Channel Life Limited

Transfer of Insurance Business from Channel Life Limited to Sanlam Developing Markets Limited

31 July 2019

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Report by the Channel Life Limited Head of Actuarial Function on the impact of the proposed transfer of the insurance business of Channel Life Limited to Sanlam Developing Markets Limited in terms of section 50 of the Insurance Act, 2017

1. Introduction

1.1. Background

Channel Life Limited ("Channel Life") and Sanlam Developing Markets Limited ("SDM") have entered into an agreement ("Proposed Transfer") in terms of which Channel Life will transfer all of its insurance business to SDM with an effective date of 1 January 2019 ("Effective Date"). The Proposed Transfer is subject to the approval of the Prudential Authority under section 50 of the Insurance Act.

The stated rationale for the Proposed Transfer is a rationalisation of the life insurance subsidiaries of Sanlam Life Insurance Limited ("Sanlam Life") to avoid unnecessary duplication of costs, to reduce complexity, to comply with regulatory requirements, and to align to the amended regulatory environment for insurance companies. Both Channel Life and SDM are wholly-owned subsidiaries of Sanlam Life.

1.2. Purpose and scope

This report is prepared in my personal capacity as Head of Actuarial Function for Channel Life. The report is required by Prudential Standard GOI 6, which requires me to express an opinion on the soundness of the Proposed Transfer. I have also considered professional guidance as issued by the Actuarial Society of South Africa in the form of Advisory Practice Notes APN 106 and APN 108. As a result, the purpose of this report is to summarise my review of the Proposed Transfer and to record my opinion on:

- The soundness of the Proposed Transfer; and
- The likely effect of the Proposed Transfer on Channel Life policyholders.

My opinions are limited to the potential effects on the shareholder and policyholders. I do not consider the potential effects on other stakeholders.

No alternative schemes have been presented and accordingly I do not express an opinion on possible alternative courses of action.

1.3. Declaration of interest

I declare that I am the Head of Actuarial Function for both Channel Life and SDM, employed by SDM. This creates a potential conflict of interest in relation to my opinions for both entities in respect of the Proposed Transfer. However, given the specific circumstances surrounding the Proposed Transfer, I am satisfied that I am able to objectively perform my duties for both entities, and that there are sound and defensible reasons for continuing to act in this instance. As a precaution, the shareholder has secured the services of an independent actuary to review the Proposed Transfer.

1.4. Information provided

In formulating my opinion, I have relied on the following information (amongst others) as provided by Channel Life and SDM:

- Board documents on the Proposed Transfer;
- Audited prudential solvency return sheets OF1 and OF2 pre-transfer for both entities;
- Audited prudential solvency return sheets OF1 and OF2 post-transfer for both entities;
- Audited annual financial statements pre-transfer for both entities;
- Own Solvency and Risk Assessment (ORSA) reports for both entities (draft);
- Transfer agreement (draft);
- Channel Life policyholder communications (draft); and
- Transfer process and plans.

I have conducted appropriate reviews of the information provided and I am satisfied that the information provided is relevant, reliable and free from bias.

2. Overview of the Proposed Transfer

2.1. Structures

In 2005, Sanlam Life bought African Life Assurance Company Limited. In 2008, African Life Assurance Company Limited changed its name to Sanlam Developing Markets Limited.

In 2006 Sanlam Life acquired a majority stake in Channel Life. The final minorities of Channel were bought out in 2010. Following this the operations of Channel Life were merged into those of SDM, and the decision was taken to stop selling new individual recurring premium policies in Channel Life (other than Channel 4 Life which was stopped in 2012), and to rather sell them in SDM. From 2016 new group schemes were written in SDM, and existing Channel Life group schemes were renewed in SDM (where feasible). Channel Life was also closed to new Guarantee Plan business in September 2016. Thus since 2017 there has been no new business in Channel Life, other than existing group scheme membership growth, and continuations, alterations and reinstatements of existing individual business. Channel Life is thus in run-off, yet remains a going concern according to the assessment of its board.

