



Transfer of certain business of Mobius Life Limited to Scottish Friendly Assurance Society Limited.

The report of the Independent Expert

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Prepared by:

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CONTENTS

1. Executive Summary	4
Introduction	4
Overview of the Scheme	4
Financial position of SF and Mobius pre- and post-Scheme	8
The profile of risks to which the policyholders of Mobius and SF are exposed	11
The governance, management and service standards applicable to the Mobius and SF policies pre- and post-Scheme	12
The reasonable benefit expectations of the policyholders of Mobius and SF pre- and post-Scheme	13
The policyholder communications proposed for this transfer	15
Conclusions	16
2. Introduction	17
The Independent Expert.....	17
The purpose and scope of my report	17
Developments whilst my report was in progress	18
Qualifications and disclosures.....	18
The parties for whom my report has been prepared	19
Limitations.....	19
Technical Actuarial Standards (“TASs”)	19
The Actuarial Profession Standards (“APSS”)	19
The structure of my report.....	20
3. The UK Life Insurance market and regulatory environment	21
Introduction	21
The UK regulators	21
The Solvency II regulatory regime.....	21
The governance of UK long-term insurers	23
The governance of UK pension providers	23
The governance of UK friendly societies.....	24
A firm’s risk appetite and internal capital management policy	24
The products and long-term business relevant to this report	24
4. General considerations of the Independent Expert	26
The role of the Independent Expert.....	26
The definition of ‘policyholder’	26
Security of policyholder benefits.....	27
Treating customers fairly	27
The framework for my consideration of the proposed Scheme	27
My assessment of the effect of the proposed Scheme.....	27
The supplementary report	28
Reliances of the Independent Expert on the work of others	28

5. Background on Scottish Friendly Assurance Society Limited	30
Background.....	30
Structure of SF	30
The SF Main Fund business	32
The SLL business	33
LANMAS business	33
Rational Shelley business	34
M&GM business.....	34
Administration	34
Financial condition	35
Governance and risk management	35
Membership rights.....	37
Reinsurance.....	37
Capital management.....	38
With-profits and capital management.....	39
Risk profile	40
6. Background on Mobius Life Limited.....	41
Background.....	41
Products.....	41
Administration	43
Financial condition	43
Governance and risk management	44
Reinsurance.....	46
Capital management.....	46
Risk profile	47
7. The proposed Scheme	50
The motivation for the Scheme	50
Summary of the Scheme.....	50
Transferring assets and liabilities	51
Reinsurance.....	52
Governance Advisory Arrangement	53
SF Delegates	53
Administration	53
Membership rights.....	53
Costs of the Scheme.....	54
Variation of permission ("VOP")	54
Other	54
Groups of policyholders considered in my report	54
8. The effect of the implementation of the Scheme on the transferring Mobius policies	55
Introduction	55

The financial resources available to provide security of benefits	55
The profile of risks to which the transferring Mobius policies are exposed.....	60
The governance, management and service standards applicable to the transferring Mobius policies	62
The reasonable benefit expectations of the transferring Mobius policyholders	63
Conclusion for the transferring Mobius policies.....	64
9. The effect of the Scheme on the non-transferring Mobius policies	65
Introduction	65
The financial resources available to provide security of benefits	65
The profile of risks to which the non-transferring policies of Mobius are exposed.....	68
The governance, management and service standards applicable to the non-transferring policies	70
The reasonable benefit expectations of the non-transferring policyholders	70
Conclusion for the non-transferring policies	70
10. The effect of the implementation of the Scheme on the SF policies.....	72
Introduction	72
The financial resources available to provide security of benefits	72
The profile of risks to which the existing SF policies are exposed.....	73
The governance, management and service standards applicable to the existing SF policies.....	75
The reasonable benefit expectations of the SF policyholders	77
Conclusion for the different groups of the existing SF policies.....	79
Conclusion for the existing SF policies.....	79
11. Other considerations arising from the Scheme	80
The approach to communication with policyholders.....	80
The costs of the Scheme	83
Tax.....	83
FSCS and Financial Ombudsman Service (“FOS”).....	83
Quality of Own Funds capital	84
Variation of permission.....	84
Developments since 31 December 2016 and 31 March 2017 for SF and Mobius, respectively.....	84
The future operation of the Scheme.....	84
If the Scheme is not implemented.....	85
The exit of the UK from the European Union – “Brexit”	85
12. Conclusions	87
Appendix 1: Previous transfers for which I have acted as Independent Expert or equivalent... 88	
Appendix 2: Data relied upon	89
Appendix 3: Certificate of Compliance	91
Appendix 4: Glossary of Terms.....	92
Appendix 5: Compliance with the PRA Statement of Policy and SUP 18.2	95
Appendix 6: Compliance with the FCA finalised guidance	99

1. EXECUTIVE SUMMARY

Introduction

- 1.1. I have been instructed by Scottish Friendly Assurance Society Limited (“**SF**”) and Mobius Life Limited (“**Mobius**”) to report in the capacity of Independent Expert pursuant to Section 109 of the Financial Services and Markets Act 2000 (“**FSMA**”) on the terms of the proposed transfer of a block of long-term insurance business of Mobius to SF (the “**Transferring Business**”).
- 1.2. The Transferring Business consists of around 91 unit-linked contracts (in respect of around 13,310 policyholders/members) written by Mobius, with assets under management of around £340 million (as at 31 December 2016), comprised of:
 - Group stakeholder pension plans;
 - Individual and group personal pension plans; and
 - Trustee investment plans (“**TIPS**”) with member administration services.
- 1.3. In this report (“**my report**”) I refer to this proposed Scheme as the “**Scheme**”, and throughout the remainder of this report this term is used to cover all the proposals included in the Scheme, including any documents referred to therein relating to the proposed implementation and operation of the Scheme.
- 1.4. The purpose of my report is to report on the terms of the Scheme in my capacity as Independent Expert and this report will be provided to the High Court of Justice of England and Wales (the “**Court**”) as a requirement of the approval of the transfer of certain insurance business from Mobius to SF.
- 1.5. The purpose of my report is to review the proposed transfer of the business, outlined in paragraph 1.2, of Mobius to SF and the subsequent reinsurance of this business from SF to Mobius. In particular, I consider the effects of the proposed transfer on the security of the benefits, the reasonable expectations of the transferring and non-transferring policyholders of Mobius and the existing policyholders of SF, and the profile of risks to which they are exposed.
- 1.6. The transfer is expected to be presented to the Court for its Directions Hearing on 25 July 2018 and for its Sanctions Hearing on 29 October 2018. If approved by the Court, the Scheme will become operative on 31 October 2018 (the “**Transfer Date**”).
- 1.7. As envisaged by paragraph 2.39 of the Statement of Policy “The Prudential Regulation Authority’s approach to insurance business transfers” (the “**PRA Statement of Policy**”), I will also prepare a further report (the “**Supplementary Report**”) prior to the final Court hearing, to provide an update for the Court on my conclusions in the light of any significant events subsequent to the date of the finalisation of this report.
- 1.8. My assessment of the impact of the proposed Scheme on the various affected policies is ultimately a matter of actuarial judgement regarding the likelihood and impact of possible future events. Given the inherent uncertainty of the outcome of such future events and that the effects may differ across different groups of policies, it is not possible to be certain in respect of their effect on the policies.
- 1.9. In order to acknowledge this inherent uncertainty, the conclusions of the Independent Expert in respect of transfers of long-term insurance business under Part VII of FSMA are usually framed using a materiality threshold. If the potential impact under consideration is very unlikely to happen and does not have a large impact, or is likely to happen but has a small impact, then it is not considered to have a material adverse effect on the policies.

Overview of the Scheme

- 1.10. Mobius is an institutional investment life company and its focus and its future strategy is to develop its business for providing institutional services to corporate pension schemes in the UK, rather than focusing on individual policyholders, retail policyholders or pension services such as those that constitute to the Transferring Business.

- 1.11. SF is a friendly society incorporated under the Friendly Societies Act 1992. It has no shareholders and is owned by its members, with all SF policyholders being members. It sells life and investment insurance products, including Individual Savings Accounts (“ISAs”), to policyholders in the UK. SF maintains a single long-term business fund which is divided into a main fund (the “**SF Main Fund**”) and four separate notional sub-funds that are maintained in respect of the business previously transferred into SF from other companies. Only the SF Main Fund remains open to new business.
- 1.12. SF has a three-branch growth strategy of organic growth, business process outsourcing, and mergers and acquisitions. The aims of its mergers and acquisitions growth are to gain additional economies of scale (by increasing the number of policies and assets under management) and to develop a diversified income stream by moving into business lines within which SF is not currently well established.
- 1.13. For SF, the proposed Scheme is in line with their current focus and overall future strategy: it has a retail focus and future strategy that aims to diversify its product offering, identifying group personal and stakeholder pension business as an area of growth.
- 1.14. For Mobius, the implementation of the Scheme will reduce the exposure of the non-transferring Mobius policies to the risk of a counterparty default that currently exists in respect of the Transferring Business, reducing the amount of capital that Mobius must hold in order to protect itself against this risk.
- 1.15. The key terms of the Scheme are as set out below:
- All assets, liabilities and the policies in relation to the Transferring Business of Mobius will be transferred into the SF Main Fund, a with-profits fund that is open to new business;
 - All transferring business is unit-linked and as such the value of assets that will be transferred from Mobius to the SF Main Fund is equal to the value of the unit reserve of the Transferring Business;
 - Following the Transfer Date, all assets and any associated liabilities in relation to the Transferring Business that are currently comprised in each of Mobius’s internal linked funds, will be allocated to and become comprised in a corresponding linked fund of SF within the SF Main Fund, collectively the “**SF-Mobius Linked Funds**”. The policyholder benefits and thus the unit-linked liabilities under all transferring policies will become linked to a SF-Mobius Linked Fund that directly corresponds to the Mobius linked fund that it was invested in prior to the Transfer Date;
 - Following the implementation of the Scheme, the investment management of the Transferring Business will continue to be conducted by Mobius. The Scheme is conditional on SF entering into an investment-only reinsurance contract with Mobius: the “**SF-Mobius Reinsurance Arrangement**”. This contract will allow SF to invest all of the transferring assets within the SF-Mobius Linked Funds back into the funds that they were in within Mobius, allowing Mobius to continue to manage the investment of the assets in a way that is consistent with its current approach (i.e. investing in the funds of third parties). The SF-Mobius Reinsurance Arrangement will be structured such that SF is liable for any default by either Mobius or any third party to which Mobius subsequently invests with in relation to the Transferring Business;
 - An amount of assets equal to the purchase consideration for the Transferring Business will be transferred from SF to Mobius on the Transfer Date;
 - The Scheme will not transfer to SF the current investment-based reinsurance arrangements between Mobius and third party reinsurers in relation to the Transferring Business. Mobius is, however, amending one of its reinsurance arrangements with Legal and General Assurance (Pensions Management) Limited (“**L&GPML**”) as a result of the transfer. L&GPML has agreed to split its existing reinsurance agreement into two distinct contracts, one of which will relate to the Transferring Business and the other covering the non-transferring Mobius business. Mobius will enter into a security assignment (the “**Security Assignment**”) with SF in respect of the reinsurance agreement relating to the Transferring Business, whereby L&GPML agrees that SF can look to the rights of Mobius against L&GPML in the event of a failure of Mobius to make a payment to SF under the SF-Mobius Reinsurance Arrangement;
 - SF and Mobius also intend to enter into a Deed of Charge (also referred to as a floating charge agreement) whereby Mobius creates a floating charge over all of Mobius’s long-term insurance assets in favour of SF to secure the value of the reinsurance ceded to Mobius in respect of the Transferring Business. In the event that any insolvency practitioner appointed in relation to Mobius, or any director, agent, supervisor,

scheme administrator or other equivalent person decides or resolves to take, or actually takes, any step to distribute a dividend to any non-preferential creditor of Mobius, the floating security will crystallise into a fixed charge which will ensure that SF will rank equally in the Mobius insolvency with Mobius's own direct policyholders;

- As there are a number of floating charges created by Mobius in respect of reinsurances entered into with third party re-insureds (as chargees), and which have been identified to SF, SF has required that such chargees consent to the entry by Mobius into the Security Assignment and accordingly, in the event that the assets held with and managed by L&GPML include assets of the Transferring Business which have been invested with Mobius, SF shall have rights against L&GPML in relation to those assets in the event of an insolvency of Mobius.
- The change in the protection available to provide security of benefits to all individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010 in the Transferring Business (where the policyholder bears no counterparty default risk, as described in paragraph 6.48) (the “**Credit Neutral Policyholders**”) as a result of the Scheme is summarised below:

Event	Pre-Scheme	Post-Scheme
If Mobius defaults	Mobius would make a claim for all assets held with third parties and the total amount of assets available to Mobius would be split equitably between all of Mobius's policyholders.	<p>SF would be responsible for paying benefits in full to policyholders and making up any shortfall in the value of unit-linked benefits as a result of the default.</p> <p>As a result of the security assignment between Mobius and SF, SF can claim all assets reinsured by SF to Mobius that have been invested by Mobius with L&GPML.</p> <p>Mobius would make a claim for all assets held with all other third parties. As a result of the floating charge between Mobius and SF, the floating charge over all of the assets of Mobius will crystallise and so the total amount of assets available to Mobius would be split equitably between Mobius's direct policyholders (the holders of non-transferring Mobius policies) and the SF policyholders whose funds are reinsured to Mobius.</p> <p>If the assets received by SF (from Mobius) are not sufficient to ensure that there is no loss to the policyholders' benefits, SF would make up the shortfall using the excess capital in the SF Main Fund.</p>
If a third party that Mobius invests with defaults	<p>Mobius would be responsible for paying benefits in full to policyholders and making up any shortfall in the value of unit-linked benefits as a result of the default.</p> <p>The floating charge that Mobius has over the assets of the third party would crystallise in the event of the third party's insolvency and the assets of that counterparty would be split equitably between the third party's direct policyholders and the Mobius policyholders whose funds are invested with the third party.</p> <p>If the assets received by Mobius are not sufficient to ensure that there is no loss to the policyholders' benefits, Mobius would make up the shortfall using its excess capital.</p>	<p>SF would be responsible for paying benefits in full to policyholders and making up any shortfall in the value of unit-linked benefits as a result of the default.</p> <p>The floating charge that Mobius has over the assets of the third party would crystallise in the event of the third party's insolvency. The assets of that counterparty would be split equitably between the third party's direct policyholders and both the transferring policyholders (who are now SF policyholders) and the non-transferring Mobius policyholders whose funds are invested by Mobius with the third party.</p> <p>If the assets received by SF (from Mobius) are not sufficient to ensure that there is no loss to the policyholders' benefits, SF would make up the shortfall using the excess capital in the SF Main Fund.</p>

- The change in the protection available to provide security of benefits to all plans of Mobius issued under group policies where the member joined the scheme after 7 April 2010 in the Transferring Business, and

to all TIPs (both transferring and non-transferring) (i.e. where the policyholder bears all counterparty default risk, as described in paragraphs 6.44 and 6.45) (the “**Credit Exposed Policyholders**”) as a result of the Scheme is summarised below:

Event	Pre-Scheme	Post-Scheme
If Mobius defaults	Mobius would make a claim for all assets held with third parties and the total amount of assets available to Mobius would be split equitably between all of Mobius's policyholders.	<p>For the holders of transferring policies, SF would not be responsible for paying benefits in full to policyholders and does not have to make up any shortfall in the value of unit-linked benefits as a result of the default.</p> <p>As a result of the security assignment between Mobius and SF, SF can claim all assets reinsured by SF to Mobius that have been invested by Mobius with L&GPML.</p> <p>Mobius would make a claim for all assets held with all other third parties. As a result of the floating charge between Mobius and SF, the floating charge over all of the assets of Mobius will crystallise and so the total amount of assets available to Mobius would be split equitably between Mobius's direct policyholders (including the holders of non-transferring Mobius policies) and the SF policyholders whose funds are reinsured to Mobius.</p> <p>If the assets received by SF (from Mobius) are not sufficient to ensure that there is no loss to the policyholders' benefits, SF would not make up the shortfall using the excess capital in the SF Main Fund.</p>
If a third party that Mobius invests with defaults	<p>Mobius would not be responsible for paying benefits in full to policyholders and does not have to make up any shortfall in the value of unit-linked benefits as a result of the default.</p> <p>The floating charge that Mobius has over the assets of the third party would crystallise in the event of the third party's insolvency and the assets of that counterparty would be split equitably between the third party's direct policyholders and the Mobius policyholders whose funds are invested with the third party.</p> <p>If the assets received by Mobius are not sufficient to ensure that there is no loss to the policyholders' benefits, Mobius would not make up the shortfall using its excess capital.</p>	<p>Each of SF and Mobius would not be responsible for paying benefits in full to policyholders and does not have to make up any shortfall in the value of unit-linked benefits as a result of the default.</p> <p>The floating charge that Mobius has over the assets of the third party would crystallise in the event of the third party's insolvency. The assets of that counterparty would be split equitably between the third party's direct policyholders and both the transferring Mobius policyholders (who are now SF policyholders) and the non-transferring Mobius policyholders whose funds are invested by Mobius with the third party.</p> <p>If the assets received by SF (from Mobius) are not sufficient to ensure that there is no loss to the policyholders' benefits, SF would not make up the shortfall using the excess capital in the SF Main Fund.</p> <p>If the assets received by Mobius are not sufficient to ensure that there is no loss to the policyholders' benefits, Mobius would not make up the shortfall using its excess capital.</p>

- The policies within the Transferring Business will continue to have member administration services provided by Aegon UK plc. (“**Aegon**”);
- Within Mobius, there currently exists a Governance Advisory Arrangement (“**GAA**”) which has an oversight role over all group personal pension plans and stakeholder pension plans where such plans have two or more employees of the same employer. Following the Transfer Date, the responsibility for this arrangement will move to SF;

- With effect from the Transfer Date, the policyholders within the Transferring Business will become equal members of SF with the existing policyholders, with the membership rights as set out in the SF Memorandum and Rules; and
- SF is a friendly society and as such it requires the transfer of insurance business to be approved by the delegates of SF (the “**Delegates**”) on behalf of its members. The approval for the transfer from the Delegates of SF will be sought by way of a Special Resolution. The transfer of business is conditional on the passing of the Special Resolution by at least 75% of the Delegates in attendance and voting at the Special General Meeting (“**SGM**”) that is set to be held prior to the Sanctions Hearing. The minimum number of Delegates that must be present at the SGM is 50% of the number of Delegates that are entitled to attend and vote.

Financial position of SF and Mobius pre- and post-Scheme

- 1.16. In order to cover the potential effects of the Scheme on the financial resources available to provide security for benefits for all relevant groups of policyholders of SF and Mobius, I have divided the policyholders into the following groups for consideration, due to the similar risk exposures within each of the groups:
- The policyholders transferring from Mobius to SF;
 - The non-transferring Mobius policyholders; and
 - The existing SF policyholders.
- 1.17. I have considered the financial impact of the Scheme on the financial resources available to provide security for benefits for all relevant groups of policyholders under:
- Solvency II Pillar 1 which uses a market consistent framework for valuing the company’s assets and liabilities. The results are public and as such have been provided within my report; and
 - Solvency II Pillar 2 where the company must make a forward looking assessment of risks, solvency needs and adequacy of capital resources over the current business planning horizon. The methodology is less prescriptive than Pillar 1 and must take into account the firm’s own views about the risks that it faces, its risk appetite and the risk mitigation procedures that it has in place. Although my conclusions have considered and taken into account the financial impact of the Scheme on a Pillar 2 basis, the Pillar 2 results are private and confidential, and as such have not been provided explicitly in my report.
- 1.18. Under Solvency II Pillar 1 the assets held in respect of a policy or group of policies are represented by the technical provisions (consisting of the best estimate liability (“**BEL**”) and risk margin) and the Solvency Capital Requirement (“**SCR**”). This amount is then increased in accordance with the firm’s capital management policy.
- 1.19. The capital management policy of an insurer sets out the capital that a company has committed to hold and is typically expressed in terms of regulatory capital requirements. The regulatory capital requirements may target a specified probability of remaining solvent over a certain time horizon. By requiring additional capital to be held on top of the regulatory requirements, the capital management policy increases the probability of remaining solvent over a particular timeframe and therefore increases the security of the benefits provided under the relevant policies subject to the capital management policy.
- 1.20. When considering the financial resources available to provide the security of the benefits of a particular group of policies, reliance can only be placed upon assets held in adherence to the capital management policy and not on assets in excess of this level, since assets in the latter category are potentially available for distribution (subject to logistical constraints) or to fund strategic business growth. The current capital management policies of SF and Mobius aim to ensure sufficient excess capital is held such that they each target:
- SF: A limit of 150% of capital cover, with a trigger point of 200% upon which management actions would be considered to restore SF’s capital position. Both are considered on a Solvency II Pillar 2 basis for the entire business of SF; and
 - Mobius: A Solvency II Pillar 1 target of around 120% solvency margin and a Solvency II Pillar 2 target of 140% solvency margin.

- 1.21. Generally, capital cover and solvency margin are calculated as the amount of excess capital resources divided by the capital requirement (either the regulatory Solvency II Pillar 1 SCR or a Pillar 2 capital requirement). On a Solvency II Pillar 1 basis, the excess capital resources are the excess of the assets held in respect of a policy or group of policies (defined as the Solvency II “Own Funds”) over the value of the technical provisions, any other liabilities and the SCR. The excess capital resources are subject to any restrictions on their use due to the ring-fencing of assets.

The financial resources available to provide security for benefits for transferring Mobius policyholders

- 1.22. Table 1.1 below shows the pre-Scheme financial strength of Mobius as at 31 March 2017 and the pro-forma post-Scheme financial strength of SF as at 31 December 2016 on the Solvency II Pillar 1 basis.

Table 1.1: Pro-forma comparison of the regulatory solvency providing security for benefits to the transferring Mobius policyholders pre- and post-Scheme

Impact of the Transfer on relevant parties' solvency position		
	as at 31 March 2017	as at 31 December 2016
£m	Mobius pre-Scheme	SF post-Scheme
Assets	9,397.6	2,892.6
Technical provisions	9,377.3	2,606.3
Other liabilities	8.6	102.6
Own Funds	11.7	183.7
Adjustment for restricted Own Funds items	0.0	-19.9
Solvency II Own Funds	11.7	163.8
SCR	9.7	85.8
Excess capital	2.0	77.9
SCR coverage ratio	120%	191%

Source: Mobius's Chief Actuary's Report and SF's Chief Actuary's Report

- 1.23. Table 1.1 shows the pre-Scheme financial position for Mobius and the pro-forma post-Scheme financial position for SF as at two different dates. This is because SF and Mobius have different year-end reporting dates and, therefore, the audited liability valuations took place at different dates for each of the companies.
- 1.24. On a Solvency II Pillar 1 basis, if the Scheme had been implemented on 31 December 2016, the key impacts on the financial resources available to provide security for benefits for transferring Mobius policyholders would have been:
- The capital resources of SF would have covered its SCR with a ratio of 191%. This represents an increase from the Mobius pre-Scheme position at 31 March 2017, where the capital resources of Mobius covered its SCR with a ratio of 120%;
 - The excess capital to support the security of the benefits of the transferring Mobius policyholders increases in absolute terms from £2.0 million to £77.9 million;
 - The notional sub-funds are managed as ring-fenced funds, with a restriction to transferring surplus capital in one ring-fenced fund to cover losses outside of the ring-fenced fund. However, in the unlikely scenario where the solvency of the SF Main Fund or one of the ring-fenced funds of SF was threatened, SF would be able to transfer the restricted surplus using the capital support arrangements that SF currently has in place. As shown in Table 1.1, this would release an additional £19.9 million of surplus assets which provides further security to transferring Mobius policyholders.
- 1.25. The security for the benefits of the transferring Mobius policies will be provided by the assets of SF held in accordance with SF's current capital management policy which has a target level of capital defined on a Solvency II Pillar 2 basis as described in paragraph 1.20. There are no proposed changes to the capital management policy of SF as a result of the transfer.

- 1.26. I have reviewed SF's financial position on a Solvency II Pillar 2 basis and a capital management policy defined on a Pillar 2 basis for SF represents a stronger constraint on capital than if this had been defined on a Pillar 1 basis at the same target level of solvency cover. I am satisfied that the capital buffer of 50% of the Pillar 2 capital requirement targeted to be held by SF when compared to the capital buffer of 20% of the Pillar 1 capital requirement held by Mobius does not produce a smaller margin to provide security for policyholder benefits.

The financial resources available to provide security for benefits for the non-transferring Mobius policyholders

- 1.27. Table 1.2 below shows the pre-Scheme and pro-forma post-Scheme financial strength of Mobius as at 31 March 2017 on the Solvency II Pillar 1 basis.

Table 1.2 – Pro-forma comparison of the regulatory solvency providing security for benefits to the non-transferring Mobius policyholders pre- and post-Scheme

Impact of the Transfer on Mobius's solvency position as at 31 March 2017			
£m	pre-Scheme	post-Scheme	Scheme impact
Assets	9,397.6	9,400.5	2.9
Technical Provisions	9,377.3	9,382.9	5.6
Other Liabilities	8.6	7.6	-1.0
Solvency II Own Funds	11.7	10.0	-1.7
SCR	9.7	1.9	-7.8
Excess Capital	2.0	8.1	6.1
SCR coverage ratio	120%	522%	402%
MCR	4.4	3.3	-1.1
MCR coverage ratio	266%	301%	35%

Source: Mobius's Chief Actuary's Report

- 1.28. On a Solvency II Pillar 1 basis, if the Scheme had been implemented on 31 March 2017, the key impacts on the financial resources available to provide security for benefits for non-transferring Mobius policyholders would have been:
- The Minimum Capital Requirement ("MCR") of Mobius is expected to equal the absolute minimum capital requirement for life insurance companies of €3.7 million (approximately £3.3 million as at 31 March 2017);
 - The SCR is expected to become smaller than the absolute MCR and Mobius will be required to hold capital equal to the greater of the two. Therefore, the Solvency II Pillar 1 capital requirement for Mobius following the transfer will be the MCR. Mobius will be required to hold more capital than has been calculated, and than is required, at the 1-in-200 level (as defined for the SCR). This results in additional security for policyholders' benefits than if this minimum were not present; and
 - The pre-Scheme SCR cover of 120% should therefore be compared to the post-Scheme MCR cover of 301%. This reflects a significant improvement in Mobius's solvency position and the solvency ratio of Mobius is expected to be comfortably in excess of its current Solvency Pillar 1 target solvency coverage ratio of around 120% of solvency margin.
- 1.29. The transfer will necessitate a change to the current capital management policy of Mobius. Given the change in the Solvency II Pillar 1 capital requirement from the SCR to the MCR and the small absolute amount that the target 20% capital buffer will represent following the proposed transfer, it is my opinion that the current capital management policy of Mobius will no longer be appropriate for the non-transferring business within Mobius. Mobius's management expects that the capital management policy will be revised, by way of an increase to the target percentage of SCR, in order to reflect the post-Scheme risk profile. At the time of writing my report, the level of the post-Scheme capital management policy still needs to be discussed and approved by both the Mobius Audit, Risk and Compliance Committee ("ARC") and the Board of Mobius. I will provide an update on this within my Supplementary Report.

The financial resources available to provide security for benefits for the existing SF policyholders

- 1.30. Table 1.3 below shows the pre-Scheme and pro-forma post-Scheme financial strength of SF as at 31 December 2016 on a Solvency II Pillar 1 basis.

Table 1.3: Pro-forma comparison of the regulatory solvency providing security for benefits to the existing SF policyholders pre- and post-Scheme

Impact of the Transfer on the solvency position of SF as at 31 December 2016			
£m	pre-Scheme	post-Scheme	Scheme impact
Assets	2,552.4	2,892.6	340.2
Technical provisions	2,267.2	2,606.3	339.1
Other liabilities	102.6	102.6	0.0
Adjustment for restricted Own Funds items due to ring-fencing	-19.9	-19.9	0.0
Solvency II Own Funds	162.7	163.8	1.1
SCR	81.8	85.8	4.0
Excess Capital	80.9	77.9	-3.0
SCR coverage ratio	199%	191%	-8%

Source: SF's Chief Actuary's Report

- 1.31. On a Solvency II Pillar 1 basis, if the Scheme had been implemented on 31 December 2016, there would have been a deterioration in SF's Solvency II Pillar 1 solvency position, reducing the financial resources available to provide security for benefits for the existing SF policyholders. This arises predominantly due to an increase in the SCR of SF that must be held in relation to the risks inherent in the Transferring Business. This increase in SCR must be met by the excess assets of the SF Main Fund, thus reducing the amount of excess capital available to provide security for the benefits of the existing SF policyholders. The implementation of the Scheme will have no impact on the reserves held in relation to the current SF policies that are within the other notional sub-funds.
- 1.32. SF's capital management policy and in particular the target level of capital buffer in excess of the Pillar 2 capital requirement as described in paragraph 1.20, will not be changed by the implementation of the Scheme. Thus the security of existing policyholder benefits will only be affected by any changes to the company's continuous ability to comply with this policy as the scope of the policy as it is extended to include the transferring Mobius policyholders.
- 1.33. I have reviewed the pre-Scheme and pro-forma post-Scheme financial position of SF as at 31 December 2016 on a Solvency II Pillar 2 basis. As is the case on a Pillar 1 basis, if the Scheme had been effective as at this date, there would have been a deterioration in SF's Pillar 2 solvency position but SF still remains capitalised above the risk appetite limit of 150% of its Solvency II Pillar 2 capital requirement.
- 1.34. However, following the transfer, the solvency ratio of SF is expected to be below its risk appetite trigger point of 200% coverage of its Pillar 2 capital requirement. Consequently, management would be required to assess whether the solvency level is acceptable and whether actions are required in order to improve the solvency level above their target of 200% on a Pillar 2 basis.

The profile of risks to which the policyholders of Mobius and SF are exposed

The profile of risks to which the transferring Mobius policyholders are exposed

- 1.35. Following the implementation of the Scheme, the transferring Mobius policies will become direct policies of SF and therefore directly exposed to the risk profile of a different company that has written a different mix of business, through different distribution channels, to policyholders with different demographic profiles.
- 1.36. As a result of the implementation of the Scheme, the main changes to the risk profile to which the transferring Mobius policyholders are exposed will be:

- A material increase in exposure to equity risk (a form of market risk) in relation to SF's investment in equities in relation to its with-profits policies;
- An increase in exposure to risks in relation to: assets under management (counterparty, equity and interest rate risk); life and pension liabilities (mortality, morbidity and longevity risk); and counterparty default risk from its reinsurance and banking counterparties;
- In relation to the Credit Exposed Policyholders, prior to the implementation of the Scheme, such transferring policyholders are exposed to the risk of insolvency and default of the third parties with which Mobius invests. Following the implementation of the Scheme, as a result of the SF-Mobius Reinsurance Arrangement, the Credit Exposed Policyholders are exposed to the risk of insolvency and default of (i) Mobius and (ii) the third parties with which Mobius invests. As such, a number of the transferring members will also be exposed to the risk that Mobius becomes insolvent or defaults on its obligation as a result of the transfer; and
- In relation to the Credit Neutral Policyholders, following the implementation of the Scheme, such transferring policyholders are unaffected by the risk of insolvency of Mobius (or for that matter any third party with which Mobius invests).

The profile of risks to which the non-transferring Mobius policyholders are exposed

- 1.37. As a result of the implementation of the Scheme, the main changes to the risk profile to which the non-transferring Mobius policyholders are exposed will be:

- A material reduction in the exposure to counterparty default risk due to the SF-Mobius Reinsurance Arrangement, which will remove the counterparty risk associated with the Transferring Business as this will then be borne by SF; and
- The expected loss for non-transferring policyholders, in the event that Mobius were to become insolvent, will increase following the implementation of the Scheme as a result of the amended reinsurance arrangement between Mobius and L&GPML and security assignment between SF and Mobius, as described in paragraph 1.15. This will result in SF having priority over Mobius in respect of the assets relating to the Transferring Business that are invested with L&GPML. Prior to the transfer, these assets would have also been included in the assets available to pay policyholders' benefits in the event of Mobius's insolvency and shared equitably between all policyholders (including the non-transferring policyholders).

The profile of risks to which the existing SF policyholders are exposed

- 1.38. As a result of the implementation of the Scheme, the risk profile to which the existing SF policyholders are exposed is not expected to be impacted materially and the dominant risks remain as they were prior to the transfer. That said, the main changes to the risk profile to which the existing SF policyholders are exposed will be:

- An increase in SF's exposure to counterparty default risk in respect of Mobius as well as the third parties that Mobius invests with in relation to the Transferring Business, as a result of the SF-Mobius Reinsurance Arrangement described in paragraph 1.15; and
- An increase in SF's exposure to mass lapse risk: the Transferring Business is exposed to significant 'mass lapse' risk as there is a concentration of assets in group pension plans held by a small number of employers (who are the policyholders) and SF will become at risk of these policyholders transferring all assets under management to new arrangements within a short timeframe. This would result in a significant loss of new contributions received on the Transferring Business.

The governance, management and service standards applicable to the Mobius and SF policies pre- and post-Scheme

The governance, management and service standards applicable to the transferring Mobius policyholders

- 1.39. The Scheme will have the following impacts on the governance, management and service standards applicable to the transferring Mobius policyholders:

- The Transferring Business will be managed by SF and subject to the governance of the Board of SF who will manage the friendly society by authority of the Delegates in accordance to the Friendly Society Act, its Memorandum and Rules and any directions given by Special Resolution;
- The transferring policyholders will become members of SF, equal with all other members, and therefore have the ability to influence the management of SF through their membership rights as defined in the Memorandum and Rules of SF. As a result, the transferring policyholders will become eligible to become Delegates of SF and on the winding up of SF will be entitled to an equitable share in any surplus remaining (as determined by the Board of SF following the advice of its actuary);
- SF will form a GAA that aims to replicate the existing Mobius GAA and the SF Board Risk Committee will be responsible for the oversight and running of the GAA;
- The member administration services in relation to the Transferring Business will continue to be performed by Aegon; and
- All investment administration will continue to be carried out by Mobius with no changes immediately after the transfer to the fund links that are available to policyholders immediately before the Transfer Date. There will not be any immediate changes to the choice of investment funds available to the transferring Mobius policies after the Transfer Date as a direct impact of the proposed Scheme.

The governance, management and service standards applicable to the non-transferring Mobius policyholders

- 1.40. The Scheme will have no impact on the governance, management and service standards applicable to the non-transferring Mobius policyholders.

The governance, management and service standards applicable to the existing SF policyholders

- 1.41. The Scheme will have the following impacts on the governance, management and service standards applicable to the existing SF policyholders:
- SF will form a GAA that aims to replicate the GAA that currently exists at Mobius and provides governance oversight to the group stakeholder and personal pension policies in the Transferring Business. It will be effective from the Transfer Date. The SF Board Risk Committee will be responsible for the oversight and running of the GAA. The scope of the GAA is expected to be extended to include around 1,500 of SF's current policyholders of pension business;
 - Membership rights for all existing SF policyholders, as prescribed in the Memorandum and Rules of SF, will be unaffected by the implementation of the Scheme;
 - The policyholders within the Transferring Business will become members of SF, equally with the existing SF policyholders, resulting in a dilution of membership rights for the existing SF policyholders. Given the relative size of the Transferring Business (around 13,310 policyholders/members) compared to the size of the existing SF business (around 1.2 million policyholders), this dilution is not expected to have a material impact on the existing SF policyholders; and
 - There are no further changes arising as a result of the transfer to the governance, management or administration arrangements within SF that will impact the existing SF policyholders. In particular, there will be no changes to the way that with-profits business is managed or governed by SF.

