

Explanatory Guide for Members

Conversion of Hearts of Oak Friendly
Society Limited into an Insurance Company
and subsequent transfer of business to
Reliance Mutual Insurance Society Limited

1st June 2007

1. Introduction

This guide gives members of Hearts of Oak Friendly Society (*HOFS*) an overview of the proposed conversion of HOFS from a friendly society to a company registered under the Companies Acts (the *Conversion*) and the subsequent proposed transfer of HOFS' business to Reliance Mutual Insurance Society (*RMIS*) (the *Scheme*). We aim to carry out the conversion and transfer of the business in order to safeguard the long term interests of policyholders. In implementing the Scheme, we are proposing to undertake a restructuring of with-profits policyholder's benefits (the *Benefits Restructuring*).

In this guide we outline the key features of the Conversion, the Benefits Restructuring and the Scheme. This guide also contains a summary of the report by an independent expert – a person approved by the Financial Services Authority (*FSA*) to prepare a report on the terms of the Scheme. The independent expert has considered how policyholder's interests may be affected by the Scheme.

Please take time to read this guide as it is important that you understand how the changes may affect you.

2. Background to the Transfer Proposals

HOFS' members were notified in June 2006 that "As part of the continuing review of options, the Board of Directors has recently agreed to investigate the possibility of a transfer of the Society's engagements to another party. This course of action is being undertaken with a view to further protecting members' long-term financial interests."

The Board has continued to explore the possibility of transferring its engagements to another friendly society or mutual insurer and on 12 February 2007 the Board agreed, subject to FSA confirmation and Delegate Board approval, to transfer its business and engagements to Reliance Mutual Insurance Society during the course of 2007.

3. The proposed transferee, RMIS

RMIS was originally formed as a friendly society in 1911 and converted to a mutual insurance company in 1951. In 2001 RMIS started implementing a twin track strategy of selling niche products through intermediaries, and acquiring closed books of life insurance business.

Following the acquisition of HOFS, RMIS will be managing assets of £1.6bn on behalf of over 300,000 policy holders. This will be the sixth RMIS acquisition since 2003, through which RMIS has developed a track record for effective transfers of

business and the provision of a consistently good level of service to all policyholders thereafter.

At 31 December 2006, RMIS had free assets of £74 million. This will provide HOFS policyholders with greatly enhanced financial security.

4. The Transfer Proposals in Outline

➤ Removal of risk

The main benefit of the transfer proposals is to remove from the with-profits policies the risk of the increasing per policy costs of administration as the closed book runs off over the long term and significantly reduce the risk of increasing improvements in annuitant longevity.

➤ A separate with-profits subfund

The transfer proposals require the setting up of a separate subfund within Reliance Mutual which will accept all of the with-profits business of HOFS with the exception of unitised with-profits (UWP) policies. All of the other business of HOFS (unit-linked policies, non-profit policies and annuities in payment, along with the UWP business) will be transferred to the main RMIS fund where their guaranteed benefits will be maintained in full.

➤ One-time payment to the with-profits subfund

In return for giving up the future profits which might be expected to emerge from the business transferred to the main RMIS fund the new subfund will receive a one-time payment. This payment will go a long way towards ensuring that the minimum margin of solvency required to support the with-profits subfund can be maintained. As you know, for some years HOFS has not been able, standing on its own, to generate sufficient assets to cover the required minimum margin of solvency.

➤ Benefits restructuring

As we have been working on this transfer, it has become apparent to both the HOFS Board and to the RMIS Board that the payment to the subfund will still not be sufficient to ensure with reasonable certainty that the minimum margin of solvency required for the business in the subfund can be maintained into the future. The transfer proposals therefore include a restructuring of HOFS' with-profits policyholder's benefits.

5. What is a Benefits Restructuring?

The High Court will be asked to approve a Scheme which involves, for conventional with-profits policies only, a reduction of 12.5% in guaranteed benefits. These guaranteed benefits are the initial guaranteed sum assured and the attaching guaranteed reversionary bonuses which were last added to policies at the end of 2000. For life policies, this is subject to the reduction not being more than the attaching reversionary bonuses.

