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Re: The Part VII transfer of part of the long-term business of Legal and General Assurance Society Limited to ReAssure Limited

BACKGROUND

1. It is proposed to transfer a block of long-term insurance business from Legal and General Assurance Society Limited ("**LGAS**") to ReAssure Limited ("**ReAssure**").

2. I have been appointed by LGAS and ReAssure to report, pursuant to Section 109 of the Financial Services and Markets Act 2000 ("**FSMA**"), in the capacity of the Independent Expert on the terms of the proposed scheme (the "**Scheme**") providing for this transfer from LGAS to ReAssure.

3. In my role as Independent Expert for the Scheme, I have produced:

   - A report ("**my Main Report**") dated 3 July 2019 for the Directions Hearing at the High Court of Justice of England and Wales (the "High Court") on 11 July 2019 to assist the High Court in its deliberations on the Scheme.
   - An addendum to my Main Report ("**the addendum**") dated 12 July 2019 following the news that the Initial Public Offering of shares in ReAssure Group plc ("RGP") had been suspended.
   - A second report ("**my Supplementary Report**") dated 24 February 2020 to provide the High Court with an updated assessment of the likely effects of the Scheme ahead of the Sanction Hearing at the High Court on 10 March 2020.
   - An addendum to my Supplementary Report ("**the supplementary addendum**") dated 6 March 2020 providing an update to the Court on the operational readiness of ReAssure, late changes to the Scheme, updates on communications with policyholders in respect of objections and the potential effects of the recent epidemic of coronavirus ("**COVID-19**").

4. My Main Report, my Supplementary Report and both addendums have been made available to policyholders via the Legal & General Group website (www.legalandgeneral.com) and the ReAssure website (www.reassure.co.uk).

THE PURPOSE OF THIS NOTE

5. On the first day of the Sanction Hearing (10 March 2020), Mr Justice Zacaroli requested further information with respect to the basis used to form the conclusion outlined in Section 8.112 of my Main Report that the Fixed Expense Agreement would not have a material adverse effect on the reasonable benefit expectations of the with profits policyholders who would be transferred to the LG With-Profits Fund (the "**LGWPF**").

6. The purpose of this addendum is to provide further information as to how this conclusion was formed.

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THE FIXED EXPENSE AGREEMENT

7. As set out in 7.45 of my Supplementary Report, if the proposed Scheme were to be implemented a new fixed expense agreement (the "**Fixed Expense Agreement**") would be set up for the LGWPF within ReAssure and under the fixed expense agreement:

- The fixed per-policy schedule for in-force business was set such that the total charges for 2018 would be £32.4 million for 2018.
- The per-policy charges applied to each product group in 2020 and subsequent years will be set equal to the per-policy charges for 2018, increased in line with RPI + 0.5% p.a.

8. The Fixed Expense Agreement would be 'evergreen' (it would remain in-force until the last policy in the LGWPF were to run-off) and would have a number of advantages for policyholders in the LGWPF including:

- An immediate reduction to per policy expenses:

  Under the Fixed Expense Agreement, the per policy expenses for the transferring LGAS with-profits policyholders would be lower than if the Scheme were not implemented and the policies were to remain in the LGAS WPF.

- Reduced exposure to expense diseconomies of scale:

  Without an expense deal, as the with-profits fund policies run-off, the overheads associated with the ongoing maintenance of the fund would be spread over a decreasing population of policyholders and therefore the per-policy costs would be expected to increase (in excess of expense inflation) over time.

- Increased certainty:

  The Fixed Expense Agreement would lead to increased certainty regarding the future unit costs that would apply to the with-profit policies. This would reduce the capital requirements of the with-profit fund and would mean more money would be available for earlier distribution to the LGWPF policyholders.

- Coverage of one-off additional per-policy charges.

  The Fixed Expense Agreement would cover one-off expenses for any new business written in the LGWPF (i.e. increments accepted on pension business and new members for certain workplace schemes).