The reasonable benefit expectations of the policyholders of Mobius and SF pre- and post-Scheme

The reasonable benefit expectations of the transferring Mobius policyholders

- 1.42. The main impacts that the implementation of the Scheme will have on the reasonable benefit expectations of the transferring Mobius policyholders are as follows:

- There are no changes proposed to the policy terms and conditions for the transferring Mobius policies, except that they will become SF policies, and so the contractual benefits as set out in these terms and conditions will be unchanged by the Scheme;
- Policies transferring from Mobius into the SF Main Fund have no entitlement to, or expectation of, any share of distributions of surplus from that fund, or any other notional sub-fund after the transfer;
- The transfer will have no impact on the operation of the internal linked funds (in particular the unit pricing) or the investment of the unit-linked funds (in accordance to the investment objectives of those funds) of the Transferring Business; and
- The management of SF has confirmed that they are not proposing any change to the charges applicable to the transferring Mobius policyholders following the transfer and it will be the responsibility of the SF GAA to ensure value for money for policyholders which should act to prevent charges from being unfairly increased following the transfer.

The reasonable benefit expectations of the non-transferring Mobius policyholders

1.43. The main impacts that the implementation of the Scheme will have on the reasonable benefit expectations of the non-transferring Mobius policyholders are as follows:

- There will be no change to the terms and conditions of the non-transferring policies of Mobius;
- There will be no change to the operation of the business and, in particular, the investment strategy for the non-transferring business;
- There will be no changes to the level of charges for the non-transferring business as a result of the transfer; and
- There will be no costs or taxes incurred by the non-transferring policies as a result of planning or implementing the Scheme. These will be met by the shareholder funds of Mobius.

The reasonable benefit expectations of the existing SF policyholders

1.44. The main impacts that the implementation of the Scheme will have on the reasonable benefit expectations of the existing with-profits policyholders in the SF Main Fund are as follows:

- There will be no change to the terms and conditions of the existing with-profits policyholders in the SF Main Fund;
- The existing policyholders in the SF Main Fund will remain in the SF Main Fund following the implementation of the Scheme and there will be no changes in the operation of the SF Main Fund. In particular, the bonuses on with-profits policies, investment policy and amounts credited and debited from each of the with-profits funds will continue to be determined in line with the SF Main Fund's published Principles and Practices for Financial Management ("PPFM");
- The costs associated with the Scheme that are attributable to SF will be met from the SF Main Fund. Furthermore, as explained in paragraph 1.31 the assets to be transferred into the SF Main Fund do not cover the SCR on the Transferring Business and so this capital will be covered by the surplus assets of the SF Main Fund, further reducing the surplus assets of the fund immediately following the implementation of the Scheme. However, the SCR and risk margin are expected, if best estimate assumptions of future experience hold, to be released as the Transferring Business runs off, generating a profit for with-profits policyholders in the future. In addition, the WPA of SF has stated that the reduction in surplus assets in the SF Main Fund is expected to have no impact on the level of bonuses in the short to medium term. I therefore do not consider that the transfer will have an adverse effect on the ability to pay bonuses and thus the bonus earning capacity of the SF Main Fund; and
- The current investment policy of the SF Main Fund is unchanged by the implementation of the Scheme and the assets chosen to match the liabilities in relation to the Transferring Business will not have a material adverse effect on the investments backing the with-profits policies.

- 1.45. The main impacts that the implementation of the Scheme will have on the reasonable benefit expectations of the existing non-profit and unit-linked policyholders in the SF Main Fund are as follows:
- There will be no change to the terms and conditions of the existing non-profit and unit-linked policyholders in the SF Main Fund;
 - The existing policyholders in the SF Main Fund will remain in the SF Main Fund following the implementation of the Scheme and there will be no change to the operation of the SF Main Fund; and
 - The Scheme will have no effect on the benefits payable under the existing non-profit or unit-linked policies in SF.
- 1.46. The main impacts that the implementation of the Scheme will have on the reasonable benefit expectations of the existing policyholders in the other notional sub-funds are as follows:
- There will be no change to the terms and conditions of the existing policyholders in the other notional sub-funds;
 - The existing policyholders in the notional sub-funds will remain in the same notional sub-funds following the implementation of the Scheme and there will be no change to the operation of any of the notional sub-funds. In particular, for with-profits policies in the notional sub-funds, the bonuses on with-profits policies, investment policy and amounts credited and debited from each of the with-profits funds will continue to be determined in line with the fund's published PPFM; and
 - The costs associated with the Scheme that are attributable to SF will be met solely from the SF Main Fund and so none of the costs will be attributable to the policyholders in the notional sub-funds.

The policyholder communications proposed for this transfer

- 1.47. Regulations made under FSMA require a communication regarding the proposed transfer to be sent to every policyholder of the parties to the Scheme. However, this requirement may be waived at the discretion of the Court, which will give consideration to issues such as the practicality and costs of sending direct notices against the likely benefits for policyholders of receiving such communications, as well as the effectiveness of alternative information channels (e.g. public notices).
- 1.48. Therefore, the following communications have been proposed for this transfer:
- A legal notice of the transfer will be published in The Times, The Telegraph, the Herald and the London, Edinburgh and Belfast Gazettes;
 - Direct communications will be sent to the following groups of Mobius policyholders, for whom Mobius holds a current address, to notify them of the transfer (and thus Mobius are to seek dispensation from the Court from the requirement to contact any other additional policyholders):
 - The trustees who hold a TIP in the Transferring Business, and the adviser of the trustees (in some cases, where Mobius regularly deals with the adviser);
 - The individual scheme members of a group personal pension plan, group stakeholder pension plan or a TIP in the Transferring Business, and the individual holders of an individual personal pension plan in the Transferring Business; and
 - The trustees who hold a TIP in the non-transferring business, and the adviser of the trustees (in some cases, where Mobius regularly deals with the adviser).
 - Each Delegate of SF will receive a voting pack in advance of the SGM, which will include an explanatory document prepared by SF (containing details of the proposed transfer) alongside a copy of the communications that are to be prepared by and sent to Mobius policyholders. SF intends to seek dispensation from the Court from the requirement to contact all other members; and

- Policyholders and other interested parties will be able to obtain information from SF's and Mobius's websites, which will contain documents regarding the Scheme, including a statement setting out the terms of the Scheme and a summary of my report.

Conclusions

- 1.49. I am satisfied that the implementation of the Scheme will not have a material adverse effect on:
- The security of benefits under the policies of Mobius and SF;
 - The profile of risks to which the policies of Mobius and SF are exposed;
 - The governance, management or service standards applicable to the Mobius and SF policies; or
 - The reasonable benefit expectations of the policyholders of Mobius and SF.
- 1.50. I am satisfied that the Scheme is equitable to all classes and generations of SF and Mobius policyholders. I am satisfied that the proposed approach to communication with policyholders, including the application for the waivers, is fair and reasonable.

2. INTRODUCTION

The Independent Expert

- 2.1. When an application is made to the Court for an order to sanction the transfer of insurance business from one insurer to another, the application is subject to Part VII of FSMA and approval by the Court under Section 111 of FSMA. FSMA requires the application to be accompanied by a report on the terms of the Scheme by an Independent Expert.
- 2.2. I have been instructed by SF and Mobius to report in the capacity of Independent Expert pursuant to Section 109 of FSMA on the terms of the proposed transfer of a block of long-term insurance business of Mobius to SF.
- 2.3. My terms of reference have been reviewed by the Prudential Regulation Authority ("**PRA**") and the Financial Conduct Authority ("**FCA**").
- 2.4. My fees will be met equally by SF and Mobius. For SF from the SF Main Fund, a notional sub-fund of the long-term business fund, and for Mobius from shareholder resources.
- 2.5. It is intended that the following business will transfer to SF: all of the unit-linked group stakeholder and group personal pension business; the unit-linked individual personal pension business; and the unit-linked TIPs which have member administration services of Mobius.
- 2.6. The effective date of the Scheme is expected to be 31 October 2018.

The purpose and scope of my report

- 2.7. The purpose of my report is to report on the terms of the Scheme in my capacity as Independent Expert and this report will be provided to the Court as a requirement of the approval of the transfer of certain insurance business from Mobius to SF. The purpose of my report is to review the proposed transfer of the business of Mobius to SF and the subsequent reinsurance of this business from SF to Mobius. In particular, I consider the effects of the proposed transfer on the security of the benefits, the reasonable expectations of the transferring and non-transferring policyholders of Mobius and the existing policyholders of SF, and the profile of risks to which they are exposed. I have also considered the implications for the relevant parties if the Scheme were not to go ahead.
- 2.8. My report has been prepared under the terms of the guidance set out in the Statement of Policy "The Prudential Regulation Authority's approach to insurance business transfers" (the "**PRA Statement of Policy**") and in Chapter 18 of the Supervision Manual ("**SUP 18**") contained in the FCA Handbook. The PRA, in consultation with the FCA, has also approved the form of this report. In addition, in completing my report I have considered the FCA's finalised guidance on its approach to the review of Part VII insurance business transfers that was published in FG18/4.
- 2.9. My report will be presented to the Court and will be made available to policyholders and others via the SF and Mobius websites. Both websites will also contain copies of other Scheme-related documents, including a statement setting out the terms of the Scheme and a summary of my report. It is proposed that only the Delegates of SF, who are elected policyholders that are responsible for representing the interests of all of the members of SF, will be directly notified of the transfer. For the Transferring Business, all individual members of group personal pension plans, group stakeholder pension plans, and TIPs, and all individual holders of an individual personal pension plan will be notified directly. In addition, all trustees (and in certain cases the adviser of the trustees) who hold a TIP policy, either within the Transferring Business or the non-transferring business, will be notified directly of the transfer.
- 2.10. In assessing the impact of the implementation of the Scheme on the policyholders of SF and Mobius, and whether those policyholders are being treated fairly as a result of the implementation of the Scheme, I have had regard to:
 - The likely effect of the implementation of the Scheme on the security of policyholders' contractual benefits and on the benefit expectations of policyholders created by past practices employed, or statements made, by each company;
 - The reports from the Chief Actuaries of SF and Mobius on the impact of the implementation of the proposed Scheme; and
 - The report of the WPA of SF on the impact of the implementation of the proposed Scheme.

- 2.11. This report does not consider the impact of the Transfer on any new policies written into SF following the transfer.
- 2.12. There are no documents or other items of information that I have requested and have not been provided.
- 2.13. Appendix 2 contains a list of the main sources of data upon which I have relied.
- 2.14. There are no other transfers that are ongoing for SF or Mobius at the time of writing my report.
- 2.15. As far as I am aware, there are no matters that I have not taken into account in undertaking my assessment of the Scheme and in preparing my report, which nonetheless should be drawn to the attention of the Court in its consideration of the terms of the Scheme.
- 2.16. I have only considered the terms of the Scheme presented to me, and am not required to consider possible alternative schemes in forming my opinions.

Developments whilst my report was in progress

- 2.17. At the time of writing the original draft of my report, the report from the Chief Actuary of SF was written by Mr Donald Macleod. Mr Macleod was appointed as the Actuarial Function Holder for SF on 18 September 2012 and subsequently became SF's Chief Actuary when the Solvency II framework came into effect on 1 January 2016.
- 2.18. It is my understanding that Mr Macleod left SF in early 2018 and that his role as Chief Actuary will be filled for an interim period by an external Chief Actuary, subject to approval by the PRA. At the time of writing my report, it is understood that this will be Mr Stephen Makin, the Head of Risk and Capital Management for the Life & Financial Services practice of Hymans Robertson LLP. It is my understanding that Mr Makin will be the Chief Actuary of SF at the time of the Directions Hearing on 25 July 2018 and that an individual who will fulfil the Chief Actuary role has been recruited and they will, subject to PRA approval, assume the role of Chief Actuary of SF after the Transfer Date. Mr Makin will be the author of the Chief Actuary's report for the Sanctions Hearing on 29 October 2018.
- 2.19. SF have assured me that Mr Macleod's departure from SF was not related to the proposed transfer nor due to any concerns that he had about the proposed transfer. I have sought and received assurance from the Board of SF that to the best of its knowledge the report on the transfer produced by Mr Macleod was both accurate and complete.
- 2.20. However, a consequence of this change is that a new version of the report of the Chief Actuary of SF on the Scheme, authored by and providing the conclusions of Mr Makin on the impact of the proposed transfer on SF and its policyholders, has been written and will be submitted to the PRA and the FCA in advance of the Directions Hearing.
- 2.21. I have reviewed Mr Makin's report and can confirm that the conclusions provided are consistent with those in the initial report drafted by Mr Macleod and have not caused me to amend my conclusions. It should be noted that all references in my report to SF's Chief Actuary's Report correspond to the report authored by Mr Makin.

Qualifications and disclosures

- 2.22. I am a Fellow of the Institute and Faculty of Actuaries, having qualified in 1992, and hold a certificate issued by the Institute and Faculty of Actuaries enabling me to act as a Chief Actuary (Life) and as a With-Profits Actuary ("WPA").
- 2.23. I am a Principal of Milliman LLP ("**Milliman**") and I am based in its UK Life Insurance and Financial Services practice. I act, or have acted, as a Head of Actuarial Function, an Actuarial Function Holder, a With-Profits Actuary, an Appointed Actuary, an Independent Expert, an Independent Actuary and a Life Reinsurance Signing Actuary. I have fulfilled the role of Independent Expert (or equivalent) for five insurance business transfers that have been approved by the Court as listed in Appendix 1. I have worked on over 30 insurance business transfers in the last 20 years. Many of these transfers have involved significant levels of unit-linked business, longevity risk, with-profits business, or cross border transfers.
- 2.24. My appointment as the Independent Expert has been approved by the PRA (after consulting with the FCA) in a letter to SF dated 21 November 2017.
- 2.25. I confirm that there is nothing that could be considered to impair my ability to act independently in my review of the Scheme. I submitted a Statement of Independence to the PRA and FCA as part of the approval process. I confirm that I do not have any direct or indirect interest in SF or Mobius that could compromise my independence.

- 2.26. A certificate of compliance with Part 35 of the Civil Procedure Rules is attached as Appendix 3. I confirm that I have understood my duty to the Court.

The parties for whom my report has been prepared

- 2.27. This report, and any extract or summary thereof has been prepared particularly for the use of the bodies or persons listed below:
- The Court;
 - The Directors and senior management of SF;
 - The Directors and senior management of Mobius;
 - The FCA and the PRA, and any other governmental department or agency having responsibility for the regulation of insurance companies in the UK; and
 - The professional advisers of any of the above.
- 2.28. In accordance with the legal requirements under FSMA, copies of my report may be made available to the policyholders of SF and Mobius and to other interested parties.

Limitations

- 2.29. In preparing my report, I have had access to certain documentary evidence provided by SF and Mobius and I have had access to, and discussions with, senior management of SF and Mobius. My conclusions depend on the substantial accuracy of this information without independent verification. The principal documents which I have reviewed in respect of SF and Mobius are listed in Appendix 2. I have considered, and am satisfied with, the reasonableness of this information based upon my own experience of the UK life assurance industry.
- 2.30. In addition to the principal documents listed in Appendix 2 to this report, I have also relied on the accuracy of financial information and legal advice provided to me by SF and Mobius. The extent of my reliance in these areas has been documented in paragraphs 4.24 to 4.33 of this report.
- 2.31. This report must be considered in its entirety as individual sections, if considered in isolation, may be misleading. Draft versions of this report should not be relied upon for any purpose. I have provided a summary of this report, including the relevant conclusions, for inclusion in the policyholder communications to be circulated to Mobius policyholders and in the voting pack for the Delegates of SF; other than this, no summary of my report may be made without my express consent.
- 2.32. This report has been prepared on an agreed basis for the Court, SF, Mobius and the other bodies listed in paragraph 2.27 in the context of the Scheme and must not be relied upon for any other purpose. No liability will be accepted by Milliman, or me, for any application of my report to a purpose for which it was not intended, nor for the results of any misunderstanding by any user of any aspect of the report. In particular, no liability will be accepted by Milliman or me under the terms of the Contracts (Rights of Third Parties) Act 1999.

Technical Actuarial Standards (“TASs”)

- 2.33. My report has been prepared subject to the terms of the Technical Actuarial Standards (“TASs”) applicable to insurance transformations (“**TAS 200: Insurance**”) issued by the Financial Reporting Council. In my opinion, my report complies with TAS 200: Insurance and is also compliant with TAS 100: Principles for Technical Actuarial Work, in particular those elements of the standard that are applicable to transformations.
- 2.34. In complying with these requirements, I note that a number of the key documents listed in Appendix 2 have been prepared or reviewed by individuals who were subject to professional standards in undertaking their work, including, where appropriate, TAS requirements.

The Actuarial Profession Standards (“APSs”)

- 2.35. APS X2 issued by the Institute and Faculty of Actuaries requires members to consider whether their work requires review, whether this review should be independent and whether the reviewer has sufficient relevant experience to perform their role.
- 2.36. In my view this report does require independent peer review, and this has been carried out by a senior actuary in Milliman who has worked as the Independent Expert on a large number of transfers and has not been part of the team working on this assignment.

The structure of my report

- 2.37. Section 3 provides some information on the matters to be considered by the Independent Expert and Section 3 gives some background information on the current regulatory regime in the UK and the UK life insurance market, including a description of the unit-linked group personal and stakeholder pension product types relevant to this report.
- 2.38. Sections 5 and 6 of this report provides some background to SF and Mobius respectively, and Section 7 explains the purpose of the Scheme and summarises the key aspects of the Scheme.
- 2.39. The effects of the implementation of the Scheme on the policies of SF and Mobius and on the holders of these policies are covered in Sections 8, 9 and 10. Section 11 outlines a number of other considerations and Section 12 contains my conclusions on the Scheme.
- 2.40. The appendices contain a list of my previous assignments as Independent Expert, a schedule of data relied upon in forming my conclusions, my Certificate of Compliance, a glossary of terms used throughout this report and details of how this report complies with the PRA Statement of Policy, SUP 18.2 and the FCA's finalised guidance FG18/4.

3. THE UK LIFE INSURANCE MARKET AND REGULATORY ENVIRONMENT

Introduction

- 3.1. The regulatory regime to which UK insurers are subject, and the applicable solvency requirements, are relevant to my considerations as Independent Expert and are summarised in this section.

The UK regulators

- 3.2. Prior to 1 April 2013, regulation of insurance companies was the responsibility of the Financial Services Authority. Since 1 April 2013, responsibility for the regulation of such companies has been split between the PRA and the FCA.
- 3.3. The PRA is a part of the Bank of England, and carries out the prudential regulation and supervision of banks, building societies, credit unions, insurers and major investment firms.
- 3.4. The PRA has statutory objectives to promote the safety and soundness of the insurers that it regulates, and to contribute to ensuring that policyholders are appropriately protected. More generally, these statutory objectives can be advanced by seeking to ensure that regulated insurers have resilience against failure and that disruption to the stability of the UK financial system from regulated insurers is minimised.
- 3.5. The FCA regulates the conduct of all financial services firms in relation to consumer protection, industry stability and the promotion of healthy competition between providers.

The Solvency II regulatory regime

Introduction

- 3.6. A new regulatory solvency framework for the European Economic Area (“EEA”) insurance and reinsurance industry came into effect on 1 January 2016. This new regime is known as Solvency II and aims to introduce solvency requirements that better reflect the risks that insurers and reinsurers actually face and to introduce consistency across the EEA. All but the smallest EEA insurance companies are required to adhere to a set of new, risk-based capital requirements and the results will be shared with the public.
- 3.7. Solvency II is based on three pillars:
- Under Pillar 1, quantitative requirements define a market consistent¹ framework for valuing the company’s assets and liabilities, the results of which will be publicly disclosed;
 - Under Pillar 2, insurers must meet minimum standards for their corporate governance and their risk and capital management. There is a requirement for permanent internal audit and actuarial functions. Insurers must regularly undertake a forward looking assessment of risks, solvency needs and adequacy of capital resources, called the Own Risk and Solvency Assessment (“ORSA”), and senior management must demonstrate that the ORSA actively informs business planning, management actions and risk mitigation; and
 - Under Pillar 3, there are explicit requirements governing disclosures to supervisors and policyholders. Firms will produce private reports to supervisors and a public solvency and financial condition report.

The Pillar 1 requirements

- 3.8. The determination of a market consistent value of liabilities under Solvency II requires the insurer to calculate the BEL. The expected future obligations of the insurer are projected over the lifetime of the contracts using the most

¹ A market-consistent framework requires the values placed on assets and liabilities to be consistent with the market prices of listed securities and traded derivative instruments.

up-to-date financial information and the best estimate actuarial assumptions, and the BEL represents the present value of these projected cash-flows.

- 3.9. Under Solvency II, a company's Pillar 1 liabilities are called the "technical provisions" which consist of the sum of the BEL and the "risk margin".
- 3.10. For unit-linked life insurance business, the BEL is unbundled into unit and non-unit components, namely the unit reserve and the non-unit reserve. The unit reserve is calculated as the amount arising directly from the liability to pay the unit-linked benefits to policyholders and is equal to the market value of the unit-linked assets. The non-unit reserve is calculated using the best estimate future cash flows that are related to the management of the unit-linked business and will take into account the income received from fund management charges and the outgo for expenses and the cost of any guarantees.
- 3.11. If on a best estimate basis income exceeds outgo in relation to the unit-linked business, the non-unit reserve can be negative. In this case the BEL will be less than the unit reserve and so the unit reserve will be funded by the expected future revenue from income being greater than outgo.
- 3.12. The risk margin is an adjustment designed to bring the technical provisions up to the amount that another insurance or reinsurance undertaking would be expected to require in order to take over and meet the insurance obligations in an arm's length transaction.
- 3.13. The Pillar 1 assets are, broadly speaking, held at market value.
- 3.14. The SCR under Solvency II is the capital requirement under Pillar 1, and is intended to be the amount required to ensure that the firm's assets continue to exceed its technical provisions over a one year timeframe with a probability of 99.5%.
- 3.15. The MCR, which is typically lower than the SCR, defines the point of intensive regulatory intervention. The MCR calculation is simpler, more formulaic and less risk-sensitive than the SCR calculation. The MCR for life insurance companies is also subject to an absolute minimum of €3.7 million (approximately £3.3 million) as prescribed by the European Insurance and Occupational Pensions Authority ("EIOPA").
- 3.16. In calculating the SCR, it is expected that most firms will use the "Standard Formula", as prescribed by EIOPA. However, Solvency II also permits firms to use their own internal models (or a combination of a "Partial Internal Model" and the Standard Formula) to derive the SCR. These internal models and Partial Internal Models are subject to approval by the relevant regulator: in the UK this is the PRA.
- 3.17. The Solvency II Regulations 2015 which implement, in part, the Solvency II Directive (as amended by the subsequent Omnibus II Directive) into UK law, came into force on 1 January 2016.
- 3.18. The remainder of the Solvency II Directive has been implemented by FSMA, by rules and binding requirements imposed by the PRA and the FCA, and by directly applicable regulations made by the European Commission. The PRA has issued final statements on the transposition of Solvency II into the UK national framework. These set out the PRA's approach to the prudential regulation of firms subject to Solvency II.
- 3.19. EIOPA has published the implementing technical standards and guidelines for the new regime and these have been endorsed by the European Commission, are legally binding and apply to all national regulators under the scope of Solvency II.

Own Funds and capital

- 3.20. Under the Solvency II regime, the excess of assets over liabilities, plus any subordinated liabilities, is known as Own Funds. Own Funds can be thought of as the capital available in the company to cover capital requirements.
- 3.21. Under Solvency II, companies are required to classify their Own Funds into three tiers, which broadly represent the quality of the Own Funds in relation to their ability to absorb losses. The Own Funds of the highest quality are classified as Tier 1. In order to be classified as Tier 1, Own Funds must exhibit both of the following:
 - Permanent availability, i.e. the item is available, or can be called up on demand, to fully absorb losses on a going concern basis, as well as in the case of winding up; and
 - Subordination, i.e. in the case of winding up, the total amount of the item is available to absorb losses and the repayment of the item is refused to its holder until all other obligations, including insurance and reinsurance obligations towards policyholders and beneficiaries of insurance and reinsurance contracts, have been met.

- 3.22. Own Funds that are classified as Tier 2 or Tier 3 are of a lower quality, with less ability to fully absorb losses.

Ring-fenced funds

- 3.23. Solvency II includes the concept of a ring-fenced fund. This refers to any arrangement where an identified set of assets and liabilities are managed as though they were a separate undertaking, meaning that there are restrictions on the extent to which surplus in the ring-fenced fund may be transferred to shareholders or used to cover losses outside the ring-fenced fund.
- 3.24. In the UK, many firms have set up ring-fenced funds in order to reflect the arrangements applicable to their with-profits funds (as defined under the previous regulatory regime) and the with-profits and non-profit business within the with-profits fund.

The governance of UK long-term insurers

- 3.25. For most UK long-term insurers the Board of Directors is the firm's governing body, and is ultimately responsible for setting the strategic direction of the firm, overseeing the activities of the firm's day-to-day management and approving the firm's financial statements.
- 3.26. Under Solvency II, all insurers are required to establish an actuarial function, but it is not defined as being performed by an individual. The actuarial function is responsible for, amongst other things, coordinating the calculation of the technical provisions and expressing opinions on the firm's underwriting policy and the adequacy of the firm's reinsurance arrangements. The person having responsibility for the actuarial function under Solvency II is known in the UK as the Chief Actuary.
- 3.27. The PRA has introduced a governance regime for UK insurers called the Senior Insurance Managers Regime ("**SIMR**") which became effective on 7 March 2016, and which defines a set of senior insurance management functions ("**SIMF**"), including:
- Chief Executive Officer ("**CEO**");
 - Chief Financial Officer ("**CFO**");
 - Chief Risk Officer ("**CRO**");
 - Chief Actuary;
 - Head of Internal Audit; and
 - Chief Underwriting Officer (general insurance firms only).
- 3.28. The individuals responsible for these functions will be subject to PRA approval, although there are conversion arrangements under which individuals approved under the previous approved persons regime may take up approved roles under SIMR.
- 3.29. In addition to the roles listed above, those firms with with-profits business must appoint an actuary (or actuaries) to perform the "with-profits actuary function". This individual is the WPA, and his responsibilities include advising the firm's management on the key aspects of the discretion to be exercised affecting those classes of the with-profits business of the firm in respect of which he has been appointed. The WPA role is one of the SIMFs.
- 3.30. In relation to each with-profits fund, firms must appoint a With-Profits Committee ("**WPC**") (or a "with-profits advisory arrangement" if appropriate given the size, nature and complexity of the fund in question). The WPC's role is to advise and provide recommendations to the firm's governing body on the management of the with-profits business, and to act as a means by which the interests of with-profits policyholders are appropriately considered within a firm's governance structures.

The governance of UK pension providers

- 3.31. As of 6 April 2015, Section 19.5 of the FCA's Conduct of Business Sourcebook ("**COBS**") was updated to include requirements for UK firms that operate workplace personal pension schemes to establish and maintain to establish an independent governance committees ("**IGCs**").

- 3.32. IGCs have a duty to scrutinise the value for money of the provider's workplace personal pension schemes, taking into account transaction costs, raising concerns and making recommendations to the provider's board as appropriate. IGCs must:
- Act solely in the interests of relevant scheme members; and
 - Act independently of the provider.
- 3.33. If a firm considers it appropriate, having regard to the size, nature and complexity of the relevant schemes it operates, it may establish a GAA instead of an IGC. Their objectives remain the same as those for IGCs.

The governance of UK friendly societies

- 3.34. Friendly societies are mutual organisations that are owned by members rather than shareholders and as such, the Board of the society is committed to maintain accountability to its members.
- 3.35. Although the business of the society is under the direction of the Board, to ensure accountability, friendly societies may be structured such that their members elect Delegates who are responsible for representing the interests of all of the members on behalf of them.
- 3.36. Members can raise any issues through their Delegates and the Board would meet with the Delegates regularly at Annual General Meetings ("**AGMs**") or Special General Meetings ("**SGMs**"). All general meetings other than AGMs are referred to as SGMs.
- 3.37. In addition to this, many friendly societies embrace best practice in corporate governance by committing to the principles of the FCA's UK Corporate Governance Code ("**the Code**"). The Association of Financial Mutuals have produced an annotated version of the Code that contains annotations relevant to mutual and friendly societies.

A firm's risk appetite and internal capital management policy

- 3.38. The Board of a firm is responsible for the management of the company and for its exposure to risk. The Board will typically set out its appetite for risk in a form which references the probability that the Board is willing to accept of not being able to pay policyholder liabilities as they fall due and/or meet regulatory requirements.
- 3.39. In order to ensure that day-to-day fluctuations in markets and experience do not lead to a breach of their risk appetite and regulatory capital requirements, firms usually aim to hold more capital than strictly required to meet the regulatory minimum. The details of the target level of capital buffer are typically set out in the firm's capital management policy.
- 3.40. The capital management policy of a firm is set by and owned by the Board and describes the capital that the Board has determined should be held in the company. Changes to this policy usually require Board approval and appropriate consultation with the prudential regulator (the PRA in the UK).
- 3.41. The capital management policy is typically stated in terms of the capital requirements set down by the relevant regulations. The regulatory capital requirements typically target a particular probability of remaining solvent over a certain time horizon: for example for the Solvency II regulatory regime it is a 99.5% probability of remaining solvent over a one year time horizon. By requiring additional capital to be held on top of the regulatory requirements, the capital management policy increases the probability of remaining solvent over a particular timeframe and therefore increases the security of the benefits provided under the policies subject to that policy.
- 3.42. The level of capital required may also be driven by the desire of the Board to maintain a certain credit rating with external credit rating agencies.

The products and long-term business relevant to this report

- 3.43. The proposed Scheme provides for the transfer of a block of unit-linked business written by Mobius, consisting of individual personal pension plans, group and individual stakeholder plans, and TIPs, all of which are used as saving vehicles for retirement.
- 3.44. Personal pensions were introduced by the Finance Act 1986 and became available from 1 July 1988. They are individual, portable pensions that offer an alternative to occupational pension schemes for employees.

- 3.45. They are available as individual personal pensions or as part of a group personal pension scheme. Group personal pension schemes are sold by insurance companies to employers as a way for them to provide pension benefits for employees. The insurer would administer the personal pensions together as a single scheme but for each individual member, the contract he or she has would be similar to that of an individual personal pension. The contracts are written under personal pension legislation rather than occupational pension legislation.
- 3.46. Stakeholder pensions were introduced by the UK government in April 2001 and are a form of personal pension. They were created to allow non-members of a company pension scheme to make provision for their retirement. That is, you do not have to be an employee to take out a stakeholder pension.
- 3.47. When stakeholder pensions were first introduced, contributions at any frequency had to be accepted provided they were greater than £20 (net of basic tax). Charges were subject to a maximum cap of 1% p.a., taken daily, of the fund value allowing low cost, flexible retirement savings for customers. For policies that started after 6 April 2005, the 1% p.a. capped charge was increased to 1.5% p.a. for the first 10 years of the policy, reducing to 1% p.a. after that.
- 3.48. Since 2012 UK employers have been required to automatically enrol all eligible workers into a qualifying pension scheme although workers can choose to "Opt out" of this arrangement. Fund charges under auto-enrolment have been capped at 0.75% p.a. from April 2015 on default funds; the fund in which contributions are invested if the scheme member does not make an alternative choice.
- 3.49. In 2013, the UK government have launched a review of the levels of charges on pre-2001 personal pensions and may consider introducing charge caps on these policies. Whilst so far, no such caps have been introduced on these personal pensions policies, the potential for capping at some point in the future remains.
- 3.50. TIPs allow trustees of UK registered pension schemes, whether occupational pension schemes or self-invested personal pension schemes, the opportunity to manage their funds flexibly and provide access to a range of funds that would otherwise be unavailable to them, such as the funds of third party insurers.
- 3.51. For the avoidance of doubt, none of the business to be transferred under the Scheme include any profit-sharing or participating features.

4. GENERAL CONSIDERATIONS OF THE INDEPENDENT EXPERT

The role of the Independent Expert

- 4.1. I have compiled this report in accordance with paragraphs 2.27 to 2.37 of the PRA Statement of Policy, with paragraphs 31 to 41 of Section 2 of SUP 18 and taken into consideration the recommendations provided in Section 6 of the FCA's finalised guidance FG18/4, which give guidance on the form of the Scheme Report, i.e. this report.
- 4.2. As described in Section 7 of this report, the Scheme proposes to transfer certain business of Mobius to SF. I need to consider the terms of the Scheme generally and how the different groups of policyholders of SF and Mobius are likely to be affected by the implementation of the Scheme. In particular I need to consider:
 - The effect of the implementation of the Scheme on the security of the policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;
 - The effect of the implementation of the Scheme on the benefit expectations of policyholders; and
 - The effect of the implementation of the Scheme on the standards of service provided to policyholders and the governance applicable to the management of their policies.
- 4.3. I am only required to comment on the effects of the implementation of the proposed Scheme on policyholders who enter into contracts with SF and Mobius prior to the Transfer Date of the Scheme.
- 4.4. In this report I have not restricted my assessment of the Scheme to adverse effects.
- 4.5. The type of policy held by a policyholder will be a key determinant of the risks to which the policyholder is exposed. Other than this, the key determinants of the policyholder's risk exposure will be the characteristics of the company in which the policy is held, for example:
 - The size of the company;
 - The amount and quality of capital resources available, other calls on those capital resources and any capital support currently available to the company;
 - The internal capital management policy of the company;
 - The investment strategy of the company;
 - The mix of business of the company;
 - The company's strategy, for example, whether the company is open or closed to new business, its acquisitions strategy; and
 - Other factors, such as operational risks faced by the company, reinsurance arrangements of the company, the company's governance framework and its tax position.

The definition of 'policyholder'

- 4.6. In this report I use the term 'policyholder' to include all of the following, whether or not they are policyholders as a matter of law:
 - The holders of unit-linked individual personal pension policies with Mobius;
 - The holders of unit-linked group personal and stakeholder pension policies with Mobius, as well as the underlying members;
 - The trustees of pension funds who are holders of TIP policies with Mobius, as well as the underlying members; and
 - All policyholders of SF.

Security of policyholder benefits

- 4.7. As part of my role as Independent Expert for the Scheme, I need to consider the security of policyholder benefits, that is, the effect of the implementation of the Scheme on the likelihood that policyholders will receive their guaranteed benefits when these are due.
- 4.8. In considering and commenting upon policyholder security, I will primarily consider policyholders' guaranteed benefits. The regulations require insurance companies to hold a minimum amount of capital in addition to the assets backing a realistic estimate of their liabilities to policyholders. Insurance companies must also demonstrate that they can fulfil their regulatory requirements and meet policyholder claims as they become due in adverse scenarios. Therefore, the amount by which the assets available to support the long-term insurance business exceed the long-term liabilities provides security for the guaranteed benefits.

