TRUE SOUTH

ACTUARIES & CONSULTANTS

Section 50 proposed transfer

of the insurance business of Channel Life Limited to Sanlam Developing Markets Limited

Report by independent actuary

The Board of Directors: Sanlam Developing Markets Limited

The Board of Directors: Channel Life Limited

Sanlam Business Park

13 West Street

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2198

31 July 2019

<u>Independent actuarial report on proposed Section 50 transfer of insurance business</u>

The report attached to this letter:

- was commissioned from True South Actuaries & Consultants ("True South") by Sanlam Life Limited ("Sanlam Life") to be addressed to the two boards of directors listed above
- concerns itself with the intended transfer, on effective date 1 January 2019, of all insurance business of Channel Life Limited ("Channel Life") to Sanlam Developing Markets Limited ("SDM") as per section 50 of the Insurance Act no 18 of 2017 (the "Insurance Act")
- addresses at least the (relevant) aspects that the Actuarial Society of South Africa ("ASSA") expects its members to consider when commenting in an independent capacity on the relative merits of a proposed section 50 transfer
- assumes knowledge of terms that could reasonably be expected from a Board of an insurance company (such as HAF, ORSA, GOI, Prudential Standards, with-profit, bonus stabilisation reserves, diversification benefit, loss absorbing capacity etc)
- is intended to form part of the application for the proposed transfer and may thus, in addition to the addressees, be considered by all parties involved in this process.
- assumes that any late changes to the transfer agreement reviewed (document received on 23 July with file name "Transfer Agreement 20190625 (004).docx"), will not invalidate the statements contained in this report.

In my opinion, as an independently actuary, free from any potential conflict of interest, the proposed transaction safeguards the rights, entitlements and security of all classes of policyholders affected by it (also including also the current SDM policyholders). Having performed an in-depth investigation into the rationale and mechanics of the proposed transfer, I find that it is both appropriate and fair to affected policyholders.

Francois Hugo (FASSA)

For and on behalf of True South Actuaries & Consultants

1 APPOINTMENT

1.1 Background to appointment

As per section 50(5) of the Insurance Act, the Prudential Authority ("PA") may appoint a person, at the cost of the insurer or controlling company, to assess the proposed transfer, transaction or change and express a view on the desirability or otherwise thereof. Although the PA has not (yet) requested an independent actuarial report, it may do so, in which case this report will serve this purpose.

Sanlam Life nevertheless took the decision to commission an independent actuarial report to affirm the appropriateness and fairness of the proposed transfer to the Channel Life and SDM Boards. This was (at least in part) in anticipation of a potential view that the two transacting parties could be conceived as not being sufficiently independent due to them sharing the same HAF and being constituted with the same board members for many years.

The cost of this report will (as is the case for all costs related to the transfer) be covered by SDM.

This report does not replace the HAF reports required by the Prudential Authority as part of the submission for approval of the envisaged transfer.

1.2 Qualifications and experience

This report has been prepared by Francois Hugo acting for and on behalf of True South Actuaries and Consultants. The table below sets out his relevant experience:

Table 1 – Independent actuary qualifications, experience and appointments

Relevant academic and professional qualifications	• *BSc University of Stellenbosch* • *B Comm (Hons) University of Pretoria* • *FIA (Fellow of the Institute of Actuaries in the United Kingdom)* • *FASSA (Fellow of the Actuarial Society of South Africa)*
Relevant experience	Co-founder and executive director of True South Actuaries & Consultants (a provider of independent actuarial services to many providers of insurance products in South Africa) More than 20 years' post qualification actuarial consulting experience mostly (although not exclusively) in the life insurance industry. Holder of a Long-term insurance practising certificate. Several Head of Actuarial Function ("HAF") appointments under the Insurance Act. Currently contributing (in capacity as HAF) to 3 other section 50 transfers.

1.3 Declaration of interest

Other than the benefits accruing in respect of professional fees for this assignment, neither the author, nor True South has any financial interests[1] in any of the companies under consideration and would not benefit financially from whether the proposed transfer takes place.

