Supplementary Report of the Chief Actuary of

The Prudential Assurance Company Limited

on the proposed transfer 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 Financial Services and Markets Act 2000

Jonathan Hughes FIA
Chief Actuary

The Prudential Assurance Company Limited

4 December 2018

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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 the business of the PAC Poland branch (and certain other historic overseas business) ("PAC's European liabilities") to Prudential International Assurance (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 In his capacity as Chief Actuary of PAC, Stewart Gracie produced a report dated 29 June 2018 for the Directors of PAC (the 'Main Report') in which he reviewed the proposed transfer of PAC's European liabilities to PIA. 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 9 July 2018.

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

i) The proposed transfer will transfer PAC's European liabilities (and the corresponding assets as defined in the Main Report) to PIA. The business to be transferred includes non-profit protection and with-profits business written by PAC in Poland, unit-linked and with-profits business written by PAC in France, non-profit protection and with-profits business written by PAC in Malta as well as with-profits business written in Germany and Ireland that was transferred to PAC from the Equitable Life Assurance Society (ELAS) in 2007.

ii) Reinsurance treaties will be put in place between PIA and PAC in respect of the transferring with-profits business to reinsure the business back into the respective PAC with-profits funds. This arrangement is set up to ensure that the transferring policyholders continue to effectively participate in the respective with-profits funds from which they have been transferred on the same terms and with the same level of protection as they had pre-transfer.

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 transfer from the perspective of transferring PAC policyholders and the remaining PAC policyholders. The Head of Actuarial Function (HoAF) of PIA has considered the transfer from the perspective of the existing PIA policyholders in her Supplementary Report (referenced in section 1.8 below). I have reviewed this report.

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, having taken over the role from my predecessor, Stewart Gracie.

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 29 June 2018 remain valid.

1.8 Gemma O'Neill, the HoAF of PIA has produced a Supplementary Report which confirms that the conclusions set out in her Main Report dated 29 June 2018 remain valid.

1.9 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 PIA, 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.

1.10 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 and PIA, the PAC With-Profits Committee, the PAC With-Profits Actuary, the PIA HOAF, the Independent Expert, the PRA, the FCA and the CBI.

1.11 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, has provided this review and my report incorporates his feedback. The proposed transfer is also subject to review by an Independent Expert.

1.12 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 PRA.

1.10 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 31 December 2017 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 31 December 2017. These results are summarised in Figure 2.1 below.

Figure 2.1 – PAC Solvency II valuation results before and after the transfer (as at 31 December 2017)

	Pre-transfer		**Post-transfer**		**Impact**	
	Total PAC shareholder-backed business (1) **£m**	**Total PAC With-Profits Fund(2), (3)** **£m**	**Total PAC shareholder-backed business (1)** **£m**	**Total PAC With-Profits Fund(2), (3)** **£m**	**Total PAC shareholder-backed business (1)** **£m**	**Total PAC With-Profits Fund(2), (3)** **£m**
Assets	78,556	132,826	78,626	132,826	69	-
Best Estimate Liabilities (BEL)	58,826	115,632	58,894	115,632	69	-
Risk Margin (net of TMTP)	1,366	726	1,367	726	-	-
Other Liabilities	4,554	6,890	4,554	6,890	-	-
Own Funds	**13,810**	**9,578**	**13,810**	**9,578**	**-**	**-**
SCR	7,143	4,775	7,143	4,775	-	-
Surplus	**6,666**	**4,803**	**6,666**	**4,803**	**-**	**-**
Solvency ratio	193%	201%	193%	201%	-	-

Notes:

(1) The results for the PAC shareholder-backed business have been restated to allow for the transaction PAC entered into on 14 March 2018 to transfer an agreed portfolio of the shareholder-backed non-profit annuity business to Rothesay as the transaction had a material impact on the solvency position of PAC's shareholder-backed business.

(2) 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.

(3) The results shown include the Defined Charge Participating Sub-Fund (DCPSF) assets and liabilities.