Treating customers fairly

- 4.9. I also need to consider the proposals in the context of the regulatory obligation on both companies to treat their customers fairly and, in particular, the effect of the implementation of the Scheme on policyholders' reasonable benefit expectations.
- 4.10. This involves considering the effect of the implementation of the Scheme on any areas where discretion is involved on behalf of the relevant insurance company, for example in determining the charges applied to a policy and the benefits granted to the policyholder, as well as consideration of the effect of the implementation of the Scheme on the management, service and governance standards of the company in question.

The framework for my consideration of the proposed Scheme

- 4.11. The framework for my conclusions is a consequence of the Court's consideration of prior schemes. In particular, principles stated by Evans-Lombe J. in *Re AXA Equity & Law Life Assurance Society plc and Axa Sun Life plc* (2001) (based on principles outlined by Hoffman J. in *Re London Life Association Ltd* (1989)) are often used as the basis for the consideration of insurance business transfers by the Independent Expert and by the Court.
- 4.12. In particular, Evans-Lombe J. stated in *Re AXA Equity and Law* that "the court is concerned whether a policyholder, employee or other interested person or any group of them will be adversely affected by the scheme". He went on to state: "That individual policyholders or groups of policyholders may be adversely affected does not mean that the scheme has to be rejected by the court. The fundamental question is whether the scheme as a whole is fair as between the interests of the different classes of persons affected".
- 4.13. The most common interpretation of these (and other relevant) statements has been that a conclusion that "no group of policyholders is materially adversely affected by the Scheme" provides a sufficient condition to conclude that the fairness of the Scheme as a whole has been demonstrated.
- 4.14. This is therefore the framework within which I undertake my consideration of the proposed Scheme.

My assessment of the effect of the proposed Scheme

- 4.15. Given the inherent uncertainty of the outcome of future events and that the effects of such future events may be different for different groups of policies, it is not possible to be certain of the effect of the proposed Scheme on the affected policies.
- 4.16. In order to acknowledge this inherent uncertainty, the conclusions of the Independent Expert in relation to transfers of long-term insurance business are usually framed using a materiality threshold. If the potential impact under consideration is very unlikely to happen and does not have a significant impact, or is likely to happen but has a very small impact, then it is not considered to have a material effect on the policies.
- 4.17. A scheme may have both positive and negative effects on a group of policies and the existence of detrimental effects should not necessarily imply that the Court should reject the scheme as the positive effects may outweigh the negative effects or the negative effects may be very small.
- 4.18. The assessment of materiality will also take into account the subject being considered and the nature of the potential impact so that, for example, the materiality threshold for a change that could have a direct financial

impact on policyholders' guaranteed benefits is likely to be lower than the materiality threshold for a change that does not have a direct financial impact.

- 4.19. Therefore, my overall assessment of the effect of the implementation of the proposed Scheme on the various affected policies is ultimately a matter of expert actuarial judgement regarding the likelihood and impact of future possible events. In the analysis in Sections 8 to 11 of this report, where there may be expected to be adverse changes, I have where possible provided an indication of the likely effect of the changes for the policies in terms of the size and/or the likelihood of the occurrence of those changes.

The supplementary report

- 4.20. As envisaged by paragraph 2.39 of the PRA Statement of Policy, I will also prepare a Supplementary Report prior to the final Court hearing, to provide an update for the Court on my conclusions in the light of any significant events subsequent to the date of the finalisation of this report.
- 4.21. The Supplementary Report will be made available on the SF and Mobius websites.

Reliances of the Independent Expert on the work of others

- 4.22. The facts and instructions, both written and verbal, which are material to the opinions expressed in my report, or upon which those opinions are based are:
- Financial information provided by SF and Mobius;
 - Legal advice provided by the legal firms retained by SF and Mobius in respect of this Scheme; and
 - Information contained within the principal documents listed in Appendix 2 to this report.
- 4.23. I have considered all of the facts and instructions presented to me (some of which support and some of which detract from my opinions) in determining my overall opinions and conclusions.

The financial information in this report

- 4.24. For both SF and Mobius, the Solvency II SCR is based on the Solvency II Standard Formula.
- 4.25. The financial information used in the analysis of the effects of the proposed Scheme is set out in Sections 8, 9 and 10 of this report.
- 4.26. I have not carried out a full independent review of these Solvency II results as at 31 December 2016 for SF and 31 March 2017 for Mobius, but:
- I have reviewed the methodology and assumptions used to prepare the results for both companies;
 - The SF Solvency II results as at 31 December 2016 have been reviewed by SF's external auditor (Deloitte LLP). The scope of its review included the balance sheet, technical provisions, Own Funds, SCR and MCR of SF as at 31 December 2016. The SF Solvency II results as at 31 December 2016 that are presented in my report are broadly consistent with these figures;
 - The Mobius Solvency II results as at 31 March 2017 have been reviewed by Mobius's external auditor (Mazars). The scope of its review included the balance sheet, technical provisions, Own Funds, SCR and MCR of Mobius as at 31 March 2017 that have been included within my report; and
 - I have reviewed the methodology and assumptions used to prepare the SF and Mobius post-Scheme Solvency II figures as at 31 December 2016 and 31 March 2017, respectively, and I am comfortable with the impacts that have been used.
- 4.27. I am satisfied that it is reasonable to rely upon these Solvency II results for the purpose of this report. I have been provided with more recent, but unaudited figures, as at 30 September 2017 which show that there have been no significant changes to the numbers that are presented within this report.

- 4.28. My Supplementary Report will contain Solvency II financial information as at 31 December 2017 and 31 March 2018 for SF and Mobius, respectively, and will provide an update on the effect of the implementation of the proposed Scheme based upon these figures.

My reliance on legal advice

- 4.29. My report is prepared for the Court as part of the process of submission of the Scheme to the Court. I am not an expert in legal matters and hold no qualifications in UK law (insurance regulations or otherwise) and therefore rely on input from experts in UK insurance law in relation to a number of areas. In particular:
- I rely on the management of SF's understanding that there are no provisions in the Previous Schemes, as defined in paragraph 5.11, that are required to be amended due to the implementation of the Scheme, that could have an adverse impact on policyholders;
 - I rely on input from legal experts in order to ensure that my understanding of the proposed Scheme, and my description of its relevant features in my report, is accurate; and
 - I rely on assurances provided by legal experts that the Deed of Charge between Mobius and SF ensures that the position of SF in the insolvency of Mobius will be that it will be placed in terms of priority *pari passu* with Mobius's direct policyholders upon any application of the Insurers (Reorganisation and Winding Up) Regulations. However, at the time of writing my report, the SF-Mobius Reinsurance Arrangement (as described in 7.28 to 7.33) and the Deed of Charge (as described in paragraphs 7.35 to 7.36) are not finalised. Therefore, I have yet to see a final legal opinion confirming this point and I will provide an update on this in the Supplementary Report. To the extent that the final legal opinion that I am provided differs from the assurances I have currently received and have used in forming the opinions within this report, I will also comment on any implications that these differences have on my conclusions.
- 4.30. Obtaining the facts in respect of the operation of the Scheme from the legal experts provides a sound basis from which to carry out my review and analysis using actuarial expertise.
- 4.31. In order to get a sound legal understanding of the Scheme I have relied upon the legal firms retained by SF and Mobius in respect of this Scheme, namely CMS Cameron McKenna Nabarro Olswang LLP ("**CMS**") and Dentons UK and Middle East LLP ("**Dentons**"). Neither CMS nor Dentons have been retained by me, and neither CMS nor Dentons have any liability for the advice that they have provided that has been made available to me.
- 4.32. My reasons for this reliance are:
- CMS and Dentons are large international legal firms with a wide range of experience in UK insurance law and it is my view that they have the relevant and appropriate qualifications and knowledge of the laws and regulations governing insurance business transfers in the UK.
 - The nature of the information and advice from CMS upon which I have relied is factual and in particular concerns how this Scheme (including the Deed Charge and how it would be applied) and the Previous Schemes will operate in accordance with UK law. As such, I am satisfied that the advice or information given by CMS and Dentons would not be different if they were retained directly by me in respect of the proposed Scheme.
- 4.33. I am therefore comfortable that it is appropriate for me to rely on the conclusions of CMS and Dentons in forming my view on the Scheme.

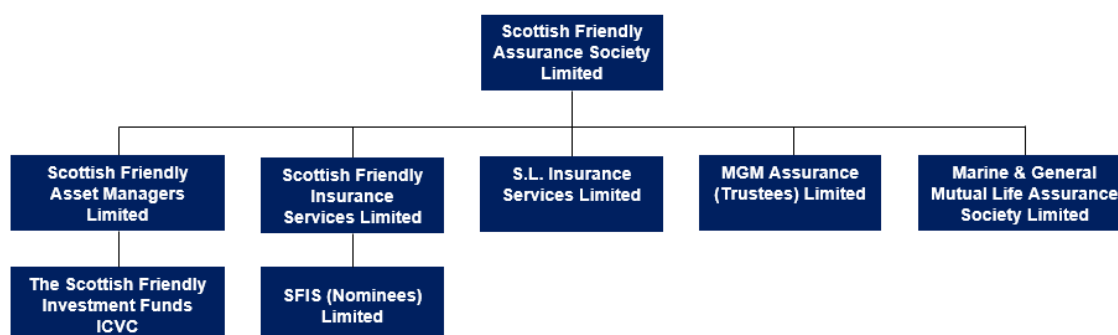
5. BACKGROUND ON SCOTTISH FRIENDLY ASSURANCE SOCIETY LIMITED

Background

- 5.1. SF was founded in 1862 as the City of Glasgow Friendly Society. In 1992, it acquired a small Scotland-based friendly society and assumed the name Scottish Friendly Assurance Society Limited.
- 5.2. The company is a friendly society incorporated under the Friendly Societies Act 1992. It has no shareholders and is owned by its members, with all SF policyholders being members. It sells life and investment insurance products, including ISAs, to policyholders in the UK. Small volumes of legacy products were sold across Europe by SF or by companies that have been acquired and premiums are still received for these.
- 5.3. SF is a financial services group who market and maintain a range of life, savings and investment products and have the following fully owned subsidiaries:
 - **Scottish Friendly Asset Managers Limited** – offers a range of investment products including ISAs, Junior ISA and Child Trust Funds and is authorised and regulated by the FCA;
 - **Scottish Friendly Insurance Services Limited** – provide back office support and bespoke insurance products to other financial service organisations and is authorised and regulated by the FCA;
 - **S.L Insurance Services Limited** – agents for the transaction of general branch insurance, but it is virtually dormant and is unregulated;
 - **SFIS (Nominees) Limited** – which is currently dormant and is unregulated;
 - **MGM Assurance (Trustees) Limited** – the trustee entity for the oversight of certain closed defined benefit pension schemes and is unregulated; and
 - **Marine & General Mutual Life Assurance Society Limited (“M&GM”)** – authorisation to effect and carry out life insurance business has been cancelled by the PRA and SF are currently awaiting action from Companies House for the company to be struck off.
- 5.4. In addition, Scottish Friendly Asset Managers Limited is the Authorised Corporate Director for Scottish Friendly Investment Funds ICVC, an Open Ended Investment Company (“OEIC”) that provides the stocks and shares component of the Scottish Friendly ISA and Child Trust Funds. The company is unregulated.
- 5.5. SF had approximately 513,000 members and around £2.4 billion in technical provisions on a Solvency II basis as at 31 December 2016.
- 5.6. SF has a three-branch business growth strategy of:
 - Organic growth through the development of its product range and distribution channels;
 - Mergers and acquisitions and consolidation in the life sector, with the aim of producing long-term economies of scale; and
 - Business process outsourcing to partners in order to capitalise on cost efficiencies within its administration.

Structure of SF

- 5.7. Below is the current legal structure of SF prior to the Scheme.

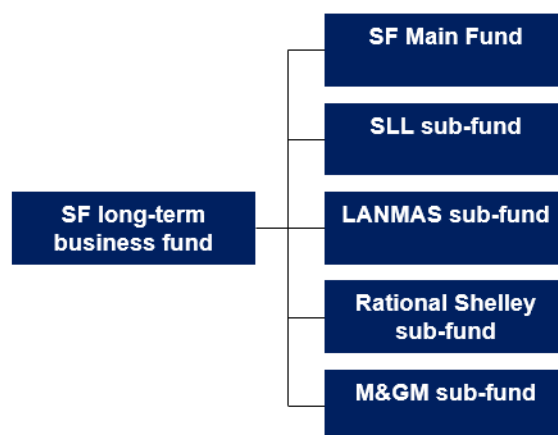


Source: SF's 2017 SFCR

- 5.8. SF is authorised by the PRA to effect and carry out long-term insurance business in Classes I, III and IV², as set out in Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. The main products are whole of life policies, endowment assurances, term assurance and ISAs.
- 5.9. SF maintains a single long-term business fund which is divided into a main fund, the SF Main Fund, and four separate notional sub-funds that are maintained in respect of the business previously transferred into SF from:
- Scottish Legal Life Assurance Society Limited ("**SLL**");
 - London, Aberdeen and Northern Mutual Assurance Society Limited ("**LANMAS**");
 - Rational Shelley Friendly Society Limited ("**Rational Shelley**"); and
 - M&GM (where this notional sub-fund excludes some lines of business that were transferred into the SF Main Fund, as outlined in paragraph 5.17).

Only the SF Main Fund remains open to new business.

- 5.10. Below is the current structure of SF's single long-term business fund prior to the Scheme.



Source: SF's Chief Actuary's Report

² Classification of long-term insurance business: I – life and annuity, II – marriage and birth, III – linked long-term, IV – permanent health, VI – capital redemption contracts and VII – pension fund management.

- 5.11. The SF Main Fund and the notional sub-funds contain business that was transferred into SF by previous schemes under Part VII of FSMA (the “**Previous Schemes**”) and are subject to the conditions set out in the Transfer Agreement sanctioned by the Court at that time.
- 5.12. Each notional sub-fund has been ring-fenced, as defined under Solvency II, for the purpose of calculating the Solvency II Pillar 1 solvency position. The excess capital of each sub-fund (over the notional SCR for each sub-fund) therefore does not contribute to the excess capital at the total SF level. Consequently, the Own Funds in each notional sub-fund are restricted resulting in the SCR coverage ratio equalling 100%.
- 5.13. The SF Main Fund is not ring-fenced for the purpose of calculating the Solvency II Pillar 1 solvency position.
- 5.14. The SF Main Fund and each notional sub-fund are with-profits funds that each have a separate pool of assets, investment strategy, bonus rates and PPFM.

The SF Main Fund business

- 5.15. The SF Main Fund business consists of conventional and unitised with-profits business, significant volumes of unit-linked life and pension business, and non-profit whole of life and term assurance business.
- 5.16. The SF Main Fund contains policies that were written by SF, or that were obtained through the acquisitions of Royal Standard Friendly Society, Preston Operative Assurance and Pioneer Friendly Society Limited.
- 5.17. In addition, following the acquisition of M&GM on 31 May 2015, a block of unit-linked and term assurance business was transferred into the SF Main Fund.
- 5.18. The SF Main Fund had technical provisions on a Solvency II Pillar 1 basis of £1,127 million, as at 31 December 2016.
- 5.19. The table below summarises the in-force business of the SF Main Fund on a Solvency II Pillar I basis, as at 31 December 2016. The figures in the table exclude the risk margin component of the technical provisions.

Table 5.1 – Breakdown of the business of the SF Main Fund as at 31 December 2016

Product type	Number of policies	Gross BEL	Reinsurance asset	Net BEL
		£m	£m	£m
Conventional with-profits	111,569	258	-	258
Unitised with-profits	45,813	99	-	99
Unit-linked life	41,579	346	-	346
Unit-linked pensions	15,520	224	-	224
Whole of life	266,926	28	-	28
Term assurance	151,727	131	159	-28
Other	12,463	35	2	33
Total	645,596	1,121	161	960

Source: SF’s Chief Actuary’s Report

- 5.20. The SF Main Fund with-profits policyholders are entitled to the profits or losses arising in the SF Main Fund. Profits or losses will emerge from the non-profit business written within or transferred into the SF Main Fund and from the subsidiary companies of SF.
- 5.21. In addition, the SF Main Fund makes a charge against each of the four notional sub-funds to cover the administration of the business within the notional sub-fund. The charge is subject to any conditions that are set out in the relevant Previous Schemes. Profits or losses emerge in the SF Main Fund if there is any difference between the charge applied and the actual expenses incurred in administering the business within the notional sub-fund.

- 5.22. The estate of the SF Main Fund is managed in accordance with its PPFM; the SF Main Fund has a separate PPFM for unitised with-profits business and conventional with-profits business written within the fund.
- 5.23. Despite the fact that all SF with-profits policyholders ultimately bear the risk of all business undertaken by SF, wherever possible any risks arising in respect of business that has been transferred into a notional sub-fund is not borne by the SF Main Fund. Similarly any risks arising in respect of the SF Main Fund will not normally be borne by a notional sub-fund. This is achieved by ensuring that any losses incurred on business written in the SF Main Fund are covered by the surplus capital in the SF Main Fund and likewise, any losses incurred on business written in the notional sub-funds are covered by the surplus capital in that fund.
- 5.24. However, in circumstances where the solvency of the SF Main Fund is threatened, capital support arrangements exist such that the SF Main Fund may be supported by these sub-funds. Similarly, should the notional sub-funds be unable to support their own transferred business the SF Main Fund would be required support the benefits. Further information on these arrangements is provided in paragraphs 5.79 and 5.80.

The SLL business

- 5.25. The SLL business had technical provisions on a Solvency II Pillar 1 basis of £78 million, as at 31 December 2016. The SLL business consists of:
- Conventional with-profits business;
 - Unitised with-profits business;
 - Unit-linked business (both life and pension business); and
 - Non-profit protection business (whole of life and term assurances).
- 5.26. The SLL sub-fund is a notional sub-fund containing policies that were written by SLL prior to the acquisition by SF in 2007.
- 5.27. The SLL transferred business has been attributed its own notional sub-fund and has its own notional estate that is managed in accordance to its own PPFM.
- 5.28. The policyholders within the SLL sub-fund bear all business risks arising from the business within the fund itself, but in the normal course does not bear any business risks that arise from other funds (including the SF Main Fund). The exceptions to this are:
- Tax – SF is taxed as a whole and the amount payable may differ from the tax that would have been payable if the SLL sub-fund and the rest of SF were taxed as independent entities. When this business was transferred to SF, it was agreed that the SLL sub-fund will be allocated 50% of any tax benefits (or be charged 50% of any additional tax) as a result of the amalgamation; and
 - SLL Staff Pension Scheme – it was agreed when the business was transferred to SF that the risks associated with the SLL Staff Pension Scheme are shared between the SLL sub-fund and SF's other funds. The pension scheme is now wound up and the risks associated with the scheme have been mitigated by purchasing 'buy-in' annuities with third party insurance companies and ensuring sufficient assets in the SLL sub-fund are available to meet SF's obligations.
- 5.29. The SLL sub-fund is closed to new business.

LANMAS business

- 5.30. The LANMAS business had technical provisions on a Solvency II Pillar 1 basis of £22 million, as at 31 December 2016. The LANMAS business consists of:
- Unitised with-profits business;
 - Unit-linked business (both life and pension business); and
 - Non-profit protection business (term assurances).

- 5.31. The LANMAS sub-fund is a notional sub-fund containing policies that were written by LANMAS prior to the acquisition by SF in 2007.
- 5.32. The policyholders within the LANMAS sub-fund bear all business risks arising from the business within the fund itself, but in the normal course does not bear any business risks that arise from other funds (including the SF Main Fund).
- 5.33. The LANMAS sub-fund is closed to new business.

Rational Shelley business

- 5.34. The Rational Shelley business had technical provisions on a Solvency II Pillar 1 basis of £9 million, as at 31 December 2016. The business consists of:
- Conventional with-profits business; and
 - Non-profit protection business (whole of life and term assurances).
- 5.35. The Rational Shelley sub-fund is a notional sub-fund containing policies that were written by Rational Shelley prior to the acquisition by SF in 2005.
- 5.36. The policyholders within the Rational Shelley sub-fund bear all business risks arising from the business within the fund itself, but in the normal course does not bear any business risks that arise from other funds (including the SF Main Fund).
- 5.37. The Rational Shelley sub-fund is closed to new business.

M&GM business

- 5.38. The M&GM business had technical provisions on a Solvency II Pillar 1 basis of £1,030 million, as at 31 December 2016. The business consists of:
- Conventional with-profits business;
 - Unitised with-profits business;
 - Immediate and flexible income annuities; and
 - Non-profit protection business (whole of life assurances).
- 5.39. The M&GM sub-fund is a notional sub-fund containing policies that were written by M&GM prior to the acquisition by SF in 2015.
- 5.40. The policyholders within the M&GM sub-fund bear all business risks arising from the business within the fund itself, but in the normal course does not bear any business risks that arise from other funds (including the SF Main Fund).
- 5.41. The M&GM sub-fund is closed to new business.

Administration

- 5.42. SF carries out the administration of its business both internally and using third parties. The internally administered systems are able to support all aspects of policy administration, including new policy set up, ongoing policy maintenance and the payment of claims, maturities and surrenders for policies written or acquired by SF. The provision of administration services is the principal activity of Scottish Friendly Insurance Services Limited.
- 5.43. In addition there are a number of delegated authority agreements with specific partners, each of which involve the delegation of specified aspects of policy administration. These include distribution contracts for protection policies with BGL Group Limited, Neilson Financial Services Limited and Nucleus Financial Group Limited, and Union Insurance Services. In the case of all delegated authority agreements, the actual processes delegated to the third party are tailored to reflect the specific partner's responsibilities (e.g. payment collection or the payment of claims). All such arrangements are subject to strict oversight through ongoing review against SF's outsourcing policies and responsibility for ensuring ongoing compliance sits with the appropriate SF governance committee.

Financial condition

- 5.44. I have considered both the Solvency II Pillar 1 and Pillar 2 financial positions in my assessment. However, as the Solvency II Pillar 2 disclosures are submitted privately to the PRA, I am unable to disclose details of the financial position on this basis. I have used the Solvency II Pillar 2 information in my assessment of the risk profile of SF, which is covered in paragraphs 5.88 to 5.92.
- 5.45. The Solvency II Pillar 1 balance sheet as at 31 December 2016 (the most recent date at which full audited liability valuation results are available) for SF is shown in Table 5.2 below.

Table 5.2 – Solvency II financial information as at 31 December 2016

SF Solvency II Pillar 1 balance sheet as at 31 December 2016						
£m	SF Main Fund	SLL	LANMAS	Rational Shelley	M&GM	Total
Assets	1,246.7	93.2	24.7	9.9	1,178.0	2,552.4
Technical provisions	1,127.4	77.8	22.2	9.5	1,030.4	2,267.2
Other liabilities	26.3	4.5	0.3	0.1	71.5	102.6
Adjustment for restricted Own Funds items due to ring-fencing	-0.0	-9.8	-2.2	-0.2	-7.7	-19.9
Solvency II Own Funds	93.0	1.2	0.0	0.1	68.4	162.7
SCR	12.2	1.2	0.0	0.1	68.4	81.8
SCR coverage ratio	763%	100%	100%	100%	100%	199%

Source: SF's Chief Actuary's Report

- 5.46. The row labelled "Adjustment for restricted Own Funds items due to ring-fencing" reflects the fact that the SLL, LANMAS, Rational Shelley and M&GM sub-funds are all treated as ring-fenced sub-funds and so any excess assets will ultimately be distributed to the sub-funds' policyholders. The excess capital in the sub-funds therefore does not contribute to the excess capital at the total SF level.
- 5.47. Due to the capital support arrangements that are in place, whereby the SF Main Fund and the notional sub-funds can effectively provide capital support to one another if required, it is appropriate to consider the SCR coverage for the total SF business.
- 5.48. As at 31 December 2016 the Solvency II Pillar 1 SCR coverage of the total business was 199%. SF targets a level of capital cover on Solvency II Pillar 2 basis, with a lower limit of 150% for the total business. I have also reviewed the pre-Scheme and pro-forma post-Scheme financial position of SF as at 31 December 2016 on a Solvency II Pillar 2 basis and the solvency cover significantly exceeded this internal target at 31 December 2016.
- 5.49. At the time of writing my report, SF does not utilise any of the long-term guarantee measures introduced in the Solvency II Directive such as the matching adjustment, the volatility adjustment or any transitional measures.

Governance and risk management

- 5.50. SF is structured such that its members elect Delegates who are responsible for representing the interests of all of the members on behalf of them to the Board of SF. Delegates are members that are elected in accordance to rules outlined in the Memorandum and Rules of SF. The powers and responsibilities of Delegates to represent the interests of the membership are also outlined in the Memorandum and Rules of SF.
- 5.51. The Board of SF manages the friendly society by authority of the Delegates in accordance with the provisions of the Friendly Society Act, its Memorandum and Rules and to any directions given by Special Resolution. This includes the power to accept a transfer of business from another friendly society or proprietary company.

- 5.52. It is a governance requirement of SF that, for the transfer of insurance business into or out of SF, the transfer must be approved by the Delegates on behalf of all SF members by way of a Special Resolution.
- 5.53. The Board of SF must contain between five and eleven members of SF. Subject to this requirement, the Board cannot include more than five individuals who are not Delegates.
- 5.54. The Board meets with Delegates annually at AGMs, where the Delegates should seek to put forward the views of the members that they represent. SGMs are convened by the Board whenever it thinks fit, or on the requisition of at least eight Delegates.
- 5.55. SF has committed to the principles of the Association of Financial Mutuals' annotated version of the Code to ensure best practice in corporate governance.
- 5.56. In order to manage and mitigate risk, SF has an internal control system that operates at several levels within the company:
- **Board level** – The overall responsibility for risk management and implementing strategic controls is with the Board of SF. It has delegated a number of responsibilities and powers to the CEO of SF (and by them onto other members of SF's staff) and to Board committees. The Board reviews the effectiveness of its financial, operational and compliance controls and risk management systems annually;
 - **Board committees** – Board committees such as a Risk Committee and Audit Committee have been established and appropriate powers have been given to them. The committees and control functions of SF are responsible for providing ongoing oversight and challenge of the risk exposures and internal control environment. In particular:
 - The Risk Committee provides focused support and advice on risk governance, assisting the Board in reviewing the internal control systems for managing all aspects of business risk; and
 - The Audit Committee is responsible for reviewing SF's internal control systems (including internal financial controls) and ensuring that they continue to be effective. It also advises the Risk Committee as appropriate of any concerns regarding the effectiveness of the current control framework;
 - **Executive Risk Committee ("ERC")** – SF has an ERC which is the primary forum for executive oversight and challenge of the risk and control environment across the business and is chaired by the Head of Risk at SF. All executives are responsible for the identification, assessment, management and control of risks in their respective areas, delegating such parts of this responsibility to appropriate managers or other individuals where practical. The executives are required to report on their respective area at the ERC on at least a quarterly basis;
 - **Business areas** – SF ensures that each operational area of the business are responsible for the identification and management of day-to-day risks and controls within their area; and
 - **Internal audit** – SF has an internal audit process which is responsible for delivering regular, risk-based audits covering all aspects of work undertaken by the business areas and Board committees.
- 5.57. SF uses the Standard Formula to calculate its SCR and expects to continue to use this going forward. Under Solvency II Pillar 2, insurers are required to make their own assessment of risk exposures. SF does this by maintaining a Risk Management Framework ("RMF") with the key objective of ensuring there is a sound and consistent basis for the identification, measurement, management, monitoring and reporting of their risk profile.
- 5.58. The RMF also sets out how risk management operates throughout the business and how the framework is linked to risk appetite, risk policies, business strategy, and to solvency and capital management.
- 5.59. The ORSA plays a central role in the RMF and is a key management tool used by senior management to inform decision making. SF presents a risk dashboard, informed by its ORSA, to the Risk Committee to highlight any significant movements in the risk profile of the business going forwards. The risk dashboard contains, for each risk category, key risk indicators and associated metrics that enable risk to be measured on an ongoing basis against agreed appetite.
- 5.60. The ORSA is submitted privately to the PRA and it is not appropriate for me to disclose the financial assessment in detail, but I have given careful consideration to the nature of the risks and their relative contribution to the risk profile of SF.

- 5.61. SF has a waiver granted by the FCA such that it is not currently required to have a GAA in place for any of the pension business that it has written.

Membership rights

- 5.62. Any person may become a member of SF by effecting a policy of assurance, a pension policy or a permanent health insurance policy in accordance with the prevailing contribution and benefit rates at the time of effecting the policy. All policyholders of SF are equal members of SF.
- 5.63. Rights for members are prescribed in the Memorandum and Rules of SF. These rights include (but are not limited to) the right to vote and to nominate or be elected as a Delegate in accordance with the Rules.
- 5.64. SF's Rules require the Board to appoint an actuary in accordance with the Rules. Upon winding up of SF, or upon being dissolved by consent, any surplus remaining will be divided among members in equitable shares as determined by the Board of SF on the advice of the actuary.

Reinsurance

- 5.65. SF actively uses reinsurance as a means to mitigate and manage risk within the business.
- 5.66. SF has in place several reinsurance treaties with a range of reinsurers. The reinsurance programs cover three main blocks of business:
- Protection business including term assurances, critical illness and accelerated critical illness – to cover the mortality and/or morbidity risk;
 - Flexible Income Annuity business – investment based reinsurance to facilitate external investment management of this unit-linked business; and
 - In-force annuities – to cover longevity risk which arises from annuitants living longer than expected.

Protection business including term assurance, critical illness and accelerated critical illness business

- 5.67. SF has reinsurance treaties in place that cover its protection business and retains only a small exposure to mortality risk which is consistent with its risk appetite. These treaties are with Munich Reinsurance Company (UK Life Branch), Swiss Re Europe S.A. (UK Branch), Hannover Life Reinsurance (UK) Limited, RGA International Reinsurance Company Limited (UK Branch), Pacific Life Re Limited and SCOR Global Life SE (UK Branch).
- 5.68. Furthermore, each term assurance product offered by SF contains limits on new business sales volumes. This is monitored on an ongoing basis which allows SF to control the upper exposure to any particular arrangement.
- 5.69. This approach has allowed SF to gain exposure to the term assurance market without significant exposure to mortality risk.

Flexible Income Annuity business

- 5.70. The Flexible Income Annuity book of business was acquired from M&GM in June 2015. The underlying assets have been reinsured to Retirement Advantage, which is the trading name of M&GM Advantage Life Limited, and there exist arrangements in place through a floating charge deed to ensure that the counterparty exposure is minimal. The Canada Life Group (U.K.) Limited acquired Retirement Advantage in January 2018.

In-force annuities

- 5.71. An in-force annuities book of business was acquired from M&GM in June 2015 and all policies were already in payment. M&GM had already set up three reinsurance arrangements with Hannover Re (UK Life Branch), Retirement Advantage and RGA International Reinsurance Company Limited (UK Branch) that meant that the annuity business was virtually all reinsured.
- 5.72. Whilst SF is exposed to the risk that one of these reinsurers may default, the risk is reduced by there being three different arrangements in place. In addition, collateral is held in respect of the reinsurance arrangements, which limits the amount of exposure should the reinsurer default.

Capital management

5.73. In September 2016 the Board of SF approved its Capital Management Risk Policy (“**CMRP**”) which aims to ensure that capital management risks to which SF is exposed are managed appropriately.

5.74. The CMRP contains a set of core requirements including:

- Ensuring that decisions taken by management are consistent with SF’s strategic objectives and risk appetite that are approved by the Risk Committee; and
- Ensuring that managers are accountable for the management of risk, including internal controls, in their area, and all SF employees must comply with the CMRP.

Furthermore, SF aims to hold sufficient capital to meet the PRA’s capital requirements in a number of asset and liability stress conditions. The Board’s appetite for asset and liability mismatch is set out in the company’s risk appetite framework and has been set at “Low” to reflect the strategic intent to retain prudent levels of capital beyond the regulatory requirement and to avoid the need to raise capital in the future.

5.75. SF has established minimum control standards and supporting practices and procedures that align with the agreed priorities of the business. The minimum control standards for capital management are set out in the CMRP to manage risks within the defined risk appetite statement and are as follows:

- Monthly calculation of solvency position, with results reported to the internal Risk Committee as part of the RMF and the Board;
- Daily monitoring of market movements to identify any significant changes that may impact their assets or liabilities; and
- Annually registering management actions that are taken in order to recover solvency position.

5.76. The CMRP does not provide the precise limits that would trigger a breach. However, I have been informed by the management of SF that the risk appetite for solvency management is a limit of 150% of capital cover, with a trigger point of 200% of capital cover at which SF would consider options to restore its solvency position, both on a Solvency II Pillar 2 basis calculated for the entire business of SF.

5.77. In addition to the overall capital management policy of SF as outlined above, SF aims to maintain assets to cover 100% of the notional Solvency II Pillar 1 SCR associated with the liabilities of each of the notional sub-funds, as well as further assets sufficient to provide an appropriate amount of working capital within the fund.

5.78. SF’s CMRP states that a register of such actions must be drafted, retained and reviewed annually by SF as a minimum control standard. The management actions that are available to the Board of SF in order to restore solvency in the event that the solvency position of the company falls beneath the trigger point of 200% of capital cover (on a Solvency II Pillar 2 basis) are outlined within SF’s recovery plan. This document is prepared by the Chief Actuary of SF and requires Board approval. The Chief Actuary uses the following criteria for selecting appropriate management actions for the Board to consider: whether it is effective in managing solvency, whether it is fair to policyholders, whether it is economically viable and finally whether it is legally viable. Based on the recovery plan as at 31 March 2017, the management actions available to SF in order to restore solvency in the short-term include, but are not limited to:

- De-risking its investments (e.g. selling equities, property or corporate bonds for cash and gilts);
- Reducing bonuses payable to with-profits policyholders;
- Improving the matching of assets to liabilities for its non-profit business;
- Reducing costs of running the business;
- Selling a subsidiary or block of non-profit business; and
- Closing to new business on less profitable or less capital efficient new business channels.

5.79. The Previous Schemes of each of the notional sub-fund provide that each can borrow from or lend capital to the SF Main Fund should that be required. Within my report these are referred to as the “**capital support arrangements**”. The capital support arrangements are set up such that any of the notional sub-funds can provide

capital to or be provided with capital from the SF Main Fund, either on a temporary or a permanent basis. To date, SF has not used this functionality for any of the notional sub-funds.

- 5.80. The capital management policy for the with-profits funds is discussed in further detail in paragraphs 5.81 to 5.87.

