

# Scottish Friendly Assurance Society Limited

Report on a proposed transfer of business from Mobius Life Limited  
pursuant to Part VII of the Financial Services and Markets Act 2000

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For and on behalf of Hymans Robertson LLP  
23 May 2018

Strictly Confidential

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# 1 Background and overview

## Introduction

- 1.1 Scottish Friendly Assurance Society Limited (“Scottish Friendly”) has agreed to acquire a block of long-term insurance business, referred to as “Carter” or “the Carter business”, from Mobius Life Limited (“Mobius Life”). The proposed transfer of the Carter business to Scottish Friendly will be achieved by a Scheme of Transfer (“the Scheme”) pursuant to Part VII of the Financial Services & Markets Act 2000 (“FSMA”). The Scheme effecting the proposed transfer is subject to approval by the High Court. The Scheme effective date is expected to be 31 October 2018, at which point the Carter business will transfer from Mobius Life to Scottish Friendly.
- 1.2 The purpose of this report is to describe the proposed Scheme and to consider its impact on the benefit expectations of the existing Scottish Friendly policyholders at the date of transfer, the future security of those benefits, and the principles to treat customers fairly and manage conflicts of interest. Specifically, I have considered how the proposed Scheme is expected to affect the security of future benefits, the benefit expectations, and the fair treatment of existing Scottish Friendly policyholders prior to and beyond the transfer. I have not considered the transfer from the perspective of the transferring Mobius Life policyholders.
- 1.3 I have written this report at the request of the Board of Scottish Friendly in my capacity as Scottish Friendly’s interim Chief Actuary. I understand that a copy of my report will accompany the requisite application to the High Court requesting the sanctioning of the Scheme, and accordingly that it may be made available to policyholders and other parties affected by the Scheme.
- 1.4 Additionally, my report will be made available:
  - to Mr Philip Simpson of Milliman LLP who has been retained by the Boards of Scottish Friendly and Mobius Life to report in the capacity as Independent Expert pursuant to Section 109 of FSMA in connection with the proposed transfer,
  - to Mr David Lechmere of OAC plc, Scottish Friendly’s With-Profits Actuary,
  - to Mr John Hoskin of Barnett Waddingham LLP, Mobius Life’s Chief Actuary,
  - to the Prudential Regulation Authority (“PRA”) and the Financial Conduct Authority (“FCA”), and
  - on Scottish Friendly’s website as part of its publicity of the proposed transfer.
- 1.5 Permission is hereby granted for such distribution and publication on the condition that the entire report is so distributed or published. I am content for the report to be used by Mr Simpson and Mr Lechmere, for it to be read by Mr Hoskin, the PRA and the FCA, and for it to be made available on Scottish Friendly’s website as part its publicity of the proposed transfer.

## Summary conclusions

- 1.6 It is my opinion that that the Scheme does not have a material adverse impact on the security of benefits, benefit expectations, or the fair treatment of existing Scottish Friendly policyholders and that there is no reason, in those terms, why the transfer should not proceed. The basis for this conclusion is developed throughout the rest of this report, which must be read in its entirety.

### Status, credentials and declarations of interest

- 1.7 I am a Fellow of the Institute and Faculty of Actuaries (“IFoA”), having qualified in 1999. I have held the Chartered Enterprise Risk Actuary designation since 2011. I hold the Chief Actuary (Life), Chief Actuary (Life, Non-Directive), and With-Profits Actuary practising certificates issued by the IFoA.
- 1.8 I am a partner of Hymans Robertson LLP (“Hymans Robertson”). Following the resignation of Mr Donald Macleod, Scottish Friendly’s previous Chief Actuary, I was appointed to act as Chief Actuary to Scottish Friendly on an interim basis. At the date of my report, my formal appointment to the controlled Chief Actuary function SIMF 20 remains subject to approval by the PRA. Although much of my report, particularly in relation to the background to the Scheme and Scottish Friendly, is based on a draft report prepared by Mr Macleod, this report and the conclusions outlined herein are mine.
- 1.9 Beyond the fees payable to Hymans Robertson by Scottish Friendly under the terms of a Service Order dated 16 April 2018, I have no financial interest in either company. Specifically, neither I nor my immediate family have any policies, investments, or other holdings in Scottish Friendly or Mobius Life.
- 1.10 Other partners and staff of Hymans Robertson have advised, and continue to advise, Scottish Friendly on various matters. These have not influenced my report and its conclusions.

### Other advice and opinions

- 1.11 In their capacities as described in Section 1.4 above, Mr Simpson, Mr Lechmere and Mr Hoskin have each prepared reports on the Scheme. I have read drafts of their reports and considered their conclusions. I have relied on Mr Lechmere’s report and in particular his conclusions in respect of the impact of the proposed Scheme on the benefit expectations of the existing Scottish Friendly policyholders at the date of transfer, the future security of those benefits, and the principles to treat customers fairly and manage conflicts of interest.
- 1.12 In addition, the Board of Scottish Friendly has confirmed that the procedures and practices described in Section 5 of this report are not expected to be changed as a direct result of implementing the Scheme.

### Reliances and limitations

- 1.13 Other than as set out in Section 1.5, my report and the opinions and conclusions it contains are for the sole use of the directors of Scottish Friendly to help them to understand the expected impact of the proposed Scheme. It may not be relied upon by any other person or for any other purpose.
- 1.14 In preparing this report I have relied without independent verification on the accuracy and completeness of information provided by Scottish Friendly, including information received orally. In particular, I have relied upon:
- the data and calculations provided and used for the Pillar 1 and Pillar 2 valuations as at 31 December 2016,
  - Scottish Friendly’s understanding of the business transferring to it from Mobius Life, as validated by means of its due diligence thereon, including in relation to policy charges, administration expenses, and historical persistency experience, and
  - information contained in Mr Macleod’s most recent draft report on the Scheme prior to his leaving Scottish Friendly’s employment, including that relating to the background to the Scheme and to the structure and operation of Scottish Friendly.
- 1.15 Appendix A sets out the documents supplied to me and which I have considered in preparing my report.

- 1.16 To the extent that the information supplied in connection with the proposed transfer and associated agreements is incomplete or inaccurate, or should these change, this may materially impact my report and its conclusions. In that regard:
- my report should be considered in the context that a number of aspects relating to the Scheme are in draft form and may be subject to change, which may alter my conclusions, and
  - prior to the final Court hearing to sanction the Scheme, I will prepare a supplementary report for the Board of Scottish Friendly, appraising it of any major developments affecting the proposed transfer, including any implications for policyholders and any changes to the reported financial position.
- 1.17 Hymans Robertson accepts no liability to any third parties unless it has accepted such liability in writing. My report must not be recited, referred to, published, quoted, distributed, released, replicated, reproduced or modified (in whole or in part) except as required by law, regulatory obligation, or as set out in the Service Order, without prior written consent. Should consent be given, my report may only be released in its entirety and without modification.
- 1.18 Draft versions of the report must not be relied upon by any person for any purpose.
- 1.19 My report should not be interpreted as fact or likelihood or expectation of a particular financial outcome. Investment, demographic, expense and other experience may ultimately differ (either positively or adversely) from the assumptions underlying this report.
- 1.20 It is assumed that readers of this report have (or are advised by others who have) appropriate knowledge of matters relating to transferring portfolios of long-term insurance business in a Solvency II environment as this is required to understand the analysis and opinions presented.
- 1.21 Nothing in this report should be considered to be investment, accounting, tax or legal advice, all of which are outside of the scope of my engagement. My report is based upon my understanding of circumstances and events as at its date.

