



Scottish Friendly Assurance Society Ltd.

Supplementary Report by the With-Profits Actuary on the proposed Part VII transfer from Mobius Life Ltd

Prepared by

David Lechmere FIA

10 September 2018

Actuarial
Governance, risk & compliance
Redress calculations
Software

Progress with confidence

Contents

1.	Introduction	1
2.	Changes to the Scheme and related arrangements	4
3.	Material Developments affecting Scottish Friendly	5
4.	Developments in the external environment	6
5.	Security and Benefit Expectations of Scottish Friendly policyholders	7
6.	Conclusion	9
	Appendix 1 – Documents Reviewed	10
	Appendix 2 - Impact of Scheme on Pillar 1 solvency position	11

1. 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 9 November 2018, at which point the Carter business will transfer from Mobius Life to Scottish Friendly.
- 1.2. In my capacity as Scottish Friendly's With-Profits Actuary I prepared a report dated 22 May 2018 which considered the impact of the proposed Scheme on the benefit expectations of the existing policyholders of Scottish Friendly at the date of transfer, the future security of these benefits and the principles to treat customers fairly and manage conflicts of interest.
- 1.3. Following the Directions Hearing held on 26 July 2018, correspondence with policyholders and further discussions with the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"), the High Court will be asked to approve the proposed transfer at the Sanctions Hearing on 7 November 2018.
- 1.4. Within that context, the purpose of this "Supplementary Report" is:
 - to consider any material developments since the last report relating to the Scheme and supporting arrangements, to Scottish Friendly, or in external factors such as the economic and regulatory environments,
 - to comment on any communications received from members in response to notification of the intended transfer, and
 - to consider whether the conclusions presented in my original report remain valid in the light of these developments.
- 1.5. I have been commissioned by the Board of Scottish Friendly to produce this Supplementary Report under the existing terms of business with my employer, OAC plc. The conclusions described in this Report are mine. The Supplementary Report should be read in conjunction with my original report.
- 1.6. I understand that a copy of this Report will accompany the application to the High Court for the Scheme to be sanctioned and will be sent to the PRA and the FCA. I am aware that in accordance with the relevant applicable legislation, copies of this Report may be made available to policyholders and all other parties affected by the Transfer.

Credentials and Declaration of Interest

- 1.7. I qualified in 1982 as a Fellow of the Institute and Faculty of Actuaries. I hold current practising certificates as a Chief Actuary (Life), Chief Actuary (Life Non-Directive) and With-Profits Actuary. I have been the With-Profits Actuary of Scottish Friendly since 15 March 2010 and before that I filled the role of the Independent Person with respect to with-profits governance for the years 2006 to 2009.

- 1.8. I have no financial interest in Mobius and no financial interest in Scottish Friendly apart from the fees payable to my employer for my services as With-Profits Actuary. I do not hold policies with either company.

Scope and Access to Information

- 1.9. The scope of the Supplementary Report is to review any developments since the production of my original report to ensure that the interests of the existing Scottish Friendly members are not adversely affected. This includes both with-profits and non-profit policyholders and policyholders in the existing sub funds. It will consider any communications received from members with regard to the proposals. It will then consider whether the conclusions in the original report remain valid.
- 1.10. In preparing this report I have had full access to documents held by Scottish Friendly. I have been provided with all the information which I have requested and had all my questions answered.

Compliance

- 1.11. The proposed Transfer is within the Scope and Authority of the Technical Actuarial Standards published by the Financial Reporting Council and therefore my report is required to comply with those standards. The relevant standards are TAS 100 and TAS 200.
- 1.12. In terms of Data and Modelling I have relied on the information provided to me by Scottish Friendly. I have reviewed the results to ensure they are reasonable. The conclusions drawn are my own and I believe that the report complies with TAS 100 and TAS 200 in all respects.
- 1.13. The report has also been subject to review by the Actuarial Team at Scottish Friendly and to peer review by an actuary within OAC who has not been directly involved in the process. No issues were raised by that review and I am satisfied that the processes are compliant with the requirements of Actuarial Practice Standard X2.