[1] Some indirect interest may exist through exposure to the holding company of SDM and Channel Life through collective investment schemes.

2 SCOPE

2.1 Legislation and professional guidance

In terms of Prudential Standard GOI 6 as issued by the Prudential Authority which deals with "Transfers of Business and Other Significant Transactions by Insurers", it is required (in paragraph 2.4) that *"any independent expert appointed by the Prudential Authority under section 50(5) of the Act to review and report on any aspects of the proposed transfer or any aspects of the process involved is responsible for reporting honestly and accurately on these matters*."

In identifying the aspects that need to be considered, I have referenced professional guidance issued by the Actuarial Society of South Africa and specifically Advisory Practice Note ("APN") 108. This practise note is entitled *"Transfer of Long-Term Business of a Registered Insurer - Role of the Independent Actuary (v2)".*

2.2 Overlap of topics covered in three actuarial reports

Two further actuarial reports (apart from this one) are required in terms of Prudential Standard GOI 6 as issued by the Prudential Authority which deals with "Transfers of Business and Other Significant Transactions by Insurers". The standard requires that *"The head of the insurer's actuarial function is responsible for expressing an opinion to the board of directors about the soundness of the proposed action as far as the action relates to his or her functions as set out in GOI 3 (Risk Management and Internal Controls for Insurers)."*

These reports (which have the same author as the two entities share a HAF), would also have considered the same professional guidance issued by the Actuarial Society of South Africa:

- *Advisory Practice Note 106: Head of Actuarial Function for South African Insurers (v6)* ("APN106") and
- *Advisory Practice Note 108: Transfer of Long-Term Business of a Registered Insurer - Role of the Independent Actuary (v2)*, ("APN108") as issued by the Actuarial Society of South Africa. (APN106 mentions that although APN108 is intended to apply to independent actuaries appointed by the regulator, the HAF should have regard to this guidance where relevant and appropriate.)

It would therefore be reasonable to expect a degree of overlap in topics considered by the three actuarial reports.

3 INFORMATION CONSIDERED

3.1 Decision on information to be considered

I confirm that I was not instructed by any of the parties on what should be included in, or excluded from the report, although I allowed myself to be guided on information that could be considered confidential / sensitive. I was provided with access to all parties I wished to interview and all information, reports and documents I considered material to the formulation of the required opinion.

3.2 Information requested, provided and considered

In formulating the opinions in this report, I have considered the following:

Table 2 - Information considered by the independent actuary

Information category	*Comments*
Project-related information (apart from info provided by the HAF – see below)	The "Request for Quote" document from Sanlam Life addressed to True South containing background information on the proposed transfer. It is entitled: "Request for quote for external actuarial review: Transfer of the existing Channel Life Ltd ("Channel Life") insurance business to Sanlam Developing Markets Ltd ("SDM")."
	Transfer Agreement between SDM and Channel Life: "Transfer Agreement 20190625 (004).docx"
	An internal (Sanlam) "file note" dated 10 July and entitled "Channel Life Ltd licence closure tax impact".
	Project plan for proposed transfer: An excel file entitled "Channel Transfer Project Plan v 2.xlsx". Project Plan update in the form of a PowerPoint presentation: "
	Various interactions via e-mail and telephone with Werner Barnard, Jurie Gouws, Taher Mohamed, Simon Louw and Feroza Joosub.
	Completed Prudential Authority application form IF024 ("Application for Approval to Transfer Assets and Liabilities").
	Extract form the minutes of the Board of directors meeting (23 May) of Channel Life related to the potential transfer of all insurance business to SDM Extract from the minutes of the Board of directors meeting (23 May) of SDM related to the potential transfer of business to SDM from Channel Life.
Communication Plan	Word document with file name "Communications Plan_Transfer of the Channel Life Licence.docx" which sets out the communication plan to policyholders, business partners and staff.
	Word documents containing the following: • Letter to policyholders • The Client Call Centre on-hold message • Formal notice for Government Gazette • FAQ for policyholders