With-profits and capital management

- 5.81. SF manages the five with-profits funds (including the notional sub-funds) with the objective of meeting policyholders' reasonable expectations and equitably distributing the estate, while ensuring as far as possible that each fund can meet its regulatory solvency requirements without shareholder support.
- 5.82. SF provides commentary on the target ranges for the size of the estate within the PPFM of each with-profits fund where relevant, and each fund has its own run-off plan:
- **SF Main Fund** – The target range for the estate is between 5% and 25% of the total of the realistic reserving requirements of the relevant business;
 - **SLL** – No target range for the size of the estate. Following the SLL sub-fund's closure to new business in May 2002, the SLL sub-fund's estate is being distributed to SLL with-profits policyholders in a manner that is fair having regard to different classes, generations and country of origin of the business;
 - **LANMAS** – No target range has been set for the estate of the LANMAS sub-fund; rather it will be distributed by means of an enhancement to asset shares until it is determined that the LANMAS sub-fund is to be wound up;
 - **Rational Shelley** – No target range has been set for the estate of the Rational Shelley sub-fund; rather it is to be distributed by means of the smoothing process as described in the PPFM; and
 - **M&GM** – There is no explicit preferred size or target range for the estate. Instead, the PPFM states that the preferred size of the estate is the level required to meet the objectives for the management of the estate for this fund, namely meeting the Solvency II Pillar 1 technical provisions and capital requirements of the fund, allowing the fund greater investment freedom, providing working capital for the fund, supporting smoothing of benefit payments, meeting exceptional one-off costs in the managing of the business and providing additional security for policyholder benefits.
- 5.83. In the case of the SF Main Fund, if the estate falls below the minimum level, SF will initiate management actions to restrict the investment policy of the fund, the smoothing of benefits to existing policyholders and/or the level of new business being written in the funds.
- 5.84. The bonuses on with-profits policies, investment policy and amounts credited to and debited from each of the with-profits funds are determined in line with the fund's published PPFM.
- 5.85. The Board of SF is responsible for overseeing the management of with-profits business written within the SF Main Fund and all notional sub-funds. The Board is advised by an external WPA who provides oversight of the with-profits funds and advises the Board of SF on decisions affecting the fund. The role of the WPA is to assess how the with-profits funds have been run and to monitor compliance with its PPFM and to report annually to policyholders on this.
- 5.86. The Board has also appointed an external Independent Person to review PPFM compliance and the governance arrangements in place to achieve it.
- 5.87. The non-profit business within the various with-profits funds are not entitled to share in any profits arising in the fund.

Risk profile

- 5.88. SF's risk profile is a mix of market, credit, insurance and business risk. As at 31 December 2016 the Solvency II Pillar 1 risk profile of SF as defined by contribution to the SCR was as follows:

Table 5.3 – SF's Solvency II SCR as at 31 December 2016

Risk sub-module	£m
Market risk	65.9
Counterparty risk	11.6
Life underwriting risk	10.3
<i>Diversification</i>	<i>-14.6</i>
Operational risk	7.8
<i>Loss absorbing capacity of technical provisions</i>	<i>-4.5</i>
<i>Adjustment due to ring-fenced funds</i>	<i>5.2</i>
Total SCR	81.8

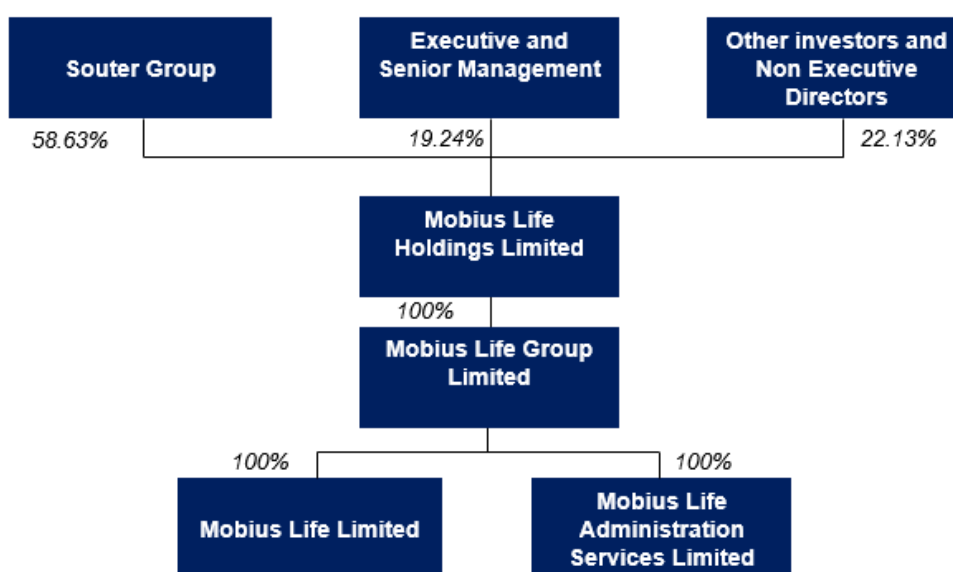
Source: SF's 2017 Solvency and Financial Condition Report ("SFCR")

- 5.89. The largest risk exposure is to market risk, particular in the M&GM notional sub-fund, arising in relation to equity risk and interest rate risk. Significant exposures to equity risk are driven by the investment in equities in respect of the with-profits asset shares and the cost of guarantees for that business in the event of a fall in market values.
- 5.90. The dominant risks for SF as a whole are the market risks of equity risk and interest rate risk, counterparty risk and operational risk with pre-diversification capital allocation being around £49 million, £15 million, £12 million and £8 million for each of these risks, respectively.
- 5.91. The primary driver of counterparty risk refers to the risks that reinsurers or banks are unable to satisfy their obligations resulting in financial loss to SF. In order to mitigate this risk, SF seeks out only high quality counterparties and to avoid concentration risk, whereby SF has high exposure to a small number of counterparties, they use a variety of banks and reinsurers to diversify the risks.
- 5.92. Operational risk arises due to the failure of internal people, processes or system, or by external events. For SF operational risk includes the risk of fraud, failure of financial management, failure of human resources, failure of internal processes and the risk of regulatory or legal change that damages SF's business model.

6. BACKGROUND ON MOBIUS LIFE LIMITED

Background

- 6.1. Mobius Life Limited ("**Mobius**") was established as a proprietary company in February 2014, and is the principal operating subsidiary of the Mobius Life Group Limited ("**MLG**") which in turn is wholly owned by the holding company Mobius Life Holdings Limited ("**MLHL**").
- 6.2. Mobius Life Limited was founded and incorporated in 1995. It was formerly known as Hackremco (No. 1076) Limited (until December 1995), Liberty International Pensions Services Limited (until May 1996), Liberty International Pensions Limited (until July 2000), Schroder Pensions Limited (until February 2003) and Investment Solutions Limited (until February 2014).
- 6.3. As at 31 March 2017 the ultimate controlling party of MLHL was the Trustees of the Souter 2011 Family Trust ("**Souter Group**"), with minority shares owned by the executive and senior management team and other investors and non-executive directors in the proportions shown in the MLHL operational structure chart below:



Source: Mobius's 2017 SFCR

- 6.4. Mobius has permission to effect and carry out insurance business of Classes I, III and VII³, as set out in Part II of Schedule 1 to the Financial Services and Markets Act 2000 (Regulated Activities) Order 2001. All business that is being transferred is linked long-term business and thus falls within Class III.

Products

- 6.5. Mobius is a life insurance company that writes solely unit-linked insurance business in the UK within the following lines of business:
- **Institutional pensions:** allowing pension fund trustees to manage their funds flexibly within TIP policies. These are offered by Mobius both with and without member administration services. Those that are without member administration services are investment-only policies where Mobius, or a third party contracted by Mobius, do not perform member administration; and

³ Classification of long-term insurance business: I – life and annuity, II – marriage and birth, III – linked long-term, IV – permanent health, VI – capital redemption contracts and VII – pension fund management.

- **Individual personal pension, group personal pension and group stakeholder pension business:** allowing employers to use the services of Mobius to provide defined contribution pension arrangements that also comply with auto-enrolment, for their employees. Mobius provide the investment administration services, offering a choice of investment funds that the policyholders can choose to invest in. Mobius offers pension saving to retirement and although a number of policies contain a clause that allows the holder to request an annuity they currently have no post-retirement policies.

6.6. Table 6.1 shows the composition of Mobius's in-force business by broad product category as at 31 March 2017:

Table 6.1 – Mobius business at 31 March 2017

Product type	Number of policies	Number of members	Assets under management (£000s)
Transferring Business			
Group stakeholder pension	18	6,417	136,901
Group personal pension	48	6,160	204,981
Individual personal pension	20	20	559
Trustee investment plans (with member administration services)	5	713	11,153
Total Transferring Business	91	13,310	353,594
Non-Transferring Business			
Trustee investment plans (without member administration services)	386	N/A	9,029,644
Total	477	13,310	9,383,238

Source: Mobius's Chief Actuary's Report

- 6.7. Mobius's core business is the operation of the institutional pension platform which accounts for around 96% of assets under management, and its current marketing, sales efforts and strategy for future growth is focused on providing only TIPs without administration services.
- 6.8. New members can continue to join existing group stakeholder and group personal pension plans, and new group schemes can be established despite the fact they are not actively marketed. No new individual personal pension contracts are written and this line of business is treated by Mobius as a closed book.
- 6.9. All policyholder benefits are linked to the value of assets held by Mobius in internal unit-linked funds. Mobius's unit-linked funds are predominantly invested in third party Collective Investment Schemes ("CISs") or the internal linked funds of other UK insurers. The latter is provided by means of reinsurance contracts between Mobius and the third party insurers that act solely as an investment vehicle.
- 6.10. Policyholders are charged fees based on the value of funds under management, either by way of annual management charges incorporated within the linked fund unit pricing or by way of an explicit charge payable periodically.
- 6.11. All TIPs provided by Mobius can be terminated by Mobius subject to a three month notice period. This is a market-standard clause for TIPs where the policyholders are institutional investors. All other business cannot be terminated unilaterally by Mobius.
- 6.12. A number of Mobius policies contain a clause that allows the holder to request an annuity. There are no specified terms within the clause and as such the annuity would be priced upon request. To date, no policyholders have requested to take advantage of this option.
- 6.13. For all of Mobius's in-force policies, there are no guaranteed benefits, such as life cover, and no investment guarantees, for example, implied or explicit minimum investment returns on policies or guaranteed annuity options that could be provided by Mobius on vesting.

Administration

- 6.14. The Transferring Business is currently administered by an external third party, Aegon, and it has been responsible for the member administration since August 2016.
- 6.15. Prior to this date, the administration was provided by BlackRock Investment Management (UK) Limited ("**BlackRock**") with an agreement for administration services dated 5 May 2010. This was transferred to Aegon when it acquired BlackRock's UK Defined Contribution platform and administration business in 2016.
- 6.16. The services provided by Aegon include the following:
- **New and potential new business** – Completion and sign off of all invitations to tender and questionnaires, attending new business pitches and allowing site visits from potential customers;
 - **New financial products and services** – Providing costings and implementation for adding new products to the administration systems;
 - **Implementation services** – Providing documentation to customers, being the contact point for the employer and employees, providing application packs to potential new members of schemes and dealing with enquiries;
 - **Changes to scheme design** – Providing costings and implementation for changes to the administration systems and general services provided following changes to the design of existing schemes; and
 - **General administration services** – A range of services are provided with respect to new members, contracted out members, ongoing member administration services, dealing with complaints from members and transfers out and in to schemes. It provides services with respect to early leavers, retirements, deaths, fund redirection and fund switching and along with providing illustrations and benefit statements to members.
- 6.17. In addition, a range of services directly in relation to auto-enrolment are provided, including:
- **Record keeping** – Maintenance of auto-enrolment records in accordance with applicable Pensions Act 2008 requirements and The Pension Regulator's ("**TPR**") guidelines;
 - **Contact centre** – a dedicated auto-enrolment contact centre for "Opt outs", "Opt ins" and employees wishing to join a scheme;
 - **Auto-enrolment specific communications** – producing and delivering auto-enrolment specific communications to policyholders after the date from which the employer is obliged to apply the applicable auto-enrolment requirements to its eligible workers; and
 - **Auto-enrolment services** – providing services and assistance for the provision of certain auto-enrolment services on behalf of Mobius.
- 6.18. The non-transferring business does not have member administration carried out by either Mobius or any third party contracted to Mobius.

Financial condition

- 6.19. I have considered both the Solvency II Pillar 1 and Pillar 2 financial positions of Mobius in my assessment. I am unable to disclose details of the Pillar 2 financial position, as this is submitted privately to the PRA, but have used this information in my assessment of the risk profile of Mobius, which is covered in paragraphs 6.57 to 6.70.
- 6.20. The Solvency II Pillar 1 balance sheet as at 31 March 2017 (the most recent date at which full audited liability valuation results are available) for Mobius is shown in Table 6.2 below.

Table 6.2 – Solvency II financial information as at 31 March 2017

Mobius Solvency II Pillar 1 balance sheet as at 31 March 2017	
	£m
Assets	9,397.6
Technical provisions	9,377.3
Non-insurance liabilities	8.6
Solvency II Own Funds	11.7
SCR	9.7
Excess capital	2.0
SCR coverage ratio	120%

Source: Mobius's Chief Actuary's Report

- 6.21. The SCR coverage for Mobius as at 31 March 2017 was 120% (31 March 2016: 131%). Mobius targets a Pillar 1 solvency coverage ratio of around 120% of solvency margin. Mobius was on target for the period ending 31 March 2017 with a small excess of own funds above their limit (the unrounded figure being 120.1%).
- 6.22. As at 31 March 2017, the SCR coverage of Mobius was lower than that reported at 31 March 2016, primarily as a result of its exposure to reinsurance counterparties. The SCR calculated on a Pillar 1 basis using the Standard Formula requires capital to be held against reinsurance counterparties where Mobius is at risk if the reinsurer defaults. As described in paragraphs 6.44 and 6.45, Mobius is at risk if the reinsurer defaults for all Credit Neutral Policyholders.
- 6.23. The amount of capital to hold is dependent on the credit rating of the counterparty, or, if no ratings exists, the published SCR coverage of the reinsurer. As at 31 March 2016, Mobius had calculated their SCR assuming that all material counterparties were capitalised such that they would have been treated as having an "AA" credit rating. However, following the publication of companies' SFCRs in 2017, the SCR coverage ratio of one of Mobius's counterparties had reduced to 122%, consistent with a "BBB" rating. This resulted in a significantly higher capital requirement for this counterparty, raising the overall SCR and reducing the SCR coverage ratio.
- 6.24. The risk margin component of Mobius's 31 March 2017 technical provisions, assumes that a management action will have been carried out by 31 March 2018 to eliminate the exposure to counterparty default risk. The management action would have been to disinvest assets that, at 31 March 2017, were invested in the unit-linked funds of other insurers and invest them in CISs within one year.
- 6.25. This management action has been replaced by the proposed transfer of business to SF, which has an expected Transfer Date of 31 October 2018. The management action will therefore be implemented six months later than planned and as such the risk margin in the financial information as at 31 March 2017 presented in Table 5.5 above is marginally understated compared to the position if the management action were not allowed for.
- 6.26. However, any pre-Scheme financial position presented in my report should be representative of the position immediately preceding the Transfer Date of the Scheme, and so should allow for any material changes since 31 March 2017. At the Transfer Date, the transfer of business will be imminent and as such the assumption that the exposure to counterparty default risk will be eliminated within a one year timeframe will hold, consistent with the assumptions used to calculate the risk margin in the balance sheet as at 31 March 2017.
- 6.27. As such, I believe it is reasonable to use the Solvency II Pillar 1 balance sheet presented in the SFCR and Mobius's Chief Actuary's report without revision as the Mobius pre-Scheme financial position, as this is representative of the position immediately preceding the Transfer Date of the Scheme.

Governance and risk management

- 6.28. In order to manage and mitigate risk, Mobius has an internal control system that operates at several levels within the company:

- **Board level** – Responsible for implementing strategic controls and do this through quarterly meetings to assess both the performance, risk and compliance of the business by both executive and non-executive directors;
- **Sub-committees** – Mobius has an ARC, Investment Committee, and Remuneration Committee all of whom provide the Board with support to identify risks and to monitor and develop the internal control environment of the company; and
- **Business areas** – Mobius ensures that each area of the business is responsible for the day-to-day controls being conducted. Business areas do this by providing adequate training to their staff, through risk identification and by ensuring the implementation and ongoing monitoring of appropriate controls.

- 6.29. The Board has established a risk management framework which is intended to identify, measure, manage, mitigate and report the risks and to help support and provide inputs to the ORSA. The ORSA process at Mobius brings together the risk management, and business and capital planning processes. As part of this, stress and scenario tests (including forward looking projections and reverse stress tests) are performed annually, which assist management with the understanding of the business model and its risks. Mobius also produce an annual ORSA report that is presented to the Board.
- 6.30. The Board supports the ORSA process by defining the risk appetite for the firm at the business segment level for all key risks, in particular:
- **Counterparty** – Limited appetite for credit and counterparty risk;
 - **Operational** – Whilst this is an accepted risk, internal controls are implemented in order to minimise this risk; and
 - **Market** – Limited appetite for direct market risk.
- 6.31. The Board is also responsible for ensuring that ownership of the management of each risk type is clear and has set internal monitoring thresholds or performance indicators on the key risks of the business within the risk appetite. The thresholds are monitored on an ongoing basis and are reviewed at quarterly meetings of the Board and the ARC.
- 6.32. The ARC is responsible for monitoring and supervising the effective functioning of the business, providing an objective review of the operational effectiveness of the firm's internal systems and reporting. It must provide adequate challenge to management and assess the appropriateness of the control procedures in place to mitigate risks.
- 6.33. Mobius has a CRO who monitors the risks of the business and reports activity to the ARC and the Board. The CRO assigns responsibility for each risk to an owner in the correct business area to ensure efficient control over the risk.
- 6.34. The ARC is responsible for monitoring the adequacy of risk management applied to Mobius and in particular the adequacy of management's response to key risks and ensuring that the risk management process is aligned to Solvency II requirements.
- 6.35. Mobius assesses its underlying risk profile, its comfort with the risks taken and whether those are within the risk appetite on a continuous basis. Key risks and mitigating actions and controls in place to manage the identified risks are detailed a risk register, which is maintained by senior management and the ARC, and is reviewed quarterly by the CRO.
- 6.36. The risk appetite is summarised in a dashboard for regular management review, alongside other risk management information including updates on any risk items that have previously been as significant, emerging risks and horizon risks.
- 6.37. Mobius calculates the overall gross risk assessment based on impact and probability measures that are agreed on by the ARC. Mitigating controls and the owner of the risk are documented, alongside any actions that are in place to address the risk.

Governance Advisory Arrangement

- 6.38. Mobius has a GAA in place which has an oversight role over all group personal and stakeholder pension plans where such plans have two or more employees of the same employer. Their scope includes all of the group personal pension plans and group stakeholder pension plans of the Transferring Business.
- 6.39. The aims, objectives and structure of the GAA is outlined in its Terms of Reference.
- 6.40. The responsibility of the GAA is to represent the interests of the members of the relevant schemes, to review the quality of these schemes and to assess and ensure that the contracts provide value for money for policyholders.
- 6.41. In particular, the GAA must ensure compliance with law and regulations, ensure charge caps meet regulatory requirements, review auto-enrolment implementation and assess communications to members. The GAA must publish its findings annually.
- 6.42. The GAA meets at least four times a year and comprises of five representatives, three of whom are external and thus independent of Mobius and two representatives of Mobius. The GAA is chaired by an independent representative.

Reinsurance

- 6.43. Mobius uses investment only unit-linked reinsurance arrangements to allow policyholders access to the internal linked funds of third party insurers. Mobius does not separate out the reinsurance arrangements between its different product lines, for example, their reinsurance arrangement with L&GPML covers individual personal pensions, group personal pensions, group stakeholder pensions and TIPs where the policyholder has chosen to be invested in L&GPML funds.
- 6.44. Under Section 21 of the FCA's COBS, Mobius must meet its obligations to policyholders in full upon the default of a reinsurer, unless the risk of reinsurer default is clearly outlined and documented in policyholder literature as being borne by the policyholder.
- 6.45. All plans issued under group policies where the member joined the scheme after 7 April 2010, and all TIP policyholders have this wording in their policyholder literature and as such bear the risk of reinsurer default themselves. For the Transferring Business, as at 31 March 2017, this applies to 4,455 of the 13,310 transferring members/policyholders.
- 6.46. Following the issue of the Insurers (Reorganisation and Winding Up) Regulations 2003, Mobius entered into charge agreements with all reinsurers whereby a floating charge is made on the reinsurer which crystallises in the event of the reinsurer insolvency. This floating charge ensures that Mobius ranks equally with the reinsurer's own direct policyholders upon the reinsurer's insolvency.
- 6.47. In the case of insolvency of a reinsurer, eligible policyholders could potentially recover any loss or deficit as a result of the reinsurer default from the Financial Services Compensation Scheme ("FSCS"). However, despite the floating charge arrangements between Mobius and its reinsurance counterparties, the reinsurer's own direct policyholders would be eligible for compensation from the FSCS, whereas not all of Mobius's policyholders would benefit from the extra protection offered by the FSCS. In these cases, if policyholders feel disadvantaged by reason of accessing a certain fund through Mobius rather than accessing the fund directly, they may take legal action against Mobius. I am unable to comment upon the likely success or otherwise of any such action.
- 6.48. Mobius is at risk if the reinsurer defaults for all individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010, as their policy terms and conditions do not explicitly pass the risk of a reinsurer defaulting on to the policyholder. For the Transferring Business, as at 31 March 2017, this applies to approximately 8,855 of the 13,310 transferring members/policyholders.
- 6.49. Mobius has not written any business with traditional life insurance risks such as mortality or morbidity and as such there exists no reinsurance in relation to such risks.

Capital management

- 6.50. The Board of Mobius has a capital management policy in place which has an objective of ensuring that capital within Mobius is managed appropriately and meets the Solvency II requirements.

- 6.51. The Board and senior management of Mobius have set internal monitoring targets for the amount of required capital that the company must hold in order for them to operate. The required capital targets reflect the key risks that Mobius face. These thresholds are monitored on an ongoing basis and are reviewed formally at monthly and quarterly meetings that are held by the Board and the ARC.
- 6.52. Mobius uses both a Pillar 1 and Pillar 2 Solvency II basis for assessing capital adequacy with separate targets for each:
- Pillar 1 – Target of around 120% solvency margin; aiming to demonstrate capital adequacy over a one year timeframe to a 99.5% confidence level using Standard Formula stresses; and
 - Pillar 2 – Target of 140% solvency margin; aiming to demonstrate capital adequacy over a one year timeframe to a 99.5% confidence level using stresses that reflect the nature and extent of risks that have been accepted by Mobius.
- 6.53. Mobius's capital management includes capital planning and the annual production of a documented capital plan (the "**Capital Plan**") that is approved and signed off by the Board. The Capital Plan is a forward looking assessment of the business' capital position against projected capital requirements. It is updated annually following the business planning process and the related Solvency II Pillar 1 and 2 calculations, or when an event materially impacts the capital position of the company.
- 6.54. In the event that the capital adequacy targets are not met, or the indication that this is likely to occur in the Capital Plan, a new issuance of capital may be required to raise the level of capital held by Mobius above the target thresholds. Any new issuance of capital would need to be of the highest quality as set out in the Solvency II regulations and would require Board sign off. In addition, management actions may also be undertaken to restore solvency above the target threshold.
- 6.55. Dividend payments are only declared following a significant update to the Capital Plan and following discussion with the PRA. The company may distribute by way of dividend the full amount of distributable profits disclosed in the audited accounts each year, or another amount provided that following such dividend payment, the company will continue to hold a level of cover that is above the appropriate regulatory requirement or the capital adequacy thresholds.
- 6.56. Any changes to Mobius's capital management policy needs to be approved by both the ARC and the Board of Mobius.

Risk profile

- 6.57. Mobius's main risks arise from its:
- Assets under management: market and credit risk;
 - Policy charges and expense mismatching: lapse risk and expense risk;
 - Current policyholders transferring their business out of Mobius: lapse risk;
 - Reinsurance and bank counterparties: counterparty default risk; and
 - Investment operations, outsourcing arrangements, IT and infrastructure causing operational risk.
- 6.58. As at 31 March 2017 the Solvency II Pillar 1 risk profile of Mobius as defined by contribution to the SCR was as shown in Table 6.3 below.

Table 6.3 – Mobius’s Solvency II SCR as at 31 March 2017

Risk sub-module	£m
Market risk	4.0
Counterparty risk	6.1
Life underwriting risk	4.2
<i>Diversification</i>	<i>-4.1</i>
Operational risk	0.9
<i>Loss absorbing capacity of deferred tax</i>	<i>-1.3</i>
Total SCR	9.7

Source: Mobius’s 2017 SFCR

- 6.59. Since Mobius’s TIP policies can be terminated unilaterally by Mobius at any time, subject to a three month notice period, almost all market and life underwriting risk arises from their personal and stakeholder business that form the majority of the Transferring Business.
- 6.60. Mobius only writes unit-linked insurance business and as such it does not face the risk of a loss due to the mismatching of assets and liabilities in the event of market movements, as this would be passed on directly to the policyholder through a reduction in the value of their units. However, charges to policyholders are based on a percentage of assets under management, and as such, a general fall in market values will reduce the value of assets under management and in turn revenue.
- 6.61. In addition, in order to seek enhanced investment returns for its shareholders and to reduce their credit risk exposure to banking institutions, Mobius has invested surplus assets in a small number of CISs. As at 31 March 2017, Mobius has around £6 million invested in such schemes and consequently, Mobius is exposed to market risk in relation to these investments.
- 6.62. The life underwriting risks that Mobius is exposed to are lapse and expense risk. It faces lapse risk in respect of both:
- Active lapses – whereby actively contributing members of pension schemes stop contributing to their scheme. In this case their assets remain with Mobius but there will be no future growth of assets under management due to contributions and subsequently revenue through charges; and
 - Transfers – whereby members, or an entire policy with an employer including multiple members, transfer their pension assets from Mobius to another arrangement. Within the Transferring Business, there currently is a concentration of assets across a small number of employers and there is a risk to profits if those employers transferred their assets to another provider.
- 6.63. Lapses will result in a loss of assets under management and therefore future income from charges. In particular, Mobius is exposed to lapses early on in the lifetime of a unit-linked policy, since there may have been insufficient income from charges to recover the initial expenses incurred in selling and setting up the policy.
- 6.64. Mobius faces the risk of expense overrun; if there is lower than expected new business levels or reductions in business revenues (either through reduced income from charges or higher lapses than expected), expenses incurred in the running of the business may exceed income from charges. There is also the risk of one-off or exceptional costs, potentially arising due to an operational risk event or due to legal fees, which could cause the revenue from charges to be insufficient to cover the expenses.
- 6.65. In order to mitigate this risk, on a monthly basis, senior management monitor the actual business performance (revenues from charges against expenses paid) against the expected performance that was forecasted in business planning, taking corrective action if necessary by reducing variable costs and discretionary expenditure.
- 6.66. In addition, Mobius has certain contractual rights that help protect itself against the risk of expense overrun. Firstly, charges on most policies could be increased subject to a period of notice and any regulatory restrictions. Secondly, Mobius has the ability to terminate TIP policies provided they give three months’ notice.
- 6.67. Exposure to the risk of default from assets that are invested and held with third party CISs and third party insurers’ funds is borne, in general, by policyholders. Any reduction in capital value flows through to the policyholders and

Mobius has entered into floating charge agreements with reinsurers to ensure that the reinsurance policy ranks equally to the reinsurer's direct policyholders in the event of wind-up.

- 6.68. As described in paragraphs 6.44 to 6.48, the exception to this are all individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010, whereby Mobius is exposed to the risk of counterparty default. In addition, Mobius faces the risk of legal action being taken against them in the event of a default from one of the third parties. The majority of the counterparty default risk capital held by Mobius as at the 31 March 2017 was in relation to the Transferring Business.
- 6.69. Despite the fact that the majority of counterparty default risk sits predominantly with policyholders, Mobius monitors the credit ratings and solvency of all reinsurance counterparties to ensure they are not exposed to undue counterparty risk.
- 6.70. Other risks to which Mobius is exposed include:
- Liquidity risk – if Mobius cannot realise investments and other assets to pay its obligations (operational cash flows and policyholder benefits) as they fall due; and
 - Operational risk – arising from errors in manager trading, unit pricing or cash settlement errors resulting in financial loss. Many of these could result in client complaints and reputational damage.

7. THE PROPOSED SCHEME

The motivation for the Scheme

- 7.1. Mobius is an institutional investment life company and its focus and its future strategy is to develop its business for providing institutional services to corporate pension schemes in the UK, rather than focusing on individual policyholders, retail policyholders or pension services such as those that constitute the Transferring Business. The Transferring Business is not actively marketed and there is no new business pipeline in terms of new employers.
- 7.2. The current employers use the Transferring Business as their defined contribution pension offering and new members join the scheme as the employer hires new staff.
- 7.3. SF has a three-branch growth strategy of organic growth, business process outsourcing, and mergers and acquisitions. The aims of its mergers and acquisitions growth are to gain additional economies of scale (by increasing the number of policies and assets under management) and to develop a diversified income stream by moving into business lines within which SF is not currently well established.
- 7.4. As such, the proposed Scheme is in line with SF's current focus and overall future strategy: it has a retail focus and future strategy that aims to diversify its product offering, identifying group personal and stakeholder pension business as an area of growth.
- 7.5. Furthermore, benefits under the policies that make up the Transferring Business are linked to the value of assets held by Mobius in internal linked funds. Most of Mobius's internal linked funds invest in third party funds, including CISs, such as Authorised Unit Trusts and Open Ended Investment Companies, and the internal linked funds of other third party insurance companies. To facilitate access to the internal linked funds offered by other insurance companies, reinsurance contracts are used as discussed in paragraph 6.43.
- 7.6. Under Section 21 of the FCA's COBS, Mobius must meet its obligations to policyholders in full upon the default of a reinsurer, unless the risk of reinsurer default is clearly outlined and documented in policyholder literature as being borne by the policyholder. All holders of plans issued under group policies where the member joined the scheme after 7 April 2010, and all TIP policyholders have this in their policyholder literature and as such bear the risk of reinsurer default themselves. For the Transferring Business, as at 31 March 2017, this applies to approximately 4,455 of the 13,310 transferring members/policyholders. Mobius is at risk if the reinsurer defaults for all individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010. For the Transferring Business, as at 31 March 2017, this applies to approximately 8,855 of the 13,310 transferring members/policyholders.
- 7.7. Consequently, Mobius must hold a sufficient level of capital to cover the risk of the reinsurers defaulting in relation to these policies. The amount of capital Mobius is required to hold depends on the credit rating of each reinsurer as this is a key indicator of the likelihood of the reinsurer defaulting. In the absence of the credit rating the solvency ratio is used. As such, Mobius is exposed to the risk of a deterioration in the credit rating or solvency ratio of one or more of the reinsurance counterparties. Following the transfer to SF, the reinsurance counterparty risk in respect of the Transferring Business will be removed for Mobius.

Summary of the Scheme

- 7.8. The Scheme is expected to be presented to the Court for a Directions Hearing on 25 July 2018 and for a Sanctions Hearing on 29 October 2018. If approved by the Court then it will be implemented with a scheduled Transfer Date of 31 October 2018.
- 7.9. Subject to the approval of the Scheme by the Court, certain unit-linked business of Mobius will transfer to SF on the Transfer Date. The Transferring Business is all of the unit-linked group stakeholder and group personal pension business, all of the unit-linked individual personal pension business, and all of the unit-linked TIPs which have member administration services of Mobius.
- 7.10. The Scheme does not transfer the current investment reinsurance arrangements in relation to the Transferring Business to which Mobius is the reinsured party to SF. Consequently, SF and Mobius will enter into a reinsurance agreement to cover those liabilities under the Transferring Business to which reinsurance contracts have been retained.
- 7.11. Further information on is provided within paragraphs 7.26 to 7.38.

Transferring assets and liabilities

- 7.12. The number of unit-linked policies to be transferred is approximately 91 (in respect of around 13,310 policyholders/members), constituting around £340 million of Solvency II technical provisions (as at 31 December 2016). All of the transferring policies and technical provisions will be transferred into the SF Main Fund, and so the transfer does not directly impact any of the SF notional sub-funds.
- 7.13. The Transferring Business consists of the following unit-linked contracts written by Mobius:
- Group stakeholder pension plans;
 - Individual and group personal pension plans; and
 - Trustee investment plans with member administration services.
- 7.14. The policy benefits of the Transferring Business and hence the value of the unit-linked liabilities, are linked to the value of assets held by Mobius in internal linked funds.
- 7.15. The majority of Mobius's internal linked funds invest in third party CISs and third party insurers' funds, and as such the assets backing the unit-linked liabilities of the Transferring Business are currently held by those third parties. In particular, where the assets have been invested in the internal linked funds offered by other insurance companies, the assets backing the unit-linked liabilities are currently held by the third party insurer and reinsured by Mobius. However, they are held on Mobius's Solvency II Pillar 1 balance sheet as assets held to cover linked liabilities, rather than as a reinsurance asset.
- 7.16. On and with effect from the Transfer Date, the value of the assets backing the unit-linked liabilities of the Transferring Business will be transferred to the SF Main Fund. If the transfer had occurred on 31 December 2016, the value of the transferring assets would have been £344 million.
- 7.17. Following the Transfer Date, all assets and any associated liabilities in relation to the Transferring Business comprised in each of Mobius's internal linked funds will be allocated to and become comprised in a corresponding linked fund of SF within the SF Main Fund, collectively the SF-Mobius Linked Funds. There will be no impact on the number or value of units and they will be consistent with the number and value when they were invested in the relevant Mobius linked funds immediately prior to the Transfer Date.
- 7.18. The policyholder benefits and thus the unit-linked liabilities under all transferring policies will become linked to a SF-Mobius Linked Fund that directly corresponds to the Mobius linked fund that it was invested in prior to the Transfer Date.
- 7.19. To ensure that the investment links on the unit-linked business immediately following the transfer are consistent to those before the transfer, the Scheme is conditional on SF entering into an investment-only reinsurance contract with Mobius: the SF-Mobius Reinsurance Arrangement. This mechanism allows SF to invest all of the transferring assets within the SF-Mobius Linked Funds back into the funds that they were in within Mobius, allowing Mobius to continue to manage the investment of the assets in a way that is consistent with before the transfer (i.e. investing in third party funds).
- 7.20. This is consistent with the mechanism that Mobius is currently using to invest in the funds of third party insurers, as discussed within paragraph 6.43.
- 7.21. Following the transfer, all rights, benefits, powers and claims for the assets of Mobius relating to the Transferring Business, including against a third party, will transfer from Mobius to SF. However, the assets themselves remain invested in the third party funds.
- 7.22. All liabilities, duties and obligations of Mobius relating to the Transferring Business, excluding the **"Excluded Policies"**, are to be transferred to SF on the Transfer Date.
- 7.23. Excluded Policies comprise of those policies in the Transferring Business under which any liability remains unsatisfied or outstanding at the Transfer Date for reasons such as:

For the purpose of paragraph 1(3) of Schedule 12 to FSMA, an EEA State other than the UK is the state of the commitment for the policy. The appropriate regulator has not, prior to the making of the Order by which the Court sanctions this Scheme, provided the certificate referred to in paragraph 4 of Schedule 12 to FSMA with respect to the relevant EEA State which is the state of the commitment;

- The Court determines the policy will not be transferred at the Transfer Date; and
- The policy cannot be transferred pursuant to FSMA on the Transfer Date.