Reliances and Limitations

- 1.14. I have relied on the accuracy of the information which has been supplied to me, particularly where that information was in published documents such as the statutory returns. I have reviewed the calculations in workbooks supplied to me to ensure that the numbers are suitable for the purpose for which they are being used. I am satisfied with the reasonableness of the information and the calculations.
- 1.15. I have relied on the report and the Supplementary Report produced by the Chief Actuary of Scottish Friendly who is the holder of a Chief Actuary (Life) Practising Certificate and whose report has been prepared in accordance with the Technical Actuarial Standards.
- 1.16. This Supplementary Report is produced for the Board of Scottish Friendly, however I understand that it will also form part of the documentation supporting the Scheme. I am content for it to be used by the Chief Actuary and the Independent Expert and read by the PRA and the FCA.
- 1.17. This report must be read as a whole as any attempt to rely on a part of it invalidates the report.
- 1.18. The opinions expressed in this report are valid only for the purpose of the report.

1.19. OAC shall not have any liability to any third party in respect of the contents of this report or any actions taken, or decisions made as a consequence of the results, advice or recommendations contained in it.

Other Information

1.20. A list of the documents supplied to me and which I have considered is shown in Appendix 1.

2. Changes to the Scheme and related arrangements

Transferring Business

- 2.1. A portfolio of unit-linked long-term business written by Mobius is to be transferred to Scottish Friendly. The portfolio will be transferred into the Scottish Friendly Main Fund.
- 2.2. All transferring policyholders of Mobius will become members of Scottish Friendly.
- 2.3. Scottish Friendly will pay Mobius the sum of £3.1 million representing an allowance for the profits expected to emerge from the portfolio unit-linked business. This money will be paid out of the Scottish Friendly Main fund.
- 2.4. There have been no major changes to the composition of the portfolio from December 2016, as summarised in the following table.

Date	Fund value (£m)	Member count
31 December 2016	343.8	12,963
31 March 2018	335.9	12,812

Reinsurance Treaties

- 2.5. The assets of Carter will be transferred to Scottish Friendly via a reinsurance agreement with Mobius. To protect against the risk of default a floating charge will be provided by Mobius on the assets acquired. This process is described more fully in the reports of the Chief Actuary.

Transfer

- 2.6. The rights under the contracts will not be changed as a result of the transfer.
- 2.7. It is proposed that the transfer will take place on 9 November 2018.
- 2.8. The member count and the value of the funds are slightly lower than those in my original report as a result of natural movements over the period.
- 2.9. However there have been no material changes to the Scheme which would cause me to change my opinion that the Scheme does not have any adverse impact on the existing members of Scottish Friendly.

3. Material Developments affecting Scottish Friendly

- 3.1. Since the original reports were produced Scottish Friendly has agreed terms with Canada Life Limited ("Canada Life") to acquire a portfolio of legacy business ("Mars", the "Mars portfolio") from Canada Life, and a Business Transfer Agreement ("BTA") was signed on [dd] June 2018.
- 3.2. Fuller details of this are included in the Supplementary Report of Scottish Friendly's Chief Actuary.
- 3.3. I have not been asked to report formally to the Board on the proposal however I have read the report produced by the Chief Actuary and I agree with his view that this proposed transfer should not cause any detriment to the existing members of Scottish Friendly. The Scheme to transfer the Mars portfolio will in any case be subject to the approval of the Court and this will ensure that the rights of existing members are protected.
- 3.4. I am therefore content that this development does not affect my view that the transfer of the Mobius portfolio will not act to the detriment of the existing members of Scottish Friendly.

4. Developments in the external environment

- 4.1. In his Supplementary Report the Chief Actuary of Scottish Friendly has highlighted a number of changes in the external environment since the original reports were produced and also mentioned a number of external factors that may have an impact on insurance business in the future.
- 4.2. The Chief Actuary has considered the economic environment, the political environment, with particular reference to Brexit, and the regulatory environment.
- 4.3. I agree with him concerning the issues that need to be considered, and I do not believe there are any other issues which might have an impact on the Scheme.
- 4.4. I also agree with his conclusion that there are no developments in the external environment which are likely to have a material impact on the proposed Scheme.
- 4.5. I am therefore satisfied that there have been no changes in the external environment which affect my conclusions concerning the Scheme.

