Summary of the Supplementary Report of the Independent Expert on the proposed Scheme to transfer a block of the European International Life Insurance Business of Scottish Widows Limited to Scottish Widows Europe SA

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Background

1.1 Scottish Widows Limited (SWL) is a private limited company incorporated in England and Wales and domiciled in the UK. It is a life insurance subsidiary of Scottish Widows Group (SWG), which is a subsidiary of Lloyds Banking Group plc (LBG or Group), the ultimate parent company. Under European Union (EU) regulations, UK insurance companies can sell policies and service business written in the European Economic Area (EEA) countries on a Freedom of Services or a Freedom of Establishment basis (commonly referred to as "EU passporting rights"). SWL has previously written life insurance and pensions business, primarily in Germany, Austria and Italy under EU passporting rights.

1.2 On 23 June 2016, the UK voted to leave the EU and on 29 March 2017, the UK government officially notified the European Commission of its intention to withdraw from the EU (Brexit). Brexit is expected to take effect on 29 March 2019. It is uncertain whether UK insurance companies will continue to be able to sell policies and service business (including the collection of premiums and payment of claims) written in EEA countries outside of the UK, under EU passporting rights, after 29 March 2019. Therefore, unless suitable transitional or grandfathering arrangements between the UK and the EU are agreed prior to 29 March 2019, it is expected that it will become illegal for SWL to continue to service the policies written under EU passporting rights.

1.3 SWL has established a new wholly-owned subsidiary in Luxembourg, Scottish Widows Europe SA (SWE), which was authorised by the Luxembourg Insurance Supervisory Authority, Commissariat aux Assurances (CAA) and Ministry of Finance as a life insurance company on 1 February 2019. Following authorisation, the CAA gave notice to the regulators of the EEA countries in which, SWE will service insurance policies under EU passporting rights. SWE has received approval from the CAA for setting up branch offices in Germany and Italy; it has also received a response from the German regulator BaFin acknowledging the set-up of the branch office in Germany. SWE is expecting to receive a response or no objection from the Italian regulator for setting up a branch office in Italy in early March 2019.

1.4 SWL intends to transfer the policies written under EU passporting rights to SWE so that it can be certain that it will be able to service this business following Brexit. This transfer will be carried out using a legal process known as a Part VII transfer of insurance business (under the Financial Services and Market Act 2000 as amended) (FSMA). The terms of the transfer are set out in a document known as the Scheme. The Scheme provides certainty that SWL will be able to lawfully service the business written under EU passporting rights post-Brexit. The Part VII transfer of these policies from SWL to SWE (Transferring Policies), together with the associated reinsurance agreement, charge agreement, unit linked servicing agreement and the indemnity agreement that sit alongside the Scheme, are referred to as the Transfer.

1.5 I have classified the Transferring Business into two main groups unitised with-profits business (Transferring UWP Business) and unit-linked business (Transferring UL Business).

1.6 Immediately following the transfer, the Transferring UWP Business will be reinsured back to SWL through a reinsurance agreement (the Reinsurance Agreement), which will also create the associated collateral arrangements known as the funds withheld (FWH). To provide further security for the Transferring Business, SWL will enter into a floating charge agreement (the Charge Agreement) with SWE. The Transferring UL Business will remain with SWE, but to ensure that the operations of the Transferring UL Business remain unchanged, SWE will enter into a service agreement with Lloyds Bank Plc (LB) to enable them to provide support for the back office management tasks related to the Transferring UL Business (Unit Linked Service Agreement), as happens at present for SWL. SWE will also enter into a service agreement with Lloyds Bank GmbH (LB Europe) relating to HR and payroll services.

1.7 Additionally, to provide protection for SWE against any litigation claims resulting from SWL's actions prior to the transfer of business to SWE, SWL will enter into an indemnity agreement (the Indemnity Agreement) with SWE. The Charge Agreement will also cover the obligations of SWL under the Indemnity Agreement.

1.8 I prepared a previous report dated 14 November 2018 (the Report) in my capacity as Independent Expert in which I considered the impact of the proposed Scheme on policyholders and other affected parties.

1.9 I also prepared another report dated 5 March 2019 (the Supplementary Report), the purpose of which was to provide the Court with an updated assessment of the likely effect of the proposed Transfer and to consider whether or not the conclusions reached in my Report remain unchanged after taking into account any financial and non-financial developments since the publication of the Report and of any objections received in relation to the proposed Transfer.

1.10 This is a summary of the Supplementary Report. Both this report and the Supplementary Report should be read in conjunction with the Report. For the avoidance of doubt, capitalised terms used in this report shall have the same meaning as in the Report.

