

## **Ecclesiastical Life Limited**

### **Supplementary report on the proposed scheme of transfer of part of the business of Ecclesiastical Life Limited to Homeowners Friendly Society Limited**

#### **Introduction**

1. In this Supplementary Report I, as With-Profits Actuary of Ecclesiastical Life Limited, provide further information and commentary in relation to the proposed scheme of transfer of part of the business of Ecclesiastical Life Limited to Homeowners Friendly Society Limited.
2. This Supplementary Report should be read together with my original Report "Report to Ecclesiastical Life Limited on the proposed scheme of transfer of part of the business of Ecclesiastical Life Limited to Homeowners Friendly Society Limited" dated 7 October 2010, and is subject to the same conditions as that report. Terms used in this Supplementary Report have the same meaning as in the original Report.
3. In paragraph 3.36 of my original Report I noted that ELL's objective has been to manage the With Profit Fund to meet its own regulatory (including its ICA, or Pillar 2) capital requirements. In consequence it wishes to consider the full range of possible management actions available in order to identify those that are most appropriate, having regard to policyholders' interests, commercial considerations arising from the proposed transfer (which may impact on the timing of any actions), and the prevailing financial conditions. I noted that additional work was being undertaken in order to clarify further the management actions that may appropriately be taken, and any implications for the management of the fund, including investment strategy.
4. The possible actions under consideration included:
  - De-risking of the inherited estate (by reducing or eliminating investment in equities and property);
  - Unwinding of equity futures held in the With Profit Fund;
  - Changing the level of the EBR;
  - Changing the composition of the EBR (as between UK equity, overseas equity and property investments);
  - Reducing risk in respect of the fixed interest portfolio;
  - Changing the future strategy in relation to the level of regular bonus rates; and
  - Introducing charges for guarantees.
5. The aim of the set of actions to be developed is to ensure that, having taken the actions, the With Profit Fund then has sufficient capital resources to meet its own Pillar 2 capital requirements without recourse to external capital support.
6. This Supplementary Report considers further developments in relation to these actions and also any changes in financial conditions since my original Report.

#### **Management actions**

7. The possible actions referred to above have now been considered by ELL, and by Engage. The additional management actions were being considered from the perspective of whether they were in principle management actions that might be appropriate in current circumstances, although the full detail of how they might be implemented (and in particular the scale of any adjustments, for example guarantee charges or regular bonus reductions) has not yet been explored.

8. In particular, as well as identifying appropriate details in respect of the management actions, it is important to note that a number of the potential management actions involve significant levels of transactions to sell and reinvest assets in the With Profit Fund. As such, it is necessary to take into account the investment considerations associated with these actions as part of the process to choose which actions are most appropriate. It will be necessary to consider the views of the investment managers on the optimal balance of risk versus reward for different categories of asset class. It will also be necessary to be satisfied that there are no undue costs or loss of value to the With Profit Fund as a result of any transactions undertaken, and that the timing of the transactions is arranged so as to optimise the position.
9. Given the proposed transfer, responsibility for management of the With Profit Fund will only remain with the ELL Board for the short period prior to the proposed Effective Date, 30 November 2010, after which the responsibility will lie with the Engage Board. The ELL Board confirmed that, if responsibility for management of the With Profit Fund were to remain with the ELL Board (which with the proposed transfer is not likely to be the case) it would wish or consider it reasonable to take the following actions prior to the development of the run-off plan:
  - In the light of the proposed transfer it is reasonable for the following two actions to be taken but for the timing of the 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
  - It would 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
  - It would 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
10. It will be for the Engage Board, rather than the ELL Board, to make any associated decisions in respect of actions to be taken following the transfer. Nonetheless, for continuity of management of the With Profit Fund, it is helpful to have recorded the ELL Board's views.
11. De-risking the inherited estate and thereby eliminating its investment in equities and property, will reduce the investment risk within the inherited estate, and is likely to lead to a more stable solvency position, although it will give rise to lower growth in the inherited estate in future if equities and property produce strong future investment returns. There will be no impact on the investments in respect of assets backing the base policy liabilities (the asset shares).
12. In relation to unwinding the futures held in the With Profit Fund and selling equities so as to leave the effective EBR unchanged, the futures had certain commercial advantages when transacted. However, it is now considered that the risks involved outweigh the current advantages, and the same overall investment strategy is better achieved by direct investment rather than by holding more equities than are required and reducing the effective holding via futures. The impact on policyholders should be minimal, as the effective EBR will not change.
13. In principle these changes could have happened before transfer, but there are commercial advantages that they take effect after the transfer.
14. It has also been concluded that reduction in risk in respect of the fixed interest portfolio is desirable, and action may be taken following the transfer to improve the credit quality – essentially selling higher risk

lower rated investments in favour of lower risk higher rated investments. This is likely to be done as suitable opportunities arise, when investment conditions appear favourable,

15. For these three management actions it has been concluded that they are desirable in any event, taking account of what may be decided as part of the run-off plan to be developed to take account of closure of the With Profit Fund. For the other management actions (ie the third, fourth, sixth and seventh in the list in paragraph 4 above) it has been concluded that it is appropriate to consider them in conjunction with the run-off plan.
16. I believe that the ELL Board's conclusions, summarised in paragraph 9 above, in relation to these matters are reasonable.

### **Financial conditions**

17. I have also received and reviewed updated financial information in relation to ELL and Engage, in respect of the financial position at 30 June 2010 and 30 September 2010 respectively. In my opinion the updated financial information does not materially affect the conclusions in my original Report.

### **Distribution of the inherited estate**

18. The details in relation to distribution of the inherited estate will be developed as part of the run-off plan and are not currently known. I understand that policyholders who left the With Profit Fund after 25 August 2010, the date at which the ELL Board determined that the With Profit Fund would be closed on 30 November, whether or not the transfer took place, will be eligible for the distribution (though there is no guarantee at this stage that any particular policyholder or group of policyholders will receive a benefit).

### **Conclusion**

19. In my original Report I concluded that:
  - In my view the Scheme is consistent with the fair treatment of the transferring with-profits policyholders of ELL, and will not materially affect their reasonable benefit expectations.
  - I have reviewed the report of ELL's AFH on the Scheme, and have no reason to disagree with his conclusions in relation to the security and service standards of ELL with-profits policyholders; in particular I have no reason to believe that these are likely to be adversely affected by the Scheme.
20. In the light of the further developments referred to above and the additional information available to me I consider that these conclusions remain appropriate.

*Andrew Sanders*



**Andrew Sanders**  
**With-Profits Actuary, Ecclesiastical Life Limited**

**Towers Watson Limited**  
**18 November 2010**