Proposed Scheme to transfer the entire business of Phoenix Life Assurance Limited, Standard Life Assurance Limited and Standard Life Pension Funds Limited to Phoenix Life Limited

Update to the Supplementary Reports by the Chief Actuaries on the impact of the Scheme on Policyholders of the Companies

2 October 2023

Updated on 3 October 2023

Introduction

This note is an update to the supplementary reports written by the Chief Actuaries of Phoenix Life Limited (Phoenix), Phoenix Life Assurance Limited (PLAL), Standard Life Assurance Limited (SLAL) and Standard Life Pension Funds Limited (SLPF) entitled:

- 'Supplementary Report by the Chief Actuary on the impact of the Scheme on Policyholders of Phoenix Life Limited', which was a report by Andrew Rendell;
- 'Supplementary Report by the Chief Actuary on the impact of the Scheme on Policyholders of Standard Life Assurance Limited and of Standard Life Pension Funds Limited', which was a report by Simon Thomlinson; and
- 'Supplementary Report by the Chief Actuary on the impact of the Scheme on Policyholders of Phoenix Life Assurance Limited', which was a report by Andrew Rendell.

In this update, references to "our", "we" and "us" reflect joint statements made by the Chief Actuaries where each should be considered to be making statements in respect of the companies for which they are Chief Actuary. This update also has sections specific to each Chief Actuary's considerations, which use "my" and "I", which should be interpreted accordingly for each Chief Actuary.

In our supplementary reports, dated 20th September 2023, we noted that the conclusions we had reached in our earlier reports dated 18th April 2023 were unchanged. In particular we concluded that the Scheme should not have any material adverse impact on the security of benefits or the reasonable expectations of the policyholders in the companies of which we are Chief Actuary.

This update to the supplementary reports provides details of an error that has been identified in the assessment of SLAL's Heritage WPF liabilities and capital requirements, and includes our updated view of the financial positions presented in our supplementary reports. We also confirm that our opinions remain unchanged from our supplementary reports. The SLAL With-Profits Actuary has considered our update and she has provided an update supporting the conclusion.

The restated financial positions included in this update reflect the best estimate of the impact of correcting the error. This estimate is based on restating a number of model runs from the valuation process with the error removed, so we are comfortable that the estimated impacts shown in this update are appropriate for the purpose of the update, which should be read in conjunction with the supplementary reports. Analysis of the error is ongoing, including further model runs to validate and refine the estimated impact. Given the nature of the error and the approach taken to quantify its effect on the solvency position of the Heritage WPF, we are comfortable that any revision to the estimated impact will not affect the conclusions of our assessment of the Scheme's impact on the security and benefit expectations of policyholders.

This update was amended on 3 October to provide additional information and further rationale for our conclusions. Additions to the original update are shown in italics.

This update and the underlying preparation work that has been carried out is in our opinion compliant with the relevant Technical Actuarial Standards issued by the Financial Reporting Council that apply to certain types of actuarial work, namely TAS100: General Actuarial Standards and TAS 200: Insurance.

Context

Phoenix, PLAL, SLAL and SLPF apply a consistent control and risk management framework used to manage risk by reference to Board approved defined risk appetite statements. With regard to the production and review of valuation results this is performed by the finance function and includes analysis of change, comparisons with expected results and deeper analysis where results are outside of defined tolerances. The Chief Actuaries sign off the valuation result prior to it being reviewed by the Board Audit Committee. Where limitations are identified in controls, these are reported to the Board Audit Committee and actions taken to improve the control environment. The same processes are used for the June valuation as are used for the December valuation, noting that the latter is also subject to an external audit of the Own Funds calculation.

The Solvency Capital Requirement (SCR) is calculated using the companies' internal model which is developed by the actuarial function and subject to independent review by the risk function. It includes an assessment of capital to be held for operational risk, which takes into account the risk of mis-statement from model risk that could remain despite the controls described above.

As noted in our supplementary reports, capital may also be retained over and above the capital policy to make allowance for mis-estimation risk between valuations. While it is impossible to completely remove the risk of financial mis-statement, these steps give us confidence that policyholder security is robustly maintained, and they apply equally to Phoenix, PLAL, SLAL and SLPF before the Scheme and to Phoenix after the Scheme.

As an error has been identified which affects the balance sheets upon which the financial analysis of the Scheme is based, it is appropriate to restate the analysis and confirm that the conclusions reached in relation to the Scheme remain appropriate.

