



Scottish Friendly Assurance Society Ltd.

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

Prepared by

David Lechmere FIA

22 May 2018

Actuarial
Governance, risk & compliance
Redress calculations
Software

Progress with confidence

Contents

1.	Introduction	1
2.	Background information	3
3.	Summary of the Scheme	4
4.	The Effect of the Scheme - Security	6
5.	The Effect of the Scheme – Benefit Expectations	8
6.	Conclusion	11
	Appendix 1 – Documents Reviewed	12
	Appendix 2 - Impact of Scheme on Pillar 1 solvency position	13

1. Introduction

1.1. I have been requested by Scottish Friendly Assurance Society Limited (SF) to prepare a report in my capacity of With-profits Actuary on the proposed transfer of a block of long-term insurance business (known as 'Carter') from Mobius Life Ltd (Mobius) to SF, and to consider the impact of the proposed Scheme on the benefit expectations of the existing policyholders of SF at the date of transfer, the future security of these benefits and the principles to treat customers fairly and manage conflicts of interest. The transfer will be achieved by a Scheme of Transfer pursuant to Section 109(1) of the Financial Services and Markets Act (FSMA).

Purpose

1.2. The purpose of the Scheme is to transfer the block of long-term insurance business from Mobius into SF.

1.3. I understand that it is the intention of SF and Mobius to make an application to the High Court under Section 107 of the FSMA for an Order under Section 111 sanctioning the Scheme and making provision under Section 112 for its implementation.

1.4. 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

1.5. I qualified in 1982 as a Fellow of the Institute 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 SF 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.

1.6. I have no financial interest in Mobius and no financial interest in SF apart from the fees payable to my employer for my services as with-profits actuary. I do not hold policies with either company.

1.7. I have been engaged by SF to produce this report under the existing terms of business with my employer, OAC plc. The conclusions described in this Report are mine.

Scope and Access to Information

1.8. The scope of my report is to review the Scheme to ensure that the interests of the existing SF members are not adversely affected by the proposal. This includes both with-profits and non-profit policyholders and policyholders in the existing sub funds.

1.9. In preparing this report I have had full access to documents held by SF. I have been provided with all the information which I have requested and had all my questions answered.

Compliance

- 1.10. 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.
- 1.11. In terms of Data and Modelling I have relied on the information provided to me by SF. 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.
- 1.12. 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

- 1.13. 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.
- 1.14. I have relied on the report produced by the interim Chief Actuary who is the holder of a Chief Actuary (Life) Practising Certificate and whose report has been prepared in accordance with the Technical Actuarial Standards.
- 1.15. This 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 interim Chief Actuary and the Independent Expert and read by the PRA and the FCA.
- 1.16. This report must be read as a whole as any attempt to rely on a part of it invalidates the report.
- 1.17. The opinions expressed in this report are valid only for the purpose of the report.
- 1.18. 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.

2. Background information

Scottish Friendly Assurance Society Ltd.

- 2.1. SF is a Friendly Society registered and incorporated under the Friendly Societies Act 1992 with No. 3 COLL (S). The registered office of SF is situated at Scottish Friendly House, 16 Blythswood Square, Glasgow G2 4HJ.
- 2.2. SF is an authorised person for the purposes of FSMA and has Part 4A permission under FSMA to carry out long term insurance business in classes I, III and IV as set out in Part II of Schedule 1 to the Regulated Activities Order.

Mobius

- 2.3. Mobius Life Limited ('Mobius') is an authorised unit-linked UK life insurance company. It is authorised by the Prudential Regulation Authority and regulated by the Financial Conduct Authority and the Prudential Regulation Authority. It is Registered in England and Wales at: 7th Floor, 20 Gresham Street, London EC2V 7JE. Registered No. 3104978.
- 2.4. Mobius has a Part 4A permission under FSMA to effect and carry on Long Term Business in the United Kingdom in classes I, III and VII set out in Part II of Schedule 1 to the RAO. As at the date of this Scheme, the business which Mobius is intending to transfer falls within class III set out in Part II of Schedule 1 to the RAO.
- 2.5. The Carter portfolio is a contract-based pension business offering group personal pension (GPP) and group stakeholder pensions (GSP) to employers for them to provide Defined Contribution (DC) pension arrangements for their employees. There are small volumes of individual personal pension business and trustee investment plans with associated member administration services. The business offers pension saving to retirement, however they currently do not offer any post retirement products.
- 2.6. The portfolio has c.13,000 policyholders, 67 employers and c.£350m of assets under management as at 30/09/2016. The majority of the policyholders are 'preserved' members. That is, they are no longer employed and/or contributing to the scheme, however their pension assets remain invested with Mobius.