In November 2018, the boards of Channel Life and SDM approved in principle the Proposed Transfer.

2.2. Salient features of the Proposed Transfer

The following are some of the salient features of the Proposed Transfer that are relevant to my review and opinion:

- The Effective Date is 1 January 2019. Implementation will occur at a later date once approval has been obtained from the Prudential Authority, in consultation with the Financial Sector Conduct Authority. Implementation will entail a roll-back of accounts such that all insurance business-related transactions emerge in SDM from the Effective Date.

- Only policyholder assets and liabilities will be transferred. There will be no transfer of any shareholder assets. In particular, there will be no transfer of any capital required to back the risks emanating from the Channel Life insurance business, for example as determined by the prudential Solvency Capital Requirements.

- The Proposed Transfer will be based on the IFRS values of assets and policy liabilities as at the Effective Date and effectively no consideration will be payable by SDM for the purchase of the Channel Life insurance business.

- The costs relating to the Proposed Transfer will be borne by SDM's shareholder.

- In the opinion of Sanlam Group Tax, the Proposed Transfer will not have a negative tax impact on policyholders since the assets will be transferred in accordance with the provisions of section 45 of the Income Tax Act (relating to transfers of assets between companies within the same group of companies).

- The investment managers and the investment mandates of the Channel Life policyholder asset portfolios will not change as a result of the Proposed Transfer.

- The intention is to transfer policyholder assets per distinct investment portfolio to SDM. As a result, other than legal ownership, there is expected to be no change in the assets.

- Channel Life outsources its entire operations, including management, servicing and systems. The bulk by number of policies is outsourced to SDM. Smaller books are outsourced to other parties, and these arrangements will continue post-transfer. Thus there is expected to be no material change to the administration processes of either Channel Life or SDM as a result of the Proposed Transfer.

- The terms and conditions of Channel Life policies will not be affected by the Proposed Transfer.

- Once the Proposed Transfer has been implemented, the Channel Life insurance license will be terminated (subject to regulatory approvals), and the company eventually wound-up.

2.3. Types of business

The categories of policies to be transferred are shown in the table below together with their IFRS liabilities (gross of reinsurance). Assets of equivalent value at the Effective Date will be transferred. The nature of each category is briefly described below.

IFRS liabilities (R millions)	Dec 2018	Dec 2017
Policyholder liabilities	**5,111**	**5,655**
Individual business	*5,087*	*5,627*
- Market linked portfolios	143	210
- Smoothed bonus portfolios	158	170
- Annuities	2	2
- Non-participating excluding Guaranteed Plans	155	169
- Non-participating business - Guaranteed Plans	4,628	5,076
Group business	*23*	*28*
- Market linked portfolios	2	2
- Non-participating business	21	26
Long-term & current liabilities *	**326**	**261**
TOTAL	**5,436**	**5,916**

** excluding tax provision which will remain in Channel Life*

Individual business

- Market linked portfolios: These consist of single premium linked investment policies, and recurring premium market-related savings policies. The block of business has multiple asset managers and products.
- Smoothed bonus portfolios: This is a closed book of recurring premium smoothed bonus savings policies backed by a segregated pool of assets managed by Sanlam Investments.
- Annuities: This category comprises of a small number of non-profit fixed and with-profit annuities.
- Non-participating business excluding Guaranteed Plans: This block of business is made up of a variety of life policies including funeral, credit life, a cancer product, personal accident, and other life products.
- Non-participating business – Guaranteed Plans: This block of business represents all single premium guaranteed investment business held by Channel Life, which provide a fixed guaranteed maturity value after 5 years. The book is expected to be completely run off by early 2022 (excluding voluntary continuations after maturity).

Group business

- Market linked portfolios: This is a small portfolio of linked Fund business.
- Non-participating business: This consists largely of assistance business to groups (such as funeral parlours), as well as “grouped individual” such as state pensioners. It also includes some group PHI claims in payment in run-off.