Description of the error *and approach to estimating its impact*

The error that has been identified relates to modelling, in certain circumstances, of the investment mix of the Heritage WPF in SLAL. It results in an overstatement of the Own Funds in SLAL and an understatement of the SCR in SLAL.

The error affects the valuation results shown in our main reports and our supplementary reports for the pre Scheme financial position of SLAL and the estimated post Scheme financial position of Phoenix. There is no impact on the pre Scheme financial position of Phoenix, PLAL or SLPF.

The error will be corrected for future valuations and historic impacts will be investigated. The Scheme will have no impact on the actions taken or their impact on customers.

The amounts shown in this update reflect estimates of the impacts of correcting the error at 30 June 2023. *As noted above the error results in an overstatement of the Own Funds in SLAL and an understatement of the SCR in SLAL. The error predominantly affects the Heritage WPF in SLAL, with a much smaller effect in the SLAL PBF.*

The restated financial positions and analysis shown in this update reflect the best estimate and consider the residual uncertainty of the impact of correcting the error.

The impact on Own Funds was assessed by a full rerun of the valuation models having corrected for the error. We are therefore comfortable that this is a robust assessment of this element of the impact.

The increase in SCR in the SLAL PBF is small with an estimated impact of £5m that has been prudently doubled to £10m for the purposes of this update. This prudent approach provides sufficient allowance for uncertainty in our view.

It was not possible in the required timescale to complete a full re-run of the SCR process, which involves the use of many multiple runs of the valuation models under varying stress conditions, calibrating a simpler distribution to fit to the outcomes of those model runs, and then simulating losses that might arise under a very large number of differing stress scenarios. Instead, the Heritage WPF SCR impact was assessed by running the valuation model, having corrected the error, on the "representative scenario". This is a single scenario that is considered most representative of the type of event that would give rise to a loss equal in size to the SCR. We consider the impact of the error in this scenario (which is a c£110m increase in the Heritage WPF SCR after the Scheme becomes effective) to be a good estimate of the true impact of the error but acknowledge that there is some residual uncertainty because the results of the full process may be different.

Given the residual uncertainty that a full SCR run may provide a different impact to that in the representative scenario described above, we also considered what the restated financial positions would be if the impact of the error on the Heritage WPF SCR was roughly double our estimate derived as set out above., an outcome that we consider to be unlikely. We have set out our rationale in the following sections as to why we feel that the residual uncertainty does not affect our conclusions.

Restated financial positions

The restated tables in this update have been prepared on the same basis as the corresponding tables in our supplementary reports. This includes, for example, the approach used to determine the amount of TMTP and the inclusion of loans issued by SLAL and PLAL in July, which continue to be presented as if they were in place on 30 June 2023.

SLAL and SLPF Chief Actuary's update

The table below restates the financial position of SLAL as at 30 June 2023 before the effect of the Scheme to remove the estimated impact of the error. The 30 June 2023 financial position included in Table 2 of my supplementary report is shown for comparison. There is no impact on the financial position of SLPF before the effect of the Scheme.

	SLAL as at 30 June 2023 before the effect of the Scheme (restated)			*SLAL as at 30 June 2023 before the effect of the Scheme (original)*		
	Own Funds £m	**RFF Restriction** £m	**SCR** £m	*Own Funds* *£m*	*RFF Restriction* *£m*	*SCR* *£m*
Heritage WPF	1,898	1,288	610	*1,943*	*1,398*	*545*
SLAL PBF and Shareholders' Fund	2,453	-	1,366	*2,453*	-	*1,356*
Total	**4,351**	**1,288**	**1,975**	*4,396*	*1,398*	*1,900*
			Total			*Total*
Excess of Adjusted Own Funds over SCR			**£1,087m**			*£1,097m*
Solvency Ratio – All funds			**155%**			*158%*

As shown in the table above, correcting the error reduces the Own Funds and increases the SCR in the Heritage WPF. There is a smaller increase in SCR in the PBF. Since the majority of the impact is in the Heritage WPF, which is a strong ring-fenced fund (the surplus of which is not available to the company as a whole), the correction has only a relatively small impact on the overall solvency position of SLAL before the effect of the Scheme.

I have provided the estimated impacts of fixing the error to the Phoenix Chief Actuary, who has updated his estimate of the pro forma financial position of Phoenix after the effect of the Scheme below.

