contract with an intermediary company, Prudential Distribution Ltd (PDL), and after the transfer, the IT services will be provided to the Polish business through the same intermediary. In effect the services will continue to be provided by the same company (PGDS) and it will only be the legal structure through which services are provided which changes.

5.6.11 A change in ownership structure is also proposed in respect of Prudential Polska. Prudential Polska will cease to be an agent of PAC Poland and become a tied agent of PIA Poland. The ownership of Prudential Polska will change from Prudential Financial Services Limited (PFSL), a sister company of PAC, to Prudential Insurance Management Services Limited ('PIMS'), a sister company of PIA.

5.6.12 The PAC Poland business currently costs more to run than the expenses deducted from its policies i.e. it is in an expense overrun position. This is primarily because the business invested in technology to run and administer the business and has not yet reached a critical mass, although it is expected to do so by 2022. The WP reinsurance arrangement to be put in place between PAC and PIA provides that PAC will fully reimburse PIA for all expenses it incurs in relation to the with-profits business and therefore PAC will be responsible for funding any expense overrun associated with the with-profits business. Consequently, PIA will not be responsible for any expense overrun on the WP policies. However, it will be responsible for any expense overrun experienced in relation to its NP policies. This overrun is significant and its elimination is dependent on PAC Poland achieving a certain amount of growth per annum in order to reach critical mass.

5.7 Reinsurance and other implications of transfer from PAC Poland to PIA Poland

5.7.1 There is currently a quota share arrangement between PAC and Swiss Re to reinsure 75% of the mortality risk in respect of the non-profit protection business and the non-profit riders and the mortality risk on the with-profits business of PAC Poland. If the Scheme were to be implemented, the reinsurance arrangement with Swiss Re would be transferred to PIA pursuant to the Scheme with no other changes to the terms and conditions and the corresponding reinsurance asset will be allocated to PIA.

5.7.2 The part of the arrangement in respect of the mortality risk on the with-profits business of PAC Poland would be novated back to PAC (together with the corresponding reinsurance assets in respect of mortality risk only) immediately after the Scheme becomes effective, as the risk would remain with PAC due to the with-profits reinsurance arrangement between PIA and PAC.

5.7.3 The reinsurance arrangements between PIA and Swiss Re and PAC and Swiss Re will continue to cover future new business written in the PIA Poland Branch in accordance with the terms of the current arrangement between PAC and Swiss Re in respect of the PAC Poland Branch business. This is not part of the Scheme as it would only impact future policyholders.

5.7.4 Two high value with-profits whole of life policies written by PAC in Malta are currently reinsured with Swiss Re under a separate reinsurance arrangement. If the Scheme were to be implemented the PAC Malta business would be transferred to PIA and reinsured to PAC and so this reinsurance arrangement would remain with PAC.

5.7.5 A reinsurance treaty will be set up to reinsure the Polish with-profits business into the WPSF. The treaty has been drafted to ensure that the existing Polish policyholders will receive the same economic benefit following the transfer that they would have if the policies had not been transferred and remained in PAC.

Policyholders will continue to have access to the same underlying assets and with-profits proposition that they currently have.

In particular, in line with the current With-Profit fund offering available to Poland, PAC will continue to maintain two distinct asset pools denominated in Polish Zloty and offering different strategic asset allocations (25% equity backing ratio (EBR) and 50% EBR). The business will be reassured from PIA into these two asset pools. The business written under the reinsurance treaty will be managed on a basis that is consistent with existing Polish With-Profit business within the PAC WPSF. The arrangement is set up to ensure that the reasonable expectations of the transferred policyholders are maintained and to also protect the interests of other PAC policyholders and the estate.

PAC will grant PIA a ‘pari passu’ charge over the assets of PAC’s such that in the event of PAC becoming insolvent, PIA would rank alongside the direct written policies of PAC.

In addition, PAC must calculate bonus rates in a manner consistent with the policy terms and conditions and the approach it has hitherto taken in respect of transferring policies. Any changes to the methodology for calculating bonus rates must be no less favourable than would have been the case if the policies had continued to be PAC policies. PIA must declare bonuses in accordance with the bonus rates notified to it by PAC.