… continued

Information	*Comments*
Financial information	Audited annual financial statements of the two entities as at 31 December 2018.
	Quantitative and Qualitative reports submitted (in 2019) to the Prudential Authority for both transacting entities as at 31 December 2018 (i.e. four separate returns plus two annexures that accompanied the qualitative returns).
Information from the HAF of the two transacting entities	The details behind the numbers reflected in the HAF reports were provided in three spreadsheets called "Channel SCR details Q4 2018 new tool.xlsx", "Licence consolidation QRT_v4.xlsx" and "SDM projections.xlsx". (Prudential Basis numbers reflected in the HAF reports for purposes of the proposed transfer are different to what was submitted to the Prudential Authority. This is due to refinements in calculations during the 2019 calendar year. The refined numbers are the ones that were audited.)
	Reports from the HAF of both SDM and Channel Life on the proposed transfer (as required by the Insurance Act).
	Telephonic and e-mail interaction with the HAF (Simon Louw) clarifying various aspects around the provided information.
	Principles and Practices of Financial Management documents (PPFM's) for discretionary participation business within SDM and Channel Life.
	Favourable audit opinions by Ernst & Young on pre- and post-transfer numbers for both transacting entities.
Other	ORSA for SDM (entitled "Sanlam Developing Markets Limited Own Risk and Solvency Assessment Report 2019 submission" version 8.0 dated 19 July 2019 ORSA for Channel Life (entitled "Channel Life Limited Own Risk and Solvency Assessment Report 2019 submission" version 8.0 dated 19 July 2019" (Although in an "advanced draft" stage, the documents I considered were not yet final.)
	The Memorandum of Incorporation for Channel Life: This was obtained to ensure a complete picture of Channel Life policyholder entitlements.
	Investment and capital management policies of SDM and Channel Life: "SDM and Channel Investment Policy and Strategy Aug2015.docx" and "Capital management policy v6.docx".

Given my interaction with individuals that provided information, I have no reason to believe that such information is not relevant, not reliable or in any way biased.

4 RATIONALE

4.1 History

Sanlam Life, as part of its growth strategy to enter the entry level market in Southern Africa:

- purchased African Life Assurance Ltd in 2005 - now known as SDM
- acquired a majority stake in Channel Life in 2006 and bought out remaining minorities in 2010.

No new business has been written onto the Channel Life license since 2017 other than existing group scheme membership growth, and continuations, alterations and reinstatements of existing individual business:

- In 2010, 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 such policies into the SDM license
- Channel Life was also closed to new Guarantee Plan business in September 2016
- From 2016 new group schemes were written in SDM, and existing Channel Life group schemes were renewed in SDM (where feasible).

Channel Life now wishes to sell and transfer its insurance business and SDM wishes to accept such transfer. To this end, I have had sight of minutes of the Board meetings of both entities, both held on 23 May 2019:

- Channel Life: "The Board resolved that the Company be and is hereby authorised to conclude and execute the Transfer Agreement …"
- SDM: "Having considered and discussed the memorandum *Transfer of business from Channel Life Ltd to Sanlam Developing Markets* dated 15 May 2019, the Board resolved that the Company be and is hereby authorised to conclude and execute the Transfer Agreement …".

4.2 Rationale behind the proposed transfer

Sanlam Life wishes to rationalise the life insurance subsidiaries within the group with the aim of avoiding unnecessary duplication of compliance costs and to simplify the legal structure within which it provides insurance products.

Both SDM and Channel Life are wholly-owned subsidiaries of Sanlam Life offering similar products to a similar market. Channel Life is closed to new business with SDM now accepting new business that would have been written into the Channel Life license in the past. Administration services are mostly being performed by SDM.

As such, and in order to place Sanlam Life in a position to close the Channel Life license without any prejudice to policyholders, it is the intention to transfer all its remaining Channel Life policies to SDM with effective date 1 January 2019.

