Halifax Assurance Ireland Limited

Transfer of life assurance business

21 June 2012

Certified as a true copy
by [signature]
on 21 June 2012

TOWERS WATSON

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Section 1: Introduction

1.1 This is the report of the Appointed Actuary of Halifax Assurance Ireland Limited ("HAIL") on the proposal to transfer the life assurance business of HAIL to the St Andrews Life Assurance plc ("SALA"). Both companies are part of the Lloyds Banking Group.

1.2 In accordance with Section 13 of the Assurance Companies Act 1909, the High Court of Ireland ("the Court") is required to sanction any proposal to transfer life assurance policies from one legal entity to another. A report from an independent actuary must be presented to the Court as part of the application for approval of the Scheme of Transfer ("the Scheme"). It is also general practice for the Independent Actuary's report to be accompanied by reports from the Appointed Actuaries of the transferring entity (in this case, HAIL) and the receiving entity (in this case, SALA).

1.3 The purpose of this report is to present my assessment of the impact of the proposed Scheme on the policyholders of HAIL, and specifically on the security of their benefits and their reasonable expectations regarding the operation of their life assurance policies, and should not be relied upon for any other purpose.

1.4 This report is laid out as follows:

- Section 2 provides an executive summary of this report;
- Section 3 contains a description of the transferring business of HAIL;
- Section 4 summarises the financial positions of HAIL as at 31 December 2011;
- Section 5 describes the proposed Scheme of Transfer;
- Section 6 considers the impact of the Scheme of Transfer on the policyholders of HAIL;
- Section 7 contains the conclusions;
- Section 8 contains the reliances and limitations associated with this report.

1.5 The report should be read in its entirety, as individual sections may be misleading if read in isolation. In particular, I draw your attention to the reliances and limitations set out in Section 8. The report has been produced in accordance with the statement of work in place between Towers Watson and HAIL (dated 10 March 2010) and the associated general terms and conditions.

1.6 I am a Fellow of the Society of Actuaries in Ireland and the Institute of Actuaries. I am employed by Towers Watson as a consulting actuary and have been the Appointed Actuary of HAIL since 2005. I do not possess any insurance policies with either HAIL or SALA.

Financial information

1.7 The financial information quoted in this report is taken from the reported solvency position of HAIL as at 31 December 2011, the reported solvency position of SALA as at 31 December 2011 and the SALA Actuarial Function Holder report.

Section 2: Executive summary

2.1 This is the report of the Appointed Actuary of Halifax Assurance Ireland Limited on the proposal to transfer the life assurance business of HAIL to St Andrews Life Assurance plc.

2.2 HAIL was founded in 2001 with a licence to write Class I life assurance business and Class IV permanent health insurance business (as specified in the Consolidated Life Directive) in Ireland. The company is a wholly-owned subsidiary of St Andrews, a public limited company incorporated in 1995 in the UK, which is a wholly owned subsidiary of Lloyds Banking Group. HAIL ceased to write new life assurance business in July 2010.

2.3 The principle activity of HAIL is the underwriting of life assurance and permanent health elements of Payment Protection Insurance ("PPI") for Lloyds Banking Group customers. PPI cover is provided on credit card, personal loan and overdraft products. HAIL's sister company, Halifax Insurance Ireland Limited (HIIL), underwrites the non-life insurance risks on the same PPI business.

2.4 SALA is a UK regulated insurance company selling life and pensions insurance business and is also part of Lloyds Banking Group. SALA is regulated by the UK Financial Services Authority ("FSA") and is authorised to write Class I, III and IV business.

2.5 The principle activity of SALA is the underwriting of ordinary long-term insurance and savings business and associated investment activities in the UK. SALA offers a wide range of life insurance products such as protection type products including whole life and investment type products through LBG. SALA also currently underwrites PPI insurance.

Solvency position of HAIL

2.6 The Regulatory Returns to the Central Bank of Ireland show that as at 31 December 2011, HAIL had assets of £49.5 million in excess of its liabilities available to cover the company's statutory minimum solvency margin requirement of £14.6 million. The Central Bank of Ireland has indicated that they would like to see solvency at 200% of the actual solvency margin calculation (with no minimum) subject to an overall absolute minimum of €3.5 million. HAIL's solvency position as at 31 December 2011 was strong with a solvency coverage level of 338%.

Solvency position of SALA

2.7 The Regulatory Returns to the FSA show that as at 31 December 2011, SALA had assets of £412.3 million in excess of its liabilities available to cover the company's statutory minimum solvency margin requirement of £122.8 million. SALA's solvency position as at 31 December 2011 was strong with a solvency coverage level of 336%.

