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LIFE Conference & Exhibition

25-27 November 2009
EICC, Edinburgh

Phoenix & London Assurance Limited
GAR Compromise Scheme

Mike Kipling, Pearl Group
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Agenda

- Background to project
- Feasibility study
- Scheme design and communication
- Implementation
- Opportunities for others

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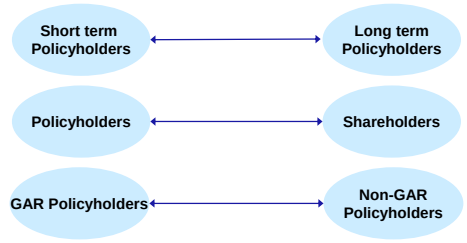
Managing PALAL fairly raised issues



- Issues common to most with profits funds…
- …. GAR issue particularly acute

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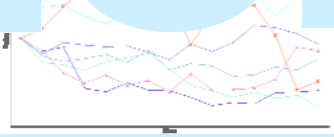
A number of options were considered

Options
- Unitisation
- Compromise of different guarantees
- Compromise of GARs

Evaluation
- Model impact on policyholders
- Model impact on shareholders

Conclusion
- Unitisation most favourable result
- GAR Compromise
  - Good result
  - low execution risk



- Conclusion driven by circumstances of PALAL – others will be different

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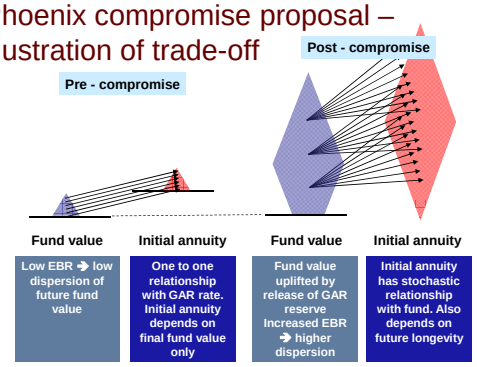
Phoenix compromise proposal – illustration of trade-off



Low EBR → low dispersion of future fund value	One to one relationship with GAR rate. Initial annuity depends on final fund value only	Fund value uplifted by release of GAR reserve Increased EBR → higher dispersion	Initial annuity has stochastic relationship with fund. Also depends on future longevity

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Feasibility Study

- **Customer interest**
  - Carry out telephone survey of 300 potentially included customers
  - Only 12% definitely not interested; majority wanted to know more
- **Legal/ Regulatory/Tax**
  - Leading counsel approached; confirmed that Chapter 26 applies; 75% majority by 'value'.
  - FSA approached; independent actuary identified
  - HMRC confirm tax position of policyholder or fund not affected

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Feasibility Study

- **Financial/Fairness**
  - Can enough reserve be released to boost asset share enough to get policyholder support yet avoid shareholder subsidy?
  - Identify all the special cases (e.g. paid-up policies) ; check fair across range of products, issue dates, retirement year, etc (on best estimate basis).
- **Systems development**
- **Proactive PR – press and IFAs**
- **Plan/Budget/Governance**

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Feasibility Study

- **Measure of shareholder value**
  - Market-consistent Embedded Value (MCEV)
    - Requirement : must not increase
    - Shareholder Objective : must not decrease

	£
Shareholder net assets	-
Value of future profits	+
Economic 'burnthrough'	+/-
Non-economic 'burnthrough'	+
Cost of capital	+
Other (e.g. tax)	+/-
TOTAL	0

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Feasibility Study - Outcome

- **WPC not satisfied**
  - as shorter term policyholders had a higher than10% chance of a material shortfall (caused by volatility in stochastic illustration)
- **Rethink**
  - Fairness test : 90% chance of not being more than 5% worse off
    - Excludes policies with less than 10 years to run; Population reduces from 100k to 50k
    - but 'worst' 50k for risk (longevity,persistency)
  - Carry out full population 'appetite' mailing

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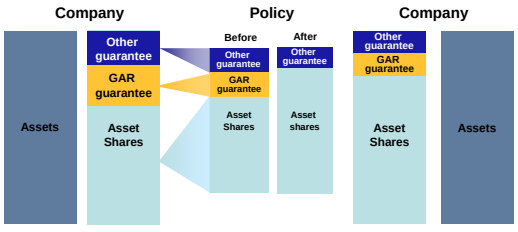
Balance sheet impact