5.7.6 PIA shall be responsible for all administration expenses associated with the with-profits business, including development costs. The treaty provides that PAC shall reimburse PIA fully for these expenses.

5.7.7 The reinsurance arrangement also provides that PIA will receive, as reinsurance commission, a portion of the shareholder’s allocation of surplus arising from the Polish business following a 90:10 allocation.

5.7.8 To protect the interests of the policyholders, the circumstances in which the treaty can be terminated is limited and the terms of any termination will (subject to limited exceptions) be subject to the agreement of an independent actuary and the With-Profits Committee of PAC (or any replacement or successor committee), whose role will be to ensure that no policyholders are materially disadvantaged in this scenario.

5.7.9 Protection in case of insolvency:

Existing Policyholders of PAC Poland currently have recourse to the UK Financial Services Compensation Scheme ('FSCS'), which pays policyholders 100% of their benefits in the event of PAC going insolvent. This may not continue to apply after the part VII transfer of the businesses to PIA.

New policyholders of PIA Poland (i.e. those written directly into PIA Poland) will not have any protection comparable to the FSCS. This is the case for other life insurance businesses in Poland, so does not put PIA at a disadvantage, and was not considered by Poland SMT as a critical factor in relation to achieving sales forecasts.

It is the view of the PAC Chief Actuary that the loss of FSCS protection does not represent a material adverse impact on the security of benefits or on policyholders' reasonable expectations, on the basis that the probability of PIA not being able to pay policyholders' contractual benefits is remote.

5.8 Overview of other business to be transferred from PAC to PIA

5.8.1 PAC established a branch and began writing business in France in 2000. The PAC France branch ('PAC France') ceased writing new business in 2003 but remains open to top-up business from existing policyholders. There are currently 769 policies remaining in the branch as at 31st December 2017 representing liabilities of c. £44m. on a Solvency II basis. The Scheme proposes to transfer business from PAC France to PIA and for PIA to manage it on a freedom of services basis. The business being transferred comprises single premium bonds which are invested in a mix of with profit and unit linked funds. The WP policyholders currently access the DCPSF on a 100:0 basis, and will continue to do so via a reinsurance arrangement between PIA and PAC, as set out in section 5.10 of this report.

5.8.2 PAC established a branch in Malta in 1955 writing business through a direct sales force. The branch ceased writing business in 1982 and was de-authorised. In 2015, the business was converted from a freedom of establishment basis to a freedom of services basis by PAC. The Scheme proposes to transfer business from PAC Malta to PIA and for PIA to manage it on a freedom of services basis. The business being transferred comprises 17 whole of life with profit policies and 4 non-profit whole-of-life insurance policies representing liabilities of c. £3m. on a Solvency II basis as at 31st December 2017. The WP policyholders currently access the WPSF of the PAC with profits fund on a 90:10 basis, and will continue to do so via a reinsurance arrangement between PIA and PAC, as set out in section 5.10 of this report.

5.8.3 PAC has policyholders in Germany and Ireland which were acquired in 2008 as part of the transfer of certain business which was originally sold by overseas branches of Equitable Life to PAC. The Scheme proposes to transfer this business, known as the Equitable Life Assurance Society ('ELAS') business, to PIA. The transferring ELAS business is comprised of 439 with profit annuity contracts, mainly purchased life annuity contracts, which were originally written in Germany and 237 with profit annuity contracts, mostly retirement annuity contracts, originally written in Ireland representing liabilities of c. £24m. on a Solvency II basis as at 31st December 2017. PAC currently operates the transferring ELAS business on a freedom of services basis in Germany and Ireland. Following the transfer, PIA will continue to operate the German business on a freedom of services basis, the Irish business will come under PIA's domestic Irish authorisation. The transferring ELAS policyholders currently access the DCPSF of the PAC with profits fund on a 100:0 basis, and the transferring ELAS policyholders will continue to do so via a reinsurance arrangement between PIA and PAC, as set out in section 5.10 of this report.