2.8 SALA is also required to perform regular calculations to measure the level of its solvency on a more realistic basis called the Internal Capital Assessment regime ("ICA"). This is in addition to the Pillar 1 capital requirement assessment which is based on fixed percentages of reserves and capital at risk. Companies must hold assets in excess of the higher of the Solvency I requirement and the ICA assessment. SALA's ICA assessment at 31 December 2010 showed available assets of £1,276 million leaving £899 million excess assets over the ICA capital requirement of £377 million. The solvency margin ratio under the ICA at 31 December 2010 was 338%. The estimate of SALA's ICA result as at 31 December 2011 is available assets of £999 million leaving £563 million excess assets over the ICA capital requirement of £436 million.

Scheme of Transfer

2.9 The overall outcome of the Scheme will be that the life assurance contracts in place between HAIL and its customers will be transferred to SALA. SALA will then become the entity with the ultimate responsibility for fulfilling all obligations and responsibilities to the former customers of HAIL under these contracts. These obligations will be met, where possible, from the assets of SALA and the transferring insurance policies will become part of SALA.

2.10 The assets of the SALA, including those assets transferred from HAIL as part of this Scheme, will be available to provide for the payment of benefit entitlements to the transferring HAIL policyholders.

2.11 The table in paragraph 6.12 of this Report demonstrates that the transfer of the HAIL business will have a minimal impact on the overall solvency position of SALA, and that SALA will remain in a strong solvency position after the transfer. The table also shows that the post transfer HAIL solvency position is also strong. Should there be any excluded policies at the effective date then there would be sufficient resource remaining within HAIL to meet the regulatory requirements.

2.12 It is my opinion, based on the information outlined in this Report, that the transferring policyholders are no worse off from a security of benefits point of view as a result of the proposed Transfer. It is also my opinion that should there be any excluded policies then the excluded policyholders would not be materially worse off from a security of benefits point of view as a result of the proposed Transfer.

2.13 It is intended that, after completion of the transfer, the policy administration will continue to be performed by the same staff whether the proposed outsourcing referred to in paragraph 3.16 of this Report goes ahead or not. It is therefore my opinion that transferring policyholders, and any remaining excluded policyholders, should be no worse off from a service point of view as a result of the proposed transfer.

2.14 The Scheme of transfer does not contain any specific provisions relating to Policy Holders Reasonable Expectation ("PRE"). I have explained my interpretation of PRE to the Actuarial Function Holder of SALA, and he has indicated that his interpretation and application of PRE post-transfer will be similar. It is my view that the reasonable expectations of the transferring policyholders will be unaffected by the transfer.

Conclusion

2.15 I have reviewed the information provided to me in relation to the proposed transfer, including the Scheme of Transfer, the report of the SALA Actuarial Function Holder and the report of the Independent Actuary.

2.16 Based on this information, I am satisfied that the proposed transfer:

- Does not reduce the benefit expectations of HAIL's policyholders;
- Will not lead to a reduction in the overall level of security of the HAIL policyholders' benefits; and
- Will not lead to a diminution of the levels of service provided to the HAIL policyholders.

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Section 3: Background to HAIL

Introduction

3.1 This section describes the business of the transferring company, HAIL. It also contains a summary of how PRE is managed in HAIL.

3.2 The financial position of HAIL, as at 31 December 2011, which is the effective date of the most-recently audited set of financial statements, is summarised in Section 4 of this report.

HAIL

3.3 HAIL was founded in 2001 with a licence to write Class I life assurance business and Class IV permanent health insurance business in Ireland. The company is a wholly-owned subsidiary of St Andrews, a public limited company incorporated in 1995 in the UK, which is a wholly owned subsidiary of Lloyds Banking Group. HAIL ceased to write new life assurance business in July 2010.

3.4 The principle activity of HAIL is the underwriting of life assurance and permanent health elements of Payment Protection Insurance ("PPI") for Lloyds Banking Group customers. PPI cover is provided on credit card, personal loan and overdraft products. HAIL's sister company, HIIL, underwrites the non-life insurance risks on the same PPI business.

3.5 HAIL underwrites various life, critical illness and accident and sickness benefits as part of payment protection insurance provided to customers in the UK. There are four main product types;

- Single premium unsecured personal loan repayment cover ("UPLRC");
- Recurrent single premium credit card repayment cover ("CCRC");
- Recurrent single premium secured personal loans repayment cover ("SPLRC"); and
- Recurrent single premium overdraft repayment cover ("ORC").

3.6 As at the end of March 2012, there were 64,582 single premium policies and 375,061 recurrent single premium policies in force in HAIL. It is worth noting that for recurrent single premium policies, only the death cover is underwritten in HAIL and the premium is monthly renewable.

3.7 In recent years HAIL customers have made a significant number of claims seeking compensation payments relating to previously-sold payment protection insurance policies. These compensation claims relate to both single premium and regular premium products where customers have claimed that a HAIL policy was inappropriately sold to them, and that the benefits and costs offered by these policies were inconsistent with their needs. There is continued focus on the PPI market in the UK and as such there continues to be a risk of possible future such claims. However, the risk of HAIL having to meet the liability in relation to these customer redress claims is mitigated by the fact HAIL has received internal legal advice that there is no liability on the part of HAIL for any discrepancies within the sales and marketing process and that any such claims will be met by the parent Bank (ie the distributor). This has been the process to date in HAIL in relation to any such claims. The exception to this is the policies that were sold from HAIL through the direct sales channel. A redress provision of £1.3 million is held in the HAIL accounts as a current liability in respect of possible redress claims relating to these policies.