Other Information

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

Other reports

- 2.8. I have read and considered the reports produced by the interim Chief Actuary of SF. I have relied on the information in the report produced by the interim Chief Actuary of SF, although I have reviewed the information to ensure that it is reasonable and that any conclusions drawn from it are reasonable.

3. Summary of the Scheme

Transferring Business

- 3.1. A portfolio of unit-linked long-term business written by Mobius is to be transferred to SF. The portfolio will be transferred into the SF Main Fund.
- 3.2. All policyholders of Mobius will become members of SF.
- 3.3. SF 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 SF Main fund.

Jurisdiction of Policyholders

- 3.4. The policyholders in the SF Main Fund are domiciled in the UK, other than a very small number domiciled in the Republic of Ireland. The policyholders of the transferring business are mainly domiciled in the UK with a very small number domiciled outside the UK whose contracts were made in the UK.

Effect of the Transfer

- 3.5. I have been provided with a copy of the Scheme in respect of the proposed transfer.
- 3.6. Under the Scheme the unit-linked business will be transferred into the Main Fund of SF.
- 3.7. All premiums and other sums payable to Mobius in respect of the transferred business will, from the Effective Date, become payable to SF.
- 3.8. SF will assume all the liabilities in respect of the transferred business, including the responsibility to pay claims.

Assets Transferred

- 3.9. The amount of assets transferred into the SF Main Fund to match the liabilities of the transferred unit-linked business is £344m based on the business in force at 31 December 2016. This comprises the value of the linked funds in which the unit-linked policies are invested and an amount in respect of sterling reserves (which is negative) for the transferring unit-linked policies. The regulatory capital for this business will be provided from the existing free capital within the SF Main Fund.

Operation of Sub Funds

- 3.10. SF currently has four notional sub funds comprising business transferred from Scottish Legal Life, LANMAS, Rational Shelley and MGM. There will be no changes to any of the sub funds as a result of the transfer.

Reinsurance Treaties

- 3.11. SF has reinsurance treaties in force for some of its existing term assurance business, for some of its immediate annuity business and for its Flexible Income Annuity business. None of these treaties are affected by the proposed transfer.

3.12. 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 report of the interim Chief Actuary.

Circularisation of policyholders

3.13. Notification of the Scheme will be published in national newspapers. All individual policyholders of Mobius will be contacted directly, where this is possible. SFA has a Board of Delegates who represent the membership and these delegates will be supplied with a full pack of information about the transfer. The transaction will require a positive vote from the delegates (75% in favour) in order to proceed. It is not SF's intention to circularise its other policyholders and a dispensation will be requested from the Court. The main reasons for not notifying all SF policyholders are as follows:

- The exercise would be disproportionately expensive given that there is no practical impact on the SF policyholders.
- There will be no change to the administration or claims handling of the SF policies as a result of the transfer.

Costs of the Scheme

3.14. SF's and Mobius' own transaction costs, such as legal and consultancy fees and the costs of any redundancies arising from the transfer, being borne by the respective firms. The costs of the Independent Expert will be shared equally between SF and Mobius.

Transfer

3.15. The rights under the contracts will not be changed as a result of the transfer.

3.16. It is proposed that the transfer will take place on 31 October 2018.

Reserving and Regulatory Capital

3.17. The regulatory capital requirements in respect of the transferring unit-linked business will be met by assets already held in the SF Main Fund.

4. The Effect of the Scheme - Security

4.1. As the with-profits actuary for SF my responsibility is to consider the interests of the existing with-profits policyholders and to report on the effect of the scheme on their security and benefit entitlements. The scope of my report also extends to the other policyholders of SF. In this section I consider the Scheme as it affects the security of the policyholders who are all members of SF. The effect on benefit expectations and other contractual conditions is considered in Section 5.

Capital and Solvency

4.2. The security of the current policyholders relies on the technical provisions (including the Risk Margin) which are set in accordance with the Solvency 2 Rules, the Solvency Capital Requirement (SCR), and in the free reserves.

4.3. In his report the interim Chief Actuary reviews the solvency position of SF before and after the transfer.

4.4. The figures have been calculated as at 31 December 2016, based on the reported Pillar 1 position and the calculated Pillar 2 position, and on the information provided by Mobius regarding the Carter business. Allowance has been made for any material changes since 31 December 2016. The methodologies and assumptions used in the calculations are consistent with those used at 31 December 2016 for Pillar 1 and broadly consistent with those as at 31 December 2016 for Pillar 2.