### Compliance with professional standards

- 1.22 The Financial Reporting Council sets out technical actuarial standards for members of the IFoA. This report is subject to and complies with the following standards:
- Technical Actuarial Standard 100: Principles for Technical Actuarial Work
  - Technical Actuarial Standard 200: Insurance
- 1.23 In addition, the IFoA sets professional standards for its members. This report has been prepared having due regard to the requirements of the following Actuarial Profession Standards:
- APS L1: Duties and Responsibilities of Life Assurance Actuaries. I believe that I have had access to sufficient information and resources, including the opinion of Scottish Friendly's With-Profits Actuary, in preparing my report.
  - APS X2: Review of Actuarial Work. This report is subject to and complies with the requirements for peer review set out in APS X2.

### Glossary of terms

- 1.24 Throughout this report, including in this introduction, a number of terms and abbreviations are used. These are typically defined where first used, but they are summarised in the glossary of terms in Appendix B.

### Structure of Report

1.25 The remainder of my report is structured as follows:

- Section 2 gives an overview of Scottish Friendly,
- Section 3 outlines the proposed Scheme,
- Section 4 considers the estimated financial position of Scottish Friendly before and after the transfer,
- Section 5 sets out the expected effect of the Scheme on Scottish Friendly's existing policyholders,
- Section 6 sets out my conclusions,
- Appendix A sets out the documents supplied which I have considered in preparing my report,
- Appendix B lists the various terms and abbreviations mentioned in this report, and
- Appendix C shows the detailed Pillar 1 results before and after the transfer.

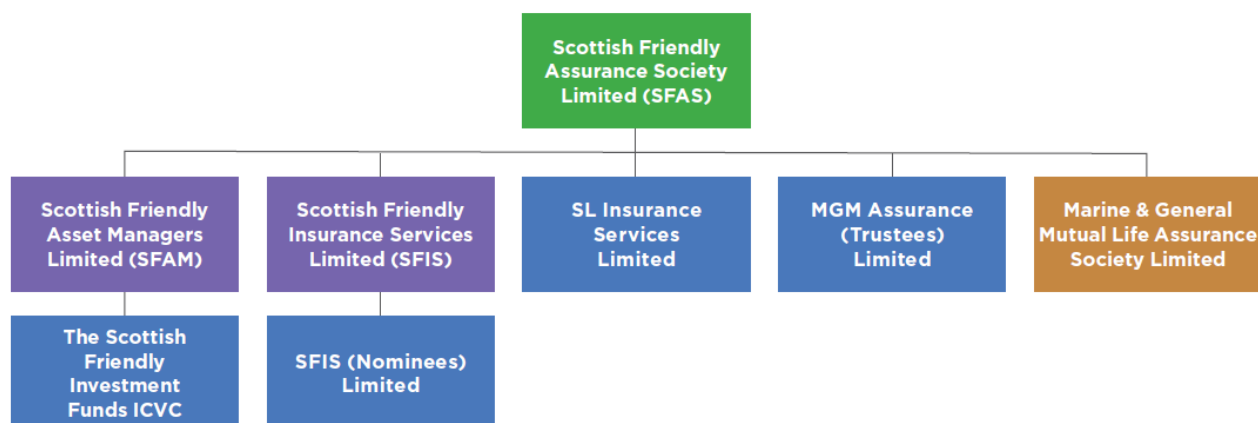
## 2 Overview of Scottish Friendly

### History

2.1 Scottish Friendly traces its origins back to 1862 as the City of Glasgow Friendly Society, a friendly society. In the early 1990s, the City of Glasgow Friendly Society acquired Scottish Friendly and rebranded itself as the Scottish Friendly Assurance Society.

### Structure of Scottish Friendly

2.2 The diagram below shows a summary of the legal structure of Scottish Friendly prior to the Scheme.



2.3 Scottish Friendly is a friendly society incorporated under the Friendly Societies Act 1992 and regulated by the PRA and by the FCA. Scottish Friendly is a mutual society and has no shareholders. Scottish Friendly and its assets are owned by its members, whether they are with-profits policyholders or non-profit policyholders. Scottish Friendly has a Board of Directors, which is its ultimate governing body. Distribution of surplus and declaration of bonuses is determined by the Board upon the advice of the With-Profits Actuary.

2.4 Scottish Friendly has a three-part growth strategy of organic growth, mergers and acquisitions (“M&A”), and business process outsourcing. Scottish Friendly’s recent M&A activity is as follows:

- On 31 December 2005, Rational Shelley Friendly Society (“Rational Shelley”) transferred its business to Scottish Friendly.
- On 31 May 2006, Preston Operative Assurance (“Preston Operative”) transferred its business to Scottish Friendly.
- On 1 July 2007, Pioneer Friendly Society (“Pioneer”) transferred its business to Scottish Friendly.
- On 30 September 2007, Scottish Legal Life Assurance Society Limited (“Scottish Legal”) transferred its business to Scottish Friendly.
- On 31 December 2007, London Aberdeen & Northern Mutual Assurance Society (“LANMAS”) transferred its business to Scottish Friendly.
- On 30 November 2012, Royal Standard Friendly Society (“Royal Standard”) transferred its business to Scottish Friendly.
- On 31 May 2015, business was transferred from Marine & General Mutual Life Assurance Society (“MGM”) to Scottish Friendly by means of a Part VII Scheme.

- 2.5 Scottish Friendly Asset Managers Limited (“SFAM”), Scottish Friendly Insurance Services Limited (“SFIS”), SL Insurance Services Limited (“SLIS”) and SFIS (Nominees) Limited are wholly owned subsidiaries of Scottish Friendly. SFAM markets OEIC, ISA and Junior ISA products. SFIS offers back-office support services for financial services organisations. SLIS was a subsidiary of Scottish Legal which sold third-party policies direct to policyholders.
- 2.6 MGM Assurance (Trustees) Limited is the trustee entity for oversight of the closed ex-MGM defined benefit pension scheme. MGM is no longer an authorised insurer and it is in the process of being closed down.

### Scottish Friendly sub-funds

- 2.7 Scottish Friendly maintains one long-term business fund, the SF Main Fund. Within this structure, separate notional sub-funds are maintained in respect of Scottish Legal, LANMAS, Rational Shelley and MGM, each of which has its own investment strategy, bonus rates and Principles and Practices of Financial Management (“PPFM”). These sub-funds are ring-fenced for the benefits of the relevant policyholders.

| Long-term business fund |                |        |                  |     |
|-------------------------|----------------|--------|------------------|-----|
| SF Main Fund            | Scottish Legal | LANMAS | Rational Shelley | MGM |

- 2.8 The business within each of the funds is broadly:
- SF Main Fund: with-profits business, both conventional and unitised, together with significant volumes of unit-linked life and pension business, such as ISAs, non-profit whole of life policies and term assurance business (most of which is reinsured).
  - Scottish Legal: with-profits business, both conventional and unitised, together with unit-linked life and pension business, significant volumes of non-profit whole of life policies and small volumes of term assurance business.
  - LANMAS: unitised with-profits business, together with unit-linked life and pension business and a small number of term assurance policies.
  - Rational Shelley: conventional with-profits business and whole of life policies.
  - MGM: with profits business, both conventional and unitised, immediate annuities and flexible income annuities.
- 2.9 All Scottish Friendly policyholders are members of Scottish Friendly, whether their policies have been written in the SF Main Fund or in any of the sub-funds.