- 7.24. The Scheme also contains provisions for the possibility of some liabilities and assets being transferred after the Transfer Date for technical reasons. These provisions are included within the Scheme as a safeguard and it is expected that there will be no assets or liabilities being transferred after the Transfer Date. To the extent that there are such delays in completing the transfer, I am satisfied that such delays will not adversely affect policyholders' interests, and have not considered them further in this report.
- 7.25. In addition, an amount of assets equal to the purchase consideration for the Transferring Business will be transferred from SF to Mobius on the Transfer Date. This amount will be adjusted to take into account any change in the value of the assets backing the unit-linked liabilities and the average age of the policyholders of the Transferring Business, that has occurred between the date in which the purchase consideration amount was calculated and the Transfer.

Reinsurance

- 7.26. The Scheme does not transfer the current investment-based reinsurance arrangements between Mobius and third party insurers in relation to the Transferring Business, to SF. Mobius has negotiated fee rates with these third party insurers that both Mobius and SF believe to be competitive and in addition, are retaining responsibility for the investment administration for the transferring business after the Transfer Date. As such, it is intended that the existing investment reinsurance arrangements that Mobius has should stay in place and will not be altered in any way as a result of the transfer.
- 7.27. The sole exception to this is the current investment reinsurance arrangement between Mobius and L&GPML. Mobius is amending one of its reinsurance arrangements with L&GPML as a result of the transfer. L&GPML has agreed to split its existing reinsurance agreement into two distinct contracts, one of which will relate to the Transferring Business and the other covering the non-transferring Mobius business.
- 7.28. On and with effect from the Transfer Date, the assets and liabilities in respect of the Transferring Business will be reinsured by SF (the reinsured) to Mobius (the reinsurer) under the SF-Mobius Reinsurance Arrangement.
- 7.29. The SF-Mobius Reinsurance Arrangement will be structured such that SF is liable for any default by either Mobius or any third party to which Mobius subsequently reinsures in relation to the Transferring Business. Following the proposed Scheme, SF must continue to meet its obligations in full on all individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010, with no recourse to Mobius. Consequently, Mobius will no longer be liable for any losses as a result of its reinsurance contracts with third party insurers.
- 7.30. For the plans issued under group policies where the member joined after 7 April 2010, and the TIPs within the Transferring Business, the transferring policyholders will continue to bear the risk of default by these external reinsurance arrangements and will also bear the risk of any default by Mobius.
- 7.31. The arrangement will last for a minimum term of 5 years and SF will pay Mobius an investment administration charge of 8 basis points per annum on the reinsured assets under management.
- 7.32. The SF-Mobius Reinsurance Arrangement can be terminated subject to a three month notice period after this 5 year period in accordance with its terms.
- 7.33. This SF-Mobius Reinsurance Arrangement can also be cancelled prior to the expiry of the minimum term by SF provided that SF serve a three month notice and pay an early termination fee. If SF terminate before the end of 5 years but agree to outsource the investment administration for the Transferring Business to Mobius Life Administration Services Limited (a subsidiary of MLG), the early termination fee is waived.
- 7.34. Mobius's other external reinsurance arrangements, relating to non-transferring policies, will remain in place after the Scheme has been implemented

Deed of Charge

- 7.35. SF and Mobius are intending to establish a floating charge over all of the assets of Mobius up to the value of the reinsurance ceded to Mobius in respect of the Transferring Business. This floating charge crystallises into a fixed

charge in the event of the Mobius's insolvency. The Deed of Charge will come into effect on or before the Transfer Date.

- 7.36. This floating charge will ensure that SF ranks equally with Mobius's direct policyholders upon Mobius's insolvency.

Security assignment

- 7.37. In addition, SF and Mobius will enter into the Security Assignment in relation to Mobius's rights under a reinsurance agreement between Mobius and L&GPML in respect of a part of the Transferring Business that has been invested with L&GPML under such reinsurance agreement. This will come into effect from the Transfer Date.
- 7.38. Upon SF enforcing its rights under the Security Assignment it would be able to require L&GPML to make payments in respect of the applicable Transferring Business managed by L&GPML directly to SF (thereby avoiding a defaulting Mobius) and exercise such other rights against L&GPML as Mobius would have had under the terms of the reinsurance agreement in respect of the Transferring Business.

Governance Advisory Arrangement

- 7.39. Within Mobius, there currently exists a GAA in place which has an oversight role over all group personal pension plans and stakeholder pension plans where such plans have two or more employees of the same employer.
- 7.40. Following the Transfer Date, the responsibility for this arrangement will move to SF. The SF Board will be responsible for the oversight and running of the GAA. The GAA will be effective from the Transfer Date.
- 7.41. Currently, SF has waivers in place for its pension business which allows them to waive the requirement for a governance arrangement, however, following the transfer the waivers are not expected to be renewed. As such, the scope of the transferred governance arrangement would need to be extended to include SF's current book of pension business.
- 7.42. It is intended that the external members of the existing committee would be asked to continue their role for SF and the internal representatives will be replaced by individuals of similar experience at SF.

SF Delegates

- 7.43. SF is a friendly society and as such it requires the transfer of insurance business to be approved by the Delegates on behalf of members. The approval for the transfer from the Delegates of SF will be sought by way of a Special Resolution.
- 7.44. SF will convene a SGM prior to the Court hearing to sanction the Scheme. The transfer of business is conditional of the passing of the Special Resolution by at least 75% of the Delegates in attendance and voting at the SGM. The minimum number of Delegates that must be present at the SGM is 50% of the number of Delegates that are entitled to attend and vote, or the whole nearest number to but not exceeding 50% of the number of Delegates.
- 7.45. I will provide an update on this in my Supplementary Report.

Administration

- 7.46. The policies of the Transferring Business are all currently administered externally by Aegon as described in paragraphs 6.14 to 6.17 under a contract between Mobius and Aegon. This contract will be novated to SF under the Scheme with no changes.
- 7.47. The non-transferring Mobius policies are TIPs without member administration services and as such there is no requirement for a separate agreement with Aegon following the transfer to cover the remaining business.
- 7.48. There will be no change to the administration of the existing SF policies.

Membership rights

- 7.49. With effect from the Transfer Date, the holders of policies in the Transferring Business will become members of SF with the membership rights as set out in the SF Memorandum and Rules.

- 7.50. It is my understanding that all policyholders of the Transferring Business will become members of SF equally with all existing SF members.

Costs of the Scheme

- 7.51. Mobius and SF will each bear their own costs of the Scheme, other than for certain costs such as my Independent Expert fees, Court fees and Counsel's fees which will be shared equally between the parties, as will the costs of advertising the Scheme.
- 7.52. The costs incurred in notifying the transferring policyholders of the proposed Scheme will be borne by Mobius, whereas the costs of notifying the Delegates of SF will be borne by SF.
- 7.53. Costs associated with the Scheme that are attributable to SF will be met solely from the SF Main Fund. The costs for Mobius will be paid out of shareholder resources and not charged to unit funds.

Variation of permission ("VOP")

- 7.54. At the time of writing my report SF are not authorised to perform the regulated activity (as specified in article 52 (a) of FSMA (Regulated Activities) Order 2001) of 'establishing/operating/winding up a stakeholder pension scheme'. Since there are 6,417 members of stakeholder pension schemes (18 policies) in the Transferring Business it is a requirement for SF to gain permission for this regulated activity prior to the transfer of business.
- 7.55. In July 2018 SF applied to the PRA for a VOP in relation to this regulated activity. The proposed Scheme is conditional on SF gaining approval and if permission is not granted, the proposed transfer will not go ahead.

Other

- 7.56. Any policies which fall within the definition of Transferring Business but which cannot be transferred under the Scheme for legal reasons will become Excluded Policies and will be reinsured to SF on the terms set out in the Scheme. This may occur where the state of the commitment of a particular policy was not the UK but elsewhere within the EEA and the consent of the regulator in that state had not been obtained. Following a review of its policyholder records, Mobius has identified 47 policyholders who had an address in an EEA state other than the UK at the time the policy was entered into. It is possible for these 47 policies that the state of the commitment was not the UK. Other than these 47 policies the management of Mobius believes for the remainder of the Transferring Business that no EEA state, other than the UK, is the state of the commitment.
- 7.57. Mobius will retain responsibility for the investment administration and Aegon will retain the member administration of any Excluded Policies from the Transfer Date.
- 7.58. There are no other contractual counterparties whose agreements are affected by the proposed transfer.

Groups of policyholders considered in my report

- 7.59. In order to cover the potential effects of the Scheme on the policyholders of SF and Mobius, I have divided the policyholders into the following groups for consideration in this report, due to the similar risk exposures within each of the groups:
- The policyholders transferring from Mobius to SF;
 - The non-transferring Mobius policyholders; and
 - The existing SF policyholders:
 - The existing with-profits policyholders in the SF Main Fund;
 - The existing non-profit and unit-linked policyholders in the SF Main Fund; and
 - The existing policyholders in the other notional sub-funds.
- 7.60. The following Sections 8, 9, and 10 of cover these sub-divisions of policies and Section 11 covers some other considerations arising from the Scheme.

8. THE EFFECT OF THE IMPLEMENTATION OF THE SCHEME ON THE TRANSFERRING MOBIUS POLICIES

Introduction

- 8.1. In this section I consider the effect of the implementation of the Scheme on the transferring policies of Mobius.
- 8.2. As described in Section 7, the Transferring Business comprises of the following unit-linked business of Mobius:
- Group stakeholder pension business;
 - Group personal pension business;
 - Individual personal pension business; and
 - TIPs which have member administration services.
- 8.3. The Transferring Business is referred to in this and subsequent sections of this report as the transferring Mobius policies or the transferring policies and have Solvency II technical provisions of approximately £340 million as at 31 December 2016.
- 8.4. As a result of the implementation of the Scheme, the transferring Mobius policies will transfer into and become direct policies of SF. Therefore, the key points to consider are:
- The financial resources available to provide security for the benefits of the transferring Mobius policies following the implementation of the Scheme compared to those currently available;
 - Any change to the profile of risks to which the transferring Mobius policies will be exposed as a result of the implementation of the Scheme;
 - The effect of the implementation of the Scheme on the governance, management and service standards applicable to the transferring Mobius policies; and
 - The effect of the implementation of the Scheme on the reasonable benefit expectations of the transferring Mobius policyholders.

These are considered in turn below.

The financial resources available to provide security of benefits

- 8.5. Currently, the assets underlying the benefits payable to the transferring Mobius policies are invested in CISs or the third party funds of insurers (through reinsurance arrangements). However, Mobius is responsible for paying the benefits due to policyholders, and can subsequently claim an appropriate amount from the third parties. Should third party insurers be unable to fulfil its obligations under these reinsurance arrangements, Mobius must continue to meet its obligations in full on all individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010, as described in paragraph 6.48. This applies for the majority of the Transferring Business and as at 31 March 2017 applies to approximately 8,855 of the 13,310 transferring members/policyholders.
- 8.6. Therefore the transferring policies currently rely primarily on the available resources of Mobius for the security of their unit-linked benefits. That is:
- Assets backing the technical provisions and SCR held in respect of the unit-linked benefits of the transferring policies as required under the Solvency II regulations; and
 - The additional capital resources required by the Mobius capital management policy, with the financial strength that provides security for the benefits including the strength of the governance around the capital management policy and changes to it.
- 8.7. In addition, for plans issued under group policies where the member joined the scheme after 7 April 2010, as well as the TIP business, policyholders also rely on the available resources of the third party insurers that Mobius hold investment reinsurance agreements with.
- 8.8. Following the implementation of the Scheme, the assets underlying the benefits payable to the transferring Mobius policies are to be invested by SF in Mobius's funds (and subsequently invested by Mobius), as described in

paragraphs 7.17 to 7.19. However, SF would be responsible for paying the benefits due to policyholders, and then subsequently claim an appropriate amount from Mobius, who will then in turn claim an appropriate amount from their external counterparties.

- 8.9. Should Mobius be unable to fulfil its obligations under the SF-Mobius Reinsurance Arrangement, SF must continue to meet its obligations in full on all individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010. For the plans issued under group policies where the member joined after 7 April 2010, and the TIPs within the Transferring Business, the transferring policyholders will bear the risk of default by Mobius.
- 8.10. As a result of the amended investment reinsurance agreement between Mobius and L&GPML and the Security Assignment that the companies are entering into, as described in paragraphs 7.27, 7.37 and 7.38, SF would, in the scenario of a Mobius default on its obligations under the SF-Mobius Reinsurance Arrangement, be entitled to make a claim for unpaid monies on the assets that Mobius has invested with L&GPML in relation to the Transferring Business.
- 8.11. As a result of the floating charge between SF and Mobius, as described in paragraphs 7.35 and 7.36, the remaining assets with third party insurers other than L&GPML would be used proportionately to meet obligations on both the Transferring Business and the non-transferring Mobius business.
- 8.12. The SF-Mobius Reinsurance Arrangement will be structured such that SF is liable for any default by any third party insurer to which Mobius subsequently reinsures in relation to the Transferring Business. As such, should one of Mobius's counterparties be unable to fulfil its obligations under their reinsurance arrangement with Mobius, SF must continue to meet its obligations in full on all individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010, with no recourse to Mobius.
- 8.13. For the plans issued under group policies where the member joined after 7 April 2010, and the TIPs within the Transferring Business, the transferring policyholders will continue to bear the risk of default by these external reinsurance arrangements.
- 8.14. The ability of both Mobius to fulfil its obligations under the SF-Mobius Reinsurance Arrangement, and the counterparties of Mobius to meet their obligations will affect the strength of SF and therefore security for the transferring policies will also be provided indirectly by the assets of Mobius.
- 8.15. Following the implementation of the Scheme, the security of the benefits of the transferring Mobius business will be provided by:
 - Assets backing the technical provisions and SCR held in respect of the unit-linked benefits of the transferring policies as required under the Solvency II regulations. These assets are held within the SF Main Fund, with the exception of the assets backing the unit reserves which will be immediately transferred back to Mobius following implementation of the Scheme due to the SF-Mobius Reinsurance Arrangement;
 - The additional capital resources required by the SF CMRP, with the financial strength that provides security for the benefits including the strength of the governance around the capital management policy and changes to it;
 - The SF-Mobius Reinsurance Arrangement;
 - The floating charge agreement between Mobius and SF;
 - The security assignment between Mobius and SF; and
 - The strength of Mobius including the strength of the investment reinsurance agreements between Mobius and third party insurers.
- 8.16. Since the transferring policies are transferring into the SF Main Fund, the primary source of security for the transferring policies after the implementation of the Scheme will be the excess capital resources in the SF Main Fund. However, given the capital support arrangements in place, the excess capital resources of all notional sub-funds should also be considered as available to support the transferring policies and indeed, in the scenario that the SF Main Fund was unable to meet its liabilities, the fund barriers would break down. Therefore, it is reasonable to focus on the assets and excess capital resources of SF as a whole, rather than just the SF Main Fund.

The financial strength required under Solvency II

- 8.17. Under Solvency II the assets held in respect of a policy or group of policies are represented by the technical provisions (consisting of the BEL and risk margin) and the SCR. This amount is then increased in accordance with the firm's capital management policy. At the time of writing my report, neither SF nor Mobius utilise any of the long-

term guarantee measures introduced in the Solvency II Directive such as the matching adjustment, the volatility adjustment or any transitional measures when calculating their technical provisions. Both companies use the Standard Formula to calculate their SCR.

- 8.18. The excess capital resources are the excess of the assets held in respect of a policy or group of policies over the value of the technical provisions, any other liabilities and the SCR. The excess capital resources are subject to any restrictions on their use due to the ring-fencing of assets.
- 8.19. As the assets and liabilities of each of SF's notional sub-funds are managed as though they were a part of a separate undertaking, SF identifies all notional sub-funds as ring-fenced funds under Solvency II. As such, the amount of excess capital resources arising in the notional sub-funds is restricted to zero, which reduces the total excess capital available to SF on a Solvency II Pillar 1 basis. Mobius have no ring-fenced funds restricting the movement of capital.
- 8.20. Although the approach taken to calculating the excess capital resources differs between SF and Mobius due to the ring-fencing of funds within SF, this is due to the different structure of the companies and both approaches are in line with the Solvency II regulations. Furthermore, in the unlikely scenario where the solvency of a notional sub-fund (or the SF Main Fund) was threatened, SF would be able to transfer the restricted ring-fenced excess capital using the capital support arrangements. I am therefore satisfied that these differences do not have a material adverse effect on the security of benefits of the transferring Mobius policies.

The SF and Mobius capital management policies

- 8.21. The capital management policy of an insurer sets out the capital that a company has committed to hold and is typically expressed in terms of regulatory capital requirements. The regulatory capital requirements may target a specified probability of remaining solvent over a certain time horizon: for example for Solvency II, it is a 99.5% probability of remaining solvent over a one year time horizon.
- 8.22. By requiring additional capital to be held on top of the regulatory requirements, the capital management policy increases the probability of remaining solvent over a particular timeframe and therefore increases the security of the benefits provided under the relevant policies subject to the capital management policy.
- 8.23. Capital management policies also provide a trigger for actions by management aimed at reducing the likelihood of a breach of regulatory capital requirements and subsequent regulatory intervention.
- 8.24. When considering the financial resources available to provide the security of the benefits of a particular group of policies, reliance can only be placed upon assets held in adherence to the capital management policy and not on assets in excess of this level, since assets in the latter category are potentially available for distribution (subject to logistical constraints) or to fund strategic business growth.
- 8.25. Currently the security of the benefits under the transferring Mobius policies depends upon the assets of Mobius held in accordance with the Mobius capital management policy as set out in Section 6. Following implementation of the Scheme, the transferring business and any residual assets attributed to it will be transferred into SF and security for the benefits of the transferring Mobius policies will subsequently be provided by the assets of SF held in accordance with the SF capital management policy as set out in Section 5.
- 8.26. Therefore a comparison of the relative strengths of the capital management policies of SF and Mobius is an important factor in considering the effect of the Scheme on the benefit security of the transferring policies.

The relative strengths of the capital management policies

- 8.27. The proposed transfer will not lead to any change in the risk appetite or the CMRP for SF. It is my understanding from discussions with the management of SF that SF's CMRP has a trigger point of 200% capital cover on a Solvency II Pillar 2 basis with an absolute limit of 150% capital cover also under Pillar 2.
- 8.28. In addition to the overall capital management policy of SF, each of the notional sub-funds aim to maintain assets to cover 100% of the notional SCR associated with the liabilities of its sub-fund.
- 8.29. Currently, Mobius's capital management policy that targets a lower bound of 120% of solvency margin on a Solvency II Pillar 1 basis and a lower bound of 140% of solvency margin on a Solvency II Pillar 2 basis. The management of Mobius have indicated that the intention is to increase this target percentage if the Scheme is implemented. However, given that this change to the capital management policy is conditional on the transfer taking place, it is the current capital management policy that should be considered when assessing the relative strengths of the capital management policies. The proposed increase to the target solvency margin cover post transfer should strengthen the cover compared to the current policy. If there are any material issues resulting from the revised capital management policy I will cover them in my Supplementary Report.

- 8.30. Given that SF defines its capital management policy on a Pillar 2 basis, whereas Mobius defines its on both a Pillar 1 and Pillar 2 basis, it is somewhat subjective to directly compare the relative strength of the two capital management policies. Pillar 2 differs from Pillar 1 in that it reflects a company's views on its own risk profile and can address any perceived shortcomings in applying the prescribed Standard Formula approach to calculating the capital requirement under Pillar 1.
- 8.31. I have reviewed both Pillar 1 and Pillar 2 forward looking projections prepared by Mobius as part of its ORSA process for a scenario that does not allow for the implementation of the Scheme. This shows that the capital buffer of 20% on a Pillar 1 basis is expected to remain greater than the capital buffer of 40% on a Pillar 2 basis over the current business planning horizon. As the capital management policy defined on a Pillar 1 basis represents a stronger constraint on capital for Mobius, it is appropriate to only consider Mobius's Pillar 1 target in the comparison to the capital management policy of SF (based on Pillar 2).
- 8.32. I have reviewed SF's financial position on a Solvency II Pillar 2 basis and a capital management policy defined on a Pillar 2 basis for SF represents a stronger constraint on capital than if this had been defined on a Pillar 1 basis at the same target level of solvency cover.
- 8.33. As such, the capital buffer of 50% of the Pillar 2 capital requirement targeted to be held by SF when compared to the capital buffer of 20% of the Pillar 1 capital requirement held by Mobius does not produce a smaller margin to provide security for policyholder benefits.
- 8.34. Taking this into account, I am satisfied that SF's capital management policy is at least as strong as Mobius's and therefore does not materially adversely affect the security of the benefits provided for the transferring Mobius policies.

The required response of management to a breach of the capital management policies

- 8.35. In addition to considering the actual level of capital intended to be held under the relevant capital management policies, I also consider what the required management response would be to any breach, and the controls governing changes to the capital management policies.
- 8.36. Currently, the capital management policy of Mobius only provides two potential management actions available to it in response to any breach of the capital management policy, these being:
- Not paying a dividend to shareholders if this would result in a breach of the capital management policy; and
 - Raising further capital through a new issuance of shares.
- 8.37. Additionally, if solvency cover exceeds 120% of SCR, Mobius will consider whether the excess capital can be deployed for the benefit of the business and, if not, it could be returned to shareholders via a special dividend.
- 8.38. Changes to the Mobius capital management policy are subject to approval by the ARC and the Board of Mobius.
- 8.39. SF's CMRP does not explicitly outline the range of potential management actions available to it in response to any breach of their capital management policy (these are covered by the recovery plan) that can be taken to recover the solvency position, but it does state that a register of such actions must be drafted, retained and reviewed annually by SF as a minimum control standard.
- 8.40. Therefore, the management actions that are available to the Board of SF in order to restore solvency in the event that the solvency position of the company falls beneath the trigger point of 200% of capital cover (on a Solvency II Pillar 2 basis) are outlined within SF's recovery plan as described in paragraph 5.78 of this report. These actions would have to be considered by SF if the capital cover falls below 200%, with management actions being a necessity if capital cover reduced beneath the 150% limit.
- 8.41. The SF register of management actions is reviewed at least annually by the Board of SF, and any changes to the capital management policy are subject to approval by the Board and non-objection by the PRA. At the time of writing my report, the current SF recovery plan (including the register of management actions) is set to be reviewed as part of this annual process. This review will take into consideration the impact of the implementation of the Scheme on SF, and the recovery plan will be updated if necessary. It is my understanding that the implementation of the Scheme is not expected to have an impact on the register of management actions that can be taken by SF to recover solvency position, however, I will provide an update on this within my Supplementary Report.

The financial resources available to provide security for benefits

- 8.42. Table 8.1 below shows the pre-Scheme financial strength of Mobius as at 31 March 2017 and the pro-forma post-Scheme financial strength of SF as at 31 December 2016 on the Solvency II Pillar 1 basis.

Table 8.1: Pro-forma comparison of the regulatory solvency providing security for benefits to the transferring Mobius policyholders pre- and post-Scheme

Impact of the Transfer on relevant parties' solvency position		
	as at 31 March 2017	as at 31 December 2016
£m	Mobius pre-Scheme	SF post-Scheme
Assets	9,397.6	2,892.6
Technical provisions	9,377.3	2,606.3
Other liabilities	8.6	102.6
Own Funds	11.7	183.7
Adjustment for restricted Own Funds items	0.0	-19.9
Solvency II Own Funds	11.7	163.8
SCR	9.7	85.8
SCR coverage ratio	120%	191%
Capital available for support	2.0	77.9

Source: Mobius's Chief Actuary's Report and SF's Chief Actuary's Report

- 8.43. Table 8.1 shows the pre-Scheme financial position for Mobius and the pro-forma post-Scheme financial position for SF as at two different dates. SF and Mobius have different year-end reporting dates and, as such, the audited liability valuations took place at different dates for each of the companies. I have had sight of more recent, but unaudited, financial information for both SF and Mobius, and I am satisfied that the presentation of the pre- and post-Scheme financial strength for the transferring Mobius policyholders as shown is a reasonable comparison above does not provide a misleading picture. I will however provide an update on the comparison of the pre- and post-Scheme financial position of Mobius using more recent audited results in the Supplementary Report.
- 8.44. Table 8.1 shows that on the Solvency II Pillar 1 basis, if the Scheme had been implemented on 31 December 2016, the capital resources of SF would have covered its SCR with a ratio of 191%. This represents an increase from the Mobius pre-Scheme position at 31 March 2017, where the capital resources of Mobius covered its SCR with a ratio of 120%. In addition, the excess capital to support the security of the benefits of the transferring Mobius policyholders increases in absolute terms from £2.0 million to £77.9 million.
- 8.45. Furthermore, in the unlikely scenario where the solvency of a notional sub-fund (or the SF Main Fund) was threatened, SF would be able to transfer the restricted ring-fenced excess capital using the capital support arrangements. This would release £19.9 million of surplus assets.
- 8.46. SF's pro-forma post-Scheme Solvency II Pillar 1 balance sheet does not currently allow for any capital to be held in respect of this risk of default of the third parties that Mobius invests with. Amendments to this would impact the value of the SCR and technical provisions presented in the post-Scheme position within Table 8.1. At the time of writing my report, I have received assurances from SF that this treatment has been reviewed by its external auditor, who has stated that it has no concerns over the treatment. A final statement from SF's auditor confirming this view is expected following the finalisation of the SF-Mobius Reinsurance Arrangement and the associated arrangements and agreements, as described in paragraphs 7.26 to 7.38, and an update will be provided in the Supplementary Report. In addition, I have seen the post-Scheme financial position on the basis that a "look through" approach is taken in respect of the risk of counterparty default, such that capital is held in respect of this risk, and note that it does not have a material impact on the solvency cover of SF.
- 8.47. Thus, I am satisfied that the calculations for both companies are in keeping with the Solvency II rules, and it is reasonable to infer from the above figures that the proposed Scheme is unlikely to lead to a reduction in security of benefits for transferring Mobius policies.
- 8.48. I am satisfied that the Scheme will not have a material adverse effect on the financial resources available to support the security of the benefits of the transferring Mobius policies.

Conclusion

In conclusion I am satisfied that:

- The capital management policy of SF is at least as strong as Mobius's, and therefore the security afforded to the transferring business by the applicable capital management policy will not be materially adversely affected as a result of the Scheme; and
- Based on the pro-forma post-Scheme financial position at 31 December 2016, the Scheme will not have a material adverse effect on the financial resources available to support the security of the benefits of the transferring Mobius business.

The profile of risks to which the transferring Mobius policies are exposed

- 8.49. Following the implementation of the Scheme, the transferring Mobius policies will become direct policies of SF and therefore directly exposed to the risk profile of a different company that has written a different mix of business, through different distribution channels, to policyholders with different demographic profiles.
- 8.50. Based on the method of calculating the Solvency II Pillar 1 capital requirement, the dominant risks for Mobius prior to the Scheme are:
- Counterparty default risk: on its reinsurance and bank counterparties;
 - Market risk: changes in the value of its assets under management impacting revenues received from charges; and
 - Life insurance risk: due to higher lapses (and thus lower revenue received from charges) and higher expenses than expected.
- 8.51. However, under the Solvency II Pillar 2 assessment which is designed to reflect more accurately the specific risks that Mobius is exposed to, the dominant risks it identifies are operational risk and, as under Pillar 1, counterparty default risk. The Board of Mobius believes that its exposure to market and life insurance risk is overstated by the prescribed Pillar 1 Standard Formula calculation.
- 8.52. For Pillar 2, the capital requirements reflect expected losses in the event of a stress which is more consistent with how the business is managed, for example, taking into account likely management actions.
- 8.53. SF's main risk arises due to its investment in equities in respect of the asset shares for with-profits policies and the cost of guarantees for such business in the event of a fall in market values in the M&GM notional sub-fund. It also faces material risk due to its assets under management (spread, equity and interest rate risk), life and pension liabilities (mortality, morbidity and longevity risk) and counterparty default risk from its reinsurance and banking counterparties.
- 8.54. The risk profile of SF will not be impacted materially by the implementation of the Scheme.
- 8.55. As such, the risk profile of SF (both pre- and post-Scheme) differs substantially from that of Mobius. Table 8.2 below shows Mobius's pre-Scheme Solvency II Pillar 1 risk profile as at 31 March 2017 and the pro-forma post-Scheme Solvency II Pillar 1 risk profile of SF as at 31 December 2016 (assuming the Transferring Business had transferred on that date).

Table 8.2: The profile of risks that the transferring policies are exposed to before and following the implementation of the Scheme (on a Solvency II Pillar 1 basis)

Risk sub-module	Mobius pre-Scheme	SF post-Scheme
	As at 31 March 2017 (£m)	As at 31 December 2016 (£m)
Market risk	4.0	69.7
Counterparty risk	6.1	11.6
Life underwriting risk	4.2	12.2
<i>Diversification</i>	<i>-4.1</i>	<i>-15.8</i>
Operational risk	0.9	8.2
<i>Loss absorbing capacity of deferred tax</i>	<i>-1.3</i>	<i>0.0</i>
<i>Loss absorbing capacity of technical provisions</i>	<i>0.0</i>	<i>-4.5</i>
<i>Adjustment due to ring-fenced funds</i>	<i>0.0</i>	<i>4.4</i>
Total SCR	9.7	85.8
Total MCR	4.4	31.0

Source: Mobius's Chief Actuary's Report and SF's Chief Actuary's Report

- 8.56. As a result of the transfer, the transferring Mobius policies will no longer be exposed to market or life underwriting (lapse and expense) risks in relation to non-transferring TIP business of Mobius. However, such exposures were small and the implementation of the Scheme will result in the transferring Mobius policies being exposed to a greater degree of risk in respect of these risk types. In particular, there will be a substantial increase in the exposure to equity, spread and interest rate risk (market risks) arising predominantly from the business written into the M&GM notional sub-fund of SF.
- 8.57. In addition, the transferring policies will be exposed to new types of risk as policies of SF, such as longevity and revision risk arising on SF's annuity business. The transferring Mobius policies will still be exposed to a negligible amount of mortality risk.
- 8.58. Prior to the implementation of the Scheme, the transferring Mobius policyholders are only exposed to the risk of insolvency and default of the third parties that Mobius invests with, and in such an event Mobius would be only required to meet its obligations to policyholders in full for individual personal pension plans, and plans issued under group policies where the member joined the scheme before 7 April 2010. Following the implementation of the Scheme and due to the SF-Mobius Reinsurance Arrangement, the transferring Mobius policyholders will then also be exposed to the risk that Mobius becomes insolvent or defaults on its obligation.
- 8.59. As a result of the amended investment reinsurance agreement between Mobius and L&GPML and the Security Assignment that the companies are intending to enter into, as described in paragraphs 7.27, 7.36 and 7.37, SF would be able to require L&GPML to make payments in respect of the applicable Transferring Business managed by L&GPML directly to SF (thereby avoiding a defaulting Mobius) and exercise such other rights against L&GPML as Mobius would have had under the terms of the reinsurance agreement in respect of the Transferring Business. The Security Assignment therefore limits the exposure of the transferring Mobius business to default risk in respect of Mobius.
- 8.60. Nevertheless, the solvency position of SF under Solvency II will reflect the risk profile of the company, its business and its risk concentrations, and this will feed through into the capital that will be held in accordance with the SF CMRP. This provides additional comfort that any differences in risk profile to which the transferring Mobius policies will be exposed following the implementation of the Scheme will be suitably identified, managed and protected against.
- 8.61. Therefore I am satisfied that the change in risk profile will not have a material adverse effect on the benefit security of the transferring Mobius policies.

The governance, management and service standards applicable to the transferring Mobius policies

- 8.62. The transferring Mobius policyholders will reasonably expect that following the implementation of the Scheme:
- The administration, management, and governance of the policies are in line with the contractual terms under the policies; and
 - The standards of service received are at least as good as those they currently receive.
- 8.63. The Transferring Business is currently managed by Mobius, and subject to the governance of the Board of Mobius.
- 8.64. Following the implementation of the Scheme, the Transferring Business will be managed by SF and subject to the governance of the Board of SF who will manage the friendly society by authority of the Delegates in accordance to the Friendly Society Act, its Memorandum and Rules and any directions given by Special Resolution.
- 8.65. Currently, the transferring Mobius policies have no right to influence the management of Mobius and all strategic decisions are made by the Board of Mobius. Following the transfer, the transferring policyholders will become members of SF, equal with all other members.
- 8.66. Members are eligible to become Delegates, with the membership of SF being represented by a number of Delegates at the AGM and taking part in votes on certain key decisions, such as election of the Board of SF. In addition, upon winding up of SF, any surplus remaining will be divided among members in equitable shares as determined by the Board of SF on the advice of the actuary (appointed in accordance with the Rules).
- 8.67. Following the implementation of the Scheme, SF will form a GAA that aims to replicate the existing Mobius GAA and the SF Board Risk Committee will be responsible for the oversight and running of the GAA.
- 8.68. SF currently manages relatively significant volumes of unit-linked business, around 60,000 policies as at 31 December 2016, however, the majority of that business is life business, with only around 16,000 policies being pension business similar to the Transferring Business. In addition, SF does not currently have an established GAA.
- 8.69. However, it is the intention of SF to ask the external members of the existing Mobius GAA to continue their role in the GAA for SF, and that the internal representatives of the GAA will be replaced by individuals of similar experience by SF.
- 8.70. Provided SF replicates the GAA in this way, the level of governance and management provided for the transferring Mobius policies by this governance function will not be materially different than that currently provided by Mobius. The exact structure of the SF GAA has not been finalised at the time of writing my report. I will continue to monitor progress in respect of the proposed structure of the SF GAA and provide an update on this matter in the Supplementary Report.
- 8.71. Therefore, I consider that the Board of SF is experienced in the management and governance of unit-linked business, and despite having less experience with unit-linked pensions in particular, I have no reason to believe that it will treat the transferring policyholders in a materially different way to the Board of Mobius.
- 8.72. As such, I am satisfied that the implementation of the Scheme will not materially affect the standards of governance and management applicable to the transferring business.
- 8.73. The policies of the Transferring Business are all currently administered externally by Aegon as described in paragraphs 6.14 to 6.17 under a contract between Mobius and Aegon. This contract will be novated to SF under the Scheme without amendment and as such there will be no change in the administration for the transferring Mobius policyholders.
- 8.74. Currently, the fund links available to the transferring Mobius policies and the investment objectives of the funds of Mobius can be changed by Mobius at any time.
- 8.75. Following the implementation of the Scheme, the power to change the available fund links for the transferring Mobius policies will novate to SF and, as such, SF will be responsible for deciding how to manage the SF-Mobius Linked Funds. Its powers will include the ability to open new funds, or to close, merge or change the fund links and investment objectives of the SF-Mobius Linked Funds (unless precluded by the terms of the relevant policies) on such terms as the Board of SF shall consider reasonable having regard to the interests of its policyholders.
- 8.76. The creation of the SF-Mobius Linked Funds and the SF-Mobius Reinsurance Arrangement (whereby SF has agreed to use Mobius to perform investment administration in relation to the transferring Mobius policies), as described in paragraphs 7.17 to 7.19, ensures that:
- All investment administration will continue to be carried out by Mobius with no changes to the fund links that are available immediately before the Transfer Date;

- There will be no suspension of trading for transferring Mobius policyholders around the Transfer Date; and
- There will not be any immediate changes to the choice of investment funds available to the transferring Mobius policies after the Transfer Date, as a direct impact of the proposed Scheme. No such changes are currently envisaged, but the range of available funds may change in the future as markets develop and this is unchanged by the Scheme.

