

FSC 2 - Return

Periodic Investigation: Long Term and General Insurance Business

FORM FSC 2

Register Number **143298** Period ended 31 December **2017**

Name of Society
(as registered)

Bus Employees Friendly Society

Registered Office

Suite 2, Alma House, Alma Road

Reigate, Surrey

Post Code: **KT3 4QS**

Returns under the Friendly Societies Prudential Rules
Statement of Solvency

FSC2 - FORM 9

Name of Society: **Bus Employees Friendly Society**

Period ended 31 December: **2017** Reg No **143298** Units £/£000 **£000**

| | 1 As at the end of the period | 2 As at the end of the previous period |
|------------------------|--------------------------------------|---|
| Total available assets | 10 1,132 | 1,007 |

GENERAL BUSINESS

| | | |
|---|-----|--|
| Other than long term insurance business assets allocated towards general business required minimum margin | 11 | |
| Implicit items valued in accordance with a waiver under section 148 of the Act | 11a | |
| Required minimum margin for general insurance business | 12 | |
| Excess (deficiency) of available assets over the required minimum margin (11 + 11a - 12) | 13 | |

LONG TERM INSURANCE BUSINESS

| | | |
|---|----------|-------|
| Long term insurance business admissible assets | 21 1,132 | 1,007 |
| Other than long-term insurance business assets allocated towards long term insurance business required minimum margin | 22 | |
| Total mathematical reserves (after distribution of surplus) | 23 989 | 904 |
| Other insurance and non-insurance liabilities | 24 | |
| Available assets for long term insurance business required minimum margin (21 + 22 - 23 - 24) | 25 143 | 103 |

Implicit items valued in accordance with a waiver under section 148 of the Act

| | | |
|--|--------|-----|
| Future Profits | 31 | |
| Zillmerising | 32 | |
| Hidden Reserves | 33 | |
| Total of available assets and implicit items (25 + 31 + 32 + 33) | 34 143 | 103 |

Required minimum margin

| | | |
|---|--------|----|
| Required minimum margin for long term insurance business | 41 42 | 39 |
| Explicit required minimum margin (1/6 x Line 41) | 42 7 | 6 |
| Excess (deficiency) of available assets over explicit required minimum margin (25 - 42) | 43 136 | 97 |
| Excess (deficiency) of available assets and implicit items over the required minimum margin (34 - 41) | 44 101 | 64 |

CONTINGENT LIABILITIES

| | | |
|---|----|--|
| Quantifiable contingent liabilities in respect of other than long term insurance business | 51 | |
| Quantifiable contingent liabilities in respect of long term insurance business | 52 | |

FSC 2 – Form 9A**Returns under the Friendly Societies Prudential Rules****Descriptive Section****Bus Employees Friendly Society**Register Number: **143298**

The date to which the investigation relates is:

31 December 2017

The date to which the latest previous investigation relates is:

31 December 2015

1. The Society is normally required to submit a Form FSC 2 every 3 years. However the Rules of the Prudential Regulation Authority ("PRA") changed in 2016 in respect of friendly societies similar to the Society. As part of the transitional provisions the 3 year valuation cycles for all such societies were synchronised with an FSC 2 required as at 31 December 2017 and every 3 years thereafter. It is for this reason that the previous valuation was 2 years prior to the current valuation.

2. Data supplied

For the purposes of the valuation I was supplied with:

- a. A spreadsheet extracted from the Society's database containing membership information as at 31 December 2017 and information from the Society on changes in membership in 2016 and 2017.
 - b. A schedule of investments produced by the Society's investment managers.
 - c. The Society's accounts for 2017 which I understand have been subject to audit.
3. I have relied on the accuracy of the data supplied to me.

Benefits

4. The benefits and contributions under the Society's tables are as follows:

Sickness

- a. Sickness policies provide a sickness benefit at the rate of £21 per week for the first 39 weeks of sickness, subject to a maximum of £819 in any consecutive period of 12 calendar months. In the event of death, withdrawal after 2 years of membership or retirement, a contribution refund may be payable equal to one-half of the amount by which the total contributions paid to date exceed the total sickness benefits paid throughout membership. The contribution to the Sickness Fund is £0.80 per week of which 12% is transferred to the Management Fund. Most members are covered for both sickness and provident benefits. Each member may have up to 5 units of sickness benefit.