RMIS has indicated that, if the Court approves, it would introduce a special non-guaranteed terminal bonus which initially would be at the level of the reduction in guaranteed benefits. Hence **with-profits policyholders whose policies became claims immediately after the transfer would receive the same payout as they would have received before the transfer.**

The Benefits Restructuring is designed in such a way as to reduce the required reserves without reducing policyholder benefits. The restructuring is to be achieved by replacing a portion of guaranteed benefits on conventional with-profits policies with a non-guaranteed special bonus. Non-guaranteed bonuses do not have to be reserved for. Future bonus declarations will of course depend on future fund performance.

6. Conversion from a Friendly Society to an Insurance Company

The Benefits Restructuring, which has become an integral part of the transfer proposals, cannot be undertaken using the procedure for a transfer of engagements under the Friendly Societies Act. It is proposed that the transfer will occur in two stages.

The first stage will be a conversion of HOFS into a new insurance company, to be called *Hearts of Oak Insurance Company Limited (HOIC)*. This will be a mere change of form and will make no material change to the assets and liabilities of the Society or the rights of its members, except that we will extend voting rights to all our members – at the moment members are represented Delegates, who are the only members entitled to vote – although members will not be asked to vote on the conversion or the restructuring. In addition, certain minor discretionary and non-discretionary benefits previously available to members under the HOFS' Rules will be withdrawn. These Rules are:

Rule 3(4)

The Board of Directors, in its absolute discretion, may provide for non-contractual benefits for the purposes of assistance to Members in need of medical convalescence or for the relief of distress generally.

Rule 3(5)

Every Member is entitled to legal advice and assistance in dealing with personal injury claims, sustained by him, his spouse or his dependent children as a result of an accident in Great Britain, Northern Ireland, the Isle of Man or the Channel Islands involving the possible liability of third parties.

HOFS is not able to continue offering these benefits as a mutual insurance company. However, withdrawing these benefits should have no significant impact. The HOFS Board is not aware of any claims being made in the last 10 years in respect of Rule 3(4). The benefits offered under Rule 3(5) involve the payment of a fixed retainer of under £10,000 per annum to a law firm to cover any such requests for legal advice and assistance.

The second stage will involve the transfer of the business from the new company under the Court approved Scheme pursuant to Part VII of the Financial Services and Markets Act 2000. This Scheme will also bring into effect the proposed Benefits Restructuring.

An explanation of the main features of the Conversion is contained in a separate document entitled “Statement of Proposed Conversion” which is in the format prescribed by the FSA under Schedule 15 to the Friendly Societies Act 1992 and is available to view on the HOFS website (www.heartsofoak.co.uk). Further details on the terms of the Scheme and the Benefits Restructuring can also be found on the HOFS website.

7. Action you can take

Members and policyholders are not being asked to participate in a vote on the proposals. However, we value your feedback.

After you have read through this guide, if you are happy with the proposals then you do not need to do anything.

However, if you do have any comments or objections in relation to the proposals, you have a right to be heard and you can make these comments or raise these objections in the following ways:

- **By writing to the Delegates**

If you have comments **on any part of the process**, you may write to the Delegates with these comments via the HOFS Leicester office. Please address your letter to the Secretary. Under the HOFS Rules, Delegates (as representatives of the members of HOFS) have the right to vote to approve the Conversion and have been asked to attend a Special General Meeting on **19 June 2007**. The Delegates will consider your comments at the Special General Meeting. If you do wish to write to the Delegates, you should do so by **18 June 2007** by writing to:

The Secretary
Hearts of Oak Friendly Society Limited
9 Princess Road West
Leicester LE1 6TH

➤ **By contacting the FSA**

If you believe that you would be adversely affected by the **Conversion**, you are entitled to put your objections to the FSA. Written or oral representations may be made to the FSA which will conduct a hearing for oral representations, if there are any. The FSA may be contacted at:

The Financial Services Authority
25 The North Colonnade
Canary Wharf
London E14 5HS
Switchboard 020 7066 1000
Contact: Richard Martin, Regulatory Transactions Division

The closing date for making written representations to the FSA at the above address or giving notice of an intention to make oral representations is **13 June 2007**. The intended date of the hearing is **21 June 2007**.