Policyholder security is provided by the strength of the capital policy, in SLAL before the Scheme and in Phoenix after the Scheme. As I note in paragraph 5.1 of my supplementary report, little reliance or benefit can be placed on any surplus over that required by the capital policy in terms of improving security for policyholders.

The estimated impact of correcting the error is not material in the context of the Scheme. As the Phoenix Chief Actuary's update below shows, Phoenix will on a pro forma basis continue to meet its regulatory capital requirements and the more onerous requirements of the Phoenix Capital Policy after the Scheme is implemented. The requirements would be met irrespective of the outcome of the matching adjustment application that I described in my supplementary report. *I have considered the additional commentary provided by the Phoenix Chief Actuary relating to the residual uncertainty of the impact of correcting the error in the context of Phoenix post-Scheme, and I support his conclusion.*

While there will be some actions required to consider the impact on the Heritage WPF of the error potentially having caused overpayments to customers in the past, any such impact is currently estimated to be small and is unaffected by the Scheme. The impact of the Scheme on the reasonable benefit expectations of policyholders is therefore unaffected by the error.

I have revisited the objections to the Scheme that have been received from SLAL policyholders, and the responses to them, in light of the error discussed in this update. I can confirm that the responses would have been no different had there been no error, and it remains the case that none of the objections received by the end of 28 September 2023 affect my conclusions.

The conclusions in my supplementary report are therefore unchanged.

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SLAL and SLPF Chief Actuary
3 October 2023

Phoenix Chief Actuary's update

The table below restates the estimated financial position of Phoenix after the effect of the Scheme as at 30 June 2023 to remove the estimated impact of the error. The 30 June 2023 financial position included in Table 3 of my Phoenix and PLAL supplementary reports and Table 4 of the SLAL and SLPF supplementary report is shown for comparison.

There is no impact of the error on the financial position of either Phoenix or PLAL before the effect of the Scheme.

	Phoenix as at 30 June 2023 after the effect of the Scheme (restated)			*Phoenix as at 30 June 2023 after the effect of the Scheme (original)*		
	Own Funds £m	**RFF Restriction** £m	**SCR** £m	*Own Funds* *£m*	*RFF Restriction* *£m*	*SCR* *£m*
Existing Phoenix WPFs	1,190	358	558	*1,190*	*358*	*558*
Heritage WPF	1,893	1,180	713	*1,943*	*1,340*	*603*
LL WPF	14	-	17	*14*	-	*17*
NPL WPF	114	-	115	*114*	-	*115*
Pearl WPF	726	311	276	*726*	*311*	*276*
SERP Fund	56	-	78	*56*	-	*78*
NPF and Shareholders' Fund	5,749	-	2,798	*5,749*	-	*2,788*
Total	**9,741**	**1,849**	**4,554**	*9,791*	*2,009*	*4,434*
			Total			*Total*
Excess of Adjusted Own Funds over SCR			**£3,337m**			*£3,347m*
Solvency Ratio – All funds			**173%**			*175%*
Solvency Ratio excluding unsupported WPFs			**219%**			*220%*

Similar to the impact shown in the SLAL Chief Actuary's update for SLAL before the effect of the Scheme, the correction has only a small impact on the overall estimated solvency position of Phoenix after the effect of the Scheme. The change to the position of the Heritage WPF in Phoenix after the Scheme is different to that of the equivalent fund in SLAL before the Scheme. This is because the absence of the Volatility Adjustment in Phoenix impacts the effect of the correction.

To illustrate the sensitivity of the financial position to the residual uncertainty of the impact of correcting the error, I have also considered what the restated financial position shown above would be if the increase in the Heritage WPF SCR was roughly double the best estimate (i.e. if the increase in Heritage WPF SCR was £200m rather than c£110m) which as noted above is considered to be an unlikely outcome. The larger increase in Heritage WPF SCR would result in the 'Solvency Ratio – All funds' reducing to 172% rather than 173% and the 'Solvency Ratio excluding unsupported WPFs' remaining at 219%. I note that the change in the former ratio under this sensitivity is still small and would not affect Phoenix's ability to meet its regulatory requirements and the more onerous requirements of the Phoenix Capital Policy (PCP).

Policyholder security is provided by the strength of the Phoenix Capital Policy. As I note in paragraph 5.1 of my Phoenix supplementary report, little reliance or benefit can be placed on any surplus over that required by the capital policy in terms of improving security for policyholders.