Provident

- b. Provident provides a retirement benefit of £2.50 for each complete month of membership since 1 January 1992 together with £1.25 for each complete calendar month of membership between 1 January 1983 and 31 December 1991, and £2.10 for each complete year of membership up to 31 December 1982. The benefit will be reduced in the event of retirement prior to age 60. In the event of the death of the member before retirement, a lump sum of £1,000 is payable provided membership has exceeded 20 years (reduced benefits are payable for shorter periods of membership). A benefit of £500 is payable in the event of the death of a spouse of a member after 20 years of membership (otherwise, £350 is payable). In the event of withdrawal after 2 years of membership, a refund is payable equal to one-half of the total contributions paid to date. The contribution to the Provident Fund is £0.20 per week, of which 6% is transferred to the Management Fund. The Provident Fund was closed to new business on 31 December 2012. Most members are covered for both sickness and provident benefits.

Retirement Savings Plan

- c. The Retirement Savings Plan makes a tax-free capital payment on retirement at age 68. Members and their partners can each hold a maximum of 6 units at £0.75 per unit per week. A policy fee of £0.25 is applicable on the first unit taken out by the member. An illustration of the guaranteed sums repaid at retirement is that for age 40 at membership the benefit per unit is £1750, age 50 the benefit at retirement is £1000 per unit, age 55 the benefit at retirement is £700 per unit and age 58 the benefit at retirement is £550 per unit. In the event of death during the first two years' membership, a refund of 75% of contributions shall be made and thereafter return of total contributions paid to date or the surrender value whichever is higher, will be made. The plan was closed to new business in 2017. At the valuation date 5 members had taken out a Retirement Savings Plan.

Membership

5. Changes in the membership of the Society in 2016-2017 are shown below.

| | 2016 | 2017 | 2016-2017 |
|-------------------------|-------------|-------------|------------------|
| In-force at 1 January | 354 | 334 | 354 |
| New entrants | 15 | 24 | 40 |
| Deaths | 0 | 0 | 0 |
| Retirements | (10) | (13) | (23) |
| Other exits | (26) | (37) | (63) |
| In-force at 31 December | 334 | 308 | 308 |

Assets and investment returns

6. The investments of the Society at 31 December were as follows:

| | 2017 | | 2015 | |
|--------------------------------------|--------------|-------------|--------------|-------------|
| | £000 | | £000 | |
| Gifts | 180 | 16% | 76 | 7% |
| Corporate bonds | 254 | 22% | 419 | 38% |
| Equities and equity type investments | 702 | 62% | 583 | 53% |
| Net cash and other assets | 2 | 0% | 20 | 2% |
| Total | 1,138 | 100% | 1,098 | 100% |

7. The management of the Society's bond and equity investments is outsourced to an investment management firm whose performance and asset allocation are monitored by the Committee of Management of the Society.
8. The investment returns in the period 2016-2017 were as follows:

| | 2017 | 2016 |
|--|-------------|--------------|
| | £000 | £000 |
| Investment income | 49 | 49 |
| Net realised investment gains in the year | 29 | 39 |
| Net unrealised gains on equities and bonds in the year | 19 | 32 |
| Total investment income and gains | 97 | 119 |
| Investments at 1 January | 1,135 | 1,098 |
| Investments at 31 December | 1,138 | 1,135 |
| Total investment return for the year | 8.9% | 11.3% |

9. Comments on the asset allocation and investment returns are made in paragraphs 34, 35 and 36.

Sickness experience

10. Given the small number of members the sickness experience of the Society can be subject to considerable random variations and can be expected to vary significantly from year to year. Expected claims are based on the valuation assumptions at 31 December 2017 (see paragraphs 16 and 23).

| | Actual claims | Expected claims | Actual/Expected |
|--------------|---------------|-----------------|-----------------|
| | £000 | £000 | |
| 2016 | 19 | 35 | 56% |
| 2017 | 26 | 34 | 77% |
| Total | 45 | 69 | 66% |

Mortality experience

11. As with the sickness experience, the small number members means that the mortality experience of the Society is subject to random variations and can be expected to vary from year to year. During the period 2016-2017 there were no member deaths compared with 4 expected member deaths on the valuation basis (paragraph 23).