9. Although the Fixed Expense Agreement is 'evergreen' the Scheme contains provisions to allow its alteration in the event of the future actions in respect of the LGWPF (such as the merging of the fund or the activation of the sunset clause). Alongside the usual governance requirements in respect of the ReAssure Fairness Committee and the LGWPF With-Profits Actuary, these future actions would require a certificate to be obtained from an Independent Actuary who would consider the effect of the Fixed Expense Agreement on the policyholders of the LGWPF.

THE VALUE OF THE FIXED EXPENSE AGREEMENT

10. In order to estimate the value of the Fixed Expense Agreement to the LGWPF one should try and value the advantages of the Fixed Expense Agreement as set out above in paragraph 8.

11. To this end, the expenses for the LGWPF in ReAssure have been projected into the future under two scenarios:

  a. Assuming the Scheme were not to be implemented so no Fixed Expense Agreement and the LGAS WPF remains in LGAS (this would be based on the LGAS expense assumptions); and

b. Assuming the Scheme were to be implemented so the Fixed Expense Agreement is in place for the LGWPF in ReAssure.

12. These projections have been carried out using the most recently available best estimate projected expense assumptions at the time of the analysis and persistency assumptions that are consistent with the 2018 Solvency II balance sheet.

13. The present value of the difference between a, and b, (discounted using a constant rate of 1%) then provides an estimate of the value to the LGWPF of the reduced exposure to future diseconomies of scale. This value was approximately £90 million.

14. As stated above, an additional advantage of the Fixed Expense Agreement is that it provides ‘certainty’ in the expenses. It is difficult to estimate this accurately but one might put a (prudent) value on this of around 3%-5% of the value of the expenses under the Fixed Expense Agreement (approximately £260 million) so approximately £10 million.

15. Ignoring the value of reduced exposure to ‘one-off additional per-policy expenses’ as it is likely to be small, an estimate of the total value of the Fixed Expense Agreement to the LGWPF would be approximately £100 million.

THE CHARGE FOR THE FIXED EXPENSE AGREEMENT

16. The Fixed Expense Agreement would be provided by the ReAssure Shareholder to the LGWPF and, as stated above, the ReAssure Shareholder has decided to charge £50 million for this agreement.

17. It should be noted that this £50 million would be paid from the estate of the LGWPF and therefore no policy asset shares would be reduced as a result of this payment.

CONCLUSION

18. The assumptions used for the projections are those used for the 2018 Solvency II balance sheet and so have been subject to audit by the external auditors of LGAS (KPMG LLP) and so I am satisfied that these are reasonable assumptions to use.

19. The Fixed Expense Agreement and the assumptions used to demonstrate its effectiveness have been subject to the following governance:

- The LGAS With Profit Committee have approved the methodology;
- The LGAS Board have approved the Fixed Expense Agreement; and
- The LGAS WPA and LGAS CA have concluded that the fixed expense agreement provides a benefit to with profit policyholders.

20. Further, the full calculation detail (as described in paragraphs 11 to 15) has been shared with the regulators.

21. I am satisfied that, as the LGWPF would be paying £50 million for a Fixed Expense Agreement that is expected to yield a benefit of approximately £100 million, the Fixed Expense Agreement would be expected to be of value to the LGWPF even in adverse conditions and the introduction of the Fixed Expense Agreement would not have a material adverse effect on the reasonable benefit expectations of the transferring LGAS with-profits policyholders.

22. Furthermore, in addition to the financial value of the Fixed Expense Arrangement, as noted in my Main Report, it is my view that the transferring LGAS policyholders would benefit from moving to a company that is strategically focused on closed-book business and in particular is committed to future investment and development of this proposition. In particular, ReAssure will be focussed on the improvement of the systems functionality and the

development of resources to best manage its closed-book business over time whereas, in contrast, a company for whom this is not a strategic focus would be less likely to make significant future investment.

Oliver Gillespie

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