4.3 Alternative arrangements

As both SDM and Channel Life are part of the same group of companies and since the business on the Channel Life license is already being administered and serviced by the same processes, procedures and systems used for other business within the group, there is no intention of the holding company to dispose of the business. As such, the most plausible alternative to transferring the Channel Life policies to SDM is to continue offering them in Channel Life. This option was deemed undesirable because the book of business is decreasing in size, which would result in the following impacts:

- The fee income from the reducing policy book would become insufficient to meet overhead cost allocations
- High levels of compliance, governance and reporting would continue to be required of Channel Life and on a diminishing book, the lack of scale would start to make these requirements excessively onerous
- The wind-down of the book until Channel Life has no more policies could take a long time due to membership growth on existing group schemes and continuations, alterations and reinstatements on existing individual business and as such the above impacts could be dragged out and have a prolonged effect.

In addition to the above impacts of the reducing policy book size, there are many inefficiencies resulting from duplication of work within the broader Sanlam Life group as a result of continuing with both life companies. These could be avoided if the policy book was transferred.

5 MECHANICS OF THE PROPOSED TRANSFER

5.1 Structures

The effective date of the proposed transfer is 1 January 2019 although the transaction cannot be implemented until approval had been obtained from the Prudential Authority (in consultation with the Financial Sector Conduct Authority). Should this approval be obtained, all business risk from the 1 January 2019 would accrue (on a no recourse basis) to SDM and accounts will be "rolled-back" such that all insurance business-related transactions as from 1 January 2019 will reflect in SDM's books. (In effect, Chanel Life will, from 1 January 2019, manage the business as an agent on behalf of SDM until the implementation date.)

After the implementation date and after all regulatory approvals had been obtained, the Channel Life insurance license will be terminated and the company eventually wound-up.

5.2 Transfer price

Only assets covering the (IFRS) policyholder liabilities will be transferred with shareholder assets[2] remaining within Channel Life post proposed transfer. As both entities are within the same group of companies, assets will effectively only change legal ownership with no resultant tax impact.

Effectively therefore, there will be no consideration paid for the business by SDM (on an IFRS basis), although it will bear the costs relating to the proposed transfer.

5.3 Impact on investment portfolios

Since [1] asset-liability management for the two entities is currently performed within the same operational framework, [2] the PPFM and its application will remain unchanged (see below) and [3] the actuarial basis for determining liabilities will remain unchanged, there will be no need for rebalancing the investment portfolios.

5.4 Impact on operations

Channel Life outsources its entire operations, including management, servicing and systems:

- SDM: By far the bulk of the business (by policy count) is outsourced to SDM. Apart from most of the risk business, this includes fully linked single premium business totalling R61m

[2] Including the portion covering the Capital Requirement associated with the transferring business

- Sanlam Life Insurance Limited: Glacier being a division of Sanlam Life, administers the Channel Guaranteed Plan (single premium guaranteed return business) and the outsourced administration will persist post-transfer[3]
- Platinum Life: This entity is responsible for administering a legacy book called "Anchor" (an arrangement that Channel Life entered into before Sanlam acquired a majority stake in Channel Life in 2006) and the outsourced administration will persist post-transfer.

The outsourcing agreements will remain in place until the date of the proposed transfer when the contract with SDM will be cancelled and those with other parties changed with SDM replacing Channel Life as the contracting parting.

5.5 Impact on reinsurance

There are several reinsurance contracts in place on the Channel Life business (involving four different reinsurers). Consent for the transfer (i.e. that reinsurers are willing to continue with the arrangements, only replacing Channel Life with SDM as the contracting party) has been obtained from Munich Re, Genre and Swiss [4].

5.6 Project progress

I have had sight of the 19 July project progress report. The Scope of the project is listed as:

- **Legal** – Agreements, Board approvals, Contracts
- **Finance** – Bank accounts, bank recons
- **Actuarial** – Compiling reports, engagement with EY
- **System / Processes** – CFD's, Premium Collections
- **Communication** – Client and staff communication
- **Distribution** - data investigation, contracts review and communications to 3rd parties
- **Group Benefits.**

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[3] The last maturity is January 2022. However, clients may (although very few had done so in the past) continue their policies as a linked policy.