Policyholder Reasonable Expectations (PRE)

Brief background to PRE as it applies to HAIL

3.8 There is no statutory regulation in relation to PRE. The Society of Actuaries in Ireland issued an Actuarial Standard of Practice, ASP LA-4, in 2006 to provide additional guidance for appointed actuaries on PRE. This standard of practice included the clarification that the Board is responsible for the proper running of the Company, including meeting policyholders' reasonable expectations.

3.9 ASP LA-4 further states that the Appointed Actuary should normally review any changes in the Company's practices relating to the exercise of its discretionary powers in relation to the treatment of policyholders and report to the Board in writing on his or her review of the change in the Company's practices.

3.10 For the type of business written by HAIL the main areas where discretion may be exercised relate to;

- Premium changes on monthly recurrent single premium business;
- Refunds payable on single premium business;
- Consistency with HAIL policy documentation.

Premium changes on recurrent single premium business

3.11 The policy conditions permit changes to premium rates for recurrent single premium business with 30 days' notice. To the best of our knowledge the company has not amended premium rates for existing customers on this business.

Refunds on single premium contracts

3.12 The other area where discretion may be exercised relates to refunds on single premium policies. For policies sold prior to August 2008 there were no guarantees in the policy conditions that refunds would be payable on a policy lapse, albeit that it has been the practice that a refund was paid. Between August 2008 and January 2009 HAIL communicated to new policyholders its intention to pay a refund of premiums in the event of a policy lapsing, and provided new policyholders with illustrations of potential refund proportions. While the company made clear in the policy conditions that the specific refund levels are not guaranteed, it explained to policyholders the circumstances in which refunds would be payable.

3.13 The refunds payable to policyholders in the past would have been calculated in line with a formula set by HAIL. On a number of occasions in the past the refund formula has been changed. As part of the process of changing the refund formula I, as Appointed Actuary, was consulted by HAIL and I would have advised the Board as to whether the proposed change was in my view, having due regard to the content of ASP LA 4, consistent with PRE.

Consistency with HAIL Policy Documentation

3.14 It is necessary to ensure that HAIL's practice, in all relevant areas, is consistent with the terms outlined in the sales documentation and policy conditions, in particular relating to whether a claim is valid or not.

Operational arrangements

3.15 HAIL employs a team of people in Shannon, Co Clare, to handle most aspects of its business in-house. The administration of the business is undertaken with support from another Lloyds Banking Group company, Halifax Brokerage Ireland Limited ("HBIL"). HBIL is also based in Shannon. The administration of HAIL business is currently carried out by HAIL and HBIL which collectively employ a total of 214 employees of which 16 are part-time.

3.16 On 21 November 2011, Lloyds Banking Group made the decision to outsource HAIL and HIIL policy and claims administration to a third party. I have been informed by HAIL that a suitable third party has been identified and discussions are on-going. It is proposed that the third party supplier will take over the existing HAIL, HIIL and HBIL site facilities and a significant number of the administration staff of HAIL, HIIL and HBIL will transfer to the new supplier. Subject to the successful conclusion of the negotiations, the intention is that the outsource arrangements will begin in late July 2012. HAIL expects that policyholders should see no change in the service provided as a result of the outsourcing.

3.17 I have been informed that if the proposed outsourcing arrangement is not approved the administration of HAIL and HIIL policies will continue to be carried on by the same HAIL, HIIL and HBIL administration staff. In this situation the required HAIL and HIIL administration staff would transfer to the HBIL entity which would administer the policies on closure of HAIL and HIIL. HAIL expects that policyholders should see no change in the service provided as a result of such a change.

Section 4: Statutory valuation of HAIL

4.1 This section of the report summarises the result of the most recent statutory valuation of HAIL, which was performed with an effective date of 31 December 2011.

Introduction

4.2 The mathematical reserves for the returns to the Central Bank of Ireland are effectively calculated as the sum of the following five components:

- The unearned premium reserve ("UPR"), reflecting premiums received before the valuation date in respect of future periods of risk cover after that date;
- The additional risk and expense reserve ("AURR") for those policies where the unearned premium is insufficient to cover future risk and expenses;
- The potential liabilities in respect of incurred but not reported ("IBNR") claims. These are claims in respect of events which occurred prior to 31 December 2011, but which have not been reported to HAIL by that date;
- The potential liabilities in respect of claims in course of payment ("ICOP"). These are the future payments that will need to be made in respect of accident and sickness claims which are currently in payment;
- Additional reserves to cover expenses (where not already allowed for in other reserves) and the risks associated with currency mismatching, asset mismatching and counter-party default; and
- Additional outstanding loss reserve ("OSLR") has also been considered to cover additional claims which the company had previously considered closed but has re-opened to determine if these claims should be paid.