3. Financial soundness

This section focuses on the expected impacts of the Proposed Transfer on Channel Life's solvency. However, the position of SDM is also considered here as this has bearing on the security of Channel Life's policyholders' benefits post-transfer.

3.1. Position at 31 December 2018 on the prudential solvency basis

Per APN 106, "soundness" in this context means the ability to maintain post-transfer a financially sound condition on the prudential solvency basis in accordance with the Insurance Act. This requires eligible own funds in excess of the Solvency Capital Requirement (SCR) and Minimum Capital Requirement (MCR). The relevant positions on the prudential solvency basis for Channel Life and SDM at 31 December 2018, before and after the Proposed Transfer, are shown in the table below. (Note: rounding differences have not been adjusted.)

In summary:

- Channel Life is expected to remain financially sound immediately after the Proposed Transfer as indicated by the SCR cover ratio of 16.3 times.
- The Proposed Transfer is not expected to materially affect SDM's solvency as measured by SCR cover ratio.

31 December 2018		Channel Life			SDM		
R millions	**Notes**	**Before**	**After**	***Change***	**Before**	**After**	***Change***
Total assets	i	6,083	691	*-5,392*	23,801	29,168	*5,367*
Total liabilities		-5,070	-20	*5,049*	-12,667	-17,716	*-5,049*
BEL	ii	-4,477	0	*4,477*	-6,055	-10,532	*-4,477*
Risk margin		-124	0	*124*	-2,106	-2,230	*-124*
Other liabilities	iii	-469	-20	*449*	-4,505	-4,954	*-449*
Prudential adjustment	iv	-25	0	*25*	-579	-579	*0*
Eligible own funds		**988**	**670**	***-318***	**10,555**	**10,873**	***318***
MCR	v	122	15	*-107*	1,273	1,354	*81*
SCR	vi	490	41	*-449*	5,093	5,416	*322*
MCR cover (times)		**8.07**	**44.70**	***36.63***	**8.29**	**8.03**	***-0.26***
SCR cover (times)	**vii**	**2.02**	**16.31**	***14.30***	**2.07**	**2.01**	***-0.06***

Notes (figures in R millions):

i. The value on an IFRS basis of assets to be transferred is 5,436. This includes a reinsurance asset of 116 which is revalued at 47 on the prudential solvency basis. Hence, the prudential solvency value of assets transferred into SDM is 5,436 - (116 - 47) = 5,367. In Channel Life, the deferred tax asset of 25 will be written off post-transfer. So Channel's assets reduce by 5,367 + 25 = 5,392.

ii. All of Channel Life's BEL is transferred into SDM so that the change under Channel Life is equal to the change under SDM.

iii. All of Channel Life's other liabilities are transferred with the exception of 20 of tax provision which must remain in Channel Life.

iv. The prudential adjustment removes the shareholder other reserves from the assets, as these are to be disregarded for determining eligible own funds. Post-transfer, this reserve is written off in Channel, and there is no change to the value of this reserve in SDM.

v. The MCR is at 25% of SCR, except for Channel Life post-transfer where the AMCR of 15 bites.

vi. Channel Life's SCR post-transfer reflects the market risks attaching to the shareholder's funds remaining in Channel. The increase in SDM's SCR post-transfer is less than the reduction in Channel's SCR due to diversification benefits post-transfer.

vii. Based on these results, Channel Life's SCR cover ratio is more than sufficient post-transfer. SDM's cover ratio decreases marginally.

The above results assume that all the reinsurance currently in place under Channel Life will transfer as is to SDM post-transfer. While there is no reason to believe this will not be the case, and the effect is not material for SDM, explicit consent to transfer reinsurance treaties is being sought from each reinsurer as a safeguard.

3.2. Forecast

Post-transfer Channel Life is expected to remain financially sound to the extent that it will have shareholder funds well in excess of SCR. In order for this to remain the case, Channel Life should not declare dividends which would cause the SCR or MCR cover ratio to drop to an unacceptable level, until such time as the insurance license has been cancelled. Once the insurance license is cancelled, the provisions of the Insurance Act would no longer apply and Channel Life would not have to maintain own funds in excess of SCR or MCR. It would then be free to declare dividends subject to the provisions of the Companies Act.