- 8.77. Mobius will retain the responsibility for the day-to-day investment management of the SF-Mobius Linked Funds as the SF-Mobius Reinsurance Arrangement states that Mobius will continue to have the right to introduce new funds, withdraw an existing fund, merge a fund with another fund (or funds) or to vary the investment objective of a fund. That said, as stated in the FCA's Thematic Review "The governance of unit-linked funds", it will be the responsibility of SF to monitor that the funds are invested by Mobius in accordance with the stated objectives set by SF. As such, the SF-Mobius Reinsurance Arrangement contains restrictions on Mobius's investment of the SF-Mobius Linked Funds, such that they must provide at least three months' prior notice to SF of any such changes (with the exception of the introduction of new funds or immaterial changes to the investment objective of a fund).
- 8.78. This SF-Mobius Reinsurance Arrangement has a term of 5 years and can only be cancelled earlier than this date by SF, and provided that SF serves a three month notice and pay an early termination fee. If SF terminates before the end of 5 years but agrees to outsource the investment administration for the Transferring Business to Mobius Life Administration Services Limited (a subsidiary of within MLG), the early termination fee is waived. .
- 8.79. As such there will be no material change in the member administration or service standards received by the transferring Mobius policies immediately following the transfer.
- 8.80. Finally, there will be no change to policyholder systems, in particular there will be no change in the interface between the Mobius investment accounting and the Aegon member administration that might otherwise impact on transaction processing.
- 8.81. Hence I am satisfied that the implementation of the Scheme will not have a material adverse effect on the governance, management and service standards applicable to the transferring Mobius policies.

The reasonable benefit expectations of the transferring Mobius policyholders

- 8.82. The transferring Mobius policies are all unit-linked retirement saving policies, and therefore policyholders' reasonable benefit expectations in respect of their policies are principally that:
- They receive their contractual benefits as set out under the policy, including, where the terms and conditions of the policy explicitly state, the option to purchase an annuity from the insurer on the vesting date of the policy (although no guaranteed annuity rates apply to the transferring Mobius policies); and
 - The policies are operated in accordance with their contractual terms, including the level of charges for unit-linked policies.
- 8.83. There are no changes proposed to the policy terms and conditions for the transferring Mobius policies, except that they will become SF policies, and so the contractual benefits as set out in these terms and conditions will be unchanged by the Scheme. Policies transferring from the Mobius into the SF Main Fund have no entitlement to, or expectation of, any share of distributions of surplus from that fund, or any other notional sub-fund after the transfer, except for any residual surplus on the winding up of SF.
- 8.84. Following the implementation of the Scheme, the creation of the SF-Mobius Linked Funds and the SF-Mobius Reinsurance Arrangement, as described in paragraphs 7.17 to 7.19, ensures that:
- All fund links in relation to the Transferring Business are fully replicated;
 - Mobius remain responsible for the investment management of funds (including the ability to add, withdraw or merge funds); and
 - Transaction and unit pricing practices will continue to be carried out by Mobius, in a similar way to before the proposed transfer.
- 8.85. Consequently, the transfer will have no impact on the operation of the internal linked funds (in particular the unit pricing) or the investment of the unit-linked funds (in accordance to the investment objectives of those funds) of the transferring business.

- 8.86. The terms and conditions of a number of Mobius policies contain a clause that allows the holder to request an annuity but currently, given the expected limited volume of business that Mobius has, it would be unable to offer attractive terms to policyholders. Following the implementation of the Scheme, the obligation to provide this annuity will be with SF. SF has experience managing annuity business (flexible income annuities and immediate annuities). In addition, it is a larger company than Mobius, in terms of the number of policyholders, and so is able to achieve greater operational efficiencies. Therefore, SF would seem to be better placed than Mobius to offer competitive rates. Therefore, I am confident that the ability to meet the contractual obligation to offer these policyholders an annuity is not materially affected by the implementation of the Scheme.
- 8.87. In addition, Mobius policyholders are currently able to exercise their Open Market Option, allowing them to choose the provider of their annuity rather than accepting the rate offered by Mobius. This option will be unaffected by the implementation of the Scheme and as such the same choice of annuity providers will be open to the transferring Mobius policyholders.
- 8.88. Currently, there are no guarantees to the level of annual management charges applicable to the transferring Mobius policies in relation to investment management. To ensure that the charges are fair they are monitored by the current GAA, as well as being subject to any regulatory caps.
- 8.89. Following the implementation of the Scheme, the management of SF has confirmed that they are not proposing any change to the charges applicable to Mobius policyholders. While there are no formal guarantees that SF will not increase the level of annual management charges, the annual management charges will be monitored by the GAA of SF, which should ensure that such charges continue to be monitored and remain fair. Given this ongoing governance, it is my opinion that the implementation of the Scheme does not give rise to a change in the level of risk to policyholders of charges being increased on their policies.
- 8.90. An exception to this is that there is an ongoing action under the existing Mobius GAA to ensure that annual management charges for each member are not in excess of 1% p.a. on default funds for those arrangements that fall outside the scope of the 0.75% p.a. statutory charge cap. Following the transfer, SF is aiming to replicate the current GAA as closely as possible and as such is expected to ensure that this action is enforced, in line with the post-Scheme Terms of Reference for the SF GAA.
- 8.91. As such, the only expected changes to the charging structure for unit-linked policies are as a result of this requirement. Since this action would have taken place if the Scheme was not implemented, and the impact is beneficial to policyholders, I am satisfied that the implementation of the Scheme will not materially adversely affect the operation of contractual terms of the transferring policyholders.
- 8.92. Furthermore, it will be the responsibility of the SF GAA to ensure value for money for policyholders which should act to prevent charges from being unfairly increased following the transfer.
- 8.93. I am therefore satisfied that the implementation of the Scheme will not have a material adverse effect on the reasonable benefit expectations of the transferring policyholders of Mobius.

Conclusion for the transferring Mobius policies

- 8.94. I am satisfied that the implementation of the Scheme will not have a material adverse effect on:
- The security of benefits under the transferring Mobius policies;
 - The profile of risks to which the transferring Mobius policies are exposed;
 - The governance, management or service standards applicable to the transferring policies of Mobius; or
 - The reasonable benefit expectations of the transferring Mobius policyholders.

9. THE EFFECT OF THE SCHEME ON THE NON-TRANSFERRING MOBIUS POLICIES

Introduction

- 9.1. In this section I consider the effect of the implementation of the Scheme on the non-transferring policies of Mobius.
- 9.2. The non-transferring Mobius policies solely include unit-linked TIP business where Mobius provides investment administration but does not offer member administration services.
- 9.3. For these policies, I consider the likely effects of the implementation of the Scheme on the security of the guaranteed benefits and on the benefit expectations of the holders of those policies.
- 9.4. The key issues to consider are:
 - The financial resources available to provide security for the benefits of the non-transferring Mobius policyholders following the implementation of the Scheme compared to those currently available;
 - The effect on the non-transferring Mobius policies of any change in the risk profile of Mobius as a result of the implementation of the Scheme;
 - The effect of the implementation of the Scheme on the governance, management and service standards applicable to the non-transferring Mobius policies; and
 - The effect of the implementation of the Scheme on the reasonable benefit expectations of the non-transferring policyholders.

The financial resources available to provide security of benefits

- 9.5. The non-transferring policies in Mobius currently achieve security for their benefits from the assets held by the company:
 - Assets backing the technical provisions and SCR held in respect of the unit-linked benefits of the non-transferring policies as required under the Solvency II regulations;
 - The additional capital resources required by Mobius's capital management policy, with the financial strength that provides security for the benefits including the strength of the governance around the capital management policy and changes to it; and
 - The investment reinsurance agreements with third party insurers.
- 9.6. Following the implementation of the Scheme, the security of the benefits of the non-transferring Mobius business will continue to be provided by the elements listed above.
- 9.7. As discussed in paragraphs 6.43 to 6.47, the ability of the third party insurers that Mobius invests with to fulfil their obligations under the investment only unit-linked reinsurance arrangements will affect the security for the non-transferring policies. In particular, the non-transferring Mobius policyholders all bear the risk of default of the third party insurers and this is unchanged by the transfer.
- 9.8. As highlighted in paragraph 8.24, when considering the financial strength available to provide the security of the benefits of a particular group of policies, reliance should only be placed upon the assets held in accordance with the capital management policy as, strictly speaking, assets in excess of the policy requirements could be paid to shareholders by way of a dividend (subject to certain governance arrangements). Also the Transferring Business of around £340 million is very small (less than 4%) relative to the total Mobius liabilities which is in excess of £9 billion. This limits the financial impact the transfer can have on the non-transferring policyholders.
- 9.9. Table 9.1 below shows the pre-Scheme and pro-forma post-Scheme financial strength of Mobius as at 31 March 2017 on the Solvency II Pillar 1 basis.

Table 9.1 – Pro-forma comparison of the regulatory solvency providing security for benefits to the non-transferring Mobius policyholders pre- and post-Scheme

Impact of the Transfer on Mobius's solvency position as at 31 March 2017			
£m	pre-Scheme	post-Scheme	Scheme impact
Assets	9,397.6	9,400.5	2.9
Technical Provisions	9,377.3	9,382.9	5.6
Other Liabilities	8.6	7.6	-1.0
Solvency II Own Funds	11.7	10.0	-1.7
SCR	9.7	1.9	-7.8
Excess Capital	2.0	8.1	6.1
SCR coverage ratio	120%	522%	402%
MCR	4.4	3.3	-1.1
MCR coverage ratio	266%	301%	35%

Source: Mobius's Chief Actuary's Report

- 9.10. Following the transfer, the MCR, as defined in paragraph 3.15, is expected to equal the absolute minimum capital requirement for life insurance companies of €3.7 million (approximately £3.3 million as at 31 March 2017). Furthermore, the SCR post-Scheme is expected to be smaller than the MCR and Mobius is required to hold capital equal to the greater of the two. As such, the Solvency II Pillar 1 capital requirement for Mobius following the transfer will be the MCR. The pre-Scheme SCR cover of 120% should therefore be compared to the post-Scheme MCR cover of 301%.
- 9.11. It should be noted that the implication of the MCR "biting", is that Mobius will be required to hold more capital than has been calculated, and than is required, at the 1-in-200 level (as defined for the SCR). This results in additional security for policyholders' benefits than if this minimum were not present.
- 9.12. Table 9.1 shows that if the Scheme had been effective as at 31 March 2017, there would have been a significant improvement in Mobius's solvency position. This is predominantly due to the following:
- Mobius's assets will increase by the purchase consideration less estimated transfer-related expenses and costs incurred by Mobius;
 - There is an offsetting increase in the technical provisions, due to the release of the value of the non-unit reserve in relation to the Transferring Business. Prior to the transfer, the value of the non-unit reserve in relation to the Transferring Business is negative and as such releasing this negative reserve results in an increase in the technical provisions for Mobius;
 - Following the implementation of the Scheme, Mobius will expect to achieve lower future profits as it will not receive the future profits on the Transferring Business. Consequently Mobius will be required to pay lower tax on its future profits and so Mobius's other 'non-insurance' liabilities will reduce by the amount of reduction in its deferred tax liability. This has a secondary impact of reducing the value of the loss absorbing capacity of deferred tax which increases the SCR by around £1.1 million;
 - There is a release of counterparty party risk capital held in respect of the current investment only unit-linked reinsurance arrangements between Mobius and the third party insurers they invest with, as this risk is transferred to SF, by way of reinsurance arrangement, as part of the transfer. Immediately following the transfer, this will be offset slightly by an increase in the counterparty default risk in relation to one of Mobius's bank counterparties who will be holding the value of the purchase consideration, net of transfer-related expenses, in cash;
 - There is a release of market and life underwriting risk capital held in respect of the current unit-linked policies. As described in paragraphs 6.59 to 6.70, the majority of these risks arise on the Transferring Business and reflect a loss in revenues for Mobius under stressed conditions. The non-transferring Mobius business has low exposure to these risks due to fact that TIPs can be terminated by Mobius at any time within a three month timeframe; and
 - There is a reduction in the risk margin component of the technical provisions predominantly due to:
 - The reduction in exposure to 'non-hedgeable' risk – in particular, the risks facing the Transferring Business as these have been transferred to SF (in particular counterparty default risk); and

- The duration that Mobius is exposed to each risk type has decreased to three months and this is accounted for in the projection period for the risk margin.
- 9.13. As a result of the implementation of the Scheme there will be no change in the value of the unit reserve component of the technical provisions since, under the reinsurance arrangement between Mobius and SF, Mobius will have a unit-linked liability to SF that is equal in value to the unit-linked liability it currently has in respect to the policyholders of the Transferring Business prior to the Scheme.
- 9.14. Since the non-transferring policies can be terminated unilaterally by Mobius at any time provided that it gives a three month notice period, Mobius has calculated the post-Scheme non-unit reserve comprising of the following:
 - The value of future expected income from annual management charges on the non-transferring business projected over three months;
 - The value of future expected income in relation to the investment administration services for the Transferring Business that will be received from SF projected over three months. This is an investment administration fee of 8 basis points per annum on the value of assets under management for the Transferring Business; and
 - The total value of expenses, excluding member administration expenses, which are assumed to be unchanged by the transfer. No member administration expenses have been included as they will be novated to SF as part of the transfer.
- 9.15. Following the transfer, the solvency ratio of Mobius is expected to be comfortably in excess of its current Pillar 1 target solvency coverage ratio of around 120% of solvency margin. As described in paragraph 9.10, following the implementation of the Scheme Mobius's SCR is expected to be smaller than its MCR and so its MCR will be its Pillar 1 capital requirement. As such, it should also be noted that if the Scheme had been implemented on 31 March 2017, the MCR coverage ratio of Mobius would have been 301% and so comfortably in excess of the 120% Pillar 1 solvency coverage target.
- 9.16. Given the change in the Pillar 1 capital requirement from the SCR to the MCR and the small absolute amount that the target 20% capital buffer will represent following the proposed transfer, the current capital management policy will no longer be appropriate for the remaining business within Mobius. As such, Mobius's management expects that the capital management policy will be revised, by way of an increase to the target percentage of SCR, in order to reflect the post-Scheme risk profile. At the time of writing my report, the level of the post-Scheme capital management policy still needs to be discussed and approved by both the Mobius ARC and the Board of Mobius.
- 9.17. In addition, I have seen the pre-Scheme and pro-forma post-Scheme financial position on a Solvency II Pillar 2 basis and this shows that the Pillar 2 capital coverage will also increase as a result of the proposed transfer. Additionally, Mobius's target solvency margin on a Pillar 2 basis is expected to continue to be comfortably met in each year over the current business planning horizon.
- 9.18. I am therefore satisfied that the proposed Scheme will not have a material adverse effect on the financial resources available to support the security of the benefits of the non-transferring policies of Mobius.

TIP Projection Methodology

- 9.19. Mobius calculates the BEL for its TIPs using a simplification. It is assumed that the policies terminate at the point at which Mobius has the unilateral right to terminate the contract and therefore no allowance is made for cash flows beyond the assumed termination date. This is typically three months, which results in Mobius projecting future cash flows over a shorter period compared to a 'run-off' approach which reflects the expected future life time of the business. This has the effect of increasing the BEL, as no account is taken of the majority of expected future profit margins. However, it also results in a lower SCR. The net effect could therefore be to increase the percentage cover for the SCR compared to a run-off approach. SF intends to use a run-off approach for the Transferring Business, including the TIPs.
- 9.20. The PRA has opined that the correct approach is to apply a long-term projection period which assumes that a firm's unilateral rights will not be exercised (i.e. the run-off approach). However, under Solvency II regulations, firms are allowed to use proportionate methods to calculate technical provisions. The PRA has opined that the use of a short projection period is an acceptable simplification. It should be noted, however, that the PRA does not consider that either of the two approaches necessarily provides greater or weaker policyholder protection, but does accept that the SCR coverage ratios of firms using different approaches will not be directly comparable.
- 9.21. Although the approaches to calculating technical provisions and the capital requirements differ in some material respects between Mobius and SF, the approaches used by both companies are likely to be acceptable to the regulator and therefore in assessing the possible changes in the security of benefits, I have compared the balance sheets of the two companies without adjustment.

- 9.22. In addition I understand that, following a review of industry practice conducted by the PRA in late 2017, Mobius's Chief Actuary has carried out additional analysis with regards to the appropriateness of maintaining the current three-month projection period for the TIP business and has recommended to Mobius's Board a slight extension of the projection period. The revised projection period will be shorter than that used by some other firms (including that proposed by SF for the transferring TIP business) for their TIP business. The proposed extension and its financial impact have been shared with the PRA and Mobius's Chief Actuary expects the proposed extension to increase both the post-Scheme Own Funds and SCR by approximately the same quantum. Consequently, Mobius's Chief Actuary expects that post transfer Mobius's excess capital will be similar to that shown above in Table 9.1, but that the SCR coverage ratio is expected to be lower at approximately 360% rather than 522%. An alternative full run-off projection results in a lower SCR cover for Mobius. It should be noted that the review, and probable change, to Mobius's TIP projection period is not related to the Scheme and would have taken place regardless of the transfer.
- 9.23. However, the actual impact on Mobius's financial position will be dependent on a number of factors, including the PRA's assessment of Mobius's proposed revised approach, which are unknown at the time of writing this report. I will continue to review the discussions between Mobius and the PRA regarding this matter and will provide an update on the outcome of these discussions in my Supplementary Report.

The profile of risks to which the non-transferring policies of Mobius are exposed

- 9.24. Table 9.2 below shows the pre-Scheme and pro-forma post-Scheme Solvency II Pillar 1 risk profile of Mobius as at 31 March 2017.

Table 9.2 – The profile of risks that the non-transferring policies are exposed before and after the transfer (on a Solvency II Pillar 1 basis)

Risk sub-module	pre-Scheme £m	post-Scheme £m	Scheme Impact £m
Market risk	4.0	0.7	-3.3
Counterparty risk	6.1	0.7	-5.4
Life underwriting risk	4.2	0.4	-3.7
<i>Diversification</i>	<i>-4.1</i>	<i>-0.5</i>	<i>3.6</i>
Operational risk	0.9	0.9	0.0
<i>Loss absorbing capacity of deferred tax</i>	<i>-1.3</i>	<i>-0.2</i>	<i>1.1</i>
Total SCR	9.7	1.9	-7.8
Total MCR	4.4	3.3	-1.1

Source: Mobius's Chief Actuary's Report

- 9.25. Mobius's Chief Actuary believes that since Mobius's non-transferring TIP policies can be terminated unilaterally by Mobius at any time, subject to a three month notice period, exposure to market and life underwriting risk can be limited. That is, if the non-transferring business becomes unsustainable in the future due to the revenue from charges being insufficient to cover its expenses, Mobius could terminate the TIP policies. Mobius would then only be exposed to a further three months of losses on this business.
- 9.26. Mobius is able to use this form of risk mitigation regardless of whether its revenue shortfall were to arise due to a fall in the market value of assets under management (as an example of market risk) or due to higher than expected expenses (as an example of life underwriting risk).
- 9.27. Currently, the annual management charges from Transferring Business more than cover the investment management and member administration costs incurred by Mobius for this business. The proposed transfer will remove this source of revenue. The charges from the non-transferring business cover its own investment management costs and overheads (noting that there are no member administration costs on this business) under best estimate assumptions, although to a lesser extent than for the Transferring Business.
- 9.28. However, under the SF-Mobius Reinsurance Arrangement, Mobius will receive, from SF, a charge of 8 basis points per annum on the assets under management for the Transferring Business, which will in part offset this loss of revenue following the proposed transfer. Given that this charge is net of any investment management costs for this business, the entire 8 basis points charge received from SF is a source of additional revenue for Mobius.

- 9.29. Following the transfer, Mobius retains some exposure to counterparty risk in relation to surplus assets that are held with banking institutions and also some market risk in relation to a small number of CISs. However, the SF-Mobius Reinsurance Arrangement will remove the counterparty risk associated with the Transferring Business. This is the primary change to the risk profile of Mobius resulting from the implementation of the Scheme.
- 9.30. Although the likelihood of insolvency for Mobius is expected to decrease following the transfer due to the limited life, market and counterparty default risk exposure as well as the expected increase to target capital buffer in the capital management policy, the transfer does slightly increase the expected loss to benefits to the non-transferring policyholders in the event of Mobius becoming insolvent.
- 9.31. If Mobius were to become insolvent:
- Currently, any shortfall between the value of policyholders' unit-linked benefits and the assets available to Mobius in order to pay those benefits would be spread across all policyholders' funds in proportion to value of their benefits; and
 - Following the proposed transfer, the amended reinsurance arrangement between Mobius and L&GPML as described in paragraph 7.27 and the Security Assignment as described in paragraphs 7.36 and 7.37, SF would, in priority to any other Mobius policyholder or secured creditor, be able to require L&GPML to make payments in respect of the applicable Transferring Business managed by L&GPML directly to SF (thereby avoiding a defaulting Mobius) and exercise such other rights against L&GPML as Mobius would have had under the terms of the reinsurance agreement in respect of the Transferring Business. After this, as a result of the floating charge arrangement described in paragraph 7.34 and 7.35, any shortfall between the value of policyholders' unit-linked benefits and the assets/amounts recoverable from Mobius in order to pay those benefits would be spread across the unit-linked funds of both SF policyholders whose benefits are reinsured with Mobius, and direct Mobius policyholders, in proportion to value of their benefits.
- 9.32. As such, an insolvency event following the transfer would result in a greater expected loss for the non-transferring Mobius policyholders than that expected currently. As at 31 March 2017, the assets under management for the Transferring Business are equal to less than 4% of the assets under management for the entire Mobius business and this proportion is expected to decrease over time. The assets relating to the Transferring Business invested with L&GPML that SF will have priority over following the transfer therefore represent a small proportion of the assets of Mobius (around 2%). As such, while the expected loss for non-transferring policyholders will increase following the implementation of the Scheme, this is not expected to increase materially.
- 9.33. In addition, given that the implementation of the Scheme reduces risk overall and in particular it removes the majority of Mobius's exposure to the risk of default of the third party insurers it invests with, the likelihood of Mobius becoming insolvent is reduced following the transfer.
- 9.34. Furthermore, any eligible non-transferring policyholders of Mobius would continue to be protected by the FSCS following the transfer and could therefore receive compensation to recover any loss or deficit in the event of Mobius's insolvency.
- 9.35. Following the implementation of the Scheme, operational risk becomes more significant for Mobius due to the reduction in the exposure to other types of risk (i.e. market, life underwriting and counterparty default risk). That said, I would expect the absolute amount of exposure to operational risk to be reduced as a result of the transfer, given that the resulting business offers a simpler and more homogeneous portfolio of products. Given this, and the fact that Mobius have sufficient risk management controls in place and state minimal risk appetite for operational risk, I am satisfied that the implementation of the Scheme will not have a material adverse effect on the level of operational risk to which the non-transferring policies are exposed.
- 9.36. Finally, as highlighted in paragraph 6.70 Mobius considers and monitors its exposure to liquidity risk. Mobius measures its liquidity risk as the amount of shareholder resources held in highly liquid assets, such as cash or short term deposits that are available to cover its overheads i.e. its operational cash flows. They are also used by Mobius in instances where policyholders wish to switch (provided that the switch amount is under £1 million) or rebalance their portfolios.
- 9.37. As at 31 March 2017, Mobius had shareholder resources held in liquid assets of around £8 million. The expenses incurred from 31 March 2016 to 31 March 2017 were around £4.6 million and so Mobius has enough liquid assets to support its operational cash flows for around two years if expenses were to remain at this level.
- 9.38. As a result of the implementation of the Scheme, Mobius's shareholder resources will increase by the purchase consideration less estimated transfer-related expenses and costs incurred by Mobius. As shown in Table 9.1, this is anticipated to be in the region of around £2.9 million. I have no reason to believe there will be a material change in Mobius's operational cash flows following the implementation of the Scheme. Therefore, provided Mobius

invests the additional shareholder resources in highly liquid assets (as is its current approach to shareholder resources), Mobius will have a lower exposure to liquidity risk.

- 9.39. In addition, almost all of Mobius's unit-linked assets are invested in highly liquid assets and this will be unchanged by the transfer.
- 9.40. Therefore I am satisfied that the implementation of the Scheme will not have a material adverse effect on the risk profile to which the non-transferring policies are exposed.

The governance, management and service standards applicable to the non-transferring policies

- 9.41. The only change proposed to the operation of Mobius is to remove its GAA. Currently, none of the non-transferring policyholders fall within the scope of the existing GAA. Following the transfer, Mobius will no longer have any group personal pensions or group stakeholder pension plans and as such a GAA is no longer required for the non-transferring business.
- 9.42. The non-transferring policies do not have their member administration undertaken by Mobius and there will be no changes to this arrangement due to the transfer. Additionally, the investment administration currently provided by Mobius will continue to be serviced and administered under the same arrangements. Non-transferring policyholders will therefore not experience any change to their existing service standards as a result of the implementation of the Scheme.
- 9.43. Client relationship management with trustees who invest using Mobius's TIPs will be unaffected by the transfer.
- 9.44. The governance of the non-transferring policies will continue to be the responsibility of the Board of Mobius.
- 9.45. The management of Mobius have confirmed that there will be no suspension of trading around the Transfer Date.
- 9.46. Following the transfer, the amended reinsurance arrangement between Mobius and L&GPML in relation to the non-transferring business, as described in paragraph 7.27, is anticipated to be on terms that are consistent with the pre-Scheme agreement between the two parties. None of the other investment only reinsurance agreements with third party insurers will change as a result of the implementation of the Scheme.
- 9.47. Hence I am satisfied that the implementation of the Scheme will not have a material adverse effect on the governance, management and service standards of the non-transferring policies in Mobius.

The reasonable benefit expectations of the non-transferring policyholders

- 9.48. The non-transferring business is unit-linked in nature, and as such, policyholders' expectations in respect of their benefits are that:
- They receive their contractual benefits as set out under the policy; and
 - The policies are operated in accordance with their contractual terms, including the level of charges for unit-linked policies.
- 9.49. There will be no changes to the terms and conditions of the non-transferring policies of Mobius. There will be no change to the operation of the business and, in particular, the investment strategy for the non-transferring business.
- 9.50. There will be no changes to the level of charges for the non-transferring business as a result of the transfer.
- 9.51. There will be no costs or taxes incurred by the non-transferring policies as a result of planning or implementing the Scheme. These will be met by the shareholder funds of Mobius.
- 9.52. Therefore the transfer will not have a material adverse effect on the benefits payable to the non-transferring policyholders.
- 9.53. For these reasons I am satisfied that the Scheme will not have a material adverse effect on the reasonable benefit expectations of the non-transferring policyholders of Mobius.

Conclusion for the non-transferring policies

- 9.54. I am satisfied that the implementation of the Scheme will not have a material adverse effect on:
- The security of benefits under the non-transferring Mobius policies;

- The profile of risks to which the non-transferring Mobius policies are exposed;
- The governance, management or service standards applicable to the non-transferring policies of Mobius;
or
- The reasonable benefit expectations of non-transferring policyholders of Mobius.

10. THE EFFECT OF THE IMPLEMENTATION OF THE SCHEME ON THE SF POLICIES

Introduction

- 10.1. In this section I consider the effect of the implementation of the Scheme on the existing SF policies.
- 10.2. For these policies, I consider the likely effects of the implementation of the Scheme on the security of the guaranteed benefits and on the benefit expectations of the holders of those policies.
- 10.3. The key issues to consider are:
- The financial resources available to provide security for the benefits of the existing SF policyholders following the implementation of the Scheme compared to those currently available;
 - The effect on the existing SF policies of any change in the risk profile of SF as a result of the implementation of the Scheme;
 - The effect of the implementation of the Scheme on the governance, management and service standards applicable to the existing SF policies; and
 - The effect of the implementation of the Scheme on the reasonable benefit expectations of the existing SF policyholders.

The financial resources available to provide security of benefits

- 10.4. Currently, the existing policies in SF achieve security for their benefits primarily from the assets held by the company:
- Assets backing the technical provisions and SCR held to meet the benefits of the existing SF policies, as required under the Solvency II regulations; and
 - The additional capital resources required by SF's CMRP, with the financial strength that provides security for the benefits including the strength of the governance around the capital management policy and changes to it.
- 10.5. Following the implementation of the Scheme, the security of the benefits of the existing policyholders in SF will continue to be provided by these two elements.
- 10.6. Table 10.1 below shows the pre-Scheme and pro-forma post-Scheme financial strength of SF as at 31 December 2016 on a Solvency II Pillar 1 basis.

Table 10.1: Pro-forma comparison of the regulatory solvency providing security for benefits to the existing SF policyholders pre- and post-Scheme

Impact of the Transfer on the solvency position of SF as at 31 December 2016			
£m	pre-Scheme	post-Scheme	Scheme impact
Assets	2,552.4	2,892.6	340.2
Technical provisions	2,267.2	2,606.3	339.1
Other liabilities	102.6	102.6	0.0
Adjustment for restricted Own Funds items due to ring-fencing	-19.9	-19.9	0.0
Solvency II Own Funds	162.7	163.8	1.1
SCR	81.8	85.8	4.0
Excess Capital	80.9	77.9	-3.0
SCR coverage ratio	199%	191%	-8%

Source: SF's Chief Actuary's Report

- 10.7. Table 10.1 shows that if the Scheme had been effective as at 31 December 2016, there would have been a slight deterioration in SF's Solvency II Pillar 1 solvency position. This is predominantly due to the following:
- SF's assets will increase by the assets backing the unit reserves of the Transferring Business, less the purchase consideration and the estimated transfer-related expenses and costs incurred by SF;
 - The technical provisions will increase in relation to the Transferring Business. This increase consists of the liability in respect of the unit reserves, an increase in the risk margin of around £1.6m and an offsetting decrease due to the negative non-unit reserve of around £6.2m; and
 - An increase in the SCR to reflect the risks associated with the Transferring Business, predominantly due to equity risk. The regulatory capital for this business will be provided from the excess capital resources in the SF Main Fund.
- 10.8. SF's CMRP and the target level of capital buffer in excess of the Pillar 2 capital requirement, will not be changed by the implementation of the Scheme and thus the security of existing policyholder benefits will only be affected by any changes to the company's continuous ability to comply with this policy.
- 10.9. I have also reviewed the pre-Scheme and pro-forma post-Scheme financial position of SF as at 31 December 2016 on a Solvency II Pillar 2 basis. As is the case on a Pillar 1 basis, if the Scheme had been effective as at this date, there would have been a deterioration in SF's Pillar 2 solvency position. However, following the transfer, the solvency ratio of SF is expected to be below its risk appetite trigger point of 200% coverage of its Pillar 2 capital requirement. Consequently, management would be required to assess whether the solvency level is acceptable and whether actions are required in order to improve the solvency level above their target of 200% on a Pillar 2 basis. However following the transfer, the solvency ratio of SF is expected to be comfortably in excess of its lower limit solvency coverage ratio of 150% of its Pillar 2 capital requirement.
- 10.10. The implementation of the Scheme will have no impact on the reserves held in relation to the current SF policies that are within the SLL, LANMAS, Rational Shelley and M&GM notional sub-funds. However, the proposed transfer will have an indirect impact on the SF policies within these funds due to the existing capital support arrangements. That is, the reduction in solvency cover leads to:
- An increase in the likelihood that the SF Main Fund will require capital support from the notional sub-funds; and
 - A reduction to the available resources of the SF Main Fund to provide capital support to the notional sub-funds should they require it in the future.
- 10.11. As noted in earlier sections of my report, when considering the financial resources available to provide the security of benefits of a particular group of policies, greater reliance can be placed upon the assets held in adherence to the capital management policy than on assets in excess of this level, since assets in the latter category are potentially available for distribution (subject to the PRA rules) or to fund strategic business growth.
- 10.12. Following the implementation of the Scheme, although there is some deterioration in the capital cover of SF, SF still remains capitalised above the risk appetite limit of 150% of its Solvency II Pillar 2 capital requirement. As such, I do not believe that the deterioration will have a material impact on the capital support available to, or the likelihood of the SF Main Fund requiring capital support from, the notional sub-funds.
- 10.13. As well as the financial resources available to SF, the existing policyholders also achieve security for their benefits from the reinsurance SF has in place with a range of reinsurers, as discussed in paragraphs 5.65 to 5.72. SF's existing reinsurance agreements will not be changed as a result of the proposed transfer.
- 10.14. I am therefore satisfied that the implementation of the Scheme will not have a material adverse effect on the financial strength of SF, and hence on the security of the benefits of the existing SF policies.

The profile of risks to which the existing SF policies are exposed

- 10.15. The dominant risks for SF prior to the Scheme are:
- Market risk: predominantly due to its investment in equities in respect of the asset shares for with-profits policies and the cost of guarantees for such business in the event of a fall in market values in the M&GM notional sub-fund;
 - Counterparty default risk: due to its reinsurance and banking counterparties; and
 - Life insurance risk: mortality, morbidity and longevity risk due to SF's life and pension liabilities.

- 10.16. Table 10.2 below shows SF's pre-Scheme and pro-forma post-Scheme Solvency II Pillar 1 risk profile as at 31 December 2016.

Table 10.2: The profile of risks that the existing SF policies are exposed to before and following the implementation of the Scheme (on a Solvency II Pillar 1 basis)

Risk sub-module	Pre-Scheme (£m)	Post-Scheme (£m)	Scheme impact (£m)
Market risk	65.9	69.7	3.8
Counterparty risk	11.6	11.6	0.0
Life underwriting risk	10.3	12.2	1.9
<i>Diversification</i>	<i>-14.6</i>	<i>-15.8</i>	<i>-1.2</i>
Operational risk	7.8	8.2	0.4
<i>Loss absorbing capacity of technical provisions</i>	<i>-4.5</i>	<i>-4.5</i>	<i>0.0</i>
<i>Adjustment due to ring-fenced funds</i>	<i>5.2</i>	<i>4.4</i>	<i>-0.8</i>
Total SCR	81.8	85.8	4.0
Total MCR	28.6	31.0	2.4

Source: SF Chief Actuary's Report

- 10.17. Table 10.2 shows that the relative profile of risks is not impacted materially by the Scheme on a Solvency II Pillar 1 basis. I have also reviewed the same analysis on a Solvency II Pillar 2 basis and I can similarly conclude that the risk profile of SF will not be impacted materially by the implementation of the Scheme. As such the dominant risks will remain as outlined in paragraph 10.15 following the proposed transfer.
- 10.18. As discussed in paragraph 7.19, the Scheme is conditional on SF entering into an investment-only reinsurance contract with Mobius, under the SF-Mobius Reinsurance Arrangement. This will increase SF's exposure to counterparty default risk in respect of Mobius.
- 10.19. However, as described in paragraph 7.27, Mobius and L&GPML intend to split their existing reinsurance agreement into two distinct contracts, where one will cover the Transferring Business. In addition to this, SF and Mobius intend to enter into a security assignment as described in paragraphs 7.37 and 7.38, such that SF would, in the scenario that Mobius defaults on its obligations under the SF-Mobius Reinsurance Arrangement, be entitled to make a claim for unpaid monies on the assets that Mobius has invested with L&GPML in relation to the Transferring Business. SF's additional exposure to counterparty default risk in respect of Mobius following the proposed transfer will be limited as result of its rights against L&GPML which it obtains through the Security Assignment.
- 10.20. SF and Mobius intend to enter into a Deed of Charge (also referred to as a floating charge agreement) whereby Mobius creates a floating charge over all of Mobius's long-term insurance assets in favour of SF to secure the value of the reinsurance ceded to Mobius in respect of the Transferring Business. The rights of SF as floating chargee will include security over the assets invested by SF with Mobius pursuant to the SF-Mobius Reinsurance Arrangement. Upon an enforcement of the Deed of Charge SF will be entitled to share *pari passu* with the holders of all other floating charges the proceeds of any enforcement available to be distributed to floating charges.
- 10.21. Absent the Security Assignment, SF would be required to hold a greater value of counterparty risk capital in relation to default risk arising under the SF-Mobius Reinsurance Arrangement. However, due to the Security Assignment, under Solvency II rules SF is not required to hold any counterparty default risk capital in respect of Mobius. At the time of writing my report, I have received assurances from SF that this treatment has been reviewed by its external auditor, and that it had no concerns over the treatment. A final statement from SF's auditor confirming this view is expected following the finalisation of the SF-Mobius Reinsurance Arrangement and the associated arrangements.

and agreements, as described in paragraphs 7.26 to 7.38, and an update will be provided in the Supplementary Report.