4.3 The background to the reserving approach used is described below.

Basic approach

Single premium business (Halifax, Branch and Chester business)

4.4 The main component of the technical provisions and mathematical reserves is the unearned premium reserve. This is calculated on the basis of the "Rule of 78" for life and critical illness business and the "Rule of 45" for accident and sickness business.

4.5 Between August 2008 and January 2009, HAIL communicated to new single premium policyholders its intention to pay a refund of premiums in the event of a policy lapsing, and has provided new policyholders during this period with illustrations of potential refund proportions. HAIL has obtained a concession from the Central Bank of Ireland in a letter dated 18 October 2007 such that the company is not required to reserve for solvency purposes for the full level of this refund guarantee introduced in 2008 on certain lines of business. Instead HAIL is able to rely on its parent to pay that portion of the premium refund corresponding to the share of the original premium paid by HAIL to its parent as commission. As such, it is appropriate to continue to reserve for these policies by way of a net of commission unearned premium reserve. However, for the purpose of calculating solvency an additional reserve of £2 million has been set up to allow for counterparty risk in relation to the potential refunds.

4.6 For business sold prior to August 2008, the master policies that we have received from HAIL explicitly state that the policies do not attract a surrender value but may receive a partial refund of premiums. The master policies also state that, after the first 30 days of a contract, premium refunds are calculated on a non-guaranteed basis. It has been indicated to us that no guarantees on these policies have been given on the level of surrender values or premium refunds. In addition to the unearned premium reserve, an AURR, an IBNR reserve and an ICOP reserve are held.

4.7 The AURR is held for individual policies where the expected cost of future claims and expenses exceeds the unearned premium reserve. This additional reserve arises mainly as a result of older policyholders where the single premium charged is not adequate, using prudent assumptions, to cover the expected cost of future death and sickness payments and associated expenses.

Recurrent single premium business

4.8 A significant component of the mathematical reserves for recurrent single premium business is the unearned premium reserve (UPR). For secured personal loan, direct sales unsecured personal loan business, credit card and overdraft repayment cover, a UPR is established equal to 55% of the premium net of commission. For direct sales secured personal loan business, a UPR of 50% of the premium net of commission is held.

4.9 In addition to the unearned premium reserve, an IBNR reserve is also held.

Contingency, asset mismatching, currency mismatching and counterparty risk reserve

4.10 A reserve covering the risk of asset mismatching, currency mismatching and the counterparty risk due to the guaranteed premium refunds is also required.

Additional Outstanding Loss Reserve

4.11 As part of the Lloyds Banking Group integration work, and in light of increased claims levels due to the economic situation, a review was commenced in 2009 to assess the adequacy of decision making in claims handling by Operations in Shannon. Subsequent to this initial review a project "Project Manor" was set up to carry out further sample testing work in 2010 to identify and estimate the possible remediation relating to claims decisions. I have set aside a reserve in HAIL of £2 million in respect of Project Manor. We refer to this additional reserve as the outstanding loss reserve.

4.12 During 2011, HAIL commenced a separate project to review the adequacy of the decision making in claims handling on 221k policies that were sold from Shannon through the direct sales channel. A redress provision of £1.3 million is held in the HAIL accounts as a current liability in respect of this issue.

Expense Overrun reserve

4.13 For the purpose of the year end valuation we have considered a number of possible scenarios including the scenarios where either the outsourcing and/or the portfolio transfer do not proceed as planned. Management provided us with the proposed expense bases under various scenarios:

- Scenario 1 - Business continues as is and runs off in line with policy lapses and maturities.
- Scenario 2 - Implement an outsourcing arrangement in quarter 1 of 2012 for the administration of HAIL policies but with no portfolio transfer of business to another legal entity in the Group.
- Scenario 3 – Implement an administration outsourcing arrangement in quarter 1 of 2012 for the administration of HAIL policies followed by a portfolio transfer of business to another legal entity in the UK within the Group in quarter 3 of 2012.

4.14 An expense overrun reserve was calculated which allowed for the excess of expected expenses in the most onerous scenario over those modelled in the other reserves, but allowing for the expected income on regular premium business. Of the scenarios considered Scenario 1 resulted in the most onerous result and a reserve of £12.5 million was held.

Solvency Margin

4.15 HAIL's solvency margin requirement at the valuation date, calculated in line with regulatory standards, was equal to £14.6 million.

Result

4.16 The result of the valuation is shown below, with comparative figures from 31 December 2010 shown for illustration purposes.