➤ **By attending the Court**

If you believe that you would be adversely affected by the carrying out of the Scheme (which covers the transfer proposals and the Benefits Restructuring) you are entitled to be heard (in person or by legal representative) by the High Court at the court hearing.

If you intend to appear at the hearing to object to the Scheme, we request that you write to HOFS' solicitors as soon as possible: Field Fisher Waterhouse LLP, 35 Vine Street, London EC3N 2AA, quoting the reference "NPT1" in your letter. It would be helpful if you could set out the nature of your objections in your letter.

Please also write to HOFS' solicitors, Field Fisher Waterhouse LLP, 35 Vine Street, London EC3N 2AA, if you wish to object to the Scheme but do not intend to appear at

the court hearing, again setting out the nature of your objections. Please quote the “NPT2” in any correspondence.

We will ensure that a record of all objections is put before the Court.

If you feel that you need more information, please see section 9 below.

8. The legal process

The Conversion

We have already made a provisional application to the FSA to confirm the proposed Conversion. We have also published details of the application in the London, Edinburgh and Belfast Gazettes, in the Daily Mail and Times newspapers, and on our website. This enables any interested parties to make any representations to the FSA concerning the process.

Under the Rules governing HOFS, the Delegate Board (in its capacity as representative of the members of HOFS) votes whether to approve the Conversion. A Special General Meeting will be held at which the HOFS Delegate Board will vote on this matter. Any communications from members will be passed to the Delegate Board for consideration at the Special General Meeting.

Any person who believes that they would be adversely affected by the Conversion is entitled to put their objections to the FSA. Written or oral representations may be made to the FSA which will conduct a hearing for oral representations, if there are any. It will then confirm or reject the Conversion. The FSA’s contact details and the deadline for making representations are set out in the previous section 7.

If the FSA approves the Conversion, HOFS then applies to the Registrar of Companies for registration as a limited company and then it can continue with the implementation of the Scheme.

The Scheme and Benefits Restructuring

To implement the Scheme (which provides also for the Benefit Restructuring), the Scheme must be approved by the High Court. We have made an application to the High Court in respect of the Scheme.

The court hearing for approval of the Scheme will take place on **26 July 2007** at The Royal Courts of Justice, The Strand, London WC2A 2LL. With the Court’s permission, we do not propose to send any further information (other than this guide) to members and policyholders about the Scheme.

Any person who believes that he would be adversely affected by the carrying out of the Scheme is entitled to be heard (in person or by legal representative) by the High Court at the court hearing.

An Independent Expert, a senior actuary who has been approved by the FSA, has been jointly appointed by HOFS and RMIS to report on the effects of the Scheme on the policyholders of both HOFS and RMIS. A summary of the Independent Expert's Report is available on our website. The Independent Expert concludes that:

- although it is impossible to say with certainty that the Benefit Restructuring is to the advantage of HOFS policyholders, on balance, the advantages the HOFS policyholders gain outweigh potential disadvantages and it is preferable to the Benefit Restructuring not happening and the HOFS Scheme not proceeding. [He] also believes that the Benefit Restructuring treats the HOFS policyholders fairly.
- the security of guaranteed benefits for the HOFS policyholders (after Benefit Restructuring, where applicable) is enhanced by the HOFS Scheme.
- the security of benefits for the RMIS policyholders, whilst initially reduced in absolute terms, is not materially adversely affected by the HOFS Scheme.
- the fair treatment and reasonable benefit expectations of the transferring HOFS policyholders and the existing RMIS policyholders will not be materially adversely affected by the HOFS Scheme.

If the High Court approves the Scheme, the Scheme will become effective on **31 July 2007**.

9. Further information

Until the High Court hearing to approve the Scheme, anyone can access this guide, the terms of the Scheme and the full Independent Expert's Report, free of charge, from our website **www.heartsofoak.co.uk**.

Alternatively, please call 0116 2549010 between 8am and 8pm Monday to Friday and 9am to 5pm on Saturdays, or write to request copies to:

The Customer Services Manager
Hearts of Oak Friendly Society Limited
9 Princess Road West
Leicester LE1 6TH

If you have any questions about the proposed changes, we hope the “Frequently Asked Questions and Answers” set out in the Appendix to this guide will help. However, if you still have further questions about the proposed changes please call us on the helpline number above or by writing to HOFS’ solicitors: Field Fisher Waterhouse LLP, 35 Vine Street, London EC3N 2AA. Please quote the reference “NPT” in your letter. It would also be helpful if you could set out the nature of your objection to the Scheme (if any) in your letter.