- 10.22. Additionally under the terms of the SF-Mobius Reinsurance Arrangement, as a result of the implementation of the Scheme SF will become exposed to the risk of insolvency and default of the third parties that Mobius invests with. In such an event, SF will be required to meet its obligations to policyholders in full for members who joined plans issued under group policies before 7 April 2010.
- 10.23. SF's pro-forma post-Scheme Solvency II Pillar 1 balance sheet does not currently allow for any capital to be held in respect of this risk of default of the third parties that Mobius invests with. At the time of writing my report, I have received assurances from SF that this treatment has been reviewed by its external auditor, and that it had no concerns over the treatment. A final statement from SF's auditor confirming this view is expected following the finalisation of the SF-Mobius Reinsurance Arrangement and the associated arrangements and agreements, as described in paragraphs 7.26 to 7.38, and an update will be provided in the Supplementary Report. In addition, I have seen the post-Scheme financial position on the basis that a "look through" approach is taken in respect of the risk of counterparty default, such that capital is held in respect of this risk, and note that it does not have a material impact on the solvency cover of SF.
- 10.24. The Transferring Business is exposed to significant 'mass lapse' risk as there is a concentration of assets in group pension plans held by a small number of employers (who are the policyholders). These policyholders have the power to transfer all assets under management to new arrangements and in the event of a number of these policyholders exercising this power within a short timeframe, this would result in a significant loss of new contributions received on the Transferring Business. Consequently, the proposed transfer introduces a reasonably significant mass lapse risk to the existing SF policyholders. However, as explained below the financial consequences of any mass lapse to SF is adequately covered by capital.
- 10.25. Under Solvency II rules, companies only need to hold capital in respect of the type of lapse that would cause the greatest loss for the company as a whole. For SF, the most significant risk in respect of lapses currently is a sustained increase in the number of lapses, rather than a mass lapse event as described above. This risk currently arises on the business in the SF Main Fund, where the Transferring Business will be transferred to.
- 10.26. Following the implementation of the Scheme, the most significant risk in respect of lapses will continue to be the risk of a sustained increase in the number of lapses, in part because this risk is also inherent in the Transferring Business. As such, no capital will be held by SF in respect of the increased risk of mass lapse. However, capital will be held in respect of the risk of increased lapses on an ongoing basis and this represents the biggest expected loss in a stressed scenario for SF following the transfer.
- 10.27. Furthermore, the Solvency II Pillar 1 SCR is intended to represent the capital required by a company to have a 99.5% probability of remaining solvent over a one year time horizon, and SF has calculated their expected post-Scheme SCR in accordance with the Solvency II rules. As such, I am satisfied that the capital held adequately reflects the risk profile of the business.
- 10.28. Finally, following the implementation of the Scheme, the calculation of the operational risk capital requirement under Solvency II regulations contains an element based on the amount of expenses incurred during the previous 12 months in respect of life insurance contracts where the investment risk is borne by policyholders. This will include the expenses on all plans of Mobius issued under group policies where the member joined the scheme after 7 April 2010 in the Transferring Business, and to all TIPs in the Transferring Business (i.e. where investment risk is borne by the policyholder). Consequently, following the implementation of the Scheme, it is estimated that SF's exposure to operational risk will increase by £0.4 million. However, given that the proposed transfer does not result in a change in the policyholder administration and investment administration of the Transferring Business, it is not anticipated that the management of the Transferring Business will introduce a material increase in exposure to operational risk for SF.
- 10.29. Therefore, I am satisfied that the implementation of the Scheme will not have a material adverse effect on the profile of risks to which the existing SF policyholders are exposed.

The governance, management and service standards applicable to the existing SF policies

- 10.30. In addition, the Scheme will not lead to any of the provisions within the Previous Schemes, as defined in paragraph 5.11, being altered. As such, the SF Main Fund and notional sub-funds will continue to be subject to the conditions set out in the Transfer Agreement sanctioned by the Court at that time.
- 10.31. The implementation of the Scheme will not lead to any changes to the servicing and administration arrangements and existing SF policies will continue to be serviced internally, or using third parties (with appropriate oversight by a dedicated operations team at SF), as described in paragraphs 5.42 to 5.43. Administration of the Transferring

Business will continue be undertaken by Aegon, as described in paragraphs 6.14 to 6.18. No change is therefore expected to service standards for the existing SF policies as a result of the Scheme.

- 10.32. Following the implementation of the Scheme, SF will form a GAA that aims to replicate the existing Mobius GAA and the SF Board Risk Committee will be responsible for the oversight and running of the GAA. The scope of the GAA is expected to be extended to include around 1,500 of SF's current policyholders of pension business. The exact structure and Terms of Reference of the SF GAA has not been finalised at the time of writing my report. However, I expect that regardless of the structure, SF's existing pensions business will benefit from the increased oversight provided by the GAA. However, I will provide an update on this in the Supplementary Report.
- 10.33. Other than the introduction of the GAA described above, there will be no changes to the way that the existing SF business is managed. In particular:
- The Board of SF will continue to manage the friendly society by authority of the Delegates in accordance with the Friendly Society Act, its Memorandum and Rules and any directions given by Special Resolution;
 - SF will continue to maintain an RMF to ensure there is a sound and consistent basis for the identification, measurement, management, monitoring and report of their risk profile; and
 - The capital support arrangements will remain in place and unchanged, and as such the SF Main Fund and the notional sub-funds can continue to provide capital support to one another if required.
- 10.34. Specifically for the with-profits business in both the SF Main Fund and the notional sub-funds, the proposed transfer will not lead to any changes to:
- The way that the five with-profits funds are managed, with the objective of meeting policyholders' reasonable expectations and equitably distributing the estate;
 - The PPFMs for the with-profits business in each of the five with-profits funds. In particular, the bonuses on with-profits policies, investment policy and amounts credited and debited from each of the with-profits funds will continue to be determined in line with the fund's published PPFM;
 - The role of the external WPA who provides oversight of the with-profits funds; and
 - The role of the external Independent Person who reviews PPFM compliance and the governance arrangements in place to achieve it.

Membership rights for existing policyholders

- 10.35. Membership rights for all existing SF policyholders, as prescribed in the Memorandum and Rules of SF and described in paragraphs 5.62 to 5.64, will be unaffected by the implementation of the Scheme. However following the proposed transfer, the policyholders within the Transferring Business will also become members of SF, equally with the existing SF policyholders. As such, the transfer will result in a dilution of membership rights for the existing SF policyholders. That is, following the transfer, the policyholders within the Transferring Business will also have the right to vote, diluting the influence of the existing SF policyholders' votes. In addition, on wind-up of SF, the free assets will also be shared (equitably as determined by the Board of SF) with the policyholders within the Transferring Business.
- 10.36. Given the relative size of the Transferring Business (around 13,310 policyholders/members) compared to the size of the existing SF business (around 1.2 million policyholders), this dilution is not expected to have a material impact on the existing SF policyholders. Furthermore, it is expected that the Transferring Business will generate a profit for SF and as such this should (at least partially) offset the reduction in the equitable share of the free assets payable to existing SF policyholders on wind-up. Also, the increased number of members will help reduce costs per member with regard to SF's fixed costs.
- 10.37. The existing SF policyholders will not receive compensation for the dilution of membership rights as a result of the implementation of the Scheme. Given that the dilution is not expected to have a material impact on the existing SF policyholders, I consider this to be reasonable.
- 10.38. Therefore, I am satisfied that the implementation of the Scheme will not have a material adverse effect on the governance, management and service standards of the policies in SF and that the Scheme is equitable to all classes and generations of SF policyholders.

The reasonable benefit expectations of the SF policyholders

The existing with-profits policyholders in the SF Main Fund

- 10.39. The existing with-profits policyholders' expectations in respect of their benefits are that:
- They receive their guaranteed benefits as set out under the policy and as declared via prior bonus declarations;
 - Their bonuses and payouts are in line with the principles and practices prescribed in the applicable PPFM; and
 - The policies are operated in accordance with their contractual terms, including the level of charges for unit-linked policies.
- 10.40. The Scheme will not alter the terms and conditions of existing with-profits policies in the SF Main Fund.
- 10.41. In relation to the existing with-profits policies in the SF Main Fund, as described above, the implementation of the Scheme will not lead to any changes in the operation of the SF Main Fund. In particular, the bonuses on with-profits policies, investment policy, surrender values and amounts credited and debited from each of the with-profits funds will continue to be determined in line with the fund's published PPFM.
- 10.42. The costs associated with the Scheme that are attributable to SF will be met from the SF Main Fund. I believe that this is reasonable as the expected surplus from the transfer will accrue in the SF Main Fund.
- 10.43. The value of the assets to be transferred into the SF Main Fund in respect of the Transferring Business will be the assets backing the unit reserve, followed by a payment from SF to Mobius of the purchase consideration for the Transferring Business. This amount is approximately equal to the BEL (i.e. the unit reserve plus the negative non-unit reserve) plus the risk margin plus the costs attributable to SF of implementing the Scheme. As such, the assets to be transferred into the SF Main Fund do not cover the SCR on the Transferring Business and so this capital will be covered by the surplus assets of the SF Main Fund, reducing the surplus assets of the fund.
- 10.44. The risk margin may be regarded as a reasonable proxy for the return the purchaser is forgoing by utilising capital to back the transferring liabilities, in this case, the return for the with-profits policyholders for using the surplus assets of the SF Main Fund to back the SCR associated with the Transferring Business. The SCR and risk margin are expected, if best estimate assumptions hold, to be released as the Transferring Business runs off, generating a profit for with-profits policyholders in the future.
- 10.45. SF will be entitled to receive management charges on the unit funds of the Transferring Business but will be liable to pay charges to Aegon for administration services and an investment administration charge of 8 basis points per annum on assets under management on the Transferring Business to Mobius. Under best estimate assumptions it is expected that the charges received will be greater than the outgoing charges and so this will generate a positive return for the with-profits policyholders in the SF Main Fund. However, this is not an additional source of surplus for the with-profits policyholders as it has already been accounted for in calculating the negative non-unit reserve.
- 10.46. Taking all of this into consideration, SF expect that the Transferring Business will generate profit for distribution to the with-profits policyholders in the SF Main Fund.
- 10.47. In addition, SF's WPA has assured me that, despite the reduction in the surplus assets of the SF Main Fund, there is expected to be no impact on the bonus prospects or level of bonuses paid to policyholders with with-profits policies in the short to medium term. SF's WPA also expects that the profits emerging from the Transferring Business will initially be applied to repay the capital cost and, once that has been extinguished, will be included in the formula used to calculate and distribute the miscellaneous surplus in the SF Main Fund as bonuses.
- 10.48. I therefore do not consider that the Transfer will have an adverse effect on the ability to pay bonuses and thus the bonus earning capacity of the policies in the SF Main Fund.
- 10.49. For the SF Main Fund, the current investment policy reflects the fact that the fund is open to new business and aims to secure the best possible return on the funds, subject to meeting contractual benefits as they fall due. This is unchanged by the implementation of the Scheme.
- 10.50. Following the implementation of the Scheme, in respect of the Transferring Business the unit-linked reserves will be matched by appropriate unit-linked funds and the non-unit reserves will be matched by fixed interest securities. As such, the investment choices are aimed at meeting the contractual benefits of the Transferring Business. This investment choice is not expected to achieve high returns for with-profits policyholders but it is consistent with the investment policy of the SF Main Fund. Given this and the fact that the non-unit reserves on the Transferring

Business are expected to be small relative to the size of the SF Main Fund overall, I am satisfied that the Scheme will not have a material adverse effect on the investments backing the with-profits policies.

- 10.51. In addition, in the report of the WPA of SF on the impact of the implementation of the proposed Scheme, the WPA concludes that he considers that:
- The benefit expectations of the SF with-profits policyholders will not be adversely affected by the Transfer; and
 - The bonus prospects of policyholders with with-profits policies will not be diminished as a result of the transfer.
- 10.52. For these reasons I am satisfied that the Scheme will not have a material adverse effect on the reasonable benefit expectations of the existing with-profits policyholders in the SF Main Fund.

The existing non-profit and unit-linked policyholders in the SF Main Fund

- 10.53. As discussed in Section 5, the non-profit and unit-linked business in the SF Main Fund predominantly comprises:
- Unit-linked life and pensions business; and
 - Non-profit whole of life and term assurance business.
- 10.54. Policyholders' reasonable expectations in respect of their benefits under such products are:
- That policyholders receive their contractual benefits as set out under the policy; and
 - The policies are operated in accordance with their contractual terms, including the level of charges for unit-linked policies.
- 10.55. There will be no changes to the terms and conditions of the existing policies of SF. The existing policyholders in the SF Main Fund will remain in the SF Main Fund following the implementation of the Scheme and there will be no change to the operation of the SF Main Fund.
- 10.56. Therefore the Scheme will have no effect on the benefits payable under the existing non-profit or unit-linked policies in SF.
- 10.57. Following the implementation of the Scheme, the solvency position of the SF Main Fund will deteriorate, predominantly as a result of an increase in the SCR required to be held in respect of the Transferring Business. However, overall SF is expected to remain capitalised above its CMRP limit of 150% of its Solvency II Pillar 2 capital requirement.
- 10.58. For these reasons I am satisfied that the Scheme will not have a material adverse effect on the reasonable benefit expectations of the existing non-profit and unit-linked policyholders in the SF Main Fund.

The existing policyholders in the other notional sub-funds

- 10.59. A full summary of the business within the SLL, LANMAS, Rational Shelley and M&GM notional sub-funds is included in Section 5 of my report. However, overall the business within these notional sub-funds comprises:
- Conventional and unitised with-profits business;
 - Unit-linked business (both life and pensions);
 - Non-profit protection business (whole of life and term assurances); and
 - Immediate and flexible income annuities.
- 10.60. There will be no changes to the terms and conditions of the existing policies of SF. The existing policyholders in the notional sub-funds will remain in the same notional sub-funds following the implementation of the Scheme and there will be no change to the operation of any of the notional sub-funds.
- 10.61. For with-profits policies, the bonuses on with-profits policies, investment policy and amounts credited and debited from each of the with-profits funds will continue to be determined in line with the fund's published PPFM.

- 10.62. The costs associated with the Scheme that are attributable to SF will be met solely from the SF Main Fund and so none of the costs will be attributable to the policyholders in the notional sub-funds.
- 10.63. For these reasons I am satisfied that the Scheme will not have a material adverse effect on the reasonable benefit expectations of the existing policyholders in the four notional sub-funds.
- 10.64. I am therefore satisfied that the implementation of the Scheme will not have a material adverse effect on the reasonable expectations of the existing SF policyholders.

Conclusion for the different groups of the existing SF policies

The existing with-profits policyholders in the SF Main Fund

- 10.65. I am satisfied that the implementation of the Scheme will not have a material adverse effect on:
- The security of benefits of the existing with-profits policyholders in the SF Main Fund;
 - The profile of risks to which the existing with-profits policyholders in the SF Main Fund are exposed;
 - The governance, management or service standards applicable to the existing with-profits policyholders in the SF Main Fund; or
 - The reasonable benefit expectations of the existing with-profits policyholders in the SF Main Fund.

The existing non-profit and unit-linked policyholders in the SF Main Fund

- 10.66. I am satisfied that the implementation of the Scheme will not have a material adverse effect on:
- The security of benefits of the existing non-profit and unit-linked policyholders in the SF Main Fund;
 - The profile of risks to which the existing non-profit and unit-linked policyholders in the SF Main Fund are exposed;
 - The governance, management or service standards applicable to the existing non-profit and unit-linked policyholders in the SF Main Fund; or
 - The reasonable benefit expectations of the existing non-profit and unit-linked policyholders in the SF Main Fund.

The existing policyholders in the other notional sub-funds

- 10.67. I am satisfied that the implementation of the Scheme will not have a material adverse effect on:
- The security of benefits of the existing policyholders in the other notional sub-funds of SF;
 - The profile of risks to which the existing policyholders in the other notional sub-funds of SF are exposed;
 - The governance, management or service standards applicable to the existing policyholders in the other notional sub-funds of SF; or
 - The reasonable expectations of the existing policyholders in the other notional sub-funds of SF.

Conclusion for the existing SF policies

- 10.68. Overall, I am satisfied that the implementation of the Scheme will not have a material adverse effect on:
- The security of benefits under the existing SF policies;
 - The profile of risks to which the existing SF policies are exposed;
 - The governance, management or service standards applicable to the existing SF policies; or
- The reasonable benefit expectations of the existing SF policyholders.

11. OTHER CONSIDERATIONS ARISING FROM THE SCHEME

The approach to communication with policyholders

- 11.1. Regulations made under FSMA require a communication regarding the proposed transfer to be sent to every policyholder of the parties to the Scheme. However, this requirement may be waived at the discretion of the Court, which will give consideration to issues such as the practicality and costs of sending notices against the likely benefits for policyholders of receiving such communications. In order to comply with SUP 18.2.46G of the FCA Handbook, the companies are required to notify the policyholders, or interested persons, at least six weeks before the date of the Court hearing at which the application to sanction the Scheme will be heard.
- 11.2. Regulations require that a legal notice in a form approved by the PRA is published in the London, Edinburgh and Belfast Gazettes, as well as two national newspapers in the UK.
- 11.3. In addition to the Gazettes, SF and Mobius will publish legal notices in The Times and The Telegraph. These newspapers have been chosen as they have a wide circulation and routinely publish legal notices in relation to transfers of insurance business. In addition, an informal notice will be published in The Herald. This has been selected as it has a wide circulation in Scotland where the head office of SF is situated.
- 11.4. Notices will also be published in regional and international variations (with the exception of The Herald), as well as online where available. Notices will not be made in any non-UK jurisdictions.
- 11.5. After discussions with the regulators regarding the transferring policies whose state of commitment may not be the UK, but another EEA state, other relevant EEA regulators will be consulted regarding the transfer.
- 11.6. It is required under The Financial Services and Markets Act 2000 (Control of Business Transfers) (Requirements on Applicants) Regulations 2001 “**CBTRA Regulations**” that where, for any policy included in the proposed transfer, the state of the commitment is an EEA state other than the UK, certain notices should be published within that state.
- 11.7. The state of the commitment for the Transferring Business has been determined as follows:
 - **TIPs with member administration services:** the policies were entered into between Mobius and the trustees of each TIP scheme. All of these trustees are established at an address in the UK, and so both parties to the contract of insurance evidenced by the policy are UK persons, acting in the course of activities conducted in the UK. Consequently, the UK is the state of the commitment for this group of policies.
 - **Individual personal pension plans, group personal pension plans and group stakeholder pension plans:** all transferring individual personal pension plans, group personal pension policies and group stakeholder policies were entered into based on an application submitted by the individual scheme member, or on behalf of the pension scheme member (i.e. by their employer). In a number of cases, a non-UK address was provided at the time of the application: Mobius has identified 8 EEA states other than the UK that may be the state of the commitment, consisting of 47 of the transferring Mobius policies.
- 11.8. Although there are around 47 members whose policies may have a state of the commitment outside of the UK, Mobius is seeking dispensation from the requirement to publish notices in any EEA state other than the UK. It is doing so on the grounds that it will be contacting all members of individual personal pension plans, group personal pension plans and group stakeholder pensions plans directly, and due to the small number of members that are based outside the UK. Given that direct communications will be sent to each of these scheme members, I am satisfied that they will receive a sufficient notification of the proposed transfer and that they will not be materially disadvantaged by notifications not being published within newspapers in their non-UK EEA state.
- 11.9. Policyholders and other interested parties will be able to obtain information from the SF and Mobius websites which will contain documents regarding the Scheme, including a statement setting out the terms of the Scheme and a summary of my report.
- 11.10. In addition to these public notifications, SF and Mobius will send direct communications to certain policyholders, with both parties seeking dispensation from the Court such that they do not have to send the statutory form of notice to all policyholders.

- 11.11. Mobius intends to send direct communications to the following groups of policyholders, where it has a current address, to notify them of the transfer:
- The trustees who hold a TIP in the Transferring Business, and the adviser of the trustees (in some cases, where Mobius regularly deals with the adviser);
 - The individual scheme members of a group personal pension plan, group stakeholder pension plan or a TIP in the Transferring Business;
 - The individual holders of an individual personal pension plan in the Transferring Business; and
 - The trustees who hold a TIP in the non-transferring business, and the adviser of the trustees (in some cases, where Mobius regularly deals with the adviser).
- 11.12. Therefore, Mobius will not be directly notifying the underlying members for TIPs in the non-transferring business, instead placing reliance on the trustees to make the details of the transfer known to their members if they wish to. Mobius's motivations for this are that:
- A single policy is issued to trustees who hold a TIP in the non-transferring business, Mobius solely perform investment management duties in relation to the funds invested with the TIP, and there are no associated arrangements to track benefit entitlements. Mobius do not perform member administration for these policies and have no direct or indirect connection with the underlying members;
 - The legal policyholder of each TIP in the non-transferring business is the body of trustees of the relevant scheme, not the underlying members of the scheme. Therefore, under CBTRA Regulations, Mobius only has a requirement to directly notify the trustees (as policyholder) of the proposed transfer and not the underlying members; and
 - Mobius believes that it would be disproportionate to send the notice to each underlying member of the TIPs in the non-transferring business as the proposed transfer is not expected to have a material adverse effect on these members.
- 11.13. I have reviewed the policyholder letters to be sent to trustees of the non-transferring TIP business and these clearly state that the trustees should consider whether to inform or consult their members about the proposed transfer. In addition, Mobius offers to provide assistance (if required) in doing this. I understand that that there is no legal obligation for the trustees to notify their members regarding the proposed transfer. Therefore, I cannot say for certain that the underlying TIP members will be duly notified by the relevant scheme trustees. However, as concluded in paragraph 9.54, I do not believe there will be a material adverse impact on this group of policyholders as a result of the implementation of the Scheme. In particular, I expect there to be no change in the governance, management or service standards applicable to the non-transferring policies of Mobius and an improvement to the security of policyholder benefits (reflected by the increase in the SCR and MCR coverage ratios shown in Table 9.1 following the implementation of the Scheme). Consequently, I would expect that any notification sent by the trustees to their members would state that the transfer is expected to have no impact on their policies. Given this, I do not believe that the non-transferring policyholder would be adversely impacted by not receiving a direct notification from its trustees on the proposed transfer.
- 11.14. Mobius has current addresses for all 13,310 transferring members that it intends to contact. If any notices are returned undelivered, Mobius will use Aegon to trace the addresses of any individuals who have moved address without having notified Aegon. The tracing work will be in line with Aegon's standard tracing process, using Experian plc. and the Department of Work and Pensions. Wherever possible, Aegon will attempt to re-deliver the notification to the policyholder. Given this, I believe the number of transferring members who will not be informed of the transfer directly as a result of Aegon not having their current address will be minimal.
- 11.15. All transferring members who are to be notified by Mobius of the proposed transfer have single life policies with Mobius and there are no joint or contingent policyholders that require consideration.
- 11.16. It is recommended within Section 7 of the proposed guidance provided in the FCA finalised guidance FG18/4, that any communications sent to policyholders should include:
- A summary of this report;
 - A supporting document such as a question and answer or frequently asked questions which gives further details and issues for note by policyholders;

- A summary of the terms of the Scheme; and
- A description of the effect of the main provisions of the Scheme.

11.17. Mobius's direct communications to policyholders will include a summary of my report, a supporting question and answer document and a summary of the Scheme, the transfer process and details on how policyholders may object to the proposed transfer. There will be three versions of policyholder mailings, one for each of the following policyholder groups:

- The trustees who hold a TIP in the Transferring Business, and the adviser of the trustees (in some cases, where Mobius regularly deals with the adviser);
- The individual scheme members of a group personal pension plan, group stakeholder pension plan or a TIP in the Transferring Business, and the individual holders of an individual personal pension plan in the Transferring Business; and
- The trustees who hold a TIP in the non-transferring business, and the adviser of the trustees (in some cases, where Mobius regularly deals with the adviser).

Each version will be tailored to the needs of that group.

11.18. I have reviewed the communications that have been prepared by Mobius to be sent to the policyholders described in paragraph 11.11 and I am satisfied that they are sufficiently detailed and clear.

11.19. The Board of SF manages the friendly society by authority of the Delegates in accordance with the provisions of the Friendly Society Act, its Memorandum and Rules and to any directions given by Special Resolution. This includes the power to accept a transfer of business from another friendly society or proprietary company. It is a governance requirement of SF that, for the transfer of insurance business into or out of SF, the transfer must be approved by the Delegates on behalf of all SF members by way of a Special Resolution.

11.20. SF will convene a SGM prior to the Court hearing to sanction the Scheme. To enable the Delegates to make an informed decision, each Delegate will receive a voting pack in advance of the SGM, which will include an explanatory document prepared by SF (containing details of the proposed transfer) alongside a copy of the communications that are to be prepared by and sent to Mobius policyholders as described in paragraph 11.17.

11.21. SF is seeking dispensation from the Court from sending direct communications regarding the transfer to policyholders other than the Delegates. This is due to the cost involved in sending the direct communications to every policyholder, which is judged to be around £400,000, being disproportionate given:

- The size of the Transferring Business is small relative to SF's business: there are around 91 transferring policies (in respect of around 13,310 policyholders/members) with around £340 million of assets under management proposed to transfer into SF, which itself has around 1.2 million policyholders and £2.5bn assets under management (as at 31 December 2016);
- The impact of the Scheme on the SF policyholders: The management of SF has concluded that the Scheme will have no adverse effect on the security or the reasonable expectations of the SF policyholders, including with-profits policyholders. In addition, the management of SF has stated that there will be no change to the administrative or operational arrangements for the SF policyholders as a result of the transfer.
- The adequacy of the other publicity proposals, namely the ability to access information on the transfer online. This is consistent with the method of policyholder communication for another recent Part VII transfer into SF.

11.22. I consider it reasonable to assume that the Delegates will represent the interests of the members of SF at the SGM as set out in the Memorandum and Rules of SF. Furthermore, in paragraph 10.65 of my report, I have concluded that I am satisfied that the implementation of the Scheme will not have a material adverse effect on the security of benefits, reasonable expectations or service standards or governance applicable to the policyholders of SF. I am therefore satisfied that there will be no detriment to policyholders caused by a waiver from the requirement to contact such policyholders directly, and consider that it would require disproportionate effort and cost to do so, as well as potentially cause unnecessary concern for policyholders not materially affected by the transfer.

11.23. I have reviewed the voting pack prepared by SF for the Delegates and are satisfied that it is sufficiently detailed and clear.

- 11.24. I am therefore satisfied that the proposed approach to communication with policyholders, including the application for the waivers, is fair and reasonable.

The costs of the Scheme

- 11.25. Mobius and SF will each bear their own costs of the Scheme, other than for certain costs such as my Independent Expert fees, Court fees and Counsel's fees which will be shared equally between the parties, as will the costs of advertising the Scheme.
- 11.26. The costs incurred in notifying the transferring policyholders of the proposed Scheme will be borne by Mobius, whereas the costs of notifying the Delegates of SF will be borne by SF.
- 11.27. Costs associated with the Scheme that are attributable to SF will be met solely from the SF Main Fund. The costs for Mobius will be paid out of shareholder resources and will not be charged to unit funds.
- 11.28. I am satisfied that this is reasonable.

Tax

- 11.29. SF and Mobius have applied to Her Majesty's Revenue and Customs ("HMRC") for confirmation that a "transfer of going concern" treatment will apply for VAT purposes but has yet to be granted. Confirmation and clearance that the transaction is not for an "unallowable purpose" for corporation tax purposes has been sought from HMRC.
- 11.30. I will provide an update on this in my Supplementary Report.
- 11.31. There is no expected impact on the personal tax liability of SF or Mobius policyholders as a result of the implementation of the Scheme.
- 11.32. There is no expected difference in the approach used by SF and Mobius in determining any tax recoverable by, or credited to, the unit-linked life and pension funds of SF and Mobius as a result of the Scheme.

FSCS and Financial Ombudsman Service ("FOS")

- 11.33. The FSCS provides compensation to individual holders of long-term insurance policies issued by UK insurers in the UK or another EEA state who are eligible for compensation under the FSCS in the event of the insurer's default.
- 11.34. The eligibility of holders of long-term insurance policies for compensation from the FSCS, and the amount of compensation payable, are dependent upon the type of policyholder, the type of policy and where the insurer is based. Compensation to eligible holders of pension savings contracts is the full amount of the claim, without limit.
- 11.35. As mentioned in paragraphs 6.44 to 6.48, currently for the transferring Mobius business, holders of plans issued under group policies where the member joined the scheme after 7 April 2010 as well as all holders of TIP policies, bear the risk of any loss or deficit as a result of a default from third party insurers that Mobius invests with via reinsurance arrangements. In this event, Mobius's policyholders would not benefit from the extra protection offered by the FSCS. Following the implementation of the Scheme, the holders of plans issued under group policies where the member joined the scheme after 7 April 2010 and all holders of TIP policies will continue to bear the risk of any loss or deficit as a result of a default from the existing third party insurers that Mobius invests with via reinsurance arrangements. As is the case prior to the Scheme, in this event, the transferring Mobius policyholders would not benefit from the extra protection offered by the FSCS, but their eligibility will be unchanged by the implementation of the Scheme.
- 11.36. Prior to the transfer, all of the transferring Mobius business bear the risk of any loss or deficit as a result of a default from Mobius. In this event, Mobius's policyholders would be eligible to claim under the FSCS and could potentially recover the loss from the FSCS. Following the implementation of the Scheme, no holders of policies within the Transferring Business would be eligible to claim under the FSCS in the event of a default from Mobius. However, the transferring policyholders would be eligible to claim under the FSCS in the event of a default from SF.
- 11.37. Implementation of the Scheme will not adversely affect eligibility for compensation from the FSCS for the non-transferring Mobius policyholders.

- 11.38. The FOS is an independent public body that aims to resolve disputes between individuals and UK financial services companies, and may make compensation awards in favour of policyholders. Only holders of policies that constitute business carried on in the UK are permitted to bring complaints to the FOS. In circumstances where Mobius currently refers policyholders to the FOS, SF will continue to do so following implementation of the Scheme.
- 11.39. Implementation of the Scheme will not adversely affect access to the FOS for either transferring or non-transferring policyholders.

Quality of Own Funds capital

- 11.40. SF and Mobius have Own Funds that are entirely classified as Tier 1 Own Funds (as described in paragraphs 3.20 to 3.22) under the Solvency II regulations.
- 11.41. I am comfortable that there are no material adverse implications for policyholders arising from the classification of the Own Funds in SF or Mobius.

Variation of permission

- 11.42. As stated in paragraph 7.54 and 7.55, at the time of writing my report SF are not authorised to perform the regulated activity (as specified in article 52 (a) of FSMA (Regulated Activities) Order 2001) of 'establishing/operating/winding up a stakeholder pension scheme'. Since there are 6,417 members of stakeholder pension schemes (18 policies) in the Transferring Business it is a requirement for SF to gain permission for this regulated activity prior to the transfer of business.
- 11.43. In July 2018 SF applied to the PRA for a VOP in relation to this regulated activity and the PRA have confirmed they are satisfied with SF and Mobius proceeding with the Directions Hearing pending permission being granted. It is my understanding that it can take between 6 to 12 months after an application is made for approval to be granted. Consequently, the Sanctions Hearing in October 2018 may be postponed until a decision has been made.
- 11.44. I have no reason to believe that SF will not be granted permission for this regulated activity and I will provide an update on this in my Supplementary Report.

Developments since 31 December 2016 and 31 March 2017 for SF and Mobius, respectively

- 11.45. Since the dates of the financial information presented in my report, these being 31 December 2016 and 31 March 2017 for SF and Mobius, respectively, I am not aware of any significant events that may have affected the financial position of SF and Mobius.
- 11.46. In the Supplementary Report, I will provide financial information as at 31 December 2017 and 31 March 2018 for SF and Mobius, respectively, and provide more detailed commentary on the effects of the implementation of the proposed Scheme based on this financial information.

The future operation of the Scheme

- 11.47. If the Scheme is approved by the Court (and subject to any subsequent amendment of the Scheme, as considered below), the Directors of SF and Mobius are committed to implementing the Scheme as set out in the Scheme document (and reflected in my report) in accordance with their fiduciary responsibilities under UK company law.
- 11.48. At any time after the Court's sanction of the Scheme, SF and Mobius must jointly apply to the Court for sanction of any amendments to it, except where the amendment is:
- Considered to be minor or technical;
 - Necessary to reflect compliance with any legal requirements, which have implications for Mobius or SF in relation to the terms or operation of the Scheme;
 - Necessary to reflect changes in actuarial practices relating to the management of the Transferring Business; or

- Required to protect the rights and reasonable expectations of the policyholders within the Transferring Business.

- 11.49. In all such cases, SF and Mobius must notify the PRA and the FCA in sufficient time in advance of the proposed amendment being made and have received an indication of non-objection from the PRA and the FCA in relation to the amendment prior to its implementation.
- 11.50. Additionally, if the Scheme is approved by the Court, the published financial position of SF and Mobius will be calculated by the firms' actuaries and accountants and will be subject to external audit.
- 11.51. In my opinion there are reasonable safeguards in place to ensure that, if approved by the Court, the Scheme will be operated as presented to the Court.

