

Proposed Transfer of Business from Ecclesiastical Life Limited to Homeowners Friendly Society

Supplementary Report from the Actuarial Function Holder

1 Introduction

This report is a supplement to the Actuarial Function Holder's report, dated 7 October 2010, on the impact on policyholders of the proposed transfer of business from Ecclesiastical Life Limited (ELL) to Homeowners Friendly Society.

That initial report noted that, at the time of issue, additional work was being undertaken to investigate the impact of various possible management actions that could be taken in the With Profit Fund (WPF). The purpose of that work was to enable the Board of ELL to consider the optimal actions to take that would ensure that the fund is, and remains, self-supporting on a Pillar 2 basis.

This report provides an update covering the results of that investigation and the decisions that have been taken by the Board. It also provides a brief commentary on more recent financial positions of the firms.

2 Management Actions Considered

The management team of ELL identified a number of potential management actions that could be taken in the fund that would reduce the level of risk in the fund. The With Profits Actuary was then asked to advise on whether these would be considered to be consistent with treating the policyholders fairly.

The actions identified were:

- Reducing the market risk arising from assets backing the inherited estate by investing such assets in a different, lower risk, mix of asset classes from those backing the asset shares.
- Unwinding the equity futures position and selling the underlying equities currently protected by selling futures.
- Reducing the equity backing ratio (EBR) of the fund
- Revising the mix of asset classes, whilst leaving the EBR unchanged (amending the proportions invested in UK equities, overseas equities and property)
- Reducing regular bonus rates
- Introducing a charge for guarantees.
- Reducing the credit risk in corporate bond investment by improving the overall credit rating of the bond portfolio

3 Timing of Management Actions

The review of potential management actions by the With Profits Actuary determined that each of them were reasonable actions to consider. However, the timing of implementation of any actions must take into account the impact on policyholder benefit expectations and the forthcoming development of a run-off plan.

The ELL Board has previously agreed a management action to set the EBR of the fund according to the financial strength of the fund. It is not believed to be appropriate to further reduce the EBR for assets backing the asset shares in advance of any run-off plan. Rather, any actions to be introduced before that time should focus on those that reduce risks without reducing expected policyholder benefits. Therefore, at this time, no further consideration is given to the potential action to further reduce EBR.

Two further actions, the reduction of regular bonuses and the introduction of a guarantee charge, were considered to be difficult to justify in advance of the forthcoming closure of the fund and the associated development of a run-off plan. These were also not investigated further.

The opinion of the With Profits Actuary, which is endorsed by ELL management, is that the other actions could all be implemented prior to the development of the run-off plan. However, the agreement in respect of the Part VII transfer of business to Engage Mutual places restrictions on sales of equities prior to transfer. Therefore the actions that involve the sales of equities (unwinding futures and revising asset class mix) can be assumed to be appropriate for implementation after the transfer date.

It was concluded that the remaining actions, de-risking the inherited estate and reducing credit risk, can be implemented at any time.

It is also noted that the improvements in financial markets since 31 December 2009 are expected to have had the effect of increasing the financial strength of the with-profits fund, so reducing the need to take management actions immediately.

4 Quantification of Management Actions

Those actions that were identified as being appropriate to implement prior to the run-off plan being completed have been investigated in more detail to estimate the financial impact of their introduction.

Firstly, the impact of taking actions to de-risk the inherited estate and to unwind the futures position was considered. This would have the effect of improving both Pillar 1 and Pillar 2 solvency positions, as shown below based on the 31 December 2009 position:

	31 DECEMBER 2009 BASE POSITION (£M)	31 DECMEBER 2009 AFTER MANAGEMENT ACTIONS (£M)
Pillar 1		
Net Free Assets	20.4	20.3
Capital Requirements	7.9	6.5
Net Free Assets	12.5	13.8
Pillar 2		
Free Assets	10.0	9.5
Capital Requirements	11.5	8.7
Net Free Assets	-1.5	0.8

This demonstrates that these actions are expected to improve the solvency position on both Pillar 1 and Pillar 2 bases. In particular, on the Pillar 2 (ICA) basis the fund is shown to be self-supporting with these management actions.

Secondly, the impacts of the other two management actions that are deemed to be appropriate prior to implementation of the run-off plan were investigated. These were amending the asset mix of the components of the EBR and reducing credit risk. In each case the investigation considered the effect of the relevant management action being implemented in addition to the de-risking inherited estate and unwinding futures actions.

On a Pillar 1 basis, neither of these actions was found to have a significant impact on solvency of the fund. On a Pillar 2 basis, the results of the scenarios that were developed to consider the potential actions were:

- Changing components of the EBR – improved net free asset position by £0.3m
- Reducing credit spread risk in corporate bond investments – improved net free asset position by £0.2m

5 Management Actions Approved by the Board of ELL

The ELL Board have considered the results of the further investigations as summarised in this report. As a result it was confirmed that if responsibility for management of the fund remained with ELL, the Board would:

1. Wish, or consider it reasonable, to take the following actions prior to the development of the run-off plan, though it is reasonable for the timing of implementation to be deferred until after the transfer:
 - De-risking the inherited estate
 - Unwinding the futures and selling the underlying equities currently protected by the futures
2. Wish to consider the following actions as part of the development of a run-off plan following the closure of the fund to new business:
 - Reducing the EBR
 - Changing the components of the EBR
 - Reducing regular bonus rates
 - Introduction of guarantee charges
3. Wish to take the following action, as and when opportunities arise, taking into account investment considerations, optimal timing and transaction costs:
 - Reduction in credit risk

6 Updated Financial Positions

My main report on the proposed transfer included information on the statutory solvency positions of the funds of both ELL and Engage effective at 31 December 2009 (for Pillar 1). I have now been able to consider more recent information; 30 June 2010 results for ELL and estimations at 30 September 2010 for Engage, and in both cases the financial positions were not materially different from those at 31 December 2009, after allowing for items that were noted in the main reports. I am satisfied that there have not been any significant changes to the financial position of either firm that would alter my view of the impact of the transfer on policyholders.


7 Conclusion

Investigations have shown that the additional management actions approved by the ELL Board would enhance the solvency of the fund and so improve the security of the benefits in the fund. I also believe that the management actions to be considered prior to the development of a run-off plan would not materially affect policyholder's benefit expectations. Whilst, in the absence of the Scheme of transfer, these actions would be implemented by the management of ELL, it is expected that after the transfer some of them will be implemented by Engage, whose Board have endorsed the actions.

I have no reason to believe that there is likely to be a significant difference in implementation of management actions as a direct result of the transfer.

I am also comfortable that there have been no significant changes in financial position of either firm.

The conclusion from my main report dated 7 October 2010 remains valid; I continue to believe that the transferring policyholders are not likely to be adversely affected by the Scheme.

A handwritten signature in black ink, appearing to read 'Paul New', with a large, stylized initial 'P' and 'N'.

Paul New
Actuarial Function Holder
Ecclesiastical Life Limited
5 November 2010