4.5. I have relied on the figures in the report of the SF interim Chief Actuary. These show that the effect of the transfer on the Pillar 1 position is that the amount of assets available to cover the SCR is virtually the same. However the increase in the SCR resulting from the additional capital required by the transferred-in portfolio means that the coverage of the SCR reduces from 199% to 192%. This is still a very satisfactory level of coverage and well within SF's risk tolerance.

4.6. A summary of the impact on the capital position is included as Appendix 2.

Existing Sub Funds

4.7. The proposed transfer will make no difference to the existing sub funds which will continue to operate as currently.

Capital management

4.8. Firms are also required by the PRA to carry out their Own Risk and Solvency Assessment (ORSA). This is often referred to as Pillar 2.

4.9. This shows that on the Pillar 2 basis the available amount of free capital is broadly consistent and the capital coverage reduces, however the amount of free capital remains comfortably above the amount which is consistent with SF's risk appetite and I therefore do not consider that the transfer is detrimental to the interests of the existing policyholders.

4.10. SF has internal tolerances around capital adequacy, primarily relating to the capital coverage on a Pillar 2 basis. These are outlined in the risk appetite within the Risk Management Framework, which feeds into the Own Risk Solvency Assessment.

4.11. 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.

Other

4.12. I have consulted the interim Chief Actuary of SF and I consider that there are no material operational risks arising from this transfer which would affect the security of the SF policyholders. This is because, as explained in paragraph 5.15, there will be no change to the operational and administrative arrangements of the existing SF business as a result of the transfer.

Conclusion

4.13. My conclusion is that the proposed Scheme has no adverse effects on the security of the policyholders in the SF Main Fund, as the free capital is broadly unchanged on the Pillar 1 basis and the reduction in free capital on the Pillar 2 basis is not significant in the context of SF's appetite for risk. The expected flow of surplus arising from the transferred business should enhance the capital position as the business unwinds. I also conclude that the security of the policyholders in the SF sub funds remains secure. 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.

5. The Effect of the Scheme – Benefit Expectations

Benefits, Guarantees and Options

5.1. The contractual benefit expectations of all the SF policyholders remain unchanged by the Scheme.

Bonus Expectations

5.2. The purchase price to be paid, the costs of the Scheme, and the increase in the Regulatory Capital Requirement are all relatively small in relation to the amount of free capital in the SF Main Fund. I therefore do not expect the Scheme to have any impact on the current bonus rates paid to existing with-profits policyholders.

5.3. The SF main fund remains financially strong and, in the long term, the charges from the Mobius business and the surplus released from the business transferred into the main fund will increase the free capital of SF and should enhance its capacity to pay bonuses. I therefore do not consider that the Transfer will have an adverse effect on the bonus earning capability of the SF Main Fund. I do not believe that the bonus expectations of the with-profits policyholders in the SF Main Fund will be adversely affected as a result of the Transfer.

5.4. The existing sub funds which contain business transferred from Marine & General Mutual, Scottish Legal Life, The London Aberdeen and Northern Assurance Society, and Rational Shelley will be unaffected by the transfer and there will be no change to the bonus expectations of the with-profits policyholders in these sub funds.

Charges and Expenses

5.5. SF will be entitled to receive the management charges applicable to the portfolio of unit-linked policies. SF will be liable to pay charges to the providers of administration and investment management services for the portfolio. It is anticipated that the difference between the value of the streams of income and outgo will result in a positive return to the SF Main fund and hence to the with-profits policyholders in that fund.

5.6. The price that SF is paying for the portfolio is, on the central set of assumptions, lower than the present value of the excess of charges over costs.

5.7. I have reviewed the assumptions made in this calculation and am satisfied that they are appropriate.

5.8. The calculations made also allow for adverse deviations in the actual experience compared to the assumptions and in most plausible scenarios there is still a profit to the fund.

5.9. In addition the possibility exists that in the future SF could take either the administration services or the investment management services (or both) in house and this would almost certainly increase the value of the future profits.

5.10. My conclusion is that while there is a small risk that the value emerging from the portfolio will fall short of the purchase price, this risk is a relatively unlikely event and the possibility of it occurring is being appropriately managed and mitigated. In any event the amount of any possible reduction in free capital is not material in the context of Scottish Friendly's overall capital position.

5.11. There will be no effect on the charges made to the existing sub funds.

Investment Policy

5.12. The current practice of SF is that the investment policy is considered separately for the Main Fund and each of the sub funds. The Investment policy takes into account the different profiles of the separate funds and ensures that the investment policy matches the profile.