	31 December 2011 £000's	31 December 2010 £000's
Long term business fund (LTBF)		
Admissible assets	61,080	133,462
Mathematical reserves		
- Unearned premium reserve	8,150	19,217
- Additional expense and risk reserve	6,053	12,162
- IBNR reserve	3,874	6,579
- ICOP reserve	4,343	7,589
- Expense Overrun reserve	12,500	2,500
- Asset mismatching reserve	2,000	2,000
- Counterparty Risk Reserve & Currency Mismatch Reserve	2,000	2,000
- Additional Outstanding Loss Reserve	2,000	2,000
Other liabilities of LTBF	3,334	8,785
A. Surplus in LTBF (before any transfer)	16,862	70,630
Shareholders fund		
Assets	28,773	58
Liabilities	2	135
B. Net shareholder assets	28,771	(77)
C. Admissible assets available to cover required minimum solvency margin (A+B)	45,633	70,553
D. Required minimum solvency margin	14,628	18,091
E. Cover for solvency margin (C/D)	312%	390%
F. Inadmissible assets	3,873	28,822
G. Total assets, including inadmissible assets, available to cover minimum solvency margin (C+F)	49,506	99,375
H. Cover for solvency margin (G/D)	338%	549%

4.17 The total assets in the LTBF available to cover the required minimum solvency margin, both admissible and inadmissible, amount to £49.5 million, providing cover for the required minimum solvency margin of 338%.

Section 5: Proposed Scheme of Transfer

5.1 In accordance with Section 13 of the Assurance Companies Act 1909, any scheme of transfer, which provides for the life assurance business carried on by an insurance company to be transferred to another body, requires the prior sanction of the Court. HAIL has prepared such a scheme for Court approval.

5.2 The key features of the Scheme are described below, in the context of their impact on the current policyholders of HAIL.

Overview of the Scheme

5.3 The overall outcome of the Scheme will be that the life assurance contracts in place between HAIL and its customers will be transferred to the SALA. SALA will then become the entity with responsibility for fulfilling all obligations and responsibilities to the former customers of HAIL under these contracts.

5.4 The assets of SALA, including those assets transferred from HAIL as part of this Scheme, will be available to provide for the payment of benefit entitlements to the transferring HAIL policyholders.

5.5 There will no changes to the HAIL policyholder terms or conditions.

5.6 The effective date of the Scheme is expected to be 31 October 2012.

Transfer of assets and liabilities

5.7 It is intended that, subject to the sanction of the Court, all of HAIL's insurance policies, together with the associated liabilities and assets (as defined in the Scheme) will be transferred to SALA as at the Effective Date, such that the policyholder liabilities are extinguished in HAIL.

5.8 The Scheme provides that the assets being transferred are sufficient to cover the transferring liabilities. There are certain items excluded from the Scheme and will remain with HAIL. Non policyholder related liabilities and all other assets are excluded from the Scheme and will remain in HAIL.

Excluded policies

5.9 While all policies were originally sold to policyholders who were UK resident, since then some 3000 policyholders are now resident in other jurisdictions both within and outside the EEA.

5.10 The Scheme therefore also provides for the possibility that there may be excluded policies. Such policies (and liabilities and assets relating to excluded policies) would remain in HAIL after the transfer. The possible excluded policies are those where an EEA regulator does not provide the necessary approvals so that certain policies may be transferred as at the effective date.

5.11 We have been informed that any excluded policies will be one hundred per-cent reinsured from HAIL to SALA until the relevant policyholder agrees to its novation to SALA or until the relevant Member State has consented, or has been deemed to consent, to the Scheme. The proposed reinsurance documentation has not been prepared at this stage as HAIL considers that the issue is unlikely to arise. If such a situation does arise then I would expect the treaty to be structured in such a way that in the unlikely event of SALA winding up then every HAIL excluded policyholder under the reinsurance treaty would rank equally to other SALA policyholders.

5.12 The Scheme also provides that if on, or after, the proposed Scheme transfer date that the relevant authorities provide consent then the relevant policies will transfer to SALA and will constitute transferring policies in all respects.

PRE

5.13 The Scheme does not include any specific provision relating to PRE.

Policy administration and customer service

5.14 At present the policy administration of the transferring policies is carried out by staff employed by HAIL and HBIL in its operations in Shannon. It is intended that, after completion of the transfer, the policy administration will continue to be performed by the same staff, whether the proposed outsourcing happens or not.

Costs of transfer

5.15 Any expenses arising in relation to the proposed transfer of these policies will be met by Lloyds Banking Group.

Tax

5.16 It is intended that policyholder tax will be unchanged as a result of the proposed Scheme of Transfer and that HAIL policyholders will be unaffected by the proposed Scheme from a tax perspective.

Section 6: Impact of proposed Scheme of Transfer

6.1 This section assesses the impact of the proposed scheme of transfer, considering the effect on security of benefits of the transferring policyholders as well as their future expectations regarding the operation of their policies.

Security of Benefits

6.2 The factors I considered in assessing the implications of the transfer for the security of policyholders benefits include:

- The current solvency positions of HAIL and SALA; and
- The expected future solvency position of SALA and HAIL.