5.9 Operational implications of other business to be transferred from PAC to PIA

5.9.1 The PAC France business under the Scheme is currently administered on PAC's behalf by PIMS, an Irish domiciled non-regulated services company which provides management services to both PIA and PAC and with the relevant services provided by Capita Life and Pensions Services (Ireland) Limited (CLPSI) pursuant to an outsourcing arrangement with PIMS. PAC has a 100% interest in PIMS. The Managing Director of PIA currently exercises delegated authority from PAC over the French business. PIA is already licenced to sell with profit and unit linked business in France on a freedom of services basis and, as such, no extension to the classifications of business written currently by PIA will be required.

The existing PAC/PIMS outsourcing arrangement for the administration, servicing and investment of the PAC France business will be transferred to PIA pursuant to the scheme, to ensure that there is no visible servicing or administrative change with respect to the business (and no change to their associated costs).

With respect to the unit-linked business in PAC France, arrangements will be put in place to ensure policyholders will continue to access post transfer the same unit-linked funds with the same unit-linked charges.

A reinsurance arrangement will be effected to ensure with profit policyholders continue to access the same benefits and asset pools, with this outlined further in section 5.10.

5.9.2 The PAC Malta business is currently administered by Prudential Distribution Limited (PDL). The Managing Director of PIA currently exercises delegated authority from PAC over the Maltese business. Following the transfer, these policies will come within the terms of the existing PIA / PIMS outsource agreement. Given the nominal number of policies, there will be no outsourcing agreement in place to cover this business between PIMS and CLPSI, and PIMS will administer the business itself (at that time it will have in place the necessary regulatory authorisations to do so). PIA is already licenced to sell with profit and non-profit business on a freedom of services basis in Malta and, as such, no extension to the classifications of business written currently by PIA will be required.

A reinsurance arrangement will be effected to ensure with profit policyholders continue to access the same benefits and asset pools, with this outlined further in section 5.10.

5.9.3 The ELAS business (including the German and Irish business) is currently being administered and serviced by Equiniti under an outsourcing agreement between PAC and Equiniti (a third party services provider). These policies will be transferred to PIA but, under the reinsurance agreement relating to the ex-ELAS business, PAC will continue to be responsible for the servicing of this business through its agreement with Equiniti, which will not transfer to PIA.

5.9.4 PIA is already licenced to sell annuity business in Germany on a freedom of services basis and in Ireland as a locally authorised insurer and, as such, no extension to the classifications of business written currently by PIA will be required.

A reinsurance arrangement will be effected to ensure with profit policyholders continue to access the same benefits and asset pools, with this outlined further in section 5.10.

5.9.5 Due Diligence:

As the French and Maltese business come under a common management line as PIA, it has not been necessary for PIA to conduct due diligence on the business being transferred.

Due diligence is being undertaken on the transferring German and Irish ELAS policies to the extent documentation is available. ELAS mis-selling liabilities have been excluded from the transfer as these would be covered by ELAS under the conditions of the Part VII transfer of the ELAS business to PAC.

5.9.6 Under the CBI's Domestic Actuarial Regime, the HoAF in Direct Life undertakings is required to 'monitor the undertaking's compliance with requirements relating to disclosure of information to domestic policyholders'. Furthermore, 'where any rights of life assurance policyholders entitle them to participate in profits related to a particular fund or part of a fund', then the 'Actuarial Report on Technical Provisions' produced by the HoAF must include 'a recommendation on any allocation of profits related to those policyholder rights'. While PIA currently has no domestic policyholders, this will change due to the Part VII transfer of the ELAS Irish annuity business to PIA. However, the proposed structure of the reinsurance treaty is such that the PIA HOAF will make recommendations on the allocation of profits related to those policyholder rights in line with those proposed by PAC.

5.10 Reinsurance and other implications of other business to be transferred from PAC to PIA

5.10.1 PIA will reinsure the with-profits elements of the transferring French, German, Irish and Maltese policies into PAC so as to provide those policyholders with continued access to the With-Profits funds and therefore provide continuity with respect of benefits. Three separate treaties will be required to cover the Maltese, French and the combined German and Irish business.

