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Briefing note on financial strength and policyholder protection

IRISH LIFE ASSURANCE PLC
August 2012

Overview

Irish Life is the No1 life and pensions company in Ireland. It follows a low risk business model, and one of its key strengths is its very strong capital adequacy.

Until June 2012, Irish Life was part of the permanent tsb Group (formerly Irish Life & Permanent Group). As a result of the re-capitalisation of the permanent tsb group, Irish Life was sold to the Minister for Finance and is held as a commercial business with a view to being sold into the market in due course.

On July 3, 2012, Standard & Poor's Ratings Services raised its long-term counterparty credit and insurer financial strength ratings on Irish Life Assurance (Irish Life) to 'BBB+' from 'BBB-'.To quote their report, Standard & Poor's say: "The ratings on ILA reflect its strong competitive position, a diversified distribution base, and very strong risk-based capital adequacy."

This note has been put together to help answer any questions from policyholders and their advisers in relation to the financial security of their investments with Irish Life.

Executive summary

Life companies like Irish Life are low risk organisations with conservatively invested assets and layers of protection for their policyholders.

- A life company must hold assets at least equal to its policyholder liabilities, and these assets must be held separately from other assets.
- Life companies are required to hold additional buffer capital on top of this, as an additional protection for their policyholders.
- Life company assets are fully ring-fenced, and are kept separate from the assets of other group companies.

Irish Life is a secure, well capitalised, low risk life assurance company.

- It is the largest life assurance company in Ireland, with approximately 1 million customers and over €34 billion in assets under management.
- It is strongly capitalised, with free assets of €704 million at December 2011, giving a solvency margin after dividend of 1.75 times the minimum amount required under regulation. The solvency requirement of the Central Bank of Ireland is 1.5 times this minimum. Based on Irish Life's current risk exposures, the target is to maintain a solvency ratio of 1.75 times the EU minimum.
- Irish Life's credit rating from S&P is BBB+ (negative outlook). This rating is constrained by the rating of the Irish sovereign, which is BBB+ (negative outlook), i.e. Irish Life's rating cannot be higher than the rating of the Irish sovereign.
- Irish Life Assurance is now a completely legally separate company from permanent tsb. Irish Life is 100% owned by the Irish Government, to be held as a commercial business with a view to being sold into the market in due course.

A. Policyholder Protection in Life Companies

Life companies like Irish Life are low risk organisations. There are layers of protection for the financial security of policyholders. There is also additional protection from the oversight and regulation of life companies.

The range of safeguards in place to protect policyholders' investments include the following:

i) A life company must hold assets at least equal to its policyholder liabilities.

- A life company is required to hold all the assets underlying its unit linked policies at all times (plus an additional amount for solvency margin which is described in more detail below).
- So in practice, a life company accepts premiums from policyholders and invests these in a range of funds on the policyholder's behalf. The life company pays claims and surrenders by simply selling the assets as needed.
- A key difference between a life company and a bank from a regulatory standpoint is that a bank is not required to hold the full amount of its deposits at all times (but can use these funds to lend out to other customers). In other words, a banks deposit liability (to repay its depositors their money on demand) is not 100% matched with liquid assets. Conversely a life company is required to hold all the assets underlying its unit linked life policies at all times. As a result, there is no equivalent concept to a 'run on a bank' for a life company, since life companies hold matching assets at all times.

ii) The assets covering the policyholder liabilities must be maintained separately from other assets.

- Assets covering policyholder liabilities cannot
  - Be transferred to other parts of the business; or
  - Be lent or used as security for a loan to acquire other assets; or
  - Be used to fund other parts of the business.
- There are also detailed regulations that apply to the calculation of assets and the valuation of liabilities. For example:
  - Liabilities must be calculated on a prudent basis.
  - There are specific rules that govern the amounts required to be put aside to cover policyholder guarantees.

iii) In addition to holding all the assets relating to policyholders separately, life companies are required to hold additional buffer capital

- This additional capital is known as "solvency margin" and is an additional security layer for policyholders.
- The minimum amount of solvency margin a life company must hold is calculated based on EU regulations.
- Most life insurers hold a solvency margin well in excess of the minimum required by these regulations.
- The precise amount held varies from company to company, depending on, for example, the level of guaranteed investment business the company has written.

  Some companies that operate "With Profits" guaranteed funds hold higher levels of solvency margin. This is to allow for the fact that current regulations do not require companies to hold explicit reserves to meet future bonus payments to "With Profits" policyholders. (Irish Life does not sell "With Profits" policies.)
- Life companies are required to invest policyholder reserves in asset types that are similar in nature and duration to the associated liabilities – or to hold substantial additional buffer capital as additional protection where there is a mismatch.

iv) The unique role of the "Appointed Actuary" within life companies provides an additional layer of oversight.