If the Scheme is not implemented

- 11.52. If the Scheme does not proceed for any reason, then the transferring Mobius policies will not become policies of SF and will remain within Mobius. Any assets or liabilities that were intended to be transferred between Mobius and SF under the Scheme will not be transferred. The transferring Mobius policies would continue to be managed by Mobius as described in Section 6.
- 11.53. Under this scenario, the SF-Mobius Reinsurance Arrangement, floating charge and security assignment agreements between Mobius would not be implemented. The amendment to the reinsurance arrangement between Mobius and L&GPML will remain in place but this would have no impact on the transferring or non-transferring business.
- 11.54. If the Scheme does not proceed, SF will have incurred the costs of the transfer that it is responsible for, reducing the amount of excess capital within the SF Main Fund. However, given the relative size of the costs incurred against the pre-Scheme excess capital (as presented in Table 10.1) the SCR coverage ratio of SF will reduce by an immaterial amount. Therefore, if the Scheme does not proceed for any reason, I believe that there would be no materially adverse effect on the security of the benefits of SF policies.
- 11.55. Likewise, Mobius will have incurred the costs of the transfer that it is responsible for, reducing the amount of its excess capital. Given that the pre-Scheme SCR coverage ratio (as presented in Table 9.1) is at its Pillar 1 target solvency ratio of around 120%, if the Scheme had been implemented on 31 December 2016, I would anticipate that the SCR would drop slightly beneath this target level.
- 11.56. As described in paragraph 6.24, prior to the proposed transfer of business to SF, a management action was proposed by Mobius to disinvest assets that were invested in the unit-linked funds of other insurers and invest them in directly held investments. If the Scheme does not proceed for any reason, it is therefore likely that the Board of Mobius will reconsider this and other management actions in order to reduce or eliminate Mobius's exposure to counterparty default risk, and to improve its solvency position. Consequently, if the Scheme does not proceed for any reason, I believe that there would be no materially adverse effect on the security of the benefits of Mobius policies.
- 11.57. Finally, if the Scheme does not proceed for any reason, SF and Mobius may look to find a way to transfer the economic benefit of the Transferring Business. It should be noted that the proposed transfer under the Scheme would provide SF with direct control over the Transferring Business which it has purchased. Any alternative arrangement where the economic benefit of the Transferring Business was indirectly transferred would limit the degree of control SF could exert.

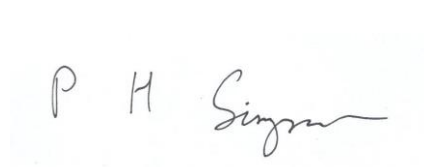
The exit of the UK from the European Union – “Brexit”

- 11.58. The exit of the UK from the European Union (“EU”) could lead to considerable disruption in the market for financial services across Europe and in particular for UK and non-UK companies relying on passporting rights to write business via the EU's freedom of establishment or freedom of service rules into the rest of the EEA or the UK respectively.
- 11.59. At the time of writing this report, there remains considerable uncertainty as to when the UK will leave the EU and around exactly what form that exit might ultimately take and I have, in this report, made no assumptions about the possible consequences of the UK leaving the EU, but have focussed on the implications of the implementation of the Scheme for the policyholders of SF and Mobius.

- 11.60. That said, if the Scheme were to be implemented, I am satisfied that the transferring Mobius policyholders would not be in a materially worse position in the scenario where the UK exits the EU than if the Scheme had not been implemented.

12. CONCLUSIONS

- 12.1. I am satisfied that the implementation of the Scheme will not have a material adverse effect on:
- The security of benefits under the policies of Mobius and SF;
 - The profile of risks to which the policies of Mobius and SF are exposed;
 - The governance, management or service standards applicable to the Mobius and SF policies; or
 - The reasonable benefit expectations of the policyholders of Mobius and SF.
- 12.2. I am satisfied that the Scheme is equitable to all classes and generations of SF and Mobius policyholders.

A handwritten signature in black ink, reading "P H Simpson", is written over a light blue rectangular background.

Philip Simpson

19 July 2018

Fellow of the Institute and Faculty of Actuaries

APPENDIX 1: PREVIOUS TRANSFERS FOR WHICH I HAVE ACTED AS INDEPENDENT EXPERT OR EQUIVALENT

2009: Transfer of Policies from American International Assurance Company (Bermuda) Limited to American Life Insurance Company.

2009: Transfer of Policies from Darta Saving Life Assurance Limited to Allianz Global Life Limited.

2012: Part VII transfer of the business of Hannover Life Reassurance (UK) Limited to its parent company Hannover Rückversicherung AG.

2012: Part VII transfer of the Finnish business of the UK branch of Skandia Life Assurance Company Limited to a new Finnish life company.

2014: Acted as the Independent Actuary for the transfer of the long-term business from PEL Altraplan (Gibraltar) PCC Limited to Augura Life Ireland.

APPENDIX 2: DATA RELIED UPON

In addition to discussions (both verbally and electronically) with SF and Mobius staff, I have relied upon the following principal documents in formulating my conclusions:

Document
The Scheme document
Report of the interim Chief Actuary of SF on the Scheme
Report of the Chief Actuary of Mobius on the Scheme
Report of the WPA of SF on the Scheme
Draft reinsurance agreement between SF and Mobius (the SF-Mobius Reinsurance Arrangement) and other associated documents
Legal advice from CMS that the Deed of Charge between Mobius and SF ensures that the position of SF in the insolvency of Mobius will be that it will be placed in terms of priority <i>pari passu</i> with Mobius's direct policyholders upon any application of the Insurers (Reorganisation and Winding Up) Regulations
Letters from SF and Mobius to the PRA and the FCA
The 2017 SFCR of SF and Mobius (financials provided are as at 31 December 2016 and 31 March 2017 respectively)
The SF 2016 ORSA Report (financials provided are as at 30 September 2016)
The Mobius 2017 ORSA Report (financials provided are as at 31 March 2017)
Draft communications to be sent to certain Mobius policyholders
Draft communications to be sent to Delegates of SF
Witness statement for SF and for Mobius
Waiver letter from Mobius to the PRA
Pre- and post-Scheme financials as at 31 December 2016 for SF and 31 March 2017 for Mobius on a Solvency II Pillar 1 and Pillar 2 basis
Assumptions and methodology document for determining the SF pro-forma post-Scheme financials
Spreadsheets containing calculations to determine the pro-forma post-Scheme SF financial position on a Solvency II Pillar 1 and Pillar 2 basis
A document from SF explaining the Chief Actuary's interpretation of the impact of the transfer on SF's exposure to counterparty default risk on a Pillar 1 and Pillar basis
Actuarial Function Report on the Solvency II valuation for SF and Mobius, as at 31 December 2016 and 31 March 2017 respectively
Q2 and Q3 2017 Solvency II results for SF (Pillar 1 and Pillar 2) and Mobius (Pillar 1 only)
2016 and 2017 Regular Supervisory Report of SF and Mobius respectively
Memorandum and Rules of SF
Articles of Association of Mobius
Risk management framework document from SF
Recovery Plan: Solvency Management Actions document from SF
Terms of Reference for the existing GAA of Mobius and the Mobius GAA Statement 2017
Draft Terms Of Reference for the proposed GAA of SF that will be created following the implementation of the Scheme
Capital management policies for SF and Mobius
A document explaining the existing reinsurance arrangements in place at SF

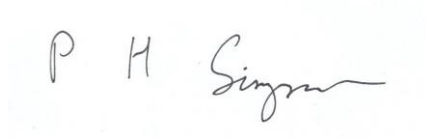
Document
The PPFMs of the SF with-profits business
Member administration agreements between Mobius and BlackRock
A confirmation letter from Aegon on the successful transfer of member administration services from BlackRock to Aegon
Letters to HMRC requesting tax clearances

APPENDIX 3: CERTIFICATE OF COMPLIANCE

I understand that my duty in preparing my report is to help the Court on all matters within my expertise and that this duty overrides any obligations I have to those instructing me and / or paying my fee. I confirm that I have complied with this duty.

I confirm that I am aware of, and have complied with, the requirements applicable to experts set out in Part 35 of the Civil Procedure Rules, Practice Direction 35 and Guidance for the instruction of Experts in Civil Claims 2014. As required by rule 35.10(2) of Part 35 of the Civil Procedure Rules and by paragraph 3.2(9)(b) of Practice Direction 35, I hereby confirm that I have understood, and have complied with, my duty to the Court.

I confirm that I have made clear which facts and matters referred to in my report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

A handwritten signature in black ink, reading 'P H Simpson'.

Philip Simpson

19 July 2018

Fellow of the Institute and Faculty of Actuaries

APPENDIX 4: GLOSSARY OF TERMS

A glossary of abbreviations used throughout my report is given below.

A

AGM	Annual General Meeting
APS	Actuarial Profession Standard
ARC	Audit, Risk and Compliance Committee

B

BEL	Best Estimate Liabilities
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C

CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIS	Collective Investment Scheme
CMP	Capital Management Policy
CMRP	Capital Management Risk Policy
CMS	CMS Cameron McKenna Nabarro Olswang LLP
COBS	The FCA's Conduct of Business Sourcebook
CRO	Chief Risk Officer

E

EEA	European Economic Area
EIOPA	The European Insurance and Occupational Pensions Authority
ERC	Executive Risk Committee
EU	European Union

F

FCA	Financial Conduct Authority
FOS	Financial Ombudsman Service
FSCS	Financial Services Compensation Scheme
FSMA	Financial Services and Markets Act 2000

G

GAA	Governance Advisory Arrangement
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H

HMRC	Her Majesty's Revenue and Customs
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I

IGC	Independent Governance Committee
ISA	Individual Savings Account

L

L&GPML	Legal and General Assurance (Pensions Management) Limited
LANMAS	London, Aberdeen and Northern Mutual Assurance Society Limited

M

M&GM	Marine & General Mutual Life Assurance Society Limited
MLG	Mobius Life Group Limited
MLH	Mobius Life Holdings Limited

O

OEIC	Open Ended Investment Company
ORSA	Own Risk and Solvency Assessment

P

PRA	Prudential Regulation Authority
PPFM	Principles and Practices of Financial Management

R

RMF	Risk Management Framework
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S

SCR	Solvency Capital Requirement
SF	Scottish Friendly Assurance Society Limited
SFCR	Solvency and Financial Condition Report
SGM	Special General Meeting
SIMF	Senior Insurance Management Functions
SIMR	Senior Insurance Managers Regime
SLL	Scottish Legal Life Assurance Society Limited
SUP	Supervision Manual

T

TAS	Technical Actuarial Standard
TIP	Trustee Investment Plan

TPR The Pension Regulator

V

VOP Variation of permission

W

WPA With-Profits Actuary

WPC With-Profits Committee

APPENDIX 5: COMPLIANCE WITH THE PRA STATEMENT OF POLICY AND SUP 18.2

The table below indicates how I have complied with the provisions of the PRA Statement of Policy ("The Prudential Regulation Authority's approach to insurance business transfers", dated April 2015) and SUP 18.2 (Insurance business transfers) that pertain to the form of the Scheme Report.

PRA Statement of Policy reference	SUP 18.2 reference	Requirement	Scheme Report paragraph reference
2.30 (1)	SUP 18.2.33 (1)	Who appointed the Independent Expert and who is bearing the costs of that appointment	2.2 and 2.4
2.30 (2)	SUP 18.2.33 (2)	Confirmation that the Independent Expert has been approved or nominated by the appropriate regulator.	2.24
2.30 (3)	SUP 18.2.33 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role	2.22, 2.23 and Appendix 1
2.30 (4)	SUP 18.2.33 (4)	Whether the Independent Expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest	2.25
2.30 (5)	SUP 18.2.33 (5)	The scope of the report	2.9 to 2.16
2.30 (6)	SUP 18.2.33 (6)	The purpose of the Scheme	7.1 to 7.7
2.30 (7)	SUP 18.2.33 (7)	A summary of the terms of the Scheme in so far as they are relevant to the report	7.8 to 7.58
2.30 (8)	SUP 18.2.33 (8)	What documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided	2.12 and Appendix 2
2.30 (9)	SUP 18.2.33 (9)	The extent to which the Independent Expert has relied on: (a) information provided by others; and (b) the judgment of others	4.24 to 4.33
2.30 (10)	SUP 18.2.33 (10)	The people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable	2.29, 4.26 to 4.27 and 4.31 to 4.33
2.30 (11)	SUP 18.2.33 (11)	His opinion of the likely effects of the Scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee	Section 8 Section 9 Section 10

PRA Statement of Policy reference	SUP 18.2 reference	Requirement	Scheme Report paragraph reference
2.30 (12)	SUP 18.2.33 (11A)	His opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the Scheme	Not applicable
2.30 (13)	SUP 18.2.33 (12)	What matters (if any) that the Independent Expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the Scheme	2.15
2.30 (14)	SUP 18.2.33 (13)	For each opinion that the Independent Expert expresses in the report, an outline of his reasons.	Sections 8 to 11
2.32 (1)	SUP 18.2.35 (1)	The summary of the terms of the Scheme should include a description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme	7.26
2.32 (2)	SUP 18.2.35 (2)	The summary of the terms of the Scheme should include a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	7.26 to 7.38
2.33 (1)	SUP 18.2.36 (1)	The Independent Expert's opinion of the likely effects of the Scheme on policyholders should include a comparison of the likely effects if it is or is not implemented	11.52 to 11.57
2.33 (2)	SUP 18.2.36 (2)	The Independent Expert's opinion of the likely effects of the Scheme on policyholders should state whether he considered alternative arrangements and, if so, what	2.16
2.33 (3)	SUP 18.2.36 (3)	The Independent Expert's opinion of the likely effects of the Scheme on policyholders should, where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders	7.59, 7.60 and Sections 8 to 11

PRA Statement of Policy reference	SUP 18.2 reference	Requirement	Scheme Report paragraph reference
2.33 (4)	SUP 18.2.36 (4)	<p>The Independent Expert's opinion of the likely effects of the Scheme on policyholders should include his views on:</p> <p>(a) the effect of the Scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;</p> <p>(b) the likely effects of the Scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:</p> <p>(i) the security of policyholders' contractual rights;</p> <p>(ii) levels of service provided to policyholders; or</p> <p>(iii) for long-term insurance business, the reasonable expectations of policyholders; and</p> <p>(c) the cost and tax effects of the Scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations</p>	Sections 8 to 11
2.35 (1)	SUP 18.2.38 (1)	For any mutual company involved in the Scheme, the report should describe the effect of the Scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes which could affect their entitlements as policyholders	10.35 to 10.38
2.35 (2)	SUP 18.2.38 (2)	For any mutual company involved in the Scheme, the report should state whether, and to what extent, members will receive compensation under the Scheme for any diminution of proprietary rights	10.37
2.35 (3)	SUP 18.2.38 (3)	For any mutual company involved in the Scheme, the report should comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without.	10.37
2.36 (1)	SUP 18.2.39 (1)	For a Scheme involving long-term insurance business, the report should describe the effect of the Scheme on the nature and value of any rights of policyholders to participate in profits	8.83 and 10.39 to 10.52

PRA Statement of Policy reference	SUP 18.2 reference	Requirement	Scheme Report paragraph reference
2.36 (2)	SUP 18.2.39 (2)	For a Scheme involving long-term insurance business, the report should, if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;	Not applicable
2.36 (3)	SUP 18.2.39 (3)	For a Scheme involving long-term insurance business, the report should describe the likely effect of the Scheme on the approach used to determine: (a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and (b) the levels of any discretionary charges	10.39 and 10.41
2.36 (4)	SUP 18.2.39 (4)	For a Scheme involving long-term insurance business, the report should describe what safeguards are provided by the Scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm	11.48 and 11.49
2.36 (5)	SUP 18.2.39 (5)	For a Scheme involving long-term insurance business, the report should include the Independent Expert's overall assessment of the likely effects of the Scheme on the reasonable expectations of long-term insurance business policyholders	8.82 to 8.93, 9.48 to 9.53 and 10.39 to 10.64
2.36 (6)	SUP 18.2.39 (6)	For a Scheme involving long-term insurance business, the report should state whether the Independent Expert is satisfied that for each firm the Scheme is equitable to all classes and generations of its policyholders	12.2
2.36 (7)	SUP 18.2.39 (7)	For a Scheme involving long-term insurance business, the report should state whether, in the Independent Expert's opinion, for each relevant firm the Scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented.	11.47 to 11.51

APPENDIX 6: COMPLIANCE WITH THE FCA FINALISED GUIDANCE

The table below indicates how I have complied with the provisions of the FCA finalised guidance (“FG18/4: The FCA’s approach to the review of Part VII insurance business transfers”, dated May 2018) that pertain to the form of the Scheme Report. In the requirements listed below the “Transferor” is Mobius, the “Transferee” is SF and the “Applicants” refers to both SF and Mobius.

Paragraph	Requirement	Scheme Report paragraph reference
6.2	Report is constructed in such a way that it is easily readable and understandable by all its users, paying attention to the following:	
	<ul style="list-style-type: none"> Technical terms and acronyms should be defined on first use. 	Throughout and Appendix 4
	<ul style="list-style-type: none"> There should be an executive summary that explains, at least in outline, the proposed transfer and the Independent Expert’s conclusions. 	Section 1
	<ul style="list-style-type: none"> The business to be transferred should be described early in the report. 	1.2 and 2.5
	<ul style="list-style-type: none"> The detail given should be proportionate to the issues being discussed and the materiality of the transfer when viewed as a whole. While all material issues must be discussed, Independent Experts should try to avoid presenting reports that are disproportionately long. 	Throughout
6.3	<ul style="list-style-type: none"> Independent Experts should prepare their reports in a way that makes it possible for non-technically qualified readers to understand. 	Throughout
	Report must consider and compare:	
	<ul style="list-style-type: none"> Reasonable benefit expectations, including impact of charges. Type and level of service, including claims handling. Management, administration and governance arrangements. 	8.62 to 8.93, 9.41 to 9.53, and 10.30 to 10.64
The level of reliance on the Applicants’ assessments and assertions		
6.6	Question the adequacy of assessments carried out by the Applicants before relying on them to reach own conclusions (including requesting additional work and evidence from Applicants in order to support their assertions).	Throughout
6.7	Explain the nature of any challenges made to the Applicants and the outcome of these within the Scheme report, rather than just stating the final position.	Throughout
6.8	Where conclusions are supported solely or largely by statements such as ‘I have discussed with the firm’s management and they tell me that...’ followed by ‘I have no reason to doubt what they have told me...’, then:	
	<ul style="list-style-type: none"> Where a feature of the proposed transfer forms a significant part of the Independent Expert’s own assessment of the Scheme’s impact, the Independent Expert should review relevant underlying material, rather than relying on the Applicants’ analysis of the material and subsequent assertions. 	Appendix 2

Paragraph	Requirement	Scheme Report paragraph reference
	<ul style="list-style-type: none"> If there are concerns about matters that fall outside the Independent Expert's sphere of expertise, such as legal issues, the Applicants must provide the Independent Expert with any advice that they have received. If the issue is significant or remains uncertain, the Independent Expert must ensure that the Applicants had obtained appropriate advice from a suitably qualified independent subject matter expert. 	4.29 to 4.33
6.9	<p>Independent Expert has challenged calculations carried out by the Applicants if there is cause for doubt on review of the Scheme and supporting documents. As a minimum, the Independent Expert should:</p> <ul style="list-style-type: none"> Review the methodology used and any assumptions made, to satisfy themselves that the information is likely to be accurate and to challenge it where appropriate; and Challenge the factual accuracy of matters that, on the face of the documents or considering the Independent Expert's knowledge and experience, appear inconsistent, confusing or incomplete. 	4.24 to 4.27
6.10	<p>Documents provided by the Applicants have been challenged where they contain an insufficient level of detail or analysis. For example:</p> <ul style="list-style-type: none"> Applicants' assertions that service levels will be maintained to at least the pre-transfer standard: Independent Expert should include not only details of the Applicants' plans and any gap analyses produced, but also include their view of their adequacy. The Independent Expert should review and compare the governance arrangements in the Transferor which produce good customer outcomes with the Transferee's governance arrangements. An example of these governance arrangements would be any committees with conduct responsibilities. Consideration of the potential post-transfer strain on resources that may occur post-transfer and that could impact on the service standards of the Transferee's existing customers and/or control over conduct of business risk. The Scheme Report should include a review of relevant management information indicators and related contingency planning. 	<p>Not applicable</p> <p>8.67 to 8.72</p> <p>10.31</p>
Sufficient comparative regulatory framework analysis		
6.11	The regulatory framework may be different for the Transferor and Transferee. In these cases, the Independent Expert must carry out sufficient analysis of the differences including, where appropriate, taking independent advice.	Not applicable
6.12	<p>For cross-border transfers ensure there is a sufficiently detailed analysis of regulatory protections post-transfer. This can include:</p> <ul style="list-style-type: none"> The extent to which existing regulatory requirements and protections continue. This includes whether there is continued access to the Financial Ombudsman Service and the Financial Services Compensation Scheme. <p>The FCA's expectation is that Applicants aim to preserve Financial Ombudsman Service, whether under the Compulsory or Voluntary jurisdictions, as far as it is possible to do to avoid any loss of protections. In the context of EU withdrawal we would expect this at least until the point of policy renewal. Some firms are able to continue to service contracts from UK branches to preserve continuity.</p>	Not applicable

Paragraph	Requirement	Scheme Report paragraph reference
	<ul style="list-style-type: none"> The comparative regulatory requirements and conduct protections across any relevant jurisdictions, compared to the UK. This includes but is not limited to complaints or compensation bodies. Analysis of the likely impacts. For example, the number of policyholders affected, the size of possible claims and any potential actions or provisions to mitigate this. Post EU Withdrawal, non-UK EEA customers may be subject to the local conduct of business rules regime, which may not include FOS or FSCS issues. In these cases, the FCA are likely to accept firms taking proportionate approaches to compare regimes. For example a high level analysis may be appropriate, selecting key UK protections for consumers that are not harmonised in the EEA, and that could be relevant to servicing contracts. This could be accompanied by an explanation that a full gap analysis has not been carried out, but that policyholders can contact the Applicants if they are concerned. Some firms are able to continue to service contracts from UK branches to preserve continuity of regime at least until renewal. 	
6.13	The Independent Expert report must contain a statement describing the two regimes. The FCA would also expect to see a considered comparison, highlighting points of significant difference that could adversely impact policyholders. The level of detail to be included must be sufficient for the Court to be in a position to be satisfied.	Not applicable
6.14	If the Independent Expert's analysis is inconclusive or there are potential conduct risks due to differences in the regulatory framework, the FCA expect to see sufficient explanation of how policyholders may be affected and the Applicants' proposals to mitigate these risks.	Not applicable
Balanced judgements and sufficient reasoning		
6.15	When stating that the Independent Expert is satisfied by referencing certain features of the Scheme, the Independent Expert must adequately explain how the features have led to their satisfaction. The Independent Expert must include both the evidence and their reasoning.	Not applicable
6.16	<p>The Independent Expert must state in their report whether they are certain there will be no material adverse impact to policyholders or whether this is their best judgement, but lacks certainty. In these instances, the Independent Expert must consider the following:</p> <ul style="list-style-type: none"> Where the Independent Expert takes the view that there is probably no material adverse impact, the Independent Expert must challenge SF and Mobius about further work that they could undertake to enable the Independent Expert to be satisfied to a greater degree. The Independent Expert should challenge the Applicants in order to gain the necessary level of confidence that their report's conclusions are robust. Applicants and Independent Experts should be aware that they will need to consider how any proposed changes/mitigations will impact all policyholder groups. 	<p>8.94, 9.54 and 10.68</p> <p>Not applicable</p> <p>Not applicable</p>
6.17	When finalising their report, the Independent Expert must check that the documents they are relying, and forming judgements, on are the most up-to-date available.	Appendix 2

Paragraph	Requirement	Scheme Report paragraph reference
6.18	Market conditions may have changed significantly since the Independent Expert's analysis was carried out and they formed their judgement. In these cases, the Applicants must discuss any changes with the Independent Expert and the Independent Expert must update their report as necessary. If the Scheme report has been finalised, the Independent Expert should comment in more detail in their Supplementary Report or by issuing supplementary letters to the Court to confirm whether their judgement is unchanged.	11.45 and 11.46
Sufficient regard to relevant considerations affecting policyholders		
6.19	Consider all relevant issues for each individual group of policyholders in both firms, as well as how an issue may affect each group. The Independent Expert is expected, when giving their opinion, to consider the: <ul style="list-style-type: none"> • Current and proposed future position of each policyholder group; • Potential effects of the transfer on each of the different policyholder groups; and • Potential material adverse impacts that may affect each group of policyholders, how these impacts are inter-related and how they will be mitigated. 	Section 8 to 11
6.20	Consider whether the groups of affected policyholders have been identified appropriately. For example, this could include instances where certain policyholder groups' services are provided by an outsourced function which is changing, but other policyholder groups do not.	7.59 and 7.60
6.21	Review and give opinion on administrative changes affecting policyholders, including: <ul style="list-style-type: none"> • Consideration of the impact of an outsourcing agreement entered into by the parties before the Part VII process began, where the administration duty 'moved' from the Transferor to the Transferee in preparation for the transfer. Provide a comparison of the pre and post-outsourced administration arrangements so the Independent Expert can clearly review and compare any changes to policyholder positions and service expectations. • For the case where the Independent Expert concludes that because the transfer will not create any change to the administrative arrangements, there will be no material impact on policyholders: consider what might happen if the transfer does not proceed and the possibility that the outsourcing agreement could be cancelled, returning the administrative arrangements to the original state. In such circumstances, consider the impact on policyholders and claimants of the outsourcing agreement as part of the Part VII process. 	Not applicable Not applicable
6.22	Review and provide opinion on all relevant issues for all policyholder groups where reinsurance was entered into in anticipation of a transfer: <ul style="list-style-type: none"> • Some firms pre-empt regulatory scrutiny by buying reinsurance against risks before they begin the transfer process. In these instances, consider if it is appropriate to compare the proposed Scheme with the position the Transferor would be in if they did not benefit from the reinsurance contract. • If the transfer is not sanctioned and the reinsurance either terminates automatically or can be terminated by the Transferee, the Independent Expert should consider the Scheme as if the reinsurance was not in place. 	Not applicable Not applicable

Paragraph	Requirement	Scheme Report paragraph reference
6.23	If the Independent Expert identifies particular sub-groups of policyholders whose benefits, without other compensating factors, are likely to be adversely affected, the Independent Expert should take into account the Transferor's obligations under Principle 6 (Customers' interests) of the FCA's Principles for Businesses.	Not applicable
6.24	Ensure there is consideration and analysis of alternatives when a loss is expected for a particular subgroup of policyholders, even if the Independent Expert does not consider this loss to be material.	10.35 to 10.38
6.25	Provide the analysis outlined in 6.24 even if the Independent Expert is able to conclude that the policyholder group as a whole is not likely to suffer material adverse impact, even if a minority may. For example where: <ul style="list-style-type: none"> Some policyholders within a group/sub-group will suffer higher charges post-transfer because the Transferee has a different charging structure. Some policyholders within a group/sub-group had free access to helplines that will no longer be available or have a significantly altered service after the transfer. 	10.35 to 10.38
6.26	Ensure that no conclusions are reached based on the balance of probabilities and without adequately considering the possible impact on all affected policyholder groups.	Sections 8 to 11
6.28	Present the consideration, evidence of challenge, and reasoning to support the Independent Expert's opinion that a change due to the Part VII transfer will not materially negatively affect a group of policyholders.	Sections 8 to 11
Commercially sensitive or confidential information		
6.29	When considering commercially sensitive information, consider policyholders' interests as the information will not be publically available.	5.44 and 6.19
6.30	In these situations, document the analysis and the information relied upon. Consider sending a separate document with further details, solely for the Court's use and not for public disclosure.	Appendix 2
The level of reliance on the work of other experts		
6.31	For large scale and complex insurance business transfers, if relying on the analytical work of other qualified professionals, it is still expected the Independent Expert to have carried out their own review of this analysis to ensure they have confidence in, and can place informed reliance on, the opinions they draw from another professional's work.	4.26, 4.27 and 4.32
6.32	Obtain a copy of relevant significant legal advice given to the Applicants, subject to appropriate arrangements to safeguard any legal professional privilege. This should be in writing or transcribed, and approved by the advisor. It should also be in a sufficiently final form for the Independent Expert to be able to review and rely on it. The Independent Expert should reflect this review, and the opinions drawn from the advice, within their report.	4.29
6.33	The Independent Expert may refer to factors that are outside their sphere of expertise and rely on advice received by the Applicants. In these cases, the Independent Expert should consider whether or not to obtain their own independent advice on the relevant issue.	4.33
6.34	Consider if the Independent Expert needs to obtain separate legal advice, this will depend on the significance and materiality of the issue.	4.33

Paragraph	Requirement	Scheme Report paragraph reference
6.35	Consider whether it is reasonable for the Independent Expert to rely on advice and whether their independence is compromised by doing so. Whether or not the legal advisor has acknowledged that it owes a duty of care to the Independent Expert will be relevant to this consideration. The FCA may challenge Independent Experts who rely on the Applicants' legal advice and merely state that they have no reason to doubt the advice and/or that it is consistent with their understanding of the position or experience of similar business transfers. The FCA's decision to challenge (or not) will depend on how complex the legal issue is.	4.31 to 4.33
6.36	<p>When deciding whether to get independent legal advice, the Independent Expert should consider, amongst other things, the following:</p> <ul style="list-style-type: none"> • The significance of the issue and the degree of potential adverse impacts to policyholders if the position turns out to be different from what the legal advice considers likely. • How much the Independent Expert relies on the legal advice to reach their conclusions. Also, if they did not rely on the legal advice, would the report contain too little information to justify the view that there is no material adverse impact? • The difficulty, novelty or peculiarity of the issue to the Applicants' own circumstances. • Applicants' proposals to explain to policyholders in communication documents the issues involved, any uncertainty, and any residual risks. • Whether the Applicants have obtained an adequate level of advice, depending on the issue's significance or uncertainty. Where relevant, whether the Applicants have engaged external advisors with the appropriate expertise and qualifications for the specific subject or jurisdiction. • Whether any advice already received is heavily caveated, qualified or there is a significant degree of uncertainty. 	4.29 to 4.33
6.37	<p>The Independent Expert may need to explain why they consider that they do not need to get independent advice to be adequately satisfied on a point. The Independent Expert's assessment should consider whether there are credible alternative arguments that could be made, whether identified in the Applicant's advice or otherwise.</p> <p>Consider where risks are identified with no suggestion about how they can be mitigated, or what the impact on policyholders may be if the risks do occur. These considerations would allow the Independent Expert to consider the worst case scenario of these impacts.</p>	4.32 and 4.33
6.38	Consider the Applicant's contingency plans if the risks identified in the legal advice occur and whether this may create negative consequences for policyholders.	Not applicable

Paragraph	Requirement	Scheme Report paragraph reference
Examples of over-reliance on the work of other experts		
6.40	Often an Applicant will get a legal opinion on whether a transfer involving overseas policyholders will be recognised in non-EEA jurisdictions. The Independent Expert may take that advice into account but there may be some material doubt as to whether a Court would adopt the approach set out in the advice. In that case, the FCA expect the Independent Expert to not use such advice as the sole basis of their conclusions that there are no materially adverse effects. The FCA would expect the Independent Expert to consider and be satisfied of the position if the advice turns out not to be the position taken by the relevant Court. The legal advice itself should address this and suggest ways of mitigating this risk.	11.8
6.41	The Independent Expert may be uncertain, for example, because the legal advice is heavily qualified or uncertain and cannot form a conclusion on an issue. In this case, they may wish to obtain further independent legal advice to ensure they can reach a more considered conclusion.	Not applicable
6.42	<p>The position may be different depending on whether the Transferor remains authorised/ in existence. So:</p> <ul style="list-style-type: none"> If the Transferor's authorisations are to be cancelled and it could wind up or is planning to do so eventually, the FCA believes that acceptable mitigations include the Transferee making a deed poll which is directly enforceable by policyholders in either the UK or the relevant jurisdiction. It is unlikely that treating these policies as excluded policies is itself an adequate mitigation. The FCA state that some Independent Experts have received advice that even if the Scheme is not formally recognised in another jurisdiction, the Courts of that jurisdiction would still act to prevent the Transferee from denying that it is liable. The FCA state that this may well be correct but it would still expect the Independent Expert to assess any material possibility, and any mitigations if it is not. Where the Transferor remains in existence and the Scheme anticipates that the policyholders will still be able to claim against the Transferor; an Independent Expert may want to seek an independent legal opinion on how likely it is that the Transferee will indemnify the Transferor in these circumstances. 	<p>Not applicable</p> <p>Not applicable</p>
6.43	Ensure the likelihood of an adverse impact should be low enough for consumers not to be adversely affected. The Independent Expert should take a view on that and seek the appropriate reassurances/ ensure mitigations are in place.	12.1 and 12.2
Ambiguous language or a lack of clarity		
6.45	At the start of the document, the Independent Expert should provide a description of where they propose to rely on information provided by the Applicants. Overly general reliance will indicate a lack of critical assessment or challenge.	2.9 to 2.13
6.47	<p>If the report does not reach a clear conclusion, either generally or on a specific issue, the Scheme report should state clearly:</p> <ul style="list-style-type: none"> That the Independent Expert has considered and is satisfied about the likely level of impact on a particular point. Where uncertainty remains, the Scheme report needs to include details of, and reasons for, this uncertainty. It should also include any further steps the Independent Expert has taken to get clarification, such as seeking further advice from a subject matter expert. 	Not applicable

Paragraph	Requirement	Scheme Report paragraph reference
	<ul style="list-style-type: none"> How the Independent Expert satisfied themselves about the uncertainty they have identified how they and formed an opinion on any potential impact. 	
Demonstrating challenge		
6.49	To ensure effective two-way challenge it is expected the Independent Expert engages with FCA or PRA- approved persons of sufficient seniority at the Applicant firm. This could be senior actuaries, including possibly the Chief Actuary, the CFO, senior underwriters and so on.	2.9
Technical actuarial guidance		
6.50	Independent Experts who are members of the Institute & Faculty of Actuaries should pay proper regard to the TASs published by the Financial Reporting Council, particularly those in relation to compiling actuarial reports.	2.33 to 2.34
6.51	Independent Expert's should be particularly aware that the revised versions of the TAS which came into force with effect from 1 July 2017 (TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance) specifically apply to technical actuarial work to support Part VII transfers.	2.33 to 2.34
6.52	Ensure compliance with paragraph 5 of TAS 100 which states that actuarial communications should be "clear, comprehensive and comprehensible so that users are able to make informed decisions understanding the matters relevant to the actuarial information". We also draw specific attention to paragraph 5.2 of TAS 100 which states that "the style, structure and content of communications will be suited to the skills, understanding and levels of relevant technical knowledge of users".	2.33 to 2.34
6.53	Actuarially qualified Independent Expert's and peer reviewers should also bear in mind the Actuaries Code and APS documents APS X2: Review of Actuarial Work and APS L1: Duties and Responsibilities of Life Assurance Actuaries. Independent Experts and peer reviewers should adhere to the required standards of their professional body, as applicable and current at the time when the work is performed.	2.35 and 2.36
Review of the communications strategy		
7.3	Independent Experts should include consideration of the proposed communications strategy and any supporting requests for dispensations from the Transfer Regulations in their report. There should be evidence that the Independent Expert has challenged proposed communications that are not clear and fair and do not adequately explain the transfer and the potential impacts on policyholders and how these have been addressed.	11.1 to 11.24