5.10.2 The Maltese business currently operates on a 90:10 basis and the reinsurance treaty will be constructed in a similar manner. The French, German and Irish business is currently run on a 100:0 basis and the reinsurance treaties will be constructed in this manner.

5.10.3 PAC will grant PIA a 'pari passu' charge over the assets of PAC such that in the event of PAC becoming insolvent, PIA would rank alongside the direct written policies of PAC.

5.10.4 Expenses associated with the Maltese business will be recharged to PAC in a manner similar to that for the Polish business. For the French business, PIA will incur the costs and fund them from explicit charges levied on the policies and passed to PIA in accordance with the treaty. For the German and Irish business, PAC will incur the expenses and deduct charges from the gross investment return credited to asset shares.

5.10.5 The best estimate of the difference between the present value of the future charges expected to accrue on the French policies and the present value of the expected expenses will be reflected in the price paid by PIA to PAC.

5.10.6 A Reinsurance Commission will be paid to PIA in respect of the Maltese business in a manner similar to that for the Polish business.

5.10.7 With respect to WP business in PAC France, PAC France policyholders will continue to access the DCPSF of the PAC with profits fund on a 100:0 basis via the reinsurance arrangements. The terms of the PAC France reinsurance treaty from a policyholder perspective will ensure that the French with profit policyholders within the PAC DCPSF receive the same treatment in terms of their reasonable expectations pre and post transfer.

5.10.8 With respect to the transferring WP business of ELAS, these ELAS policyholders will continue to access the DCPSF of the PAC with profits fund on a 100:0 basis via the reinsurance arrangements. The terms of the ELAS reinsurance treaty from a policyholder perspective will ensure that the transferring ELAS with profit policyholders within the PAC DCPSF receive the same treatment in terms of their reasonable expectations pre and post transfer.

PAC will be responsible for the payment of actual expenses for the administration and servicing of the policies to Equiniti on PIA's behalf, and will retain the fund charge in relation to this business.

5.10.9 Protection in case of insolvency:

WP policyholders of PAC France, PAC Malta and the transferring ELAS business currently have recourse to a UK Financial Services Compensation Scheme (FSCS) which pays policyholders 100% of their benefits in the event of PAC going insolvent. This may not continue to apply after the part VII transfer of the businesses to PIA.

It is the view of the PAC Chief Actuary that the loss of FSCS protection does not represent a material adverse impact on the security of benefits or on policyholders' reasonable expectations, on the basis that the probability of PIA not being able to pay policyholders' contractual benefits is remote.

5.11 Initial transfer of assets and liabilities to PIA under the Scheme

5.11.1 It is intended that the business described in section 6.2.1 will be transferred to PIA. As a result, any liability (excluding the ELAS mis-selling liabilities) that is attributable to the transferring business will be allocated to PIA.

5.11.2 Assets attributable to the transferring business will also be allocated to PIA. This includes:

(i) For unit-linked business, assets corresponding to the face value of the units;

(ii) For non-linked non-profit business, assets corresponding to the underlying Solvency II technical provisions; and

(iii) For with-profits business, assets corresponding to the asset share and net cost of guarantees and (except in respect of the with-profits business of PAC Poland, where smoothing is not applied) smoothing, which will remain a liability of the PAC WPSF.

5.11.3 As explained in sections 5.7 and 5.10 above, reinsurance arrangements will be set up to reinsure the with-profits business back to PAC.

5.11.4 The table below summarises the assets and liabilities which are expected to transfer to PIA under the Scheme.

	Poland	France	Malta	Poland	France	ELAS	Malta
Assets							
Insurance assets[1]	n.a.	✓ Face value of units	✓ Assets corresp onding to TPs*	✓ Assets corresponding to Asset share + nCoGs and (where applicable) smoothing (to be transferred to PAC as part of reinsurance treaty)			
Shareholder interest in with-profits fund	n.a.	n.a.	n.a.	✓	×	×	×
Reinsurance recoverables	✓	n.a.	✓	n.a	n.a	n.a	n.a
Current assets relating to transferring policies[2]	✓	✓	✓	✓	✓	✓	✓
Other operating assets[3]	✓	×	×	×	×	×	×
Liabilities							
Obligation to meet the insurance cashflows as they fall due	✓	✓	✓	✓	✓	✓	✓
Current liabilities relating to transferring policies[2]	✓	✓	✓	✓	✓	✓	✓
Other operating liabilities[3]	✓	×	×	×	×	×	×