[4] At the time of writing, written consent had not yet been received from RGA, although they have responded saying they "don't see any issues with the transfer" but that their legal team reviewing the letter and checking whether any further addendum to the treaty was required. RGA is not the lead reinsurer and the impact if they were to recapture (which is extremely unlikely) will be immaterial - especially in the bigger SDM context.

Under “Key risks and issues”, nothing was listed.

From discussions with Feroza Joosub (Head: Strategy & Special Projects Sanlam Sky) and Taher Mahomed (Business Change Consultant Sanlam Sky) it appeared as if the project is actively managed by an experienced team supported by a competent technical team.

6 TRANSFERRING POLICYHOLDERS

The majority of Channel Life policyholders (by number) are from the entry-level and middle market and hold funeral and credit life insurance products. However, when considering policyholder liabilities, Channel Life has large exposure to single premium policies offering investment guarantees that were sold to the middle and affluent markets. Channel Life ceased to market and sell any products since 2017 and as such, the book of policies that forms the subject of the proposed transfer is a closed book of business and will run off over time. As at 31 December 2018, however the book that will potentially be transferred was still quite sizable:

Table 3 - Transferring policyholders (Source: Returns submitted to Prudential Authority)

Number of policyholders	*Individual: Recurring*	*Individual: Single*	*Grouped Individual*	*Group*	*Total*
Risk	63 015		7 145	27	70 187
Credit Life			34 866		34 866
Funeral			133 691		133 691
Investments	3 409	4 475			7 884
Life annuities	6				6
Universal Life	8 202				8 202
Total	74 632	4 475	175 702	27	254 836

The net (of reinsurance) policyholder liability on the Prudential Supervision basis (including allowance for the risk margin) as at 31 December 2018 is set out in the table below[5]:

Table 4 - Net (of reinsurance) technical provisions (Source: Returns submitted to Prudential Authority)

Liabilities (in R'000)	*Individual: Recurring*	*Individual: Single*	*Grouped Individual*	*Group*	*Total (R'000)*
Risk	-374 067		64 075	3 627	-306 365
Credit Life			-50 490		-50 490
Funeral			-		-
Investments	147 819	4 605 592			4 753 411
Life annuities	715				715
Universal Life	74 577				74 577
Total	-150 956	4 605 592	13 585	3 627	4 471 848

[5] This table provides an indication as to the relative level. As mentioned elsewhere in this document, the returns submitted to the PA does not correspond 100% with the (audited) numbers in the HAF report.

7 IMPACT ON POLICYHOLDERS

7.1 Policy servicing, maintenance and correspondence

As explained earlier (in the section that deals with the mechanics of the proposed transfer), the proposed transfer's only impact in terms of policyholder administration would involve the contracting between entities in the background.

Policyholders should already be familiar with the overlap created by the management structures and the service experience should not be impacted by the proposed transfer.

7.2 Terms & conditions, premiums & benefits

It is clear from reading the transfer agreement between the contracting entities that SDM will accept all obligations of Chanel Life towards its policyholders that existed as at 1 January 2019. The terms and conditions of Channel Life policies will thus not be affected by the proposed transfer. The only visible change will be that SDM replaces Channel Life as underwriter.

7.3 Policyholder reasonable expectations: Non-profit business

As set out above, terms and conditions for non-profit business remain unchanged and (provided capital strength is not materially affected – see below), reasonable expectations of holders of non-profit policies would not be affected.

Investment risk for these policies is carried by shareholders and therefore investment decisions of assets backing (non-profit) policyholder liabilities do not shape policyholder expectations.

7.4 Policyholder reasonable expectations: With-profit business

Channel Life and SDM also have discretionary participation (with-profit) business. As argued below, it is my view that policyholder entitlement (and therefore reasonable policyholder expectations) for SDM and Channel Life policyholders will not be impacted by the proposed transfer.