1.11 Details of the scope of my appointment, my qualifications, limitations and reliances are contained in the Report.

Update on Brexit negotiations

1.12 There have been no developments within the public domain regarding the Brexit negotiations that provide any certainty over whether or not SWL will be allowed to continue to service business written under EU passporting rights after 29

March 2019. I understand that Germany, Italy and Austria have issued draft legislations[1] which allow the UK insurers and reinsurers a transitional period until December 2020 to continue to service the business sold in these countries under EU passporting rights in case of hard Brexit (ie an exit with no deal), however there is no certainty beyond this point.

1.13 I considered these draft transitional arrangements and discussed them with SWL. SWL remains of the view that the Scheme is necessary as the proposals by Germany, Italy and Austria are only for a transitional period, they are currently not finalised, and they are not at EU level (ie as a result the implementation would not be consistent across the EU).

1.14 I am satisfied that it is reasonable for SWL to proceed with the Scheme given that these draft arrangements are for a transitional period only with no certainty beyond December 2020, that they are not finalised and that the Scheme continues to provide SWL with certainty that the Transferring Business can continue to be lawfully serviced post-Brexit.

Update on FSCS protection

1.15 In the Report, I pointed out that the holders of the Transferring Policies who currently have FSCS protection are expected to lose FSCS protection in respect of acts and omissions (I provide examples of acts or omissions in Section 3 of the Supplementary Report) arising after the Effective Date as a result of the Transfer. I have discussed issues related to FSCS protection with SWL and its legal advisers and reviewed a note prepared by SWL's legal advisers on the impact of the Transfer on FSCS protection including the implications of the CP 26/18 published by the PRA.

1.16 I understand that claims related to acts or omissions by SWL that occur prior to the Effective Date will be covered by FSCS. The acts or omissions under a contract of insurance would cover protection in respect of insurance claims that have arisen under the policy terms and conditions of before the Effective Date. However, as SWE will not be a 'relevant person' (as defined under FSMA), I understand that any acts or omissions by SWE occurring after the Effective Date will not be covered by FSCS.

1.17 I have discussed with SWL whether FSCS protection for those Transferring Policyholders, who will lose this protection as a result of the Transfer, could be maintained, if SWE were to either obtain passporting rights to service business within the UK or set up a third country branch in the UK. I agree with SWL that transferring the Transferring Policies to SWE is required to ensure that SWL is allowed to continue to service business written under EU passporting rights after Brexit, and that these other options either do not provide the certainty required or are not necessary for SWE to carry out its day-to-day activities as explained in section 3 of the Supplementary Report.

1.18 Furthermore, the FSCS only provides protection to covered policyholders following an insolvency or default event. Given that SWE is well capitalised, is required to comply with Solvency II regulations and SWE's Capital Management Framework requires it to hold a capital buffer in excess of that required by Solvency II, the likelihood of default or insolvency of SWE, is in my opinion, remote and the conclusions stated in the Report regarding the loss of the FSCS protection are unchanged.

Updated financial information

1.19 I have reviewed the financial information for SWL and pro forma financials for SWE as at 30 June 2018, which is the most recent date that this information is available in Section 3 of my Supplementary Report. In particular, I have reviewed the updated SCR Cover Ratio figures calculated assuming the Transfer had taken place on 30 June 2018.

1.20 I have also seen estimated financials up to 31 December 2018 for SWL and SWE and reviewed the estimated changes in the financial position since 31 December 2018. I am satisfied that the conclusions in my Report still hold as the solvency position for SWL is within the Green zone[2] based on its risk appetite as defined within its Capital Management Plan (CMP) and for SWE it is at or above its capital policy.

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[1] *The link to the draft legislation in Germany :* *https://www.bundesfinanzministerium.de/Content/DE/Gesetzestexte/Gesetze_Gesetzesvorhaben/Abteilungen/Abteilung_IV/19_Legislaturperiode/Gesetze_Verordnungen/Brexit-StBG/0-Gesetz.html*

The link to the draft legislation in Italy: http://www.mef.gov.it/ufficio-stampa/comunicati/2019/comunicato_0015.html

The link to the draft legislation in Austria: https://www.parlament.gv.at/PAKT/VHG/XXVI/ME/ME_00113/index.shtml

[2] *Capital levels above the target SCR Cover Ratio as defined within the Capital Management Plan, (ie enough capital to cover the regulatory capital requirements as well as the firm's internal capital requirement) is considered to be within the Green zone.*