*Basis for calculation of Technical Provisions to be agreed

[1] There are no insurance assets related to the Poland non-profit business as the best estimate liability for this business is negative,

[2] For example reinsurance payables/recoverables, outstanding premiums and claims; current assets and liabilities are assumed to net to zero in determining the financial impact of the transfer.

[3] Other operating assets and liabilities for Poland comprise assets relating to the operation of the business, for example office furniture and equipment, property leases, software contracts.

5.11.5 PAC maintains a current account with working capital for each legal entity. This has not been considered above as the balance is expected to be reduced to zero prior to transfer of the current accounts.

5.12 Costs

5.12.1 The Part VII transfer is being undertaken alongside the application for a new PIA Poland branch. The costs related to the branch application and the Part VII have been allocated to different entities as described below.

The costs of the closure of PAC Poland and the transfer of the Polish business to PIA will be fully allocated to PAC Poland. These costs will be split between the PAC WPSF and the PAC NPSF, applying the cost allocation methodology approved by the PAC Cost Allocation Steering Committee (CASC).

The costs of setting up the PIA Poland branch will be split between PIA and PIA Poland. Costs allocated to PIA Poland will apply the same WPSF/NPSF split.

The costs associated with the transfer of the non-Polish business to PIA will be fully allocated to the PAC NPSF.

5.12.2 In respect of PIA there will be an initial upfront cost associated with the transfer project and increased ongoing costs in the form of additional expenses within PIA for the governance and oversight of the business transferred and expense overruns in respect of the PAC Poland NP business.

5.13 Taxes

5.13.1 The tax position of PIA's remaining policies will not be impacted by the transfer and so the Part VII transfer is not expected to have any effect on policyholder taxation.

5.14 Policyholder communications

5.14.1 Parties to a scheme made pursuant to Part VII of FSMA must comply with notice requirements set out in FSMA (Control of Business Transfers) (Requirements on Applicants) Regulations 2001. These require notice of the proposed transfer to be sent to all policyholders of the companies involved and published in, inter alia, the official gazettes and two national newspapers in the UK and each EEA state of the commitment for any policy included in the transfer.

5.14.2 In relation to the individual mailing requirements for PIA's existing policyholders, it is proposed that, subject to certain limited and customary exceptions, PIA's existing policyholders will be sent written details of the proposed transfer, including information on the options available to the policyholder if they have any concerns about the transfer. I confirm that the proposed approach to communication with policyholders is fair and reasonable and that the information contained in the notification to policyholders adequately describes the proposals to policyholders.

6 FINANCIAL POSITION AND RISK PROFILE OF PIA POST TRANSFER

6.1 Background

6.1.1 In calculating PIA's solvency position post transfer, Solvency II calculations were performed on the transferring business using appropriate assumptions and methodologies. The assumptions and methodologies used as well as the application of these to generate the numbers shown in the table below have been through a thorough governance, review and sign-off process within PIA.

6.1.2 In assessing the financial position of PIA post transfer the key areas of expert judgement relate to:

- Use of the Solvency II Standard Formula for PAC Poland as a proxy for internal model SCR rather than fully incorporating within PIA's internal model. This is due to the fact that the risks faced by PAC Poland are significantly different from those affecting PIA's current business and it not being practical to update PIA's internal model to reflect the characteristics of the PAC Poland business within the available timeframe. Adjustments were made to the SCR calculated for PAC Poland to reflect currency risk given that the majority of the assets and liabilities of this business are denominated in Polish zloty.
- A conservative approach has been taken in that no allowance for diversification benefits has been taken when combining the SCR of the existing PIA business with that of the PAC Poland business.
- An additional reserve was calculated in respect of expense overruns expected to be incurred on the non-profit business prior to the PAC Poland business reaching a 'steady state'.