We appreciate that the proposals being put before you are complicated. We have therefore illustrated the main features of the proposals in the diagram below.

Diagram 1 – HOFS’ Restructuring and Transfer Proposals

Conversion

- ▶ HOFS will convert to a company limited by guarantee (HOIC) registered under the Companies Act 1985 using the mechanisms set out in section 91 of the Friendly Societies Act.
- ▶ On Conversion, HOFS will cease to be a friendly society and will be governed under insurance company legislation.
- ▶ Each member of HOFS will become a member of HOIC.
- ▶ HOIC’s internal governance and procedures will be determined by new Memorandum and Articles of Association rather than the existing Rules.
- ▶ However, to ensure continuity it is proposed that the Memorandum and Articles of Association would mirror the HOFS Rules, although there would be no Delegate Board.
- ▶ The Board will remain unchanged.

Court Approved Transfer

- ▶ After Conversion, HOIC and RMIS will apply to the Court to approve the restructuring of benefits and the transfer of HOIC’s business to RMIS.
- ▶ If the transfer is approved, HOFS/HOIC members will become policyholders of RMIS with full membership rights.
- ▶ The with-profits business of HOIC will be allocated to a new sub-fund to be called “WPSF6” within RMIS’ long-term fund. The with-profits policy holders will then accrue profits based on the fortunes of that sub-fund.
- ▶ The non-profit, unit-linked and unitised with-profits business, and existing HOIC annuities in payment, will be allocated to the main RMIS fund.
- ▶ WPSF6 will receive a payment to compensate holders of HOIC’s conventional with-profits policies for the loss of this future income. This payment will further improve the solvency of the sub-fund, allowing RMIS greater future flexibility in the allocation of bonuses to policyholders.

Benefits Restructuring

The sum assured plus attaching reversionary bonuses on most with-profits policies will be reduced on transfer to RMIS by 12.5%, the reduction being matched by a special non-guaranteed bonus so that initially payments on claims are unchanged.

The reduction will be limited as follows:

- ▶ **Life policies** - reduction limited to the removal of attaching reversionary bonuses
- ▶ **Pensions Policies** - reduction to be met firstly by reducing reversionary bonuses and secondly by reducing the basic guaranteed sum assured.
- ▶ **Unitised with profits policies** - no restructuring
- ▶ **With profit annuities in payment** - no restructuring

Appendix

Questions and Answers

Why does HOFS need to convert into an insurance company?

The best way of securing the long term future for HOFS' policyholders is to restructure policyholder's benefits and transfer the business to a strong, independent mutual insurer – RMIS. Benefits can only be restructured with the approval of the Court and the only procedure available to HOFS is under the regime applying to insurance companies. Therefore, HOFS must convert itself to an insurance company in order to fall within the scope of that legislation.

Why is a transfer to RMIS being proposed?

The Transfer is being proposed as the best way of protecting the interests of HOFS' members and policyholders. HOFS has failed to meet its required margin of solvency for some time and has continued to explore the various options for safeguarding the interests of members and policyholders. It has considered continuing as an independent society, outsourcing its administration functions, pursuing a winding up and transferring its engagements to a larger organisation.

The Board takes the view that the interests of members are best served by a transfer of engagements to a larger and stronger organisation and has therefore been seeking a suitable party to whom it could transfer its engagements.

Why are you proposing to restructure with-profits policyholder's benefits?

The Benefits Restructuring is necessary because the current structure of HOFS' with-profits policyholder's benefits imposes liabilities that it will be difficult to maintain without significant financial support from RMIS's main with-profits fund. Under the transfer proposals, in order to be fair to RMIS' other policyholders, RMIS would need to charge for this support.

The valuation at 31 December 2006 indicates that the HOFS with-profits sub fund will have insufficient assets to cover its liabilities and its statutory capital requirements. We estimate that RMIS will need to provide support of the order of £8 million implying an additional charge (at 4%) to WPSF6 of over £300,000 per annum although this annual charge can be expected to reduce over time as the business in the with-profits sub fund becomes claims and the capital requirement reduces with the decline in business in force.