For with-profit policyholders, the Principles and Practices of Financial Management (PPFMs) drive bonus declarations which would, in turn, shape policyholder reasonable expectations:

Table 5 - With-profit (participating) policyholders

	Product	Number of policies	Smooth Bonus account (R'm)	Bonus stabilisation reserves	PPFM
SDM[6]	Endowments	About 74,000	296	-0,7%	Principles and Practices of Financial Management: Sanlam Developing Markets Limited's Individual Smooth Bonus Products
	Retirement Annuities	About 26,000	1,204	1.0%	
Channel Life	Unitised With-Profit (UWP)	About 10,000	57	5.0%	Channel Life Principles and Practices of Financial Managment (PPFM) UWP – 26 October 2009
	Rentmeester	About 2,500	2	1.8%	
	Bonus annuity	7	1	1.9%	Channel Life Principles and Practices of Financial Managment (PPFM) Bonus Annuities – 8 April 2008

In assessing the impact of a potential transfer on the rights of Channel Life participating policyholders, it is important to ensure that:

- [1] The duties and obligations contained in the Channel Life PPFM are assigned to SDM
- [2] Any changes envisaged to the Channel Life PPFMs will not impact benefits or security of such benefits
- [3] The bonus stabilisation reserves (BSR) and investment portfolios backing the discretionary participating policyholder liabilities don't change to the detriment of policyholders (which is important because both the BSR and composition of investment portfolios backing the with-profit business would have an impact on future affordable bonus rates)
- [4] Any additional rights granted to Channel Life policyholders in the Memorandum of Incorporation are allowed for (although the PPFM should already reflect any such additional rights).

[1] Assigning Channel Life PPFMs "obligation" to SDM: Neither of the two Channel Life PPFMs contain a clause which automatically transfers duties / obligations to the new insurer on transfer. I would therefore have preferred for the transfer agreement between the two parties for

[6] There is also a reversionary bonus portfolio, but reliable information on these old policies is not available. A separate PPFM exists for these policyholders and their treatment will not be affected by the transfer.

explicitly mention the PPFMs. However, it is clear that the PPFM forms part of the contract between Channel Life and SDM:

- The PPFM would be included in the definition of "Contracts" definition which refers to "*all contracts concluded or acquired by Channel Life in the ordinary course of the Insurance Business … in respect of which any right or obligation of Channel Life exists as at the Effective Date*"
- Insurance Business is then defined as "*the insurance business carried on by Channel Life as at the Effective Date, comprising the Assets and the Liabilities, the Contracts, the Policies, and all related goodwill …* "
- The terms governing the transfer then stipulates "*… Channel Life hereby sells, transfers, cedes and delegates the Insurance Business on a no recourse basis to SDM with effect from the Effective Date … and SDM hereby accepts such transfer, cession and delegation with effect from the Effective Date*.".

[2] Changes envisaged in the PPFMs: There will be no change in the PPFMs of current SDM policyholders. In terms of the Channel Life PPFMs, both contain the following clause: "*… policyholders will be notified of any amendments to this document, which may arise from changes to the structure of Channel Life and/or the business environment*". I have been informed that the task of this notification will be included in the transfer project plan and that the only change will be to replace Channel Life with SDM.

[3] Investment portfolios and BSRs: The following excerpt is taken from the Channel Life HAF report on the proposed transfer: "*… the investment portfolios backing (the with profit) business will remain unchanged and will be kept distinct post-transfer*".

[4] Channel life Memorandum of Incorporation: I have studied this document and found no additional entitlement that accrues to with-profit policyholders other than what is already described in the PPFM. (Paragraph 34.8 mentions that "*To the extent that any distributable profits of the Company arise from profit sharing policies, the profits so arising shall be allocated towards increasing the benefits payable under such policies according to the applicable Principles and Practices of Financial Management.")*

7.5 Costs associated with proposed transfer

All costs of the proposed transfer will be covered by SDM with no additional fees being charged to policyholders. There will thus be no loss of value to policyholders due to additional expenditure incurred as a result of the proposed transfer.