6.1.3 In respect of the PAC France, PAC Malta and the transferring ELAS businesses, which are all closed books (subject to the PAC France business still being open to top-ups), an assessment in relation to the key areas of methodology and principal assumptions underlying the Solvency II projections has not been made for reasons of materiality. The gross technical provisions in relation to these three businesses at 31st December 2017 was c.£71m, representing c. 1.2% of PIA's existing Solvency II technical provisions and will represent c. 1.1% of the combined PIA and PAC Poland projected Solvency II technical provisions as at year end 2018. Instead, reliance has been placed on governance, processes and controls within PAC which were used to produce the financial projections on a Solvency II basis for these businesses and which are similar to those that apply to PIA. Furthermore, it is assumed that sufficient assets will be transferred to PIA to cover the liabilities on a best estimate basis. The best estimate valuation will be completed prior to the transfer, and the assets transferred will be consistent with it.

6.2 Current solvency position

6.2.1 PIA's current solvency position has been assessed on a Solvency II basis, with financial impacts assuming the proposed transfer happened on 31st December 2017[2]. The results are shown below.

[2] The financial impacts do not take account of the expense overrun incurred during 2018 as PAC will be responsible for this.

PIA Solvency II Balance Sheet 31st December 2017 (£m)	Pre transfer	Post transfer
Assets	6,752	6,828
Liabilities	6,549	6,614
Own Funds	**203**	**214**
SCR	130	146
Surplus	**74**	**68**
Solvency ratio	**157%**	**147%**

6.2.2 The transfer results in a small reduction in PIA surplus. This is driven by the Polish non-profit business, where the negative Best Estimate Liability of £31m is offset by the expense overrun reserve (£10m), risk margin (£6m), deferred tax liability (£5m) and SCR (£15m). However, the transfer is expected to have a positive impact on PIA surplus in future years as the Polish business reaches critical mass and the expense overrun reserve is released.

6.3 Current risk profile

6.3.1 The transfer is expected to have a limited impact on PIA's risk profile as at 31 December 2017 given the relative material of the PAC's European business in the context of PIA. However, the transfer of the Polish business will impact upon the expected future risk profile of PIA, consistent with the growth the Polish business is expected to achieve over the next few years.

6.3.2 While the transfer of the PAC Poland business will result in a significant volume of additional WP business in PIA, the additional risks associated with this business are minimal given the reinsurance arrangements in place with PAC. The effectiveness of the reinsurance arrangement with PAC as a risk mitigation technique under Solvency II is not expected to be impacted by the exit of the UK from the European Union.

6.3.3 As the PAC Poland business is currently operating at a sub-scale level, an expense overrun reserve has been calculated to allow for the impact of expense over-runs in the period up to the attainment of a steady state. While the PAC WPSF will fund the expenses attributable to the WP business, PIA will be responsible for funding those expenses attributable to the non-profit business. As such, PIA will be exposed to any deviation in the assumptions underlying the determination of the expense over-run reserve. Based on the current assumptions, a steady state is expected to be achieved in 2022 resulting in a total estimated expense over-run of £9.9m.

6.3.4 The principal assumptions that determine the expense over-run reserve are the:

- Expected level of future expenses incurred in the Polish business
- New business volumes on all Polish business
- Level of lapses on the Polish business
- The split of future premium income between Polish WP and NP business.

6.3.5 Expenses incurred is a key financial indictor for the PAC Poland business and management devote significant time to monitoring and managing it, which acts as a risk mitigant. In addition, the assumptions in relation to new business volumes / composition and lapses have been subject to significant scrutiny.

6.3.6 Increased Operational Risk: The transfer of the Polish business to PIA will result in a portion of sales being conducted through a tied agency structure. This increases the advice risk to PIA with an associated increase in operational risk capital. This is reflected in the Polish business SCR. This is mitigated by the existing and proposed governance arrangements.

6.3.7 Currency Risk: A risk arises due to the different reporting currency used by the Polish branch. The bulk of the Polish branch assets and liabilities are denominated in Polish zloty. Future surpluses on this business will need to be converted to PIA's reporting currency (sterling). In addition, PIA will need to provide some working capital to Poland that is expected to be denominated in zloty.