Base case projections show that SDM's SCR cover ratio is not expected to be materially affected in future years as a result of the Proposed Transfer. Projections of alternative scenarios (such as shocks, stresses) have not been considered.

As noted above, due to the outsourcing of Channel Life operations, there is expected to be no material change to the administration processes of either Channel Life or SDM as a result of the Proposed Transfer. In particular, the operational expenses are expected to remain as before. Certain costs in Channel Life will diminish over time, such as audit expenses and regulatory levies. The expectation is that the Proposed Transfer will simplify the management and reduce duplication of effort. It is thus possible that some economies of scale could potentially be achieved in the medium term.

3.3. Assets

The Channel Life policyholder asset portfolios will be transferred to SDM. The investment mandates and investment managers will remain unchanged. The current investment policies, containing the asset-liability matching policies, of Channel Life and SDM are identical. As a result of these points, the asset-liability matching post-transfer will replicate the asset-liability matching pre-transfer. The Proposed Transfer is thus not expected to affect the asset-liability matching as at the Effective Date.

This does not mean this will remain the case should management deem it necessary or desirable to change the combined asset-liability matching in future. However, for the asset-liability matching to diverge in future, this is likely to require a change to the asset-liability matching policy, which would be subject to board approval as well as review by the Head of Actuarial Function.

A further implication of the above is that the Proposed Transfer is unlikely to negatively affect the liquidity of either Channel Life or SDM.

3.4. SDM risk profile

SDM's risk profile can be considered by examining the components of the SCR. This is shown in the table below as at 31 December 2018, before and after the Proposed Transfer.

31 December 2018	**SDM**		
R millions	**Before**	**After**	***Change***
Market	2,078	2,303	*225*
Interest	1,692	1,729	*37*
Equity	863	886	*23*
Property	18	18	*0*
Spread & default	172	514	*343*
Currency	314	342	*28*
Concentration	198	212	*14*
Diversification	-1,179	-1,398	*-219*
Life	5,824	6,128	*303*
Mortality	1,440	1,522	*82*
Longevity	16	16	*0*
Disability	134	143	*9*
Lapse	5,437	5,718	*281*
Expenses	640	671	*31*
Retrenchment	74	74	*0*
Catastrophe	234	251	*17*
Diversification	-2,151	-2,267	*-117*
Diversification	-1,247	-1,366	*-119*
BSCR	6,655	7,065	*409*
Operational	282	321	*39*
Participations	137	137	*0*
LACDT	-1,981	-2,106	*-125*
SCR	**5,093**	**5,416**	***322***

There is a sizeable increase post-transfer in SDM's spread & counterparty default risk, emanating primarily from the Channel Life Guaranteed Plan book. However, a significant portion of this increased risk is diversified away, and is expected to reduce significantly over the next 2 to 4 years as this book runs off.

The balance of life risks in SDM remains very similar post-transfer. Similarly, the balance of market risk versus life risk remains stable.

Overall, the Proposed Transfer is not expected to materially alter SDM's risk profile. Consequently, this is not expected to have any effect on the security of Channel Life's policyholders' benefits post-transfer.

4. Policyholders

4.1. Discretionary participation business

Channel Life has discretionary participation business in the form of smoothed bonus savings policies, and with-profit annuities. This business is managed in accordance with specific Principles and Practices of Financial Management (PPFM) documents. The PPFMs drive the bonus declarations and hence the policyholders' reasonable benefit expectations. The terms and conditions of all Channel policies will not change as a result of the Proposed Transfer. This implies that the PPFMs will not change. Additionally, the investment portfolios backing this business will remain unchanged, and will be kept distinct post-transfer. Hence there is no reason to believe that the reasonable benefit expectations of these policyholders would be adversely affected by the Proposed Transfer. Other than the maintenance of the existing PPFMs and investment portfolios, no additional measures are necessary to protect these policyholders' interests.