### SF Main Fund

- 2.10 The SF Main Fund contains policies written by SF, along with business obtained through the acquisition of Royal Standard, Preston Operative and Pioneer. In addition, a block of unit-linked and term assurance business was transferred from MGM into the SF Main Fund as part of the acquisition of business from MGM on 31 May 2015.
- 2.11 Profits will emerge in the SF Main Fund from:
- non-profit business written by Scottish Friendly and transferred from MGM into the SF Main Fund,
  - subsidiaries of SF, and



- business written within the Scottish Legal, LANMAS, Rational Shelley and MGM notional sub-funds. The SF Main Fund makes a charge against each of the notional sub-funds in line with the relevant Schemes and the difference between those charges and the actual costs incurred in administering the business within the notional sub-funds emerges as a profit for the SF Main Fund.

2.12 In the first instance these profits are attributed to the working capital of the SF Main Fund. However the Board agreed in 2015 that a mechanism should be established for distributing these profits to with-profits policyholders. Each year an assessment is made of the profits emerging from the sources listed in Section 2.11, and a share of these profits is distributed by means of enhancing the investment returns applied to asset shares.

### Other sub-funds

2.13 The Scottish Legal, LANMAS, Rational Shelley and MGM notional sub-funds are all closed to new business, and contain policies written by Scottish Legal, LANMAS, Rational Shelley and MGM prior to their transfer to Scottish Friendly. The charges made against policies within these sub-funds are governed by the relevant scheme of transfer.

### Summary of the Business

2.14 The following tables summarise of the in-force business as at 31 December 2016 as shown in the regulatory return to the PRA:

| SF Main Fund         | Policy count   | Best-estimate liabilities (£m) |                   |
|----------------------|----------------|--------------------------------|-------------------|
|                      |                | Before reinsurance             | After reinsurance |
| CWP                  | 111,569        | 258                            | 258               |
| UWP                  | 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                            | -28               |
| Other                | 12,463         | 35                             | 33                |
| <b>Total</b>         | <b>645,596</b> | <b>1,121</b>                   | <b>960</b>        |

| Scottish Legal       | Policy count   | Best-estimate liabilities (£m) |                   |
|----------------------|----------------|--------------------------------|-------------------|
|                      |                | Before reinsurance             | After reinsurance |
| CWP                  | 116,949        | 52                             | 52                |
| UWP                  | 398            | 3                              | 3                 |
| Unit-linked life     | 1,046          | 9                              | 9                 |
| Unit-linked pensions | 163            | -                              | -                 |
| Whole of life        | 397,819        | 10                             | 10                |
| Term assurance       | 919            | -                              | -                 |
| Other                | 4,376          | 3                              | 3                 |
| <b>Total</b>         | <b>521,670</b> | <b>77</b>                      | <b>77</b>         |

| LANMAS               | Policy count | Best-estimate liabilities (£m) |                   |
|----------------------|--------------|--------------------------------|-------------------|
|                      |              | Before reinsurance             | After reinsurance |
| CWP                  | -            | -                              | -                 |
| UWP                  | 1,053        | 13                             | 13                |
| Unit-linked life     | 719          | 8                              | 8                 |
| Unit-linked pensions | 69           | -                              | -                 |
| Whole of life        | -            | -                              | -                 |
| Term assurance       | 162          | -                              | -                 |
| Other                | 25           | 1                              | 1                 |
| <b>Total</b>         | <b>2,028</b> | <b>22</b>                      | <b>22</b>         |

| Rational Shelley | Policy count | Best-estimate liabilities (£m) |                   |
|------------------|--------------|--------------------------------|-------------------|
|                  |              | Before reinsurance             | After reinsurance |
| CWP              | 1,211        | 7                              | 7                 |
| UWP              | -            | -                              | -                 |
| Whole of life    | 1,740        | 1                              | 1                 |
| Term assurance   | 25           | -                              | -                 |
| Other            | 567          | 1                              | 1                 |
| <b>Total</b>     | <b>3,543</b> | <b>9</b>                       | <b>9</b>          |

| MGM            | Policy count  | Best-estimate liabilities (£m) |                   |
|----------------|---------------|--------------------------------|-------------------|
|                |               | Before reinsurance             | After reinsurance |
| CWP            | 12,165        | 523                            | 65                |
| UWP            | 5,535         | 121                            | 121               |
| Whole of life  | 1,731         | 3                              | 3                 |
| Term assurance | -             | -                              | -                 |
| Other          | 13,479        | 381                            | 20                |
| <b>Total</b>   | <b>32,910</b> | <b>1,028</b>                   | <b>209</b>        |

2.15 “Best-estimate liabilities” refers to best-estimate liabilities on a Pillar 1 basis. This is explained in Section 4.5.

## 3 Outline of the Scheme

### Overview of the business transferring

- 3.1 The Carter business is all unit-linked pensions business, with no attaching guarantees or guaranteed benefits. It comprises c.£350m of funds across c.13,000 members at 31 December 2016, the vast majority of which relates to group personal pensions (“GPPs”) and group stakeholder pensions (“GSPs”). There are small volumes of individual personal pension business and trustee investment plans with associated member administration services.
- 3.2 The Carter business is not core to Mobius Life’s long-term strategy and Scottish Friendly has agreed to acquire it, and its associated expected profits, for a consideration of £3.1m, which was based on a prudent valuation of future margins expected to be released on the Carter business over time.
- 3.3 The transfer agreement between Mobius Life and Scottish Friendly provides for the value of the consideration to be adjusted up or down depending on the value of transferring assets and the make-up of transferring members on the Scheme effective date.
- 3.4 The proposed Scheme will result in all of the Carter business in Mobius Life transferring to Scottish Friendly. The transferring business will move into the SF Main Fund, with consideration for this being paid to Mobius Life from the SF Main Fund.
- 3.5 The Carter policies are currently administered by Aegon UK plc (“Aegon”) under a contract between it and Mobius Life. This contract will be novated without amendment from Mobius Life to Scottish Friendly under the terms of the Scheme, and as such the Scheme will lead to no change in the administration of transferring Mobius Life policyholders. Investment administration is currently carried out by Mobius Life and, as part of the deal, it has been agreed that this will continue after the transfer.

### Rationale for the Scheme

- 3.6 The main rationale of the Scheme from Scottish Friendly’s perspective is to release margins relative to the purchase price, to diversify the product offering, to provide opportunity to expand into different markets, and to provide the potential for future cost savings through operational efficiencies.