Updated key dependencies

1.21 The analysis contained in the Report was prepared on the basis that a number of actions would take place in advance of the Effective Date. These key dependencies were:

- SWE receiving authorisation from the CAA (and in addition, receiving approval from the CAA to service insurance policies in the relevant EEA countries outside of the UK under EU passporting rights and receiving approval from the CAA and a response (or no objection) from the local regulators for setting up branch offices in Germany and Italy)
- SWE receiving an initial capital injection from SWL that is expected to be sufficient to capitalise SWE at its target level
- SWE and SWL entering into the Associated Arrangements, namely the Reinsurance Agreement, Charge Agreement, Unit Linked Service Agreement and Indemnity Agreement, to be effective immediately following the Effective Date.

1.22 I am satisfied that all of the key dependencies have either been completed or are on track to be completed in advance of the Effective Date.

Updated non-financial information

1.23 In the Supplementary Report I also provide updates on:

- UK COBS protection
- the overall purpose, structure and scope of the Scheme and the Associated Arrangements including the update on the transfer of FWH to SWE
- the composition of the SWE Board
- SWE set-up, operations including the branch offices, governance
- requirement of a UK Branch for SWE
- the Tied Assets arrangements as required by the Luxembourg regulations
- policyholder taxation
- tax clearances and tax due to Transfer pricing adjustment
- risk mitigation plans
- Italian surrender rights.

1.24 I have reviewed each of the developments and I am satisfied that these do not change the conclusions in my Report.

1.25 I also confirm that the change in the Effective Date for the Scheme from 28 March 2019 to 29 March 2019 does not change my conclusions with regards to the Transfer as the amendment was made for practical reasons relating to the implementation of the Transfer; it does not impact the operation of the Scheme and it has no impact on the benefits or contractual rights of Transferring Policyholders or Non-transferring Policyholders. I am also satisfied that the plan to provide an undertaking to the Court to enable the Transferring UWP Policyholders and the Non-transferring Policyholders in the CM WPF the right to enforce the conditions in relation to the termination of the Reinsurance Agreement provides additional protection to these policyholders and is consistent with the approach taken on other similar Schemes.

Updated impact on policyholders and reinsurers

1.26 In the Supplementary Report, I confirm that there have been no changes to any of my opinions set out in the Report. Overall, it remains my opinion that the implementation of the proposed Scheme and the Associated Arrangements at the Effective Date will not have a material adverse effect on the security of benefits or the future benefit expectations of the Transferring Policyholders and Non-transferring Policyholders of SWL. It is also my opinion that the Transfer will have no material adverse impact on the governance or service standards experienced by the Transferring Policyholders and Non-transferring Policyholders of SWL.

1.27 Further, I remain satisfied that there is no material adverse effect on Transferring Policyholders caused by the loss of FSCS protection as a result of the Transfer.

1.28 It remains my opinion that the Transfer will have no material adverse impact on the current external reinsurer of SWL whose contracts of reinsurance cover the Transferring Policyholders.

Policyholder communications and objections received

1.29 In the Supplementary Report, I provide an update on the policyholder communication process and respond to the objections raised. The objections can be summarised into the following categories:

- loss of FSCS protection and concerns over future security of benefits
- withholding tax for policyholders in Germany
- concerns related to the Transfer
- clarity in my Report
- request for surrender value and compensation
- other
- no reason provided.

1.30 Overall, I am satisfied that the communication process, for informing Transferring Policyholders and Non-transferring Policyholders of the Transfer, has met the requirements of the Directions Order and the policyholders have been given sufficient details and notice of the proposed Scheme. Further, I am satisfied that, at the time of writing this Supplementary Report, SWL is recording the objections received from policyholders appropriately, and that policyholders have not raised any issues that were not considered in the work leading up to the Report except those related to tax exempt status in Germany. As stated in the Supplementary Report the Transfer will not affect the tax exempt status of the policyholders. Given that no other new issues were raised, I am satisfied that there are no reasons to change the conclusions in my Report.

Conclusions

1.31 I confirm that, overall, I am satisfied that Transfer will not have a material adverse effect on the security of benefits or future benefit expectations of the Transferring Policyholders and the Non-transferring Policyholders. It is also my opinion that the Transfer will have no material adverse effect on either the governance or service standards experienced by the Transferring Policyholders and the Non-transferring Policyholders. In addition, I am satisfied that the Transfer will not materially adversely affect the reinsurer of the Transferring Business.

1.32 Given my conclusions outlined above, I see no reason why the Transfer should not proceed.

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6 March 2019.