With regard to the correction of the error, the question to be addressed is therefore whether the scale of the error could be such that Phoenix would be less able to meet the requirements of the PCP.

The calibration of the PCP (by reference to stress testing analysis), and the assessment of excess capital available in excess of the PCP, take into account the ringfenced nature of with-profits funds, i.e. that excess capital in the Heritage WPF cannot be used to support the needs of other with-profits funds or of the non profit business of the company. Capital in excess of the PCP in the Heritage WPF (or indeed in any other with-profits fund) is therefore disregarded when assessing the coverage of the PCP for the company as a whole.

The updated table above shows that, based on the best estimate of the impact of correcting the error, the Heritage WPF would have an excess after the scheme of £1180m over its SCR of £713m.

In my supplementary report I noted that the PCP parameter that would apply on implementation of the Scheme has been set to 38%. On this basis the Heritage WPF has an excess of £909m above its share of the PCP (being £1,180m less 38% of £713m). This assumes that the matching adjustment application referred to in my supplementary report is approved and, prior to that approval, the excess would be around £97m lower at £812m due to the higher SCR and associated PCP requirement arising from the absence of that approval.

Given the high confidence around the impact of the error on Own Funds and the low materiality of the impact in the SLAL PBF (and hence in the Phoenix Non-Profit Fund after the Scheme), the key residual uncertainty relates to the quantification of the impact on the Heritage WPF SCR.

The estimated increase of £110m in Heritage WPF SCR is small in relation to the excess capital available in the HWPF fund, with over £800m (without MA approval) or £900m (with MA approval) in excess of PCP remaining in the fund after this allowance. It is therefore clear that the residual uncertainty would have to be very substantial indeed before it would have an impact on Phoenix's overall coverage of the PCP.

Neither the estimated impact of correcting the error *nor the residual risk around the quantification of its impact are* material in the context of the Scheme. Phoenix will on a pro forma basis continue to meet its regulatory capital requirements and the more onerous requirements of the Phoenix Capital Policy after the Scheme is implemented. The requirements would be met irrespective of the outcome of the matching adjustment application that I described in my supplementary report.

I have revisited the objections to the Scheme that have been received from Phoenix policyholders, and the responses to them, in light of the error discussed in this update. I can confirm that the responses would have been no different had there been no error, and it remains the case that none of the objections received by the end of 28 September 2023 affect my conclusions.

The conclusions in my Phoenix supplementary report are therefore unchanged.

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Phoenix Chief Actuary
3 October 2023

PLAL Chief Actuary's update

For the same reasons noted above, the conclusions in my PLAL supplementary report are also unchanged.

I have revisited the objections to the Scheme that have been received from PLAL policyholders, and the responses to them, in light of the error discussed in this update. I can confirm that the responses would have been no different had there been no error, and it remains the case that none of the objections received by the end of 28 September 2023 affect my conclusions.

It should be noted that a small number of comments/objections were received from PLAL policyholders in relation to the solvency coverage ratio excluding unsupported with profit funds, which is lower for Phoenix after the Scheme than for PLAL before the Scheme. It can be seen from the above table that the ratio for Phoenix after the Scheme is slightly lower as a result of correction of the error and therefore the difference between the PLAL and Phoenix ratios is slightly larger. However, the impact of the error on the ratios is very small and importantly, Phoenix will continue to meet the requirements of the Phoenix Capital Policy and I remain satisfied that the concerns raised do not affect the conclusions in my report.

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SLAL With-Profits Actuary's update

I have considered the update provided by the Chief Actuaries above. It is already clear that discovery of the error does not lead to any need to change the current investment mix of the Heritage WPF and will not affect consideration of future investment strategy. The transfer of the Heritage WPF business from SLAL to Phoenix will have no effect on the ongoing investigations into the error.

The error did not affect the modelling used to set current payouts including estate distribution. The error has potentially caused overpayments to customers in the past. If there have been overpayments, we will ensure that no inappropriate costs fall on the remaining policyholders. We have a set of principles for allocating costs resulting from errors that we use as a guide to help determine when such costs should be met from shareholder funds and when they should be met from the Heritage With-Profits Fund. These principles would apply following the transfer to PLL in the same way as they have applied in SLAL.

I support the conclusions of the Chief Actuaries in respect of the with-profits policyholders of SLAL and confirm that the opinion I gave in Appendix 1 of the SLAL and SLPF Chief Actuary's supplementary report is therefore unchanged.

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