Summary of solvency position of HAIL

6.3 The Regulatory Returns to the Central Bank of Ireland show that as at 31 December 2011, HAIL had assets of £49.5 million in excess of its liabilities available to cover the company's statutory minimum solvency margin requirement of £14.6 million. The Central Bank of Ireland has indicated that they would like to see solvency at 200% of the actual solvency margin calculation (with no minimum) subject to an overall absolute minimum of €3.5 million. HAIL's solvency position as at 31 December 2011 was strong with a solvency coverage level of 338%.

6.4 The HAIL solvency position is also projected to be strong at the expected effective date of the transfer, even allowing for a planned dividend payment of £27 million in June 2012.

6.5 The most recent HAIL financial condition report prepared in 2009 showed that HAIL could withstand a range of adverse scenarios and remain solvent.

6.6 HAIL took part in the Solvency II Quantitative Impact Study 5 ("QIS5") in 2010. The calculations were performed as at 31 December 2009. The results, under the QIS 5 technical specifications, suggested that the aggregate capital requirements for HAIL would be significantly lower under Solvency II than under the current Solvency I regime.

Summary of solvency position of SALA

6.7 SALA is incorporated in the UK as a private company with limited liability. It is a wholly owned subsidiary of Halifax Life Limited which is a wholly owned subsidiary of Lloyds Banking Group.

6.8 The financial information quoted below is taken from the SALA regulatory returns to the Financial Services Authority ("FSA") as at 31 December 2011 and the SALA Actuarial Function

Holder Report relating to the proposed Scheme. SALA is subject to the prudential supervision of the FSA and is required to perform regular calculations to measure the level of its solvency. The table below summarises the financial position of SALA as at 31 December 2011 which is taken from the SALA regulatory returns to the FSA:

£m	SALA Year end 2011
Total Assets	10861.1
Mathematical Reserves	10448.8
Net assets available to cover solvency margin	412.3
Required minimum solvency margin	122.8
Excess of available assets over solvency margin	289.5
Solvency Coverage ratio	336%

6.9 SALA's solvency position on a Solvency I basis as at year end 2011 was strong. The solvency position as reported to the FSA in respect of the Solvency I position has also been strong as at year end 2010 with a solvency coverage ratio of 433%.[1]

6.10 Under FSA rules SALA is also required to undertake a Pillar 2 assessment of the adequacy of its capital resources, known as the ICA which is viewed as a more realistic capital measure compared to Pillar 1. Companies must hold assets in excess of the higher of the Pillar 1 requirement and the Pillar 2 ICA assessment.

6.11 SALA had a strong solvency position under the ICA assessment at 31 December 2010 of 338% solvency margin coverage. SALA's ICA assessment at 31 December 2010 showed available assets of £1,276 million leaving £899 million excess assets over the ICA capital requirement of £377 million. The estimate of SALA's ICA result as at 31 December 2011 is available assets of £999 million leaving £563 million excess assets over the ICA capital requirement of £436 million. The estimated ICA solvency margin coverage as at year end 2011 is therefore 229%. SALA also carried out a projection of the solvency position on an ICA basis in 2010 based on ICA projections up to year end 2013 and the results of this projection showed that the solvency position on the ICA basis is projected to remain strong up to year end 2013.[2]

[1] (source: SALA Actuarial Function Holder Report and Independent Actuary Report relating to the proposed Scheme)
[2] (source: SALA Actuarial Function Holder Report and Independent Actuary Report relating to the proposed Scheme)

Financial position after completion of the transfer

6.12 The table below shows the financial position of SALA as at 31 December 2011 after the transfer of assets and liabilities from HAIL in accordance with the Scheme:

£m	SALA	HAIL	Combined	HAIL post transfer
Total Assets	10,861.1	91.6	10,884.9	40.8
Mathematical Reserves	10,448.8	42.2	10,491.0	0.0
Net assets available to cover solvency margin	412.3	49.4	393.9	40.8
Required minimum solvency margin	122.8	14.6	137.4	3.5
Excess of available assets over solvency margin	289.5	34.8	256.5	37.3
Solvency Coverage ratio	336%	338%	287%	1166%

1. The pre transfer Hail reserves includes the redress reserve of £1.3m for mis-selling cases sold directly by HAIL that is commented on in Section 4.12.
2. The post transfer reserves in respect of HAIL business have not been restated to an FSA basis. The post transfer reserves have been made on the prudent assumption that all reserves (basic and other mathematical reserves) need to be established in SALA post transfer.
3. If the proposed transfer took place on 31 December 2011 assets equal in value to basic mathematical reserves of £22.5 million plus redress reserve of £1.3 million would transfer.
4. The post transfer HAIL position also allows for a £27 million dividend payment which was agreed to be paid by HAIL during a May 2012 Board meeting.
5. The minimum solvency margin requirement in HAIL post transfer is €3.5m (€3.7m from Dec 2012) until it relinquishes the insurance licence.
6. The HAIL post transfer reserves assume that there are no excluded policies.