### Assets and liabilities being transferred

- 3.7 All assets and liabilities associated with the Carter business will transfer to the SF Main Fund.
- 3.8 The following table shows the estimated value of the transferring Carter business as at 31 December 2016:

| Carter               | Policy count  | Technical provisions (£m) |                   |
|----------------------|---------------|---------------------------|-------------------|
|                      |               | Before reinsurance        | After reinsurance |
| Unit-linked business | 12,963        | 339.1                     | 339.1             |
| Other business       | -             | -                         | -                 |
| <b>Total</b>         | <b>12,963</b> | <b>339.1</b>              | <b>339.1</b>      |

### Capital Support

- 3.9 Capital support arrangements between the SF Main Fund and the existing sub-funds will be unaffected by the transfer.

### **Unit-linked funds and reinsurance arrangements**

- 3.10 At the date of transfer, Scottish Friendly will maintain the transferring policies' investment links. This will be facilitated by Scottish Friendly entering into an investment-only reinsurance agreement with Mobius Life under which Scottish Friendly will reinsure transferring policyholders' investment benefits to Mobius Life. In turn, Mobius Life will maintain the transferring policyholders' investment links. In this way, the transferring policyholders will ultimately be linked to the same assets immediately before and after the proposed transfer.
- 3.11 The risks to the Scottish Friendly associated with this arrangement, and their proposed mitigants, are considered in more detail in Sections 5.6-5.22.

### **Costs related to the Scheme**

- 3.12 Scottish Friendly and Mobius Life will each bear their own costs in connection with the proposed transfer, including legal fees, consultancy fees, and the costs of any redundancies arising from the transfer. The costs of the Independent Expert will be shared equally between the firms.

### **Membership rights**

- 3.13 All transferring Carter policyholders will become members of Scottish Friendly.

## 4 Financial position before and after the transfer

### Background

4.1 UK insurance companies are required, by law, to maintain a minimum level of capital resources to reduce the risk that they are unable to meet their future obligations to policyholders following adverse events. Under Solvency II, the current regulatory requirement for insurers and reinsurers in the European Union, this calculation is performed on two different bases.

### First basis: Pillar 1

- 4.2 The first basis is an assessment of the “own funds” available compared to the capital required to be covered.
- 4.3 Broadly speaking, the value of a firm’s own funds is the market value of its assets less the value of its technical provisions and other liabilities.
- 4.4 Technical provisions are intended to represent the amount that an insurer would need to pay to immediately discharge its obligations to policyholders by transferring the business to another insurer in an arm’s length transaction. Since the price of such a transaction is not readily observable in the financial markets, a theoretical transfer value is determined, equal to a best estimate liability plus a risk margin.
- 4.5 For unit-linked business such as Carter, the best-estimate liability is separated into unit and non-unit components, namely:
- the unit reserve which is the amount arising from the obligation to pay unit-linked benefits: its value is equal to the value of the relevant unit-linked assets, and
  - the non-unit (or sterling) reserve which is determined using the best-estimate of expected cash inflows to the firm (e.g. unit-linked charges) and cash outflows from the firm (e.g. administration expenses). The non-unit reserve may be negative, i.e. where the value of charges received by the firm exceeds the value of expenses incurred by it.
- 4.6 The risk margin is the amount added to the best-estimate liability to bring the technical provisions up to the theoretical transfer value. It is calculated based on the idea that, as well as the expected cost of paying the benefits and expenses, the hypothetical insurer taking on the business would also incur the cost of holding capital against those risks that it cannot hedge.
- 4.7 The regulations require insurers to maintain own funds in excess of the Solvency Capital Requirement (“SCR”). The value of a firm’s SCR is calculated by modelling the amount by which the insurer’s own funds could fall over the course of one year such that the probability that the reduction in own funds exceeds the SCR over that one-year period is 0.5%.
- 4.8 The SCR may be determined using either a firm’s own internal model (if the firm has an approved internal model) or the Standard Formula prescribed in the Solvency II Directive and associated implementing regulations. Scottish Friendly uses the Standard Formula to assess the amount of capital it is required to hold, and expects to continue to use the Standard Formula going forward.
- 4.9 Under Solvency II, firms can apply to adjust (increase) the discount rate used to value certain liabilities by using a Matching Adjustment (“MA”) (largely for non-profit annuity business) and/or a Volatility Adjustment (“VA”) (for other business). The use of the MA or VA generally lowers the valuation of liabilities, but it does not affect obligations to policyholders. Scottish Friendly does not currently make use of the MA or VA, and has no current plans to apply to the PRA to do so.

4.10 Insurers are required to disclose their Pillar 1 results to the regulator on a quarterly basis and to publish them annually on their website in the Solvency and Financial Condition Report (“SFCR”).

**Second basis: Pillar 2**

4.11 The second basis requires companies to make their own assessment of the amount of capital they need to hold, based on the risks to which they are exposed, approved risk tolerance limits, and the business strategy, to ensure that they remain able to meet its liabilities to policyholders in all but the most extreme circumstances

4.12 This calculation is referred to as the Own Risk & Solvency Assessment (“the ORSA”), also known as Pillar 2.

4.13 Of particular importance is the consideration of the Forward Looking Assessment of Own Risks (“FLAOR”). As part of FLAOR, insurance companies are expected to address the following issues:

- all material risks from all assets and liabilities; management practices, systems and controls, including risk mitigation,
- the quality of processes and inputs, and in particular the related governance issues,
- the link between business planning and the “overall solvency needs” (which is understood to incorporate regulatory and internal capital requirements, e.g. target rating capital requirements),
- explicit identification of possible emerging risk scenarios,
- relevance of potential external stresses, and
- use of a consistent valuation basis.

4.14 Unlike the Pillar 1 assessment which is publicly-available in Scottish Friendly’s SFCR, the ORSA is submitted to the regulator on a private basis.

**Assessing the expected impact of the Scheme: solvency calculations**

4.15 In order to assess whether or not the security of policyholder benefits is materially affected by the Scheme, it is helpful to compare Scottish Friendly’s solvency position before and after the Scheme.

4.16 The Pillar 1 and Pillar 2 solvency ratios provide a useful indicator of the immediate impact of the Scheme on the level of benefit security provided to policyholders.

4.17 Scottish Friendly’s solvency position before and after the transfer has been based on the reported Pillar 1 position, the calculated Pillar 2 position, and uses information provided by Mobius Life regarding the Carter business.

4.18 As at the date of commencing this report, Scottish Friendly’s most recent public SFCR disclosures were as at 31 December 2016 and, as such, my quantification of the expected impact of the Scheme is as also at the date. I will consider the position at 31 December 2017 in the supplementary report referred to in Section 1.16.

4.19 The methodologies used in, and the approach to deriving the assumptions underlying, the calculations of the impact of Carter on Scottish Friendly’s Pillar 1 and Pillar 2 solvency positions are broadly consistent with those used at 31 December 2016.

4.20 Scottish Friendly's solvency position at the Scheme effective date will differ from these estimates but, as the nature of the transferring business is such that I do not expect the impact of the Scheme on Scottish Friendly's own funds and capital requirements to change materially by performing the assessment at a different date, I consider that the following figures give a fair indication of the expected impact of the Scheme on Scottish Friendly's solvency position.

