Explanatory Note

Special Resolution, Special General Meeting 16 July 2019

1. Background

1.1. Scottish Friendly flourishes through a three-part growth strategy of organic growth, mergers and acquisitions and business process outsourcing.

1.2. ‘Mergers and Acquisitions’ includes ‘transfers of engagement’ and the aim is to gain additional economies of scale plus a diversified income stream. These aims are reflected in the opportunity now presented for Scottish Friendly: scale will be achieved through the increased policyholder numbers and uplift in assets under management and a diversified income stream will be provided from the new line of life, pension and protection business which we propose to acquire (see details in Section 2 below) and which we would hope to grow in the future.

1.3. Since 2006 we have transferred in Rational Shelley Friendly Society Limited, Preston Operative Friendly Society, a small book of business from Pioneer Friendly Society Limited, London Aberdeen & Northern Mutual Assurance Society (LANMAS), Royal Standard Friendly Society Limited, Scottish Legal Life Assurance Society Limited, Marine & General Mutual Life Assurance Society (M&GM) and most recently, Mobius Life Limited (Mobius Life). The transfer of the M&GM book of business in June 2015 was the biggest transfer undertaken by Scottish Friendly to date, more than doubling Scottish Friendly’s assets under management. Collectively, however, these eight transactions have added over £1.32bn funds under management and generate significant administration income per annum to Scottish Friendly policyholders.

1.4. The proposed transfer from Canada Life Limited (Canada Life) is another opportunity in line with Scottish Friendly’s overall strategy.

2. Canada Life

2.1. Canada Life UK has c£31bn of assets, and is part of the Great-West Life Co group (c£770bn of assets). Canada Life was founded in 1847 and has operating in the UK since 1903.

2.2. Canada Life transferring business has approximately 134,000 policyholders and £2.3bn of assets, made up of a wide range of life, pensions and protection, unit-linked, non-linked including a c£200m ring-fenced with-profits sub fund (ex-Manulife business); the reason for disposal is primarily simplification of the management of the portfolio, rather than solely for capital reasons.

2.3. The impact of the transfer on the capital position of Scottish Friendly is shown in the table below. It is expected that the capital position will deteriorate slightly albeit to a level judged to be appropriate for the increased scale. Based on the position as at 31 December 2018, the transfer is expected to reduce the capital cover from 188% to 172% with the excess capital resources increasing from £50m to £69m.

Pillar 1 position As at 31 December 2018	Pre transfer	Post transfer (£m)
Assets (£m)	2,633.2[1]	5,005.2
Liabilities (£m)	2,447.1	4,761.2
Excess of assets over liabilities (£m)	186.1	243.9
Impact of ring-fencing	(75.3)	(75.3)
Own funds (£m)	110.8	168.6
SCR (£m)	58.8	98.2
Solvency ratio	188%	172%

2.4. The Solvency Capital Requirement (SCR) is estimated to increase by £39.4m. This is primarily driven by additional market risk.

2.5. Scottish Friendly aim to hold capital above 150% and while the acquisition will result in a reduction in capital it is still within our risk appetite.

3. Corporate Governance

3.1. In January 2018, an information memorandum issued on behalf of Canada Life was made available to a number of life offices across the UK. Certainty of execution and the ability to migrate the book along with consideration were identified by Canada Life as key for the successful bidder.

3.2. Scottish Friendly provided an indicative offer to Canada Life on 25 January 2018. Following evaluation of the bid, Scottish Friendly were invited to partake in a 4 week period of due diligence along with one other party. Scottish Friendly was supported by EY; legal advice was provided by CMS Cameron McKenna Nabarro Olswang LLP.

3.3. Following the due diligence phase of the acquisition plan Scottish Friendly made an offer for the legacy portfolio of £2.3bn of life and pension business, which is no longer core to its owner, Canada Life. Scottish Friendly was informed on 6 April 2018 that they were successful and signed an exclusivity agreement as preferred bidder.