Expenses

12. Management expenses in 2017 were £82,023 and in 2016 they were £77,925.

Valuation methodology

Summary

13. The valuation is on a prospective method using a proportion of gross premiums. Negative values are eliminated. No specific allowance has been made for future benefit improvements.

Valuation interest rate

14. Cash flow projections on the valuation basis indicate that no reinvestment of future income will be made and the valuation interest rate reflects the yield on assets backing the liabilities of the Society at 31 December 2017.

Mortality

15. Mortality is assumed to be a percentage of the A67/70 ultimate tables

Sickness

16. Sickness claims are assumed to follow a table of age-related rates, samples of which are shown in paragraph 23. The claims rates are broadly equivalent to 200% of sickness on the MU AHJ sickness table.

Expenses

17. Taking into account the expected management expenditure during the 2017 and deducting the proportion of gross premiums taken as expense margins, an explicit additional expense reserve was calculated. In arriving at the additional expense reserve 3 scenarios were considered. In all 3 scenarios it was assumed that the Society would close to new business 12 months after the valuation date. The 3 scenarios were:
- a. the Society runs off its existing business.
 - b. the Society puts in hand a scheme to wind up its business and 3 years after the valuation date it dissolves.
 - c. the Society transfers its engagements to another friendly society.
18. The most onerous additional reserve was on basis (a), i.e. that the Society closes to new business and runs off its existing business. It was assumed that as a closed fund it would be possible to manage expenses (excluding investment management costs) from current levels such that they are £85,000 in 2018, £75,000 in 2019, £65,000 in 2020 and £55,000 in 2021. Thereafter the allowance for expenses was £80 p.a. per policy inflating at 3% per annum (by this stage it is likely that the Society would be outsourcing the bulk of its administration to a third party administrator).

Resilience

19. A resilience reserve has been established by considering the effect of a fall in equity values of 10% combined with either a fall or alternatively a rise, in interest rates of 0.328%. The scenario which required the higher reserve was a fall in equities of 10% combined with a rise in interest rates of 0.328%.

Other issues

20. The value of equities shown in the Society's accounts was reduced by £5,454 to allow for 6 equities whose market value was in excess of the admissibility limit.
21. No reserve for potential liquidity issues was made on the basis that the Society's investments are in quoted assets which should be readily realisable.
22. The Required Minimum Margin of solvency has been calculated in accordance with PRA Rules.

Valuation assumptions

23. The valuation assumptions used were:

Valuation interest rate: 2.25% p.a.

Mortality: 50% of A67/70

Annual benefit claims rates were:

| Age | Rate of sickness weeks p.a. |
|------------|------------------------------------|
| 20 | 1.26 |
| 25 | 1.46 |
| 30 | 1.60 |
| 35 | 1.74 |
| 40 | 1.90 |
| 45 | 2.24 |
| 50 | 2.94 |
| 55 | 3.50 |
| 60 | 4.34 |
| 65 | 5.74 |

Expenses:

Basic expense loadings were 12% of the premiums for Sickness benefits and 6% of premiums for both Provident benefits and the Retirement Savings Plan.

Additional expenses were calculated as the excess of the following amounts over the basic expense loadings:

| year | Minimum total expenses £ |
|-----------------------|---|
| 2018 | 85000 |
| 2019 | 75,000 |
| 2020 | 65,000 |
| 2021 | 55,000 |
| 2022 and subsequently | £80 pa per policy subject to inflation at 3% p.a. |

Resilience reserve:

The resilience reserve calculated on the basis described in paragraph 19 was £59,000.

