

## **Supplementary Report of the Independent Expert on the proposed Insurance Business Transfer Scheme between Ecclesiastical Life Limited and Homeowners Friendly Society Limited**

1. My Scheme Report, dated 7 October 2010, on the proposed Insurance Business Transfer Scheme to transfer part of the long term insurance business of Ecclesiastical Life Limited (“ELL”) to Homeowners Friendly Society, trading as Engage Mutual (“Engage”), set out my conclusions as the Independent Expert on the likely effects of the Scheme, particularly on the policyholders of each company. I noted in the Scheme Report that I would prepare a supplementary report (the “Supplementary Report”) to consider the results of investigations which were incomplete at the date of the Scheme Report. This Supplementary Report considers those investigations but also provides high level updates on the financial condition of the companies.
2. The Supplementary Report uses the same defined terms as the Scheme Report and is subject to the Reliances and Limitations as set out in the Scheme Report. The Supplementary Report is not subject to any current Technical Actuarial Standard issued by the Board for Actuarial Standards.
3. In preparing this Supplementary Report, I have had regard to the supplementary reports prepared by the AFH and the WPA of ELL, and the updated Scheme reports of the Engage AFH and WPA.

### **Financial Update**

4. I have been provided with updated Pillar 1 information as at 30 June 2010 in respect of ELL and as at 30 September 2010 in respect of Engage. The figures provided to me demonstrated the position allowing for the interim reinsurance arrangement which had been entered into in May 2010 and reflected the technical adjustments which were described in the Scheme Report.
5. In the case of ELL, the figures also demonstrated that a capital injection had been made into its NPF from its Shareholder Fund to ensure that the assets of the NPF were sufficient to cover its liabilities and statutory capital requirement.
6. The financial positions of ELL and Engage were not materially different from those reported as at 31 December 2009 and set out in the Scheme Report, after making allowance for the effects of the interim reinsurance arrangement.
7. I have also been provided with Pillar 2 information as at 31 December 2009 in respect of ELL along with analyses of the positions of the WPF and the non-profit Transferred Policies as if they comprised standalone funds. I am satisfied that these demonstrate that the risk profile of the Transferred Policies is unlikely to have a material effect on Engage or its policyholders.
8. Engage has recently acquired a further subsidiary company operating in the health insurance market. The terms of the transaction are such that there is an immediate increase in the capital available within the Engage group of companies. Engage will incur additional costs over the next year whilst it merges the acquired business with its existing healthcare business but the overall financial effect is expected to be beneficial.

### **Management Actions in the WPF or the Engage (ELL) WPF**

9. In my Scheme Report, I noted that ELL was undertaking investigations into the financial self-sufficiency of its WPF in the context of its PPFM, which state that the WPF should be managed having regard to its own resources (the “self-sufficiency principle”). Those investigations were not complete at the date of the Scheme Report, although the preliminary results indicated that:
  - The financial position of the WPF as at 31 December 2009 was such that it was relying to a small extent on capital outside the WPF; and
  - Management actions, consistent with the requirements of the PPFM, existed which would allow the WPF to be rendered self-sufficient at that date.