5. Security and Benefit Expectations of Scottish Friendly policyholders

Security

- 5.1. 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 EU, this calculation is performed on two different bases, referred to as Pillar 1 and Pillar 2 respectively. These bases are fully explained in the original report of the Chief Actuary.
- 5.2. In my previous report I concluded that the proposed Scheme would have no adverse effects on the security of the policyholders in the Scottish Friendly Main Fund, as the free capital was broadly unchanged on the Pillar 1 basis and the reduction in free capital on the Pillar 2 basis was not significant in the context of Scottish Friendly's appetite for risk as there will still be sufficient free capital to meet Scottish Friendly's business objectives.
- 5.3. The updated figures included in the Chief Actuary's Supplementary Report show that the financial impact remains broadly unchanged from the earlier report, and therefore my conclusion remains that there should be no adverse effect on policyholders in the Scottish Friendly Main Fund.
- 5.4. The latest figures are shown in Appendix 2.
- 5.5. I also concluded that the security of the policyholders in the Scottish Friendly sub funds would remain secure following the implementation of the Scheme. The amount of capital in the sub funds is unaffected by the transfer, and there would only be an impact in the unlikely event that they required support from the Main Fund and the solvency of the Main Fund was compromised. This conclusion remains unchanged.

Benefit and Bonus Expectations

- 5.6. The contractual benefit expectations of all the Scottish Friendly policyholders remain unchanged by the Scheme.
- 5.7. In my previous report I concluded that the Scheme did not present any material risks to bonus expectations for policyholders in the Scottish Friendly Main Fund and in the sub funds.
- 5.8. There have been no changes in the situation of Scottish Friendly, the external environment or the financial situation which would cause me to change that conclusion.
- 5.9. Equally there have been no changes since my last report with regard to the likely impact on policy charges, investment policy, administration standards, or any of the other items that I considered.

Other Matters

- 5.10. The Scheme will not require any changes to the existing Principles and Practices of Financial Management, and I do not believe there will be any change to the manner in which Scottish Friendly conducts its business and its principles of treating customers fairly.

5.11. The Scheme does not introduce any significant new conflicts of interest.

5.12. I understand that no communications have been received from Scottish Friendly policyholders regarding the proposed transfer.

6. Conclusion

- 6.1. It is still my opinion that the proposed transfer does not have any adverse impact on the existing with-profits policyholders of Scottish Friendly. I do not consider that it has an adverse impact on the policyholders with non-profit policies, or those in the current sub funds.
- 6.2. I consider that the security and benefit expectations will not be adversely affected.
- 6.3. It is still my opinion that the transfer does not introduce any significant additional operational risks into Scottish Friendly which could adversely affect the interests of the existing members.
- 6.4. It is still my opinion that there will be no detriment to the administration of the existing policies as a result of the Scheme.
- 6.5. It is my opinion that the Scheme will not adversely affect Scottish Friendly's principles of treating its customers fairly. I also do not believe that the Scheme introduces any significant new conflicts of interest.
- 6.6. I therefore conclude that there is no reason, in terms of maintaining the interests of existing members, why the transfer should not proceed.
- 6.7. I confirm that I have made clear which facts and matters referred to in this 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.



David Lechmere FIA
With-Profits Actuary

Appendix 1 – Documents Reviewed

The Scheme Document

The report of the Chief Actuary of Scottish Friendly

The Supplementary report of the Chief Actuary of Scottish Friendly

The report of the Independent Expert

The Supplementary report of the Independent Expert

Appendix 2 - Impact of Scheme on 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	LANMA S	RS	SLL	MGM	Aggregate SF before transfer
Market risk	13.7	0.4	0.0	0.5	49.3	63.9
Counterparty default risk	8.9	-	-	1.0	3.9	13.8
Life underwriting risk	11.1	0.1	0.1	0.6	10.2	22.0
Health underwriting risk	-	-	-	-	-	-
Non-life underwriting risk	-	-	-	-	-	-
Diversification	- 9.7	- 0.1	- 0.0	- 0.6	- 9.3	- 21.9
Basic Solvency Capital Requirement	24.1	0.4	0.1	1.5	54.0	77.8
Adjustment due to RFF/MAP nSCR aggregation						2.2
Operational risk	3.1	0.1	0.0	0.3	4.3	7.3
Loss-absorbing capacity of tax & technical provisions	- 7.5	-	- 0.0	- 0.3	- 5.6	- 13.5
Solvency Capital Requirement	19.7	0.4	0.1	1.4	52.6	73.9
Minimum Capital Requirement						27.0