- Embedded value neutral
- Increased capital in tails

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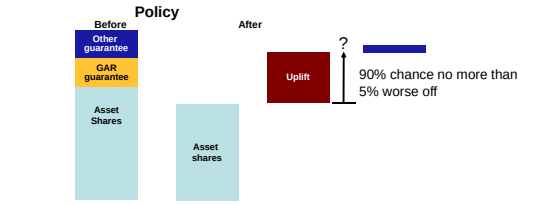
Setting the uplifts



Scenario	Pre	Post	Y>X?
1	x_1	y_1	✓
2	x_2	y_2	✓
3	x_3	y_3	✓
⋮			
n			

90% pass rate

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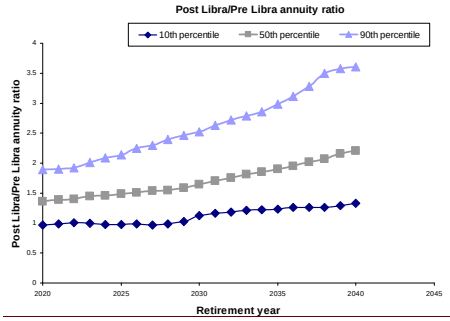
Projected benefits at different percentiles



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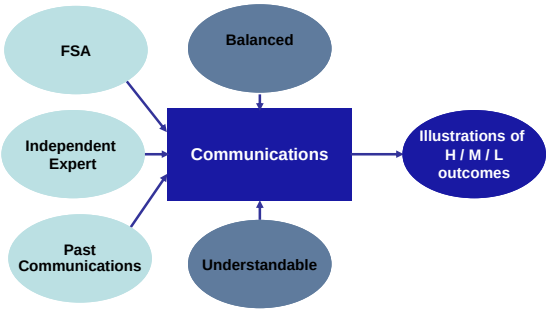
What to say to policyholders



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Policyholder illustrations

Core
- "Real world" stochastic instant model
- Mortality distribution

Pre-restructuring
- Low EBR
- Consistent with historic expectations
- Identified impact of upside and downside

After restructuring
- High EBR
- Reduced guarantees
- "Uplifts" to asset shares
- Impact of upside and downside

Issues in developing stochastic projections
- Calibration
  - Economic
  - mortality
- Maximum tax free cash
- Allowance for lapses

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Appetite Mailing

- **Aim**
  - To ascertain if there was sufficient support to implement a scheme
- **Other benefits**
  - Enables regulatory 'pre-approval' of material and large-scale test of policyholder comprehension
  - Also tests out mailing processes, help-desk, etc
  - Initiates policyholder awareness and surfaces key policyholder concerns

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Appetite Mailing

- **Other benefits, cont.**
  - PR presentation as 'seeking opinion' makes criticism less likely
  - If sufficient support exists, can use in support of final scheme, especially in PR.
- **Disadvantages**
  - Adds 12 months to elapsed time, assuming 31/12 implementation date
  - Cost!

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Appetite Mailing

- **Pack Content**
  - Letter, including 'Key Facts'
  - Individual stochastic illustration
  - Booklet with full details and explaining why might be of more or less interest to special groups (e.g. ill-health, early retirement, potential transferees, etc)
  - Reply vehicle, with space for comment
- **Development Process included**
  - Testing understanding with focus groups
  - FSA waiver to use stochastic model without accompanying deterministic one

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Appetite Mailing Outcome

- **Good response rate**
  - 30% of those mailed replied, representing 23% of the total potentially included population
    - Difference accounted for by 'goneaways' (despite efforts to recontact)
    - Telephone survey indicated good understanding
- **Majority support, but not overwhelming**
  - 75% by number, 69% by value – needed 75%+
  - Minority quite vehement about wanting to keep GAR
  - Mailing September 2008; not best time to promote move into equities!

