

# Supplementary Report on the proposed insurance business transfer from Transfer of The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited to the UK P&I Club N.V.

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## Introduction

1. Section 109 of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012 ('FSMA') requires that a scheme report must accompany an application to the High Court of England and Wales ('the Court') to approve an insurance business transfer scheme.
2. My report (the 'Scheme Report') on the proposed insurance business transfer (the 'Transfer 2') from The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited ('UKE') to UK P&I Club N.V. ('UKNV') entitled Transfer of The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited ('UKE') to the UK P&I Club N.V. ('UKNV') – Scheme Report of the Independent Expert under Part VII Section 109 of the Financial Services and Markets Act 2000 dated 12 August 2020 was submitted in evidence to the Court.
3. The purpose of this document (the 'Supplementary Report') is to briefly document for the Court any developments since the date of the Scheme