Own funds	SF Main Fund	LANMA S	RS	SLL	MGM	Aggregate SF before transfer
Assets	1,194.0	21.8	8.7	92.9	1,091.5	2,409.0
Technical provisions - life (excluding index-linked and unit-linked)	532.2	12.4	8.2	63.1	955.3	1,571.3
Technical provisions - index-linked and unit-linked	534.2	7.1	-	7.5	-	548.8
Current liabilities	34.9	0.3	0.1	6.0	61.5	102.8
Other liabilities	-	-	-	-	-	-
Total liabilities	1,101.3	19.8	8.3	76.6	1,016.8	2,222.9
Excess of assets over liabilities	92.7	2.0	0.4	16.3	74.7	186.2
Restriction of own funds due to ring-fencing	-	1.6	0.3	14.9	22.1	38.9
Own funds	92.7	0.4	0.1	1.4	52.6	147.3
Ratio of Eligible own funds to SCR	470%	100%	100%	100%	100%	199%
Ratio of Eligible own funds to MCR						546%

The figures are calculated as at 31 March 2018.

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	LANMA S	RS	SLL	MGM	Aggregate SF post transfer
Market risk	17.5	0.4	0.0	0.5	49.3	67.7
Counterparty default risk	8.9	-	-	1.0	3.9	13.8
Life underwriting risk	12.8	0.1	0.1	0.6	10.2	23.7
Health underwriting risk	-	-	-	-	-	-
Non-life underwriting risk	-	-	-	-	-	-
Diversification	- 11.0	- 0.1	- 0.0	- 0.6	- 9.3	- 22.9
Basic Solvency Capital Requirement	28.2	0.4	0.1	1.5	54.0	82.2
Adjustment due to RFF/MAP nSCR aggregation						1.9
Operational risk	3.5	0.1	0.0	0.3	4.3	7.7
Loss-absorbing capacity of technical provisions	- 7.5	-	- 0.0	- 0.3	- 5.6	- 13.5
Solvency Capital Requirement	24.2	0.4	0.1	1.4	52.6	78.4
Minimum Capital Requirement						29.3

Own funds	SF Main Fund	LANMA S	RS	SLL	MGM	Aggregate SF post transfer
Assets	1,526.7	21.8	8.7	92.9	1,091.5	2,741.7
Technical provisions - life (excluding index-linked and unit-linked)	532.2	12.4	8.2	63.1	955.3	1,571.3
Technical provisions - index-linked and unit-linked	865.4	7.1	-	7.5	-	880.0
Current liabilities	34.9	0.3	0.1	6.0	61.5	102.8
Other liabilities	-	-	-	-	-	-
Total liabilities	1,432.5	19.8	8.3	76.6	1,016.8	2,554.1
Excess of assets over liabilities	94.2	2.0	0.4	16.3	74.7	187.6
Restriction of own funds due to ring-fencing	-	1.6	0.3	14.9	22.1	38.9
Own funds	94.2	0.4	0.1	1.4	52.6	148.8
Ratio of Eligible own funds to SCR	389%	100%	100%	100%	100%	190%
Ratio of Eligible own funds to MCR						508%

The figures are calculated as at 31 March 2018.

OAC PLC, 141-142 Fenchurch Street, London, EC3M 6BL, United Kingdom
T: +44 (0)20 7278 9500 | **E:** enquiries@oacplc.com | **W:** www.oacplc.com

Actuarial
Governance, risk & compliance
Redress calculations
Software

OAC PLC is registered in England | Company no. 4663795 | VAT no. GB630678631

Progress with confidence