6.13 The assets being transferred are sufficient to cover the transferring liabilities (basic mathematical reserves of £22.5 million plus other policyholder related liabilities of £1.3 million i.e. redress reserve to be transferred over under the indemnity agreement). It is not expected that other mathematical reserves (£18.5 million at 31 December 2011 for expense overrun reserves, asset matching etc) will be required when the business is transferred to SALA and reserves are established on a FSA basis. However, in establishing the combined post transfer solvency position of SALA, the numbers in the table above assume that SALA does indeed need to establish these reserves.

6.14 The above table demonstrates that the transfer of the HAIL business will have a minimal impact on the overall solvency position of SALA, and that the SALA solvency position immediately after the proposed transfer remains strong.

6.15 The above table also shows that the post transfer HAIL solvency position is strong. Should there be any excluded policies at the effective date then there would be sufficient resource remaining within HAIL to meet the regulatory requirements.

6.16 It is my opinion, based on the information outlined above, that the transferring policyholders are no worse off from a security of benefits point of view as a result of the proposed Transfer. It is also my opinion that should there be any excluded policies, then the excluded policyholders would not be materially worse off from a security of benefits point of view as a result of the proposed Transfer.

PRE

6.17 PRE, and how it impacts on HAIL, has been outlined in Section 3 of this report.

6.18 It is not intended that the methodology used to calculate refunds on single premium business, or the premium charges on recurrent single premium business, will be changed as a result of the proposed Scheme of Transfer. SALA will maintain the right, as specified in the policy conditions, to change these aspects of the products.

6.19 In addition, we have been informed that the same claims staff will be administering claims pre and post transfer which will help ensure that there should be no change to the claims process as a result of the proposed Scheme of Transfer.

6.20 I have discussed with the Actuarial Function Holder of SALA his interpretation of PRE and he has indicated that his interpretation and application of PRE post-transfer will be similar to existing PRE practices.

6.21 It is therefore my opinion that the transferring policyholders are no worse off from a PRE perspective as a result of the proposed Scheme of Transfer.

Policy administration and customer service

6.22 At present the policy administration of the transferring policies is carried out by staff employed by HAIL and HIBL in their operations in Shannon. It is intended that, after completion of the transfer, the policy administration will continue to be performed by the same staff whether the proposed outsourcing referred to in paragraph 3.16 goes ahead or not.

6.23 It is therefore my opinion that transferring policyholders, and any remaining excluded policyholders, should be no worse off from a service point of view as a result of the proposed transfer.

Tax impact

6.24 I have been advised by HAIL that the proposed transfer does not have any tax implications on the transferring policyholders or the value of their policies, and that no clause is necessary for inclusion in the Scheme to alleviate any tax-related consequences.

Policyholder communications

6.25 I understand that this Report that I have prepared in my capacity as Appointed Actuary of HAIL will not be sent to policyholders. In my opinion, the holders of the Transferring Policies, as defined in the Scheme of Transfer being presented to the Court, are unlikely to be prejudiced or adversely affected in any way by not receiving either a full or summary version of the Report of the Appointed Actuary of HAIL on the Transfer of Business.

6.26 I have been informed that policyholders will be sent, an executive summary of the Independent Actuary's Report included in the policyholder Information Pack, together with the rest of the contents of the Circular, comprising the Managing Directors Letter, the Terms of Scheme and a Frequently Asked Questions leaflet. I have been informed by HAIL that the full suite of information relating to the Transfer, including all of the full actuarial reports, will be drawn to the attention and made available to any of the holders of the Transferring Policies on request. In my opinion, this level of communication is satisfactory.

Section 7: Conclusion

7.1 I have reviewed the information provided to me in relation to the proposed transfer, including the Scheme of Transfer and the report of the Actuarial Function Holder of SALA.

7.2 Based on this information, I am satisfied that the proposed transfer:

- Does not reduce the benefit expectations of HAIL's policyholders;
- Will not lead to a reduction in the overall level of security of the HAIL policyholders' benefits; and
- Will not lead to a diminution of the levels of service provided to the HAIL policyholders.

Rosemary Commons
Fellow of the Society of Actuaries in Ireland

Towers Watson (Ireland) Limited
65-66 Lower Mount Street
Dublin 2
Ireland

21 June 2012

Section 8: Reliances and limitations

Reliances

8.1 In producing this report I have relied without independent verification upon the accuracy and completeness of the data and information provided to us, both in written and oral form, by HAIL and SALA. Where possible, I have reviewed some of the information provided for reasonableness and consistency with my knowledge of the insurance industry.

8.2 In producing this report we have relied upon information including:

- All data provided to me as part of the December 2011 statutory valuation;
- Regulatory returns and financial statements of SALA;
- The contents of the report prepared by the Actuarial Function Holder of SALA, including related discussions; and
- Letter of representation received from HAIL dated 25 April 2012.