4.2. Impact on Channel Life policyholders

The Proposed Transfer is expected to have no to minimal impact on Channel Life policyholders for the following reasons:

- Channel Life policyholders will be informed about the Proposed Transfer (see section 4.3 below).
- There will be no change to the Channel Life policy terms and conditions.
- The Channel Life policy benefits and values will not be affected due to:
    - There being no change to terms and conditions, including premiums and charges.
    - There will not be a policyholder tax impact due to the provisions of section 45 of the Income Tax Act.
    - The investment policy, asset-liability matching policy, investment managers and the investment mandates of the Channel Life policyholder asset portfolios will not change.
    - The costs of the Proposed Transfer will be borne by SDM's shareholder.
- The client experience will not change given that Channel Life outsources its operations to SDM, and to other parties where this outsourcing will continue as before. There is no change to the contact numbers and claims procedures for example.
- All policies are being transferred and there will be no remaining policyholders in Channel Life after the transfer.

- All the governance and risk management policies and procedures of Channel Life and SDM are already aligned, and follow those of the Sanlam Group.
- The transfer is to a sister company in the Sanlam Group and there is no change to the ultimate parent company.
- SDM is a mature, large, and well-capitalised company as indicated by the SCR cover ratio above 2.0 times. The Proposed Transfer is not expected to materially alter SDM's risk profile or solvency, now and in the future. This gives comfort regarding the security of Channel Life's policyholders' benefits post-transfer.

Given that all aspects of the policies (namely terms, conditions, premiums, charges, benefits, and values) will remain unaffected by the Proposed Transfer, there is no reason to believe that the reasonable benefit expectations of policyholders would be adversely affected by the Proposed Transfer.

4.3. Communication

Management has developed a plan to ensure reasonable attempts will be made to communicate with all Channel Life policyholders regarding the Proposed Transfer. This includes direct communication (email or post), and indirect communication (such as newspaper adverts and website). Due to the nature of the book, and the age of some policies, there is a risk that some policyholders will not get the notification. However, this is mitigated by the fact that the administration of the policies remains unchanged, so that policyholders will continue to interact with the insurer in the same way as before.

The communication plan includes sales and servicing staff, and other relevant stakeholders (such as the Ombudsman for Long-term Insurance). This should enable them to deal with any related queries that may arise.

5. Conclusion

The above analysis shows that:

- Channel Life is expected to remain financially sound immediately after the Proposed Transfer as indicated by the SCR cover ratio of 16.3 times.
- Thereafter, Channel Life is expected to remain financially sound until such time as its insurance license is cancelled provided that sufficient funds are retained and not paid out as dividends.
- The Proposed Transfer is not expected to materially affect SDM's risk profile or solvency as measured by SCR cover ratio, now and in the future.
- The Proposed Transfer is not expected to affect the asset-liability matching and liquidity positions of Channel Life or SDM.
- The Proposed Transfer is expected to have no to minimal impact on Channel Life policyholders. In particular, there is no reason to believe that the Proposed Transfer will adversely affect policyholders' security of benefits or reasonable benefit expectations.

Based on this, it is my opinion that:

- The Proposed Transfer is financially sound.
- The security of Channel Life policyholders is adequately safeguarded in the Proposed Transfer.

- The reasonable benefit expectations of Channel Life policyholders are not adversely affected by the Proposed Transfer.

Signed in my capacity as Head of Actuarial Function for Channel Life Limited

Simon Louw

BEconSc(Hons), FASSA, MA

Channel Life Limited

Registration Number 1969/012487/06. Licensed Financial Services Provider FSP 19243.
Refer to the Sanlam website for directors and company secretary details.

Sanlam Business Park, 13 West Street, Houghton 2198
PO Box 1941, Houghton 2041, South Africa

T +27 (0) 0861 235 433
F +27 (0) 0861 235 329
E info@sanlamsky.co.za

Sanlam
Wealthsmiths™