Valuation Result

24. The valuation result was:

| | 31.12.17 £000 | | 31.12.15 £000 | |
|--------------------------------------|------------------|--------------|------------------|--------------|
| Total net assets at market value | 1,138 | | 1,098 | |
| Asset value adjustment | (5) | | (91) | |
| Asset value for the valuation | | 1,132 | | 1,007 |
| Reserves for Sickness benefits | (265) | | (232) | |
| Reserves for Provident benefits | (123) | | (154) | |
| Reserves for Retirement Savings Plan | (10) | | (3) | |
| Resilience reserve | (59) | | (40) | |
| Additional expense reserve | (531) | | (475) | |
| Total liabilities | | (989) | | (904) |
| Available assets | | 143 | | 103 |
| Required Minimum Margin | | (42) | | (39) |
| Excess assets | | 101 | | 64 |

25. The following table illustrates how sensitive the above result at 31 December 2017 is to a change in one of the key assumptions:

| | | Excess assets | Change in excess assets |
|---|---|------------------|-------------------------------|
| | | £000 | £000 |
| 1 | central assumptions | 101 | - |
| 2 | valuation interest rate reduced by 0.25% to 2.05% | 89 | (12) |
| 3 | mortality reduces from 50% to 40% of A67/70 | 99 | (2) |
| 4 | sickness rates increase by 10% | 67 | (34) |
| 5 | additional expense assumptions increase by 10% | 49 | (52) |

26. I emphasise that the above table simply illustrates the effect of a change in one parameter. In practice some of the parameters are likely to be correlated and so the circumstances causing one parameter to change are likely to require another parameter to change meaning that the impact on the solvency of the Society is in practice, likely to be more complex than might be implied by the table. For the purposes of the above table it has been assumed that the resilience reserve will be unchanged but in practice in certain scenarios there could be second order effects (positive or negative) on the resilience reserve.

The financial viability of the Society

27. PRA Rules require that in completing Form 9A the Appropriate Actuary makes an assessment of the financial viability of the Society and where the assessment indicates that changes are necessary or desirable, the options open to the Committee of Management along with the advantages and disadvantages of each course of action and the likely consequences of taking no action.

Financial position

28. The valuation result in paragraph 24 shows the Society to be in surplus at 31 December 2017 using the methodology and assumptions described in this report. However, the result of the valuation is sensitive to the assumptions adopted. The key assumptions concern the level of future expenses and the rates of future claims. Additionally, the investment returns achieved on the Society's assets are central to its future financial position. These factors are discussed in the following paragraphs.

Expenses

29. The Society has a very high ratio of expenses to its premium income. The decline in the number of members of the Society means that fixed administrative expenses are spread over fewer policies with the consequence that the ratio of expenses to premium income worsens.
30. If the Society is able to increase the amount of new business that it writes in a cost-effective way then this will assist in terms of reducing the share of total expenses required to be met by each policy. I am aware that as a result of a new business initiative, in the first 6 months of 2018 the Society has substantially increased the volume of new business being written.
31. In my opinion, maintaining increased levels of new business in a sustainable way which does not damage the interests of existing members could be difficult and the Society needs to consider what actions it would take if new business falters.

Sickness claims

32. The sickness experience of the Society can be expected to vary from year-to-year simply because of statistical variations which are inevitable given the small volume of business in force. However, the rise in sickness claims in 2017 compared to the previous year should be of concern to the Committee of Management.
33. In my opinion it is important that the Committee of Management monitors closely emerging trends in sickness claims and identifies any issues which may be causing a systematic increase in these claims. If this is not done the risk is that the financial position of the Society may deteriorate by more than would be the case if issues were identified early and actions were taken.

Investment policy

34. The Society invests a high proportion of its assets in equities. In recent years this has produced good investment returns for the Society but this asset allocation strategy has risks to solvency in the short term. A downturn in equity markets relative to the position at 31 December 2017 would erode the excess assets of the Society and in more extreme but plausible scenarios the solvency of the Society would be at risk.
35. If the Society were obliged to take actions to restore its solvency in the short term this might require asset sales and switching from equity investments to fixed interest bonds. The risk to members is that taking such actions quickly is unlikely to be in their best interests.
36. I appreciate that the current investment consensus is that fixed interest bonds are likely to offer low returns in the medium term and consequently increasing the proportion of assets in bonds is likely to be damaging. However, my view is that if the Committee of

Management of the Society decides to continue with a strategy of a high proportion of assets being invested in equities then it needs to increase the excess assets of the Society so that they are available to absorb short-term falls in the market value of equities. This implies bringing the expenses of the Society down as I discuss above.