7.6 Impact on policy values: Tax and costs associated with transfer

In the opinion of Sanlam Group Tax (and as reflected in the transfer agreement), asset transfers from Channel Life to SDM will qualify for relief as envisaged in section 45 of the Income Tax Act. This is because both these companies are wholly owned subsidiaries of Sanlam Life and therefore part of the same "group of companies" as defined in section 41 of the Income Tax Act rendering the proposed transfer an "intra-group transaction". The relief provided via section 45 of the ITA is aimed at facilitating the transfer of assets within a group without any immediate tax implications. An exception in respect of the UPF fund was highlighted in the transfer agreement, but since no tax is payable on this fund, this will have no bearing on policy values.

A transfer of assets from Channel Life to SDM will therefore not trigger an acceleration of capital gains tax.

An internal (Sanlam) "file note" dated 10 July and entitled "Channel Life Ltd licence closure tax impact" confirms the above view and also mentions that "*depending on the nature of assets transferred from Channel to SDM, it may have an impact on the allowable expense ratio of SDM, but given the nature of the assets transferred we rather expect an improvement therein.*" This would be a second-order impact and I don't expect it to be material.

8 FINANCIAL SOUNDNESS

8.1 Basis for assessing financial soundness

For purposes of the required opinion, "financial soundness" is clarified by actuarial guidance (on transfers), as the ability to maintain a financially sound condition on the Prudential Supervision Reporting basis as per the Insurance Act.

The single most useful statistic to assess financial soundness (as per the definition above) is the Capital Cover Ratio. The *Capital Cover Ratio* (henceforth denoted in italics to emphasise the fact that it has a very specific definition within the context) considers the extent to which the available capital (assets less liabilities valued as per the Insurance Act) for an insurer exceeds the minimum required capital for the insurer to demonstrate financial soundness (also calculated as per the Insurance Act).

8.2 Audited numbers

The calculations underlying the *Captial Cover Ratios* reported on in this document were audited and the following is quoted from the auditor's report:

- Channel life: "*In our opinion, the specified QRTs of the Insurer for the year ended 31/12/2018, and 1 January 2019, are prepared, in all material respects, in accordance with the provisions of the Insurance Act, 18 of 2017, Prudential Standards and the log files for the completion of the QRTs issued by the Prudential Authority*".
- SDM: "*In our opinion, the specified QRTs of the Insurer for the year ended 31/12/2018, and 1 January 2019, are prepared, in all material respects, in accordance with the provisions of the Insurance Act, 18 of 2017, Prudential Standards and the log files for the completion of the QRTs issued by the Prudential Authority*".

8.3 *Capital Cover Ratios* compared: As at the effective date

As set out in the Channel Life HAF report and reflected in the (abbreviated) QRT statements[7] that will accompany the transfer application to the PA:

[7] The figures in the HAF report were audited and I therefore did not review them (apart from high-level consistency checks). It needs to be noted that the IFRS surplus for SDM numbers reflects what was submitted on the QRT to the PA. Due to a late adjustment made to the AFS, there is a difference between the submitted numbers and what was shown in the AFS. In addition, the Prudential Basis numbers incorporate a methodology change related mostly to the

- For transferring policyholders (existing Channel Life policyholders), the *Capital Cover Ratio* will remain virtually unchanged (from 202% to 201%)
- For receiving (existing SDM) policyholders, the *Capital Cover Ratio* will decrease somewhat (from 207% to 201%).