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Appetite Mailing - Outcome

- **Positive Press Coverage**
  - Broadsheet financial pages, trade press….
  - …..all except Money Management


COMMENT

Completely GAR GAR

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Appetite Mailing - Outcome

- **Decide to offer 'opt-out'**
  - Policyholders to be offered three choices at vote
    - 'for', against' or 'opt-out'
  - Opt-outs would keep GAR and but could not vote
- **Advantages of Opt-out**
  - Majority who supported or did not object to scheme could not be denied by minority.
  - Minority not forced into scheme against will
  - Virtual certainty of achieving 75% support
  - Legal precedents in non-life insurance schemes of arrangement

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Notification Mailing

- **To inform all with-profits policyholders that a scheme is being initiated and that an initial ('convening') court hearing will be held**
  - to determine amongst other things who will vote
  - and to 'surface' any objections to the scheme early on
- **Voting proposals**
  - Only policyholders with GAR benefits that will be forgone may vote
  - Those who opt-out will not be able to vote
    - as not reasonable for them to be able to influence the outcome of the scheme
    - vote value will be 'peak 2' value of GAR to be given up

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Notification Mailing - Outcome

- **Plenty of questions but only a small number of formal objections**
  - mainly about 'excluded' policyholders not having vote, or
  - about minor changes to management of excluded policies (which scheme 'ring-fences' from included policies in all but extreme circumstances)
- **No further press interest despite press release.**

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Convening Hearing

- **Witness statement from company included:**
  - Almost final draft of opt-out/vote mailing material
  - Report on scheme from With-profits Actuary and Independent Actuary
  - Draft Scheme and draft post-scheme PPFM
  - Letter from FSA indicating no objection to the scheme at this stage
  - Letter from HMRC confirming preservation of tax statuses

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Convening Hearing - Outcome

- Short (40min) hearing approved progressing to vote as intended
- FSA observed but were not represented
- No policyholders chose to attend
- Minor changes made to vote material to address matters judge felt unclear

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Vote Mailing

- **Mailing pack**
  - Letter, personal illustration, explanatory booklet, 'legal' booklet (100+pages!), "How pensions work" leaflet, decision form and envelope.
  - All but legal booklet externally 'plain Englished'
  - Tested with c40 policyholders in 1-1 meetings
  - FSA comments taken into account

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Vote Mailing

- **Posted end September; last reply date 9 November**
  - Reminder after 3 weeks, including post strike message
  - Expected response 30% of mailed, 25% of which opt-outs
  - Actual 33% with only 17% opt-out
  - Checked that the 3.5% of 'no' voters didn't really meant to 'opt-out'
  - Allow 'opt-outs' to continue to be accepted after official close date
    - due to postal or other delays

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Policyholder Meeting

- **Held on 11 November**
  - Intended for creditors to meet to discuss scheme…..
  - ….and to vote on it.
  - Only five policyholders attended

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Sanction Hearing

- **Held on 11 December**
  - Formal report of vote outcome
  - FSA represented by Counsel
  - Supplementary report from IA and WPA, including updated financial
  - Court considered reasonableness and legality of scheme…
  - …and gave its sanction
  - Judge commented in particular on opt-out making his decision much easier
    - Compared to a scheme which compelled reluctant policyholders.

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Final Steps

- Documents lodged at Companies House
- Scheme became effective at 23:59 on 31 December
- Transfer values now calculated using temporary uplifts
- Notice to be mailed to all included policyholders (Q1 2010)
- Final uplifts to asset shares to be calculated
  - agreed by Independent Actuary
  - used in value calculations from 1 January 2011
- Possibility of Part VII transfer of PALAL to another Pearl group company

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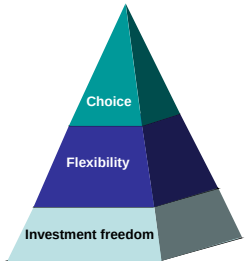
PALAL Scheme - Summary



- Opt out if consider GAR valuable
- Could leave with value for option
- Can retain policy on more favourable basis
- Higher EBR
- Alternative of constraints investment freedom

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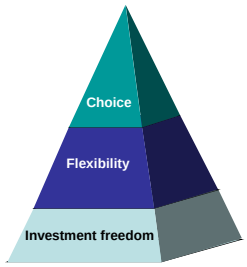

- Opt out if consider GAR valuable
- Could leave with value for option
- Can retain policy on more favourable basis
- Higher EBR
- Removes constraints on investment freedom

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Setting a Precedent

Legal Structure	Regulation
▪ Ability to change terms without crisis ▪ Opt out mechanism	▪ Flexibility to change — fair to policyholders ▪ Opt out mechanism

- Precedent may be broader than GARs schemes
  - Unitisation
  - Other compromises/restructuring

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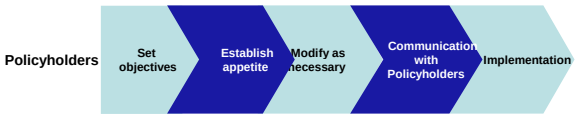
Lessons for future schemes



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