6.3.8 Counterparty Default Risk: PIA will have additional reinsurance counterparty exposure with its two material reinsurance counterparties, the PAC With Profits Fund and Swiss Re, following the transfer. The high credit quality of these counterparties is such that there is not expected to be a material increase in counterparty default risk capital over the period.

7 IMPACT OF THE PROPOSED TRANSFER ON PIA POLICYHOLDERS

7.1 Principles of assessment

7.1.1 In assessing the impact of the proposed transfer on PIA policyholders, I have considered the potential impact of the transaction on:

- the security of policyholder benefits, and
- the maintenance of policyholders' reasonable expectations.

7.2 Security of Policyholders Benefits

7.2.1 The principal barometer of the security of benefits is the solvency ratio. Based on the information outlined in section 6, the transfer of the PAC European businesses will lead to a small reduction in solvency ratio but remains in excess of PIA's risk appetite. The absolute value of available capital will also increase post-transfer.

7.2.2 The transfer will have no impact on WP bonuses attributable to existing PIA policyholders given the reinsurance arrangement in place with PAC and the commitment by PIA to declare bonuses in accordance with the bonus rates notified to it by PAC.

7.2.3 The claims of existing policyholders on the assets of the WP fund will not be adversely impacted as a result of the transfer.

7.2.4 The introduction of the PAC European businesses will increase PIA's exposure to certain risks, namely expense, operational, currency and counterparty default risk. However, the impact on the security of existing PIA policyholder benefits is not expected to be significant.

7.2.5 One positive for the security of policyholder benefits post-transfer is the additional diversification that will be provided by the Polish business and the overall larger size of PIA's balance sheet. No credit has been taken for this in the financial projections.

7.2.6 Overall, the security of policyholder benefits is not materially impacted by the transfer.

7.3 Reasonable benefit expectations

7.3.1 PIA's existing policyholders will have developed expectations about the way in which the business is managed and the benefits that they are entitled to as a result of the documentation they have received and the manner in which the business has been managed historically (policyholders reasonable expectations).

7.3.2 The transfer will not impact on the contractual benefits or other policy terms of existing PIA policyholders.

7.3.3 As the WP business is reinsured back into the PAC WP funds the expectations of policyholders in relation to future bonus declarations will not be impacted.

7.3.4 The administration and investment management processes applicable to existing PIA policyholders will be unaffected by the transfer. Policyholders will expect that the service standards they are accustomed to will not be impacted by the addition of the PAC Poland business. PIA plans to hire additional staff in order to oversee this business which mitigates the risk that staff / processes would be stretched as a result of the addition of the Polish business.

7.3.5 The tax treatment of PIA's existing policyholders benefits will be unaffected by the transfer.

7.3.6 Overall, there is not expected to be any adverse impact on policyholders' reasonable expectations as a result of this transfer.

7.4 Other considerations

7.4.1 I have considered other possible impacts of the transfer on Solvency II related requirements and do not believe there are any considerations in addition to those already discussed in this report that will affect my conclusions.

7.4.2 PIA and PAC have carried out a review of the terms of the relevant inwards and outwards reinsurance arrangements as part of their preparations for implementation of the Scheme and any issues identified have been resolved.

7.4.3 PIA policyholders & UK Financial Services Compensation Scheme (FSCS): PIA policyholders do not currently benefit from the FSCS, nor are they expected to in the future.

7.4.4 It is likely to be in the interests of PIA policyholders that their policies are underwritten by a larger entity encompassing a substantial Polish operation alongside the existing international operations. The security of PIA policyholders' entitlements should be enhanced by being provided by a larger entity with larger resources. In the long term, the solvency position of PIA will likely be enhanced by diversification of business and economic risks between those applying to the existing business and those applying to the proposed Polish branch.

8 CONCLUSION

8.1.1 In my opinion the proposed scheme will not result in any material adverse effect on either

(a) the security of the existing policyholders of PIA, or

(b) the reasonable benefit expectations of the existing policyholders of PIA.