Since Channel Life is small compared to SDM, the weighted average of the *Capital Cover Ratio* on combining these two entities could have been expected to be closer to 207% (and not the 201% noted above). The reasons for the lower level of 201% include:

- As per the transfer agreement, the shareholder funds (on an IFRS basis) in Channel Life as at 31 December 2018 will not be transferred. This loss of surplus funds (in isolation) would have resulted in a reduction in the (combined entity) *Capital Cover Ratio* to 195%. (Some surplus would still be transferred due to the IFRS liabilities – on which the value of assets transferred is based - being higher than the Prudential Basis liabilities)
- This was countered, to a degree by the fact that the combined SCR under the merged entity is lower than the sum of the two:
    - The additional market concentration risk charge for the post-transfer SDM entity reflects only 11% of the charge within Channel Life. This is due to the much bigger combined asset base which significantly reduces the risk of over-exposure to any single counter-party
    - The *diversification benefit* for the post-transfer combined SDM entity is more than for the sum of the two free-standing insurers arguably reflecting the better balance of risks post-transfer
    - There is more *Loss Absorbing Capacity* under the combined entity compared to the sum of the two separate entities reflecting previously "unused capacity" for such tax absorption within the SDM license.

The fact that the *Captial Cover Ratios* exceed 2.0 times[8] for all three groups of policyholders (SDM pre-transfer, Channel Life pre-transfer and SDM combined post-transfer), <u>as at 1 January 2019</u> serves as confirmation that there should be no concerns regarding the impact of the transfer on financial soundness.

way in which the risk margin is calculated, which results in numbers that are different to what was submitted via the QRT to the PA. The impact of these differences is too small to have any impact on the views expressed in this report.

[8] In its recent (2018-2019) annual report, the Prudential Authority mentions that the median *Capital Cover Ratio* for life insurers is 1.8 times

8.4 Future *Capital Cover Ratio* targets

Sanlam Life has indicated[9] that it intends to ensure that SDM remains well-capitalised (irrespective of whether the transfer happens or not). The stated *Capital Cover Ratio* targeted range for SDM is between 1.5 to 2.0 times over the next five years. (The targeted range for Channel Life is slightly lower at 1.3 to 1.8, but currently under review.)

I am confident in the future ability of SDM to honour policyholders' benefits as reflected in its shareholders' intentions to ensure that the entity remains well-capitalised. In addition, I am confident that this ability will not be negatively impacted by the proposed transfer.

9 COMMUNICATION PLAN

9.1 General

A comprehensive communications plan has been developed that will ensure that all Channel Life policyholders, staff and other stakeholders are provided with the necessary information relating to the proposed transfer.

Some items / scripts were still outstanding at the time when this report was finalised. However, from what I have observed and based on discussions with members of the project management team, I am satisfied with the process and that those involved (and invited to contribute to the content) are applying their minds to ensure accuracy and completeness of information.

9.2 Communication with Policyholders

It is worth noting that, since the proposed transfer will have no impact on the administration process, policyholders will continue to interact with service centers as they did before the proposed transfer.

Policyholder communication (in terms of providing information on the proposed transfer) will be in the form of:

- Registered letter (post)

[9] I received a comprehensive e-mail response from Werner Barnard (Head: SPF Actuarial: Risk & Balance Sheet Management) on this topic which confirmed that this is indeed the intention as reflected in a number of different documents, including the Risk Appetite Statement and a memo that will soon serve at the Board of SDM.

- E-mail (where this is on record)
- SMS (both before and after the proposed transfer)
- Radio
- On-hold message when calling the call centre
- Newspapers
- Formal notice per Government Gazette
- Sanlam websites.

9.3 Communication with business partners and key stakeholders

The following partners and stakeholders were identified:

- Brokers (e-mail from the head of the broker division)
- Key Accounts (e-mail / letter)
- 3rd party contracts with group benefits and the broker division (e-mail / letter)
- Reinsurers (letter requesting consent)
- Platinum Life (formal letter from legal department)
- Ombudsman (formal letter from legal department).

9.4 Communication: Staff

Various groups of employees that need to be informed of the transfer were identified. Communication will be via e-mail (with "hymn sheet" in terms of how questions should be addressed), broadcast mailer, staff newsletter, staff meetings and notices in staff publications. If is also worth noting that Channel Life employed around 9 people until July 2019, but all these employees had since been re-employed in SDM with no changes to their terms and conditions or responsibilities. No employees will be made redundant due to the transfer.