Our financial modelling has shown that this charge would quite quickly lead to the position where non guaranteed bonuses for policies in the with-profits sub fund will be progressively reduced to the point where benefits payable simply become the guaranteed benefits (the terms of the transfer guarantee that no less than guaranteed benefits will be paid on claims for with-profits policies).

A restructuring would reduce the liabilities relating to with-profits policies and thereby eliminate or reduce the support required. This is because under current regulations no explicit statutory reserves need to be held for non-guaranteed bonuses and as such there will be an immediate improvement in the capital position of the with-profits sub fund of about £11 million.

Why have you chosen not to restructure other policyholder's benefits?

The HOFS Board has considered whether there would be any merit in introducing a scheme for benefits restructuring that would apply to the non-profits business but has considered that this would be unfair as the non-profits business would not benefit from reducing the costs of the capital support to WPSF6.

Unitised with-profit business operates in a similar way to non-profit unit-linked business. Under the transfer proposed the unitised with-profit business will be transferred to the RMIS main fund and this fund will recompense the HOFS with-profit policyholders for the surpluses that are expected to emerge from this business. Given that this payment contributes to the WPSF6 capital resources in the same way as the payment in respect of the transfer of non-profit business it was concluded that the unitised with-profit business should be treated in the same way as non-profit business with no benefits restructuring.

A number of with-profit annuities are in payment. Given that payments are currently being made, these policies have been excluded from the benefits restructuring.

The Independent Expert has specifically confirmed that he believes that it is reasonable to limit the benefit restructuring to conventional with-profits policies and to exclude non-profit business, unitised with-profits business, and with-profits annuities.

Has the Board considered any alternative proposals?

The Board has also considered whether any other alternative restructuring schemes might be more favourable to with-profits members, however the other schemes that were considered were seen to be less favourable as they could lead to tax issues or would cause greater inequity between different groups of policyholders.

What is an insurance business transfer scheme?

An insurance business transfer scheme is a legal process by which an insurance company can transfer its obligations to provide insurance under current policies to another insurer. The insurance business transfer scheme transfers all policyholders and claimants at the same time and for our members and policyholders their insurance cover will continue uninterrupted.

What is proposed and what is the purpose of the Scheme?

The purpose is to legally transfer all of the business out of HOIC into RMIS through a Part VII Transfer process in the High Court. The Scheme will include measures to restructure the benefits of with-profits policyholders.

When will the transaction become effective?

Subject to approval by the High Court, the proposed transfer is expected to become effective on 31 July 2007.

What happens if the conversion does not proceed?

A vote against the conversion will prevent our proceeding to the second stage and transferring the HOIC business to RMIS. HOFS will be required to look again at the increasingly limited alternative mechanisms for safeguarding members' benefits which would then be at risk.

What happens if the Scheme does not become effective?

If the Scheme is not sanctioned by the Court, HOIC will continue in its new legal form as a company limited by guarantee under the Companies Acts but the benefits which will accrue from the restructuring of benefits and the transfer of business to RMIS will not apply. This would place HOIC in a difficult financial position.

What will happen to the insurance policies issued by HOFS?

When the Scheme becomes effective, all the existing insurance of HOFS will be transferred to RMIS. RMIS will assume the liabilities under the transferred policies. The policies and ability to claim against those policies will remain the same but set within a financially stronger firm.

As a policyholder do I need to take any action?

No, you only need to take action if you consider that you will be adversely affected by the proposed transfer and restructuring of benefits and wish to object to the transfer and

restructuring of benefits taking place. Sections 7 and 8 of this guide set out how objections can be made.

Will I need to have new policy documents?

If the Scheme becomes effective, you will not need to have new policy documents. All your existing policy documents remain valid as the terms and conditions of your policy will not be changing.

Will this transfer mean that there will be an increase in premiums?

No, if the Scheme becomes effective, this change of insurer will not affect the premium you currently pay.

Can I speak to someone about my queries?

If you have any queries you can ring our dedicated helpline on 0116 2549010.

Will HOFS' members receive a windfall payment on the transfer to RMIS?