2.2 30 June 2018 position

2.2.1 Following the Main Report, the impact of the proposed transfer on PAC's Solvency II surplus has been assessed using the latest reported results as at 30 June 2018 (assuming that the transfer had occurred at 30 June 2018). These results are summarised in Figure 2.2 below.

Figure 2.2 – PAC Solvency II valuation results before and after the transfer (as at 30 June 2018)

	Pre-transfer		**Post-transfer**		**Impact**	
	Total PAC shareholder-backed business **£m**	**Total PAC With-Profits Fund(1), (2)** **£m**	**Total PAC shareholder-backed business** **£m**	**Total PAC With-Profits Fund(1), (2)** **£m**	**Total PAC shareholder-backed business** **£m**	**Total PAC With-Profits Fund(1), (2)** **£m**
Assets	76,557	134,104	76,625	134,104	68	-
Best Estimate Liabilities (BEL)	56,253	116,629	56,321	116,629	68	-
Risk Margin (net of TMTP)	1,385	478	1,385	478	-	-
Other Liabilities	4,012	7,079	4,012	7,079	-	-
Own Funds	**14,907**	**9,918**	**14,907**	**9,918**	-	-
SCR	7,215	3,846	7,215	3,846	-	-
Surplus	**7,692**	**6,071**	**7,692**	**6,071**	-	-
Solvency ratio	207%	258%	207%	258%	-	-

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.
(2) The results shown include the Defined Charge Participating Sub-Fund (DCPSF) assets and liabilities.

2.2.2 Figures 2.1 and 2.2 above illustrate the following

(i) The surplus of PAC's shareholder-backed business improved by c.£1bn between 31 December 2017 results (after restatement to allow for the Rothesay reinsurance transaction, as detailed in the Main Report) and 30 June 2018. The movement in surplus was attributable to: the release of surplus on inforce business as it runs off, the contribution from new business, the impact of management actions and the impact of changes in market conditions, partially offset by a dividend payment by PAC to Prudential plc;

(ii) The surplus of the PAC With-Profits Fund improved by c.£1.2bn between 31 December 2017 and 30 June 2018. The movement in surplus was attributable to: the release of surplus on inforce business as it runs off, the impact of changes in market conditions and the impact of modelling developments;

(iii) The Solvency II surplus for both the PAC shareholder-backed business and the PAC With-Profits Fund are unchanged by the transfer. This is because the non-profits business is transferred into PIA which remains part of PAC's shareholder-backed business and the with-profits business will be reinsured back into the respective PAC With-Profits funds.

The increase in assets and BEL for the PAC shareholder-backed business reflects the transfer of with-profits business into PIA and the corresponding reinsurance of the business back into the respective PAC With-Profits funds.

2.2.3 Overall, PAC's financial position improved at 30 June 2018 compared to 31 December 2017, and, as set out in the Main Report, the proposed transfer is not expected to have a material impact on the financial position of PAC.

2.3 30 September 2018 position

2.3.1 Overall, PAC's financial position improved from 30 June 2018 to 30 September 2018. As per the assessments as at 31 December 2017 and 30 June 2018, it is expected that the proposed transfer will not have a material impact on the financial position of PAC.

3. PIA - FINANCIAL IMPACT OF THE PROPOSED TRANSFER

3.1 31 December 2017 position

3.1.1 The Main Report set out the impact of the proposed transfer on PIA's Solvency II surplus assuming that the transfer happened on 31 December 2017. These results are summarised in Figure 3.1 below.