4.21 The quantification of the impact of Carter is based on grouped data supplied by Scottish Friendly. Given the nature of the business, I consider this to be adequate for the purposes of this report, but I would note that the quantification of the impact may change when per-policy data is used, although I would not expect this to be material.

4.22 I will continue to monitor the company's solvency position and risk profile and report on any material considerations in the supplementary report referred to in Section 1.16.

### Expected impact of the Scheme: Pillar 1

4.23 The table below shows the Scottish Friendly Pillar 1 position before and after the Scheme. Appendix C shows these results in more detail.

| Pillar 1 result – 31 December 2016              | Pre transfer | Post transfer |
|---|--------------|---------------|
| Total Assets [A]                                | £2,552.4m    | £2,892.6m     |
| Total Liabilities [B]                           | £2,369.8m    | £2,708.9m     |
| Excess of Assets over Liabilities [C] = [A]-[B] | £182.6m      | £183.7m       |
| Own Funds <sup>1</sup> [D]                      | £162.7m      | £163.8m       |
| Solvency Capital Requirement [E]                | £81.8m       | £85.8m        |
| Excess capital resources [F]=[D]-[E]            | £80.9m       | £77.9m        |
| Capital cover [G]=[D]/[E]                       | 199%         | 191%          |

4.24 The figures shown above are gross of Scottish Friendly's existing reinsurance arrangements, and are consistent with the Solvency II results submitted to the PRA as at 31 December 2016.

4.25 The impact of Carter is to increase own funds in the SF Main Fund by £1.1m, made up as follows (subject to rounding):

- assets increase by £343.75m, the estimated value of the Mobius Life assets at the transaction date,
- assets reduce by £3.1m, the purchase price of the transaction,
- assets reduce by £0.5m, the expected costs of the project,
- liabilities increase by £343.75m reflecting policyholder unit reserves,
- liabilities reduce by £6.2m, reflecting the estimated negative sterling reserves, and
- liabilities increase by £1.6m, reflecting the estimated risk margin.

4.26 In line with the requirements of Solvency II, own funds at the Scottish Friendly undertaking level also increase by £1.1m.

1 Total capital resources once the effects of the ring-fenced sub-funds has been allowed for.



- 4.27 The impact of the Carter business on the Pillar 1 capital requirements is as follows:
- market risk capital requirements (principally equity and interest rate risk) increase by £3.8m,
  - counterparty risk capital requirements are assumed to be unchanged (see Section 5.13-5.18),
  - life underwriting risk capital requirements (driven by “lapses up”) increase by £1.9m, and
  - operational risk capital requirements (driven the increased expense to Scottish Friendly of running the Carter portfolio) increase by £0.4m.
- 4.28 After diversification, the SCR in the SF Main Fund increases by £4.0m. The aggregate SCR at undertaking level increases by the same amount in line with the requirements of Solvency II.
- 4.29 The impact of the transfer is therefore to reduce the aggregate capital cover from 199% to 191%, with the excess aggregate capital resources reducing from £80.9m to £77.9m.
- 4.30 As can be seen in Appendix C, the solvency coverage ratio of the SF Main Fund when considered in isolation reduces from 763% to 580% as a result of the Scheme.
- 4.31 These results show that Scottish Friendly is expected to be able to meet its Pillar 1 capital requirements immediately after the Scheme.

#### **Expected impact of the Scheme: Pillar 2**

- 4.32 In addition to the regulatory capital adequacy requirements, Scottish Friendly also has internal capital adequacy tolerances, primarily relating to capital coverage (i.e. the ratio of available to required capital) on a Pillar 2 basis. The risk appetite is outlined in the Risk Management Framework, which feeds into the ORSA. It is not expected that the Scheme will result in these tolerances being breached, nor is it expected that the Scheme will require the tolerances to be changed.
- 4.33 Consistent with its expected impact on a Pillar 1 basis, the expected impact of the Scheme on Scottish Friendly’s Pillar 2 solvency position is to increase both the capital available and the capital requirement, with a reduction in the capital coverage on a Pillar 2 basis. The solvency position after the transfer remains within Scottish Friendly’s risk appetite.

#### **Capital management**

- 4.34 Although Scottish Friendly operates one main fund, it uses notional sub-funds for distinct blocks of business, reflecting the policies acquired from Scottish Legal, LANMAS, Rational Shelley, and MGM. The solvency position for each of these sub-funds is determined at any point in time, and the assets which are attributed to each sub-fund are determined on a roll-forward basis allowing for investment returns on those assets and any claims and charges in respect of the underlying policies. Thus, the solvency position of the various sub-funds will be unaffected by the Scheme.
- 4.35 Capital support arrangements between the SF Main Fund and the existing sub-funds will be unaffected by the transfer.



## 5 Effect of the Scheme on policyholders

### Background

- 5.1 This section considers the effect of the Scheme on existing Scottish Friendly policyholders with respect to the security of their benefits, their benefit expectations, quality of administration, planned communications and other relevant factors.
- 5.2 I have not considered policyholders transferring to Scottish Friendly as the effect of the Scheme on those policyholders is discussed in the reports of the Mr Simpson as Independent Expert and Mr Hoskin as Chief Actuary of Mobius Life.
- 5.3 The existing notional sub-funds will continue to be maintained as separate funds following the Scheme and be managed within their agreed risk frameworks. It is not expected that the Scheme will have a material impact on the security, benefit expectations, quality of administration, planned communications or any other relevant factor for policyholders within SF existing notional sub-funds.
- 5.4 The Scheme does not result in any policies moving into or out of existing notional sub-funds.

### Capital support arrangements

- 5.5 Scottish Friendly operates a capital support arrangement such that any of the sub-funds can, either on a temporary or permanent basis, provide capital to or be provided with capital from the SF Main Fund. It is not anticipated that the Scheme will impact these capital support arrangements.

### Risk profile of the business

- 5.6 The Scheme provides for a transfer of significant volumes of unit-linked pensions business from Mobius Life to the SF Main Fund. The SF Main Fund already has material volumes of unit-linked business, so the Scheme is not expected to significantly impact its risk profile. However, I would draw out three main areas of potential risk to the SF Main Fund – persistency risk, reinsurance counterparty risk, and operational risk – which I discuss below.

### Persistency risk

- 5.7 The long-term financial benefit of this business to the SF Main Fund is expected to arise through policyholder charges exceeding the expenses incurred in acquiring and subsequently administering the business, and indeed the Carter business is ultimately expected to generate profits for the SF Main Fund.
- 5.8 While the value to the SF Main Fund of policyholder charges depends on the levels of financial markets, the main risk to the SF Main Fund achieving the level of profitability expected arises from persistency: should policyholders not remain invested for as long as assumed, this will adversely impact the SF Main Fund, and may ultimately lead to the value emerging from the portfolio falling short of the purchase price.
- 5.9 In that regard, and for the purposes of calculating the firm's non-unit reserves, I have proposed the use of a persistency assumption which is consistent with the analysis of historical persistency experience and benchmarking studies which fed into Scottish Friendly's due diligence of the transaction, although I have not validated the experience analysis or the data underlying it. This assumption should be kept under active review.
- 5.10 The risk of adverse persistency experience relative to this assumption is allowed for in determining capital requirements, via both a one-off spike in poor persistency ("mass lapse") and a permanent increase in ongoing persistency experience ("lapses up"). With policyholder charges on the Carter portfolio currently in excess of the expenses of administering it, a decrease in annual persistency experience ("lapses down") would be beneficial to the SF Main Fund, and so does not give rise to a capital requirement.