- Like all financial companies, the primary layer of oversight is the Board of Directors and the Central Bank of Ireland. Life insurance companies have an additional layer of oversight through the role of the Appointed Actuary.
- The Appointed Actuary role is a very senior and responsible position in an insurance company. It is a unique and independent role within the life insurance company structure and it does not exist in banks for example.
- The Appointed Actuary must comply with professional standards as well as legislation and regulations. He or she must act objectively and without bias to safeguard the financial security of policyholders. Individuals acting as Appointed Actuaries in life companies are specifically certified by the Society of Actuaries in Ireland.
- The Appointed Actuary is responsible for certifying the reserves and solvency margin of the company. He or she monitors the solvency of the company at all times and not just at the end of specific financial reporting periods.
- In the unlikely event that there is a material risk to the solvency of a life company, the Appointed Actuary must notify the company. If the company fails to remedy the position, the Central Bank of Ireland must be notified.
- The Minister for Finance has significant powers under the Insurance Acts to intervene in the management of a life company if policyholder security or benefits are threatened.

So to summarise:

- Life companies like Irish Life are low risk businesses. Policyholder assets are appropriately invested, ring-fenced and protected.
- Life companies are required to have layers of financial security. There are rules for calculating prudent liabilities to policyholders. Matching assets are kept in the life company to cover all liabilities. Life companies must also hold an additional security layer called solvency margin.

  The unique and independent role of the Appointed Actuary within a life company provides an extra layer of oversight.

B. The Financial Security of Irish Life

Irish Life is the largest life assurance and pension company in Ireland.

- We have approximately 1million customers in Ireland who rely on our products and services to help them to build better futures.
- We manage more money for Irish people than any other company. Overall we manage over €34 billion in assets. We have also paid out more than €1 billion in life cover and other protection benefits to Irish families over the last 5 years.
- We are proud of the fact that 6 of the 10 biggest U.S. companies operating in Ireland choose Irish Life to look after the pensions of their Irish employees. These include some of the most successful companies in the world and global leaders in fields like technology and finance.

Irish Life is a secure, low risk company with very strong capital adequacy. We operate a low risk business model, with a range of safeguards in place for our customers.

i) Low risk business model

- Irish Life's business has a low risk profile, and the structure of our balance sheet reflects this.
- 93% of our total liabilities to policyholders relate to unit linked pension, investment and savings policies. This means that the value of the policy directly reflects the value of the underlying assets we have invested in, and therefore this business is low risk from the insurance company solvency perspective.
- In the other smaller part of our business, non-linked insurance and investments (for example life cover and annuities) we hold prudent reserves specifically to cover the guarantees. These are invested in a diversified portfolio of high quality assets, principally sovereign bonds.
- In addition, in many cases we have extra protection through reassurance arrangements, as well as numerous operational safeguards.

ii) Significant additional reserves

- Irish Life holds substantially more free asset capital than the minimum amount required under regulation.
- Under EU regulation, Irish Life was required to hold minimum free assets of €402m at December 2011, in addition to policyholder funds.
- The Central Bank of Ireland has, for many years expressed a desire that companies regulated in Ireland should hold free assets of at least 150% of the required EU amount.
- In line with our low risk business model, Irish Life holds well in excess of the minimum capital requirement and has maintained a strong capital position throughout the financial and economic crisis. The solvency ratio after dividend for Irish Life Assurance as at 31 December 2011 was 1.75 times (2010: 1.75 times) the minimum EU capital requirement of €402 million (2010: €401 million). Based on Irish Life's current risk exposures, the target is to maintain a solvency ratio of 1.75 times the EU minimum. This money is invested in cash deposits, government securities and property.

Solvency cover	2011
	€m
Required Minimum Solvency Margin	402
Regulatory free assets	769
Dividend capacity	65
Regulatory free assets post dividend	704
Solvency cover (times)	**1.75**
Surplus capital post dividend	**302**

iii) Irish Life's credit rating

- On June 29, 2012, the Irish Life Group, including Irish Life Assurance, was sold to the Irish Government
- As a result Standard & Poor's Ratings Services raised its long-term counterparty credit and insurer financial strength ratings on Irish Life Assurance to **BBB+** from **BBB-**.
- The credit rating for Irish Life Assurance, BBB+ (negative outlook), is constrained by the rating on the Irish sovereign, i.e. Irish Life's rating cannot be higher than the rating of Ireland. S&P would not increase Irish Life's rating unless they were also increasing the rating on the Irish sovereign.
- In its recent review of Irish Life Assurance, S&P highlighted the key strengths of the company as its:
  - Leading competitive position in the Irish life and pensions market
  - Diversified distribution base
  - Very strong risk-based capital adequacy
- S&P also share the view that the Government will hold Irish Life as a commercial business with a view to maximising the sale price, when market conditions are suitable.

So to summarise:

- Irish Life is the largest life assurance and pensions company in Ireland, with approximately 1 million customers, and €32.8 billion in assets under management and a BBB+ credit rating from Standard & Poor's (rating equal to and constrained by the Irish sovereign rating).
- Standard & Poor's say: "The ratings on ILA reflect its strong competitive position, a diversified distribution base and very strong risk-based capital adequacy."
- Irish Life is very strongly capitalised, with capital ratios at 1.75 times the minimum required.

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