Figure 3.1 – PIA Solvency II valuation results before and after the transfer (as at 31 December 2017)[(1)]

	Before the transfer £m	**After the transfer £m**	**Impact £m**
Assets	6,752	6,828	76
Best Estimate Liabilities	6,401	6,454	53
Risk Margin (net of TMTP)	44	52	8
Other Liabilities	104	109	5
Own Funds	**203**	**214**	**11**
SCR	130	146	16
Surplus	**74**	**68**	**(6)**
Solvency ratio	157%	147%	(10)%

Notes:

(1) The results shown do not include the contribution from PIMS for consistency with results presented in PIA. Typically, within PAC (for example in valuation reports for the PAC Board), consolidated results for PIA and PIMS are presented. If results for PIMS were to be included the pre-transfer assets, best estimate liabilities, own funds, surplus and solvency ratio would be £6,756m, £6,404m, £204m, £74m and 157% respectively; the post-transfer assets, other liabilities, best estimate liabilities, surplus and solvency ratio for PIA would be £6,832m, £6,457m, £214m, £68m and 147% respectively.

3.2 30 June 2018 position

3.2.1 Following the Main Report, the impact of the proposed transfer on PIA's Solvency II surplus has been assessed using the latest reported results as at 30 June 2018 (assuming the transfer happened on 30 June 2018). These results are summarised in Figure 3.2 below.

Figure 3.2 – PIA Solvency II valuation results before and after the transfer (as at 30 June 2018)[(1)]

	Before the transfer £m	**After the transfer £m**	**Impact £m**
Assets	7,017	7,091	74
Best Estimate Liabilities	6,626	6,673	47
Risk Margin (net of TMTP)	44	51	7
Other Liabilities	138	144	6
Own Funds	**209**	**223**	**14**
SCR	137	154	17
Surplus	**73**	**69**	**(3)**
Solvency ratio	153%	145%	(8)%

Notes:

(1) The results shown do not include the contribution from PIMS for consistency with results presented in PIA. Typically, within PAC (for example in valuation reports for the PAC Board), consolidated results for PIA and PIMS are presented. If results for PIMS were to be included the pre-transfer assets, best estimate liabilities, own funds, surplus and solvency ratio would be £7,019m, £6,628m, £210m, £71m and 152% respectively; the post-transfer assets, other liabilities, best estimate liabilities, surplus and solvency ratio for PIA would be £7,093m, £6,674m, £223m, £68m and 143% respectively.

3.2.2 Figures 3.1 and 3.2 above illustrate the following:

(i) PIA's surplus has remained relatively stable between 31 December 2017 and 30 June 2018;

(ii) The impact of the proposed transfer is materially the same if assumed to occur as at either 31 December 2017 or 30 June 2018. There is a c.£3m decrease in PIA surplus due to the transfer of the PAC Poland non-profits business at 30 June 2018. This is because the negative BEL for the business being transferred to PIA is more than offset by the required risk margin and SCR and the allowance for deferred tax liabilities at the PIA level.

The other blocks of business being transferred into PIA have an immaterial impact on PIA surplus as the assets transferred broadly offset the liability and capital requirements of the business. This is because there is no need for PIA to set up any (material) SCR or risk margin in respect of the transferring with-profits business as it is fully reinsured back to PAC; and the risk margin and SCR in respect of the non-profit business from PAC France and PAC Malta is negligible given the size of the business.

3.2.3 It was recognised within the Main Report that although the solvency ratio of PIA after the transfer is slightly below PIA's target solvency ratio of 150%, it remains above the minimum levels set out in the PIA Risk Appetite Statement of a £20m buffer and a solvency ratio of 125%. This was acknowledged by PIA as a temporary position that is expected to be addressed through the delivery of the PIA strategy. In light of this, I am content that PIA is expected to be well capitalised after the transfer. However, the PIA solvency position should be closely monitored and appropriate actions should be taken if the PIA solvency position deteriorates.

3.3 30 September 2018 position

3.3.1 PIA's surplus has remained relatively stable between 30 June 2018 and 30 September 2018. The impact of the proposed transfer is therefore expected to be materially in line with the observations from previous assessments if assumed to occur as at 30 September 2018.