3.4. The legislation that applies to Scottish Friendly, allows the transfer of insurance business is approved by the Delegates on behalf of members. As Canada Life is an insurance company, Delegates' approval is sought by way of the Special Resolution, as per the Notice. Canada Life is not a mutual society and therefore does not have any members. Canada Life does not need any express policyholder approval for the transfer.

4. Process

[1] The pension scheme surplus is shown as a negative liability in this table. It is shown as an asset in the annual report and accounts.

4.1. The proposed transfer is to be carried out under section 111(1) of the Financial Services and Markets Act 2000. Scottish Friendly and Canada Life have followed a strict legal and regulatory process that includes obtaining an assessment of the transfer from an Independent Expert. The duty of the Independent Expert is to review the impact of the changes resulting from the transfer against the interests of all affected policyholders (including the Scottish Friendly policyholders) and to write a report on his findings to the Court. That report is also provided to the Regulators. A summary of the Independent Expert's report is attached, having been duly approved as providing the key points of the proposal.

4.2. We have also consulted with our regulators, the Prudential Regulation Authority ('PRA') and the Financial Conduct Authority ('FCA') (together the 'Regulators').

4.3. The Chief Actuary and the With-Profits Actuary of Scottish Friendly, together with the Chief Actuary and With-Profits Actuary of Canada Life have each written their own reports on the effects of the transfer on the companies and policyholders.

4.4. The terms of the transfer are detailed in documentation ('the Scheme'). Copies of the full Scheme document are available on request from the Secretary, Martin Pringle and on the Scottish Friendly website www.scottishfriendly.co.uk/members-area/takeover-and-acquisitions/canadalife

4.5. The transfer requires an order given by the High Court of Justice of England and Wales (the 'Court') sanctioning the Scheme. The proposed effective date of this transfer is 1 November 2019.

4.6. In addition to the approvals which are being sought as described in paragraph 4.1 above, legislation requires both Scottish Friendly and Canada Life to notify its respective policyholders of the proposed transfer and invite them to make representations (if any) to the Court. Scottish Friendly has been granted a waiver from the Court from the requirement to notify its policyholders on the basis that the approval process from the Delegates, coupled with the extensive advertisement of the transfer which Scottish Friendly and Canada Life are undertaking, are sufficient.

5. Key Features of the Terms of the Transfer

5.1. The offer was to acquire the liabilities of this business in return for receiving assets equalling the Technical Provisions (including risk margin) plus £50 million. The £50m would flex if the stand alone SCR fell below £40m or increased above £60m as at the effective date of transfer.

5.2. The Scheme will aim to transfer the bulk of the policies into the Scottish Friendly main fund. The exception to this is the ring-fenced with-profits sub-fund (c £0.2bnn from ex-Manulife business) which would be brought across to Scottish Friendly as a new ring-fenced sub-fund, with the remaining (£2.1bn) business going into the main fund.

5.3. Canada Life will retain the investment mandate for the assets post-transfer. This is in line with Scottish Friendly current approach to investments. A reinsurance arrangement will be put in place with Canada Life for certain property funds with effect from the effective date to reinsure the liability of Scottish Friendly under the Canada Life policies.

5.4. All holders of the transferring Canada Life policies will become members of Scottish Friendly, with the same rights in future as Scottish Friendly members. There are no plans to increase the number of delegates.

6. Concluding Remarks

6.1. The Scottish Friendly Board has considered the strategic, prudential, operational and conduct risks of this transaction in detail, with risk registers assessing the risks of both the transaction and the implementation.

6.2. As noted above, the transaction is in line with the agreed strategy; the Board is satisfied that it does not compromise any other strategic initiatives.

Please feel free to contact me or Martin Pringle as Company Secretary, if you wish to raise any questions in advance of the meeting. Otherwise there shall of course be an open discussion and an opportunity for questions in the course of the meeting.

The Board very much hopes that the resolution will meet with your approval in what it judges to be a valuable opportunity for Scottish Friendly, in the best interests of members.

Jim Galbraith
Chief Executive
28 June 2019

Attachments
1. Canada Life Policyholders Circular
2. Summary Report of Independent Expert