5.13. For the sub funds the policy takes account of the fact they are closed to new business and allows for the remaining outstanding term of the business in force. For the SF Main Fund the investment profile reflects the fact that the fund is open to new business and the aim is to secure the best possible return on the funds, subject to ensuring that all contractual benefits can be met as they fall due. For each separate fund the investment policy is set out in the PPFM.

5.14. The transfer of the Mobius unit-linked business into the SF Main Fund is not expected to alter the investment profile of that fund. The unit linked business will be matched by appropriate unit linked funds, and any non-unit reserves will be matched with fixed interest securities, but such reserves are likely to be relatively small in the context of the fund as a whole.

5.15. I therefore do not consider that the transfer of the Mobius business into the Main Fund will have any adverse effect on the investments backing the with-profits policies.

Administration and Service Standards

5.16. The current plan is that the transferring policies will continue to be administered by the existing third party provider. This means there should be no impact on the administration and service standards of the current SF business.

Membership Rights

5.17. All membership rights of existing members of Scottish Friendly will be preserved and remain unaffected by the Transfer. All policyholders of Mobius will become members of Scottish Friendly. The increase in membership as a result of the Transfer means that there will be a slight dilution in the membership rights of existing SF members, but I do not consider that this has a material impact on their security or benefit expectations. The number of extra members is just over 13,000 and the existing membership of Scottish Friendly is about 1.2 million, so the extra membership represents just over 0.1% of Scottish Friendly's existing membership.

Existing Sub Funds

5.18. As I have said above the existing sub funds will be unaffected by the transfer.

Governance of with-profits business

5.19. Following the Scheme, the SF Board will continue to provide governance over existing SF policyholders, non-profit and with-profits.

5.20. With-profits business governance will continue to be provided by the SF With-Profits Actuary and Independent Person, both being the same individuals who currently oversee the SF Main Fund and the notional sub funds

5.21. The PPFM documents of the SF Main Fund and the existing sub funds will remain unaltered.

Taxation

5.22. SF has received advice that there are not expected to be any adverse tax consequences of the proposed transfer and I understand that the appropriate clearances are being sought from HMRC.

Summary

5.23. I consider that the benefit expectations of the SF with-profits policyholders will not be adversely affected by the Transfer.

5.24. I consider that the benefit expectations of the SF non-profit policyholders will not be adversely affected by the Transfer.

5.25. I consider that the membership rights of the existing members of the SF Main Fund will not be adversely affected by the transfer in any material way.

5.26. I consider that the membership rights and benefit expectations of the policyholders in the current SF Sub funds are very unlikely to be affected by the transfer.

5.27. I consider that the bonus prospects of policyholders with with-profits policies will not be diminished as a result of the transfer. In fact the transfer is likely to enhance the surplus available for distribution.

5.28. I consider that service standards for existing policyholders will be maintained.

6. Conclusion

- 6.1. It is my opinion that the proposed transfer does not have any adverse impact on the existing with-profits policyholders of SF. 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. It is my opinion that the transfer does not introduce any significant additional operational risks into SF which could adversely affect the interests of the existing members.
- 6.3. It is my opinion that there will be no detriment to the administration of the existing policies as a result of the Scheme.
- 6.4. I therefore conclude that there is no reason, in terms of maintaining the interests of existing members, why the transfer should not proceed.
- 6.5. I consider that there is no need for any additional covenants or undertakings from SF or Mobius other than those given in, or pursuant to, the terms of the Scheme.
- 6.6. 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 interim Chief Actuary of Scottish Friendly

The 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 SF prior to the Scheme is outlined below (all figures in £m):

	SF Main Fund	LAN MAS	RS	SLL	MGM	Aggregate SF before transfer
Capital requirement						
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

	SF Main Fund	LAN MAS	RS	SLL	MGM	Aggregate SF before transfer
Capital requirement						
Assets	1,246.7	24.7	9.9	93.2	1,178.0	2,552.4
Technical provisions - life (excluding index-linked and 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	766%	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 SF after the Scheme is outlined below (all figures in £m):

	SF Main Fund	LAN MAS	RS	SLL	MGM	Aggregate SF after transfer
Capital requirement						
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

	SF Main Fund	LAN MAS	RS	SLL	MGM	Aggregate SF after transfer
Capital requirement						
Assets	1,586.9	24.7	9.9	93.2	1,178.0	2,892.6
Technical provisions - life (excluding index-linked and 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.

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