The regulatory environment

37. For a small friendly society with limited senior management resources ensuring that regulatory requirements are fully complied with can be challenging. However, it is essential that the Society devotes sufficient resources to ensure that it is fully compliant and meets the demands of the Regulators, in particular in relation to ensuring that the culture of the organisation is appropriate.
38. The Committee of Management will be aware of the changing regulatory climate and changes to be introduced in the near future, putting even greater emphasis on the personal responsibility of chief executives and directors.
39. Notwithstanding my comments on reducing expenses my opinion is that regulatory compliance is a priority for the Society. In my opinion if priority is not given to this matter the risk of regulatory action against the Society and individuals is increased.

Summary

40. In previous reports to the Committee of Management I have recommended that the Committee of Management should carefully consider its options and how it can act in the best interests of the Society's members. The increase in new business in the 6 months following the valuation will reduce the ratio of expenses to premiums and provided new business is written in a sustainable and cost effective way that does not damage existing members, it is to be welcomed.
41. However, I think that the Society needs to have in place plans on what actions it will take in the event that new business falters or if the current new business initiative alone does not lead to the prospect of a viable business model. These plans should include consideration of the scenarios in paragraph 17 i.e. closure to new business and run off, transfer of engagements or winding up the Society.
42. The advantage of this approach is that if necessary the Committee of Management will be able to act in a measured way which is likely to be in the best interests of members.
43. If no action is taken by the Committee of Management to develop contingency plans for adverse scenarios, the risk is that in some situations more rapid and expensive actions become necessary and more regulatory involvement is required. This is unlikely to produce a better outcome for members than acting in a planned way.

N Silby
Appropriate Actuary
June 2018

Returns under the Friendly Societies Prudential Rules
Actuary's Certificate

FSC 2 - FORM 9B

| | |
|--|-------------------------|
| Name of Society: Bus Employees Friendly Society | Reg no 143298 |
| Period ended 31 December | 2017 |

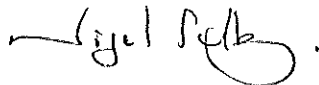
I certify that:

- (a) (i) in my opinion, proper records have been kept by the society adequate for the purpose of the valuation of the liabilities of its insurance business;
- (ii) the contents of the synopsis in Form 9A correctly reflect the results of my investigation into the financial condition of the society in respect of its insurance business;
- (iii) no matters, except as described in Form 9A, have come to my attention during the course of my investigation which in my opinion prejudice the financial viability of the society or the reasonable expectations of its members;
- (iv) I have had regard to the following standards and guidance adopted or issued by the Board of Actuarial Standards and, in so far as they are relevant to my investigation for the purposes of this certificate, I have complied with them.

TAS100 Principles for Technical Actuarial Work, TAS200 Insurance

- (b) the amount of the required minimum margin of solvency applicable to the society's insurance business immediately following the end of the period of the investigation (including any amounts resulting from an increase in liabilities arising from a distribution of surplus as a result of the investigation into the financial condition of the insurance business) is £42,428
- (c) I have no additional comments to make.

Signature



Date 29.6.18.

Name **Nigel Silby**

Address **Old Bank House**
59 High Street
Odiham
Hampshire
RG29 1LF

Qualification **FIA**

Name of Society: Bus Employees Friendly Society

Period ended 31 December 2017 ^{Reg no} 143298

Signatures to the Return

We certify that the information in this Return complies with Friendly Society - Reporting in the PRA Rulebook.

We confirm also that the society consents to a copy of this Return being placed on the public file of the society.

Chief Executive



Name (Block Capitals)

ROBERT HODGKISS

Date

28/6/2018

Secretary



Name (Block Capitals)

ROBERT HODGKISS

Date

28/6/2018

Member of Committee



Name (Block Capitals)

GRAHAM TURNER

Date

28/6/18

Additional Committee member (if the offices of the Chief Executive and Secretary are held by the same person)



Name (Block Capitals)

CHRISTOPHER J SULLIVAN

Date

28th JUNE 2018