10. The particular action tested initially was a simple reduction in the WPF's exposure to real assets such as equity shares or property (as measured by its equity backing ratio, "EBR"), since a condition of the transaction between ELL and Engage was that ELL had to demonstrate that the WPF was self-sufficient. A reduction in the EBR demonstrated that this transactional test was capable of being satisfied although it was not proposed that this action should be implemented immediately. Further investigations were needed to be undertaken to produce a more considered set of actions, which also satisfied the PPFM but which may have had a better outcome overall for the policyholders of the WPF. The further work has now been undertaken to refine the list of available actions. The full list of actions identified is:
- Reducing the EBR of the fund;
  - 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;
  - 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; and,
  - Reducing the credit risk in corporate bond investment by improving the overall credit rating of the bond portfolio.
11. The Board of ELL has considered this list, and, having taken advice from the WPA and the Independent Person for the PPFM, has concluded that these are actions, either singly or in combination, which it would have been reasonable to consider in the absence of the Scheme in order to manage the WPF to satisfy the self-sufficiency principle in its PPFM. The Board did not consider in detail the circumstances in which these actions should be applied in the future, either singly or in combination, nor the extent to which they should apply but such application would be subject to all of the terms of the PPFM.
12. I am satisfied that the actions set out are actions which could reasonably have been expected to be considered in the absence of the Scheme.
13. Most of the listed actions are unlikely to be available to ELL prior to the Effective Date to ensure that the WPF is in a state of self-sufficiency as some of the benefits which Engage would expect to achieve from implementing the Scheme as planned would be lost as a result. Also, reflecting the general improvement in financial markets seen since 31 December 2009, it is thought that the overall financial position of the WPF may have improved from that suggested in these investigations (which related to the position as at 31 December 2009), so that some actions may currently not need to be applied, or may need to be applied to a lesser extent. Furthermore, it is preferable that some of the actions should be considered in the context of the run-off plan which will be developed after the Effective Date rather than action being taken now. I believe that it is reasonable for the actions to be considered by this measured approach.
14. As a result of this measured approach, it is possible that the WPF may not be self-sufficient on the Effective Date as required under the commercial arrangements between ELL and Engage since the management actions to achieve this will not have been taken. However, the Board of Engage has concluded that it will be acceptable for this purpose that the WPF is capable of being managed to self-sufficiency. It is expected that immediately after the Effective Date, Engage will apply two actions which have little or no financial effect on the expectations of with profits policyholders but which will improve the financial position of the Engage (ELL) WPF as a whole. These actions are:
- To reduce the hedging programme by disposing of the equity futures currently held (but not the options position, which will be maintained until it expires) and to reduce equity

holdings so that the effective EBR remains broadly at the level it did with the hedging arrangements in place (i.e., around 35%); and,

- To de-risk the Engage (ELL) WPF's Estate, i.e., to reduce the risk exposure related to the excess assets of this fund.

15. The Board of ELL had concluded it would be reasonable to take these two actions in the short term, in advance of the development of the run-off plan. I also note that some of the planned improvement in the risk profile of the WPF corporate bond portfolio may have been implemented as this task has been approved by the ELL Board for immediate action subject to favourable investment opportunities being identified.

16. I am satisfied that, if the actions described in paragraph 14 are taken as proposed, Engage should be able to secure the expected financial benefits and there will be little financial risk to Engage's policyholders as a result of the commercial pre-condition not being demonstrably met on the Effective Date. I am also satisfied that the delay in implementing these actions until after the Effective Date will not disadvantage the policyholders of the WPF (or the Engage (ELL) WPF), as any additional costs that may accrue in maintaining the hedging programmes for a longer period than may otherwise be expected will be immaterial.

17. After the Effective Date, Engage will conduct further investigations based on 31 December 2010 data to produce an appropriate run-off plan, which may utilise the management actions identified above, to arrange for the orderly distribution of the Engage (ELL) WPF Estate. The run-off plan will be submitted to the FSA for consideration. As part of the run off plan, those policyholders of the ELL WPF whose with-profits policies have become claims since 25 August 2010 will be eligible to participate in the distribution of the Engage (ELL) WPF Estate if it is concluded that an immediate distribution is appropriate. This does not mean that a payment will be made but does mean that these policyholders will be no worse off than they would have been if the decision had been made to close the ELL WPF as at 25 August 2010 rather than as at the Effective Date.

#### **Policyholder Objections and Comments**

18. Both ELL and Engage have provided me with detail of objections and comments made by policyholders in writing or via the telephone helpline (whether or not these policyholders have indicated that they intend to make representation to the Court). I have reviewed the matters raised by these policyholders and do not consider that any issues have been raised which cause me to reconsider my conclusions.

#### **Conclusions**

19. In my opinion, the conclusions which I set out in my Scheme Report, namely, that

a) the implementation of the proposed Scheme:

- will not affect the security of benefits for the non-transferring ELL policyholders;
- will not materially affect the security of the benefits of the Transferred Policyholders or of Engage's policyholders; and,
- will not materially affect the benefit expectations of Transferred Policyholders or of Engage's policyholders,

b) awarding membership rights to Transferred Policyholders will not materially affect the membership rights of Engage's members,

remain appropriate.



JL McKenzie, FFA

London  
17 November 2010