- 5.11 For the Carter portfolio in isolation, the largest persistency risk relates to “mass lapse”, but at the SF Main Fund level “lapses up” is the dominant persistency risk and remains so after the addition of Carter.
- 5.12 While the Carter business does give rise to a more significant persistency risk than Scottish Friendly’s existing business, I am comfortable that it does not expose the SF Main Fund to an unacceptable level of persistency risk.

**Reinsurance counterparty risk**

- 5.13 As described above, the transferring policyholders will ultimately be linked to the same assets immediately before and after the proposed transfer. This will be facilitated by Scottish Friendly entering into an investment-only reinsurance agreement with Mobius Life under which Scottish Friendly will reinsure transferring policyholders’ investment benefits to Mobius Life. Mobius Life will in turn maintain the transferring policyholders’ investment links.
- 5.14 A large proportion of the unit-linked funds in respect of the Carter business transferring to the SF Main Fund are currently reinsured from Mobius Life to insurance company subsidiaries of various external fund managers.
- 5.15 Unlike unit-linked funds which invest directly or which “wrap” unitised investment products (such unit trusts and OEICs) where the policyholder ultimately bears the risk of default of the underlying assets, the nature of Mobius Life’s historical pre-sale disclosure is such that it, and not the policyholder, is currently exposed to the risk that the fund management reinsurance counterparty defaults on business written before 7 April 2010.
- 5.16 The reinsurance contract between Scottish Friendly and Mobius Life will be structured such that Scottish Friendly is liable for any default on pre 7 April 2010 business either by Mobius Life or by any of the third party insurers to which Mobius Life subsequently reinsures.
- 5.17 By way of security for Scottish Friendly, Mobius Life’s existing reinsurance agreement with Legal and General Assurance (Pensions Management) Ltd (“L&GPML”) will be separated into two contracts, one covering the Carter business transferring to Scottish Friendly and the other covering Mobius Life’s remaining business.
- 5.18 The contract covering the Carter business will contain security provisions which effectively give Scottish Friendly priority over Mobius Life’s other policyholders to receive the L&GPML reinsurance receivables in the event of Mobius Life becoming insolvent.
- 5.19 This allows the reinsurance receivables to be treated as collateral in favour of Scottish Friendly, the effect of which is that Scottish Friendly will not have to hold a corresponding capital requirement on its Solvency II regulatory (i.e. Pillar 1) balance sheet. This treatment has been assumed in quantifying Scottish Friendly’s Pillar 1 position after the transfer, but is subject to formal ratification from Scottish Friendly’s auditors (with whom the proposed treatment has been discussed) once all of the reinsurance-related documents are finalised.
- 5.20 Alongside the security over the L&GPML reinsurance receivables, Mobius Life will enter into a Deed of Charge in favour of Scottish Friendly giving Scottish Friendly a floating charge over assets in the Mobius Life’s long-term fund up to the value of the reinsurance ceded to Mobius Life in respect to Carter. The floating charge will crystallise in the event of default and will ensure that Scottish Friendly ranks equally with Mobius Life’s direct policyholders in that scenario.

- 5.21 While not required on a Pillar 1 basis, Scottish Friendly will make allowance on a look-through basis for the counterparty default risk of the underlying fund managers when calculating its Pillar 2 solvency position. Calculations provide comfort that the level of counterparty default risk taken on under the Scheme is not excessive.

### Operational risk

- 5.22 The Carter policies are currently administered by Aegon under a contract between it and Mobius Life. This contract will be novated without amendment from Mobius Life to Scottish Friendly under the terms of the Scheme, and as such the Scheme will lead to no change in the administration of transferring Mobius Life policyholders. Investment administration is currently carried out by Mobius Life and, as part of the deal, it has been agreed that this will continue after the transfer. There is therefore expected to be minimal operational impact on Scottish Friendly, although the performance of Aegon and Mobius Life as outsource service providers will of course be monitored.
- 5.23 Notwithstanding Section 5.22 there nevertheless will be an increase in operational risk capital requirements.

### Financial impact

- 5.24 The overall impact of the Scheme on Scottish Friendly's Pillar 1 solvency position is shown in Section 4.23. While there is a reduction in it, the resulting Pillar 1 solvency position is still well above the minimum solvency position required by the regulators.
- 5.25 The overall impact of the Scheme on Scottish Friendly's Pillar 2 solvency position has also been determined. While there is a reduction in it, the resulting Pillar 2 solvency position is still well above the minimum solvency position required by the regulators and well above Scottish Friendly's risk appetite.

### Security of Benefits

- 5.26 As set out above, the security of the benefits of the policies is provided by Scottish Friendly meeting the regulatory minimum capital requirements together with the operation of its capital policy.
- 5.27 While the Scheme does result in a reduction in Scottish Friendly's solvency coverage ratio, as set out in Section 4.23, I do not expect the Scheme to materially reduce the expectation of Scottish Friendly being able to meet its regulatory capital requirements or its capital policy after the Scheme.
- 5.28 In addition, the Carter business is expected to generate profits for the SF Main Fund, as the charges made against the Carter policies should exceed the costs necessary to administer them.
- 5.29 Consequently, I do not believe there is a material adverse impact on the security of benefits for existing Scottish Friendly policyholders as a result of the Scheme.
- 5.30 Mr Lechmere has also considered the impact of the Scheme on the security of benefits to existing Scottish Friendly policyholders. Further details are included in his report.

### Investment policy

- 5.31 Scottish Friendly's current practice is to consider investment policy separately for the SF Main Fund and each of the sub-funds. The investment policy of each fund is set out in the relevant PPFM.
- 5.32 The risk profile of existing Scottish Friendly business will not be materially impacted by the Scheme, and the transfer of the Carter business to the SF Main Fund is not expected to alter the investment profile of the fund: unit-linked liabilities will be matched with unit-linked assets and non-unit reserves, which are small in the context of the fund, will be matched with fixed interest securities.

5.33 Scottish Friendly's investment managers, the asset selection processes, and the investment strategy will not change as a consequence of the Scheme.

#### **Benefit expectations – with-profits business**

5.34 The terms and conditions for existing Scottish Friendly with-profit policies are unaffected by the Scheme.

5.35 There will be no material changes as a result of the Scheme to investment strategy, expense allocation, policy charges, or the methodology for setting or allocating bonuses for existing Scottish Friendly with-profits policyholders.

5.36 As discussed above, the Scheme does not expose the SF Main Fund to significant new risks, and it is expected that existing with-profits policyholders may ultimately benefit as the Carter business is expected to generate profits for the SF Main Fund relative to the £3.1m consideration paid to Mobius Life as that business unwinds.

5.37 Therefore, I do not expect that the benefit expectations of with-profits policyholders will be materially adversely affected as a result of the Scheme.

5.38 Mr Lechmere has also considered the impact of the Scheme on the benefit expectations of with-profits policyholders. Further details are included in his report.