HOFS' members will not receive any windfall payment if the Scheme becomes effective.

Will HOFS' members' policies be affected in any way?

If the Scheme becomes effective, the benefits under non-profit policies (being the unit linked business, the annuities in payment and the unitised with-profit policies) will remain the same. For with-profits policies a proportion of previously guaranteed benefits will be replaced by a special non-guaranteed terminal bonus.

In addition, certain minor discretionary and non-discretionary benefits previously available to all members under the HOFS' Rules will be withdrawn. These are the provision of medical assistance to members and the entitlement to obtain legal advice and assistance in dealing with personal injury claims. HOFS is not able to continue offering these benefits as a mutual insurance company.

Can a member increase his/her contribution to their plan or make other changes?

If the Scheme becomes effective, the terms and conditions of the policy remain the same.

When will a member receive their next annual statement from the Society?

HOFS with-profits statements are normally issued on the anniversary of the commencement of the policy. Once the transfer of business is completed with-profits

statements will be issued at the same time every year as other RMIS policies, in early March.

Unit-linked plan holders will receive their annual statement every year shortly after the month in which they originally took out their plan.

Will the correspondence address change?

If the Scheme becomes effective, in due course RMIS will transfer the administration of your policy to its head office in Tunbridge Wells, Kent. However for a period immediately after the transfer date, RMIS will continue to administer the business from the current HOFS office at 9 Princess Road West, Leicester.

When the transfer of administration happens, RMIS will write to you and advise you of the new contact details.

In the meantime if you have any specific queries or concerns regarding your policies you can still phone HOFS on 0116 2549010.

What will it mean being a member of RMIS?

All members of RMIS, including (if the Scheme becomes effective) those transferred from HOFS, will have voting rights and will be able to attend the AGM. With-profits policyholders will continue to be members of a with-profits fund.

Do I have to change my premium payment?

No. If the Scheme becomes effective, all premiums paid by direct debit or standing order will be transferred to Reliance Mutual's bank accounts automatically.

Can I attend the court hearing?

Yes you can. You have a right to attend the court hearing and details of how you do this are contained in sections 7 and 8 of this guide.

Does the Scheme ensure the tax exempt status of my policy?

Yes. Recent proposed changes in the law, which will take effect when the Finance Bill 2007 receives Royal Assent, will ensure that your policy's tax exempt status continues.

Glossary of Terms

<i>Benefits Restructuring</i>	the proposed restructuring of with-profits policyholders' benefits as detailed in section 3 and Appendix 1
<i>FSA</i>	the Financial Services Authority, HOFS' regulatory body
<i>Guaranteed benefits</i>	the aggregate of the sum assured and all allocated bonuses to date, which is guaranteed to be paid when the policy matures or vests, or on a death claim, provided that all premiums have been paid
<i>LIBOR</i>	the interest rate known as three-month sterling LIBOR as determined by the British Bankers Association and published in the Financial Times. This is the most widely used benchmark or reference rate for short term interest rates
<i>Policyholder</i>	the legal owner of the policy
<i>Reversionary bonus</i>	accrued bonuses, which are normally allocated to the policy on an annual basis
<i>RMIS</i>	Reliance Mutual Insurance Society Limited, a company registered in England and Wales (company number: 00491580) whose registered office is at The Great Hall, Mount Pleasant Road, Tunbridge Wells, Kent TN1 1RG
<i>Scheme</i>	the proposals drawn up by HOFS and RMIS and to be sanctioned by the High Court dealing with the transfer of HOFS' business to RMIS
<i>Sum assured</i>	the amount payable on death or maturity on a life policy whichever is earlier and on the normal vesting date of a pension policy, provided that all premiums have been paid
<i>Terminal bonus</i>	a bonus which may be payable in the event of a claim under the relevant policy. The terminal bonus is not guaranteed.
<i>Unitised With-Profits</i>	premiums are invested in "units" of the with-profits fund
<i>With-Profits Policy</i>	policy participating in the profits of the insurer's with-profits fund. Profits are allocated to policies in the form of annual and terminal bonuses
<i>WPSF6</i>	the sub-fund to be established by RMIS within its long term fund to which HOFS' with-profits business will be transferred