3.4 Projected Solvency II balance sheet

3.4.1 The Main Report included an assessment of the proposed transfer on the projected PIA solvency position. The financial projections were produced by PIA using the assumptions in the 2017 PIA Own Risk & Solvency Assessment (ORSA).

3.4.2 PIA have subsequently produced an updated version of the projection results.

3.4.3 Based on the projection results, I am content that PIA is expected to be well capitalised over the projection period. However, the PIA solvency position should be closely monitored and appropriate actions should be taken if the PIA solvency position deteriorates.

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 following the issue of the Policyholder Information booklet to transferring PAC policyholders over the period 11 July 2018 to 23 November 2018 inclusive.

4.1.2 Approximately 161 phone calls or letters have been received from transferring and remaining PAC policyholders (as at 23 November 2018). An analysis of the calls and letters indicated that approximately 103 enquiries were related to the transfer, and that the remainder were general policy enquiries unrelated to the transfer. Of those calls and letters related to the transfer, the majority were asking for further information about the transfer and/or asking about the security of their policies in the future, particularly given the potential loss of protection from the Financial Services Compensation Scheme (FSCS) as highlighted in the Main Report.

4.1.3 As of 23 November 2018, 50 objections to the transfer have been received from transferring and remaining PAC policyholders. Out of the objections, 43 are from PAC Poland policyholders, 1 is from a PAC France policyholder and 6 are from policies that were originally written by ELAS. The objections relate to concerns around the security of their policies in the future, particularly given the potential loss of FSCS protection. This included enquiries on whether they could terminate their policies and obtain a full refund of their premiums. For policies that were originally written by ELAS, there were also enquiries on whether the proposed transfer would lead to a loss of payments from the Equitable Life Payment Scheme (ELPS). This is discussed further in section 4.3.

In sections 9.2.5 and 9.2.6 of the Main Report, it was concluded 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. In addition, the loss of FSCS protection needs to be considered against the risk of an adverse outcome for EU-based policyholders resulting from the eventual outcome of the Brexit negotiations. Whilst it is difficult to put a probability on an adverse outcome, there are plausible Brexit scenarios where the adverse outcome from Brexit were the policyholders to remain in PAC would be more disadvantageous to policyholders than the loss of FSCS protection. In my view, this conclusion remains valid.

4.1.4 All objections have been replied to and have been passed to the PRA, FCA and the Independent Expert 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 and addressed in the Main Report. 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 3 December 2018, responses have been received from 25 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 Policyholders' concerns in respect of the ELPS

4.3.1 The ELPS was set up by the UK Treasury in 2011 to compensate policyholders who suffered loss in relation to certain policies written by ELAS. The ELPS is administered by National Savings and Investments (NS&I) on behalf of the Treasury and is independent of ELAS and of PAC. The ELPS closed to new claims on 31 December 2015.

Several former ELAS policyholders (that have transferred to PAC under the 2007 ELAS Scheme) who are in scope of the proposed transfer have contacted PAC to question the effect of the proposed transfer on the payments that they receive from the ELPS.

4.3.2 PAC has contacted the UK Treasury and has received confirmation that the proposed transfer would have no effect on the ELPS payments to the former ELAS policyholders to be transferred to PIA.

4.4 Prudential restructuring

4.4.1 It was noted in section 2.1.9 of the Main Report that a combined business called M&G Prudential was formed from combining two businesses within the Prudential group (namely Prudential UK & Europe and M&G) and that M&G Prudential would demerge from the Prudential group. Also, to align the ownership of Prudential plc's businesses with their operating structures, Prudential plc announced that it intends to transfer the legal ownership of its Hong Kong insurance subsidiaries from PAC to Prudential Corporation Asia Limited (PCA), another subsidiary of Prudential plc. The restructuring activity is expected to be complete by the end of 2019. Work is underway in relation to this and it is not expected that the restructuring activities would affect the conclusions from the Main Report.

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 PAC's European liabilities to PIA.

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

(d) the reasonable benefit expectations 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 PIA 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

4 December 2018