#### **Benefit expectations – non-profit business**

5.39 The terms and conditions for existing Scottish Friendly non-profit policies (including charges, premiums and promised benefits) are unaffected by the Scheme.

5.40 In addition, the range of unit-linked funds available to existing policyholders will not change and there will be no changes to unit pricing or investment administration processes as a result of the Scheme.

5.41 The benefit expectations of non-profit policyholders are therefore not expected to be materially adversely affected as a result of the Scheme.

5.42 Mr Lechmere has also considered the impact of the Scheme on the benefit expectations of non-profit policyholders. Further details are included in his report.

#### **Membership rights**

5.43 All membership rights of existing Scottish Friendly members will be preserved and remain unaffected by the proposed transfer.

5.44 The Scheme will result in around 13,000 policies transferring to Scottish Friendly, which is relatively small given Scottish Friendly's current policy base of well over one million policies.

5.45 There is therefore not expected to be a material dilution on the membership rights of existing members as a result of the transfer.

5.46 Mr Lechmere has also considered the impact of the Scheme on the rights of current members. Further details are included in his report.

#### **Governance arrangements**

5.47 There are no with-profits policies within the Carter business, and Scottish Friendly's existing with-profits governance arrangements will be unaffected by the Scheme.

- 5.48 Mobius Life currently operates a Governance Advisory Arrangement (“GAA”) which has an oversight role in respect of its GPPs and GSPs. Scottish Friendly intends to form a GAA which will replicate the existing Mobius Life arrangements. The scope of the new GAA will also be extended to include around 1,500 current Scottish Friendly policyholders, in respect of whom Scottish Friendly has a regulatory waiver to have a GAA in place.

### **Taxation**

- 5.49 It is not expected that there will be any impact on the tax position of existing Scottish Friendly policyholders as a result of the Scheme.
- 5.50 It is not expected that there will be any difference in approach in determining any tax recoverable by, or credited to, the unit-linked life and pension funds as a result of the Scheme.
- 5.51 Confirmations and clearances have been applied for from Her Majesty’s Revenue & Customs where appropriate.

### **Administration**

- 5.52 As described above, administration of the Carter policies is currently undertaken by Aegon and this will continue immediately after the Scheme. The Scheme is therefore not expected to adversely affect the administration of existing Scottish Friendly policies.

### **Notification to SF policyholders**

- 5.53 Scottish Friendly operates a delegates system, whereby a certain number of policyholders, from both Scottish Friendly and Scottish Legal, are elected to represent the interests of the policyholder book.
- 5.54 As part of the planning work for the Scheme, communication to delegates and policyholders will be considered and detailed. This should ensure that delegates and policyholders are adequately informed in a timely manner of the nature and expected effect of the Scheme.
- 5.55 The regulations governing Part VII transfers require that, unless the Court otherwise orders, all policyholders in all affected companies should be written to in order to inform them of the proposed Scheme. An application is to be made for a waiver from mailing Scottish Friendly policyholders on the grounds that the delegates, who represent the policyholders, will be written to in advance of the Scheme.
- 5.56 I am satisfied that the proposed communication plan described above is appropriate and consistent with the principles pertaining to the fair treatment of policyholders.

## 6 Conclusions

- 6.1 As set out in the preceding sections of my report, the Scheme is not expected to have a materially adverse impact on:
- the security of benefits for existing Scottish Friendly policyholders,
  - the benefit expectations for existing Scottish Friendly policyholders,
  - the fair treatment of existing Scottish Friendly policyholders,
  - the membership rights of existing Scottish Friendly policyholders, and
  - the administration and management of Scottish Friendly policies.
- 6.2 It is therefore my opinion that that the Scheme does not have a material adverse impact on the security of benefits, benefit expectations, or the fair treatment of existing Scottish Friendly policyholders and that there is no reason, in those terms, why the transfer should not proceed.

*Stephen Makin*

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**Stephen Makin FFA CERA**  
**Chief Actuary (Interim), Scottish Friendly**

**For and on behalf of Hymans Robertson LLP**  
**23 May 2018**

## Appendix A: Documents considered

The following table lists the main documents supplied to me which I have considered in preparing my report.

| Ref | Document   | Author                                  | Version / Date    |
|-----|--|---|-------------------|
| [1] | The report by the Scottish Friendly With-Profits Actuary [in draft]      | David Lechmere                          | v0.7, 22 May 2018 |
| [2] | The report of the Independent Expert [in draft]                          | Philip Simpson                          | v4.0 14 May 2018  |
| [3] | The report of the Chief Actuary of Mobius Life [in draft]                | John Hoskin                             | v5.0 17 May 2018  |
| [4] | Various reports by the Scottish Friendly Chief Actuary Report [in draft] | Donald Macleod                          | February 2018     |
| [5] | The Transfer Agreement   | CMS Cameron McKenna Nabarro Olswang LLP | 18 December 2017  |
| [6] | Project Carter Sub-Committee Meeting papers                              | Various                                 | 8 November 2017   |
| [7] | Information Memorandum   | IMAS Corporate Finance                  | February 2017     |



## Appendix B: terms and abbreviations used

| Term                     | Meaning   |
|--------------------------|---|
| Aegon                    | Aegon UK plc  |
| Carter / Carter business | the portfolio of business to be transferred to Scottish Friendly from Mobius Life   |
| CWP                      | conventional with-profits   |
| CERA                     | Chartered Enterprise Risk Actuary   |
| FCA                      | Financial Conduct Authority   |
| FFA                      | Fellow of the Institute & Faculty of Actuaries  |
| FIA                      | Flexible Income Annuity   |
| FLAOR                    | Forward Looking Assessment of Own Risks   |
| FSMA                     | Financial Services and Markets Act 2000   |
| GAA                      | Governance Advisory Arrangement   |
| GPP                      | group personal pension  |
| GSP                      | group stakeholder pension   |
| Hymans Robertson         | Hymans Robertson LLP  |
| IFoA                     | Institute and Faculty of Actuaries  |
| ISA                      | Individual Savings Account  |
| L&GPML                   | Legal and General Assurance (Pensions Management) Ltd   |
| LANMAS                   | London Aberdeen & Northern Mutual Assurance Society   |
| M&A                      | mergers & acquisitions  |
| MA                       | Matching Adjustment   |
| MGM                      | Marine & General Mutual Life Assurance Society Ltd  |
| Mobius Life              | Mobius Life Limited   |
| OEIC                     | Open Ended Investment Company   |
| ORSA                     | Own Risk & Solvency Assessment  |
| PPFM                     | Principles and Practices of Financial Management  |
| PRA                      | Prudential Regulation Authority   |
| Pioneer                  | Pioneer Friendly Society  |
| Preston Operative        | Preston Operative Assurance   |
| Rational Shelley         | Rational Shelley Friendly Society   |
| Royal Standard           | Royal Standard Friendly Society   |
| SCR                      | Solvency Capital Requirement  |
| Scottish Legal           | Scottish Legal Life Assurance Society Limited   |
| Scottish Friendly        | Scottish Friendly Assurance Society Limited   |
| SFAM                     | Scottish Friendly Asset Managers Limited  |
| SFCR                     | Solvency and Financial Condition Report   |
| SFIS                     | Scottish Friendly Insurance Services Limited  |
| SLIS                     | SL Insurance Services Limited   |
| Solvency II              | Directive 2009/138/EC of the European Parliament and of the European Council, dated 25 November 2009 on the taking-up and pursuit of the business of Insurance and Reinsurance (Solvency II) (recast) |
| the Scheme               | the Scheme of Transfer pursuant to Part VII of FSMA to transfer the Carter business to Scottish Friendly  |
| UWP                      | unitised with-profits   |
| VA                       | Volatility Adjustment   |