Limitations

8.3 This report has been produced for use by the various parties involved with this proposed Transfer which include:

- The Court having jurisdiction over the proposed transfer;
- The Independent Actuary;
- The Actuarial Function Holder of SALA
- Policyholders of HAIL
- The Central Bank of Ireland; and
- Professional advisors appointed by any of the above in connection with the proposed transfer.

8.4 No part of this report is to be disclosed to, or relied on, by any third party without the prior written consent of Towers Watson, with the exception of making the report available for inspection by or circulation to policyholders as required by legislation or in order to meet any other specified legal requirements.

8.5 The Report has been prepared by Towers Watson (Ireland) Limited on an agreed basis to meet the specific purposes of HAIL, and must not be relied upon for any other purpose. The Report has been prepared for use by persons technically competent in the areas covered. Except with the written consent of Towers Watson (Ireland) Limited, the Report and any written or oral information or advice provided by Towers Watson (Ireland) Limited must not be reproduced, distributed or communicated in whole or in part to any other person, or be relied upon by any other person. Any reference to Towers Watson (Ireland) Limited in any report, accounts or other published documents is not authorised without our prior written consent.

8.6 We understand that you may wish to share a copy of our report with your auditors. We have no objection to this if it is purely in the context of them performing their regular activities for you and is not in relation to a particular exposure, merger, acquisition or other corporate transaction. However, Towers Watson gives no warranties as to the suitability of this report and other materials for any purpose other than that for which they were originally provided and accept no responsibility or liability to your auditors in this regard. Such consent shall in no event increase our liability beyond the liability we have under our terms of engagement with you. We would ask you to draw the provisions of the above paragraph to the attention of your auditors when passing on our reports or other materials to them.

8.7 This report must be considered in its entirety as individual sections, if considered in isolation, may be misleading. Draft versions of this report must not be relied upon by any person for any purpose. No reliance should be placed on any advice not given in writing. If reliance is placed contrary to the guidelines set out above, Towers Watson disclaim any and all liability which may arise.

8.8 We have not attempted to assess the suitability or quality of HAIL's assets. We have also not investigated, or made allowance for, any claims against HAIL other than those made by policyholders under the normal terms of life insurance business. In particular, no account has been taken of liabilities in respect of leases and breaches of legislation, regulatory rules or guidance.

8.9 Where possible we have carried out consistency and reasonability checks on the data used to carry out the valuation and the resulting provisions. However, we are satisfied that the underlying data and processes will have been subject to audit prior to sign-off by the Board. Further detail of the checks carried out is contained in the report of the Appointed Actuary on the statutory valuation of HAIL as at 31 December 2011.

8.10 Assumptions are made about future experience, including economic and investment experience, tax, expenses, discontinuance rates, mortality, reinsurance and legislation. These assumptions have been made on the basis of reasonable estimates and on information provided to us by HAIL. However, actual future experience is likely to differ from these assumptions, due to random fluctuations, changes in the operating environment and other factors. Such variations in experience could have a significant effect on the results and conclusions of this report. No warranty is given by Towers Watson that the assumptions made in this report will be reflected in actual future experience.

8.11 Our review is based on the documentation provided by HAIL and is from the viewpoint of actuarial advisers. In particular we are not providing you with legal, audit, accountancy or tax advice, which are outside the normal scope of our services. Where, in the course of providing our services, we need to interpret a document, deed, accounts or relevant taxation provision in order to advise you, we do so with the reasonable skill and care to be expected of us in our professional capacity but you acknowledge that we are neither lawyers nor tax advisers nor accountants and accordingly should you want definitive advice for example, as to the proper interpretation of a document, deed, accounts or relevant taxation provision you should consult your lawyers, accountants or tax advisers for that advice.

8.12 This report was based on data available to Towers Watson (Ireland) Limited at, or prior to, 21 June 2012, and takes no account of developments after that date. Towers Watson (Ireland) Limited is under no obligation to update or correct inaccuracies which may become apparent in the report.

8.13 This report is subject to the terms and limitations, including limitation of liability, set out in our original terms of business letter dated 6 October 2010. The total liability of Towers Watson arising out of or in connection with the services provided in contract tort or otherwise (in each case including, but not limited to, negligence) shall be limited to a maximum of £2 million.

8.14 Towers Watson shall not be liable in contract tort or otherwise for any loss of revenue, business, contracts, anticipated savings or profits or for any other indirect or consequential loss whatsoever.

8.15 Any limitation of liability shall be construed to the fullest extent permitted by law.

Legal jurisdiction

8.16 This Report will be governed by and construed in accordance with Irish law and the parties submit to the exclusive jurisdiction of the Irish courts in connection with all disputes and differences arising out of, under or in connection with this Report. If any part of a provision of this Report is held invalid, illegal or unenforceable then the remainder of such provision shall remain valid and enforceable to the fullest extent permitted by law.

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