## Appendix C: impact of the Scheme on the Pillar 1 solvency position

### Solvency position prior to transfer

The Pillar 1 solvency position of Scottish Friendly prior to the Scheme is outlined below (all figures in £m):

| Capital requirement                             | SF Main Fund | LAN MAS | RS   | SLL  | MGM  | Aggregate SF before transfer |
|---|--------------|---------|------|------|------|------------------------------|
| Market risk                                     | 3.2          | -       | -    | 0.5  | 62.3 | 65.9                         |
| Counterparty default risk                       | 7.9          | -       | -    | 0.8  | 2.9  | 11.6                         |
| Life underwriting risk                          | 7.7          | 0.0     | 0.0  | 0.0  | 2.6  | 10.3                         |
| Health underwriting risk                        | -            | -       | -    | -    | -    | -                            |
| Non-life underwriting risk                      | -            | -       | -    | -    | -    | -                            |
| Diversification                                 | -5.1         | -       | -    | -0.2 | -4.0 | -14.6                        |
| Basic Solvency Capital Requirement              | 13.7         | 0.0     | 0.0  | 1.0  | 63.8 | 73.3                         |
| Adjustment due to RFF/MAP nSCR aggregation      |              |         |      |      |      | 5.2                          |
| Operational risk                                | 2.8          | 0.0     | 0.0  | 0.3  | 4.6  | 7.8                          |
| Loss-absorbing capacity of technical provisions | -4.3         | -0.0    | -0.0 | -0.2 | -0.0 | -4.5                         |
| Solvency Capital Requirement                    | 12.2         | 0.0     | 0.1  | 1.2  | 68.4 | 81.8                         |
| Minimum Capital Requirement                     |              |         |      |      |      | 28.6                         |

| Own funds  | SF Main Fund | LAN MAS | RS   | SLL  | MGM     | Aggregate SF before transfer |
|--|--------------|---------|------|------|---------|------------------------------|
| Assets   | 1,246.7      | 24.7    | 9.9  | 93.2 | 1,178.0 | 2,552.4                      |
| Technical provisions - life (excl. index-/unit-linked) | 553.8        | 13.8    | 9.5  | 68.7 | 1,030.4 | 1,676.2                      |
| Technical provisions - index-linked and unit-linked    | 573.6        | 8.3     | -    | 9.1  | -       | 591.0                        |
| Other liabilities                                      | 29.1         | 0.3     | 0.1  | 4.2  | 65.7    | 99.3                         |
| Current liabilities                                    | -2.8         | -       | -0.0 | 0.3  | 5.8     | 3.3                          |
| Total liabilities                                      | 1,153.7      | 22.4    | 9.6  | 82.3 | 1,102.0 | 2,369.8                      |
| Excess of assets over liabilities                      | 93.0         | 2.3     | 0.3  | 10.9 | 76.0    | 182.6                        |
| Restriction of own funds due to ring-fencing           | -            | 2.2     | 0.2  | 9.8  | 7.7     | 19.9                         |
| Own funds  | 93.0         | 0.0     | 0.1  | 1.2  | 68.4    | 162.7                        |
| Ratio of Eligible own funds to SCR                     | 763%         | 100%    | 100% | 100% | 100%    | 199%                         |
| Ratio of Eligible own funds to MCR                     |              |         |      |      |         | 568%                         |

The figures are calculated as at 31 December 2016.

### Solvency position post transfer

The Pillar 1 solvency position of Scottish Friendly after the Scheme is outlined below (all figures in £m):

| Capital requirement                             | SF Main Fund | LAN MAS | RS   | SLL  | MGM  | Aggregate SF post transfer |
|---|--------------|---------|------|------|------|----------------------------|
| Market risk                                     | 6.9          | -       | -    | 0.5  | 62.3 | 69.7                       |
| Counterparty default risk                       | 7.9          | -       | -    | 0.8  | 2.9  | 11.6                       |
| Life underwriting risk                          | 9.6          | 0.0     | 0.0  | 0.0  | 2.6  | 12.2                       |
| Health underwriting risk                        | -            | -       | -    | -    | -    | -                          |
| Non-life underwriting risk                      | -            | -       | -    | -    | -    | -                          |
| Diversification                                 | -7.1         | -       | -    | -0.2 | -4.0 | -15.8                      |
| Basic Solvency Capital Requirement              | 17.4         | 0.0     | 0.0  | 1.0  | 63.8 | 77.8                       |
| Adjustment due to RFF/MAP nSCR aggregation      |              |         |      |      |      | 4.4                        |
| Operational risk                                | 3.2          | 0.0     | 0.0  | 0.3  | 4.6  | 8.2                        |
| Loss-absorbing capacity of technical provisions | -4.3         | -0.0    | -0.0 | -0.2 | -0.0 | -4.5                       |
| Solvency Capital Requirement                    | 16.2         | 0.0     | 0.1  | 1.2  | 68.4 | 85.8                       |
| Minimum Capital Requirement                     |              |         |      |      |      | 31.0                       |

| Own funds  | SF Main Fund | LAN MAS | RS   | SLL  | MGM     | Aggregate SF post transfer |
|--|--------------|---------|------|------|---------|----------------------------|
| Assets   | 1,586.9      | 24.7    | 9.9  | 93.2 | 1,178.0 | 2,892.6                    |
| Technical provisions - life (excl. index-/unit-linked) | 553.8        | 13.8    | 9.5  | 68.7 | 1,030.4 | 1,676.2                    |
| Technical provisions - index-linked and unit-linked    | 912.6        | 8.3     | -    | 9.1  | -       | 930.0                      |
| Other liabilities                                      | 29.1         | 0.3     | 0.1  | 4.2  | 65.7    | 99.3                       |
| Current liabilities                                    | -2.8         | -       | -0.0 | 0.3  | 5.8     | 3.3                        |
| Total liabilities                                      | 1,492.7      | 22.4    | 9.6  | 82.3 | 1,102.0 | 2,708.9                    |
| Excess of assets over liabilities                      | 94.1         | 2.3     | 0.3  | 10.9 | 76.0    | 183.7                      |
| Restriction of own funds due to ring-fencing           | -            | 2.2     | 0.2  | 9.8  | 7.7     | 19.9                       |
| Own funds  | 94.1         | 0.0     | 0.1  | 1.2  | 68.4    | 163.8                      |
| Ratio of Eligible own funds to SCR                     | 580%         | 100%    | 100% | 100% | 100%    | 191%                       |
| Ratio of Eligible own funds to MCR                     |              |         |      |      |         | 528%                       |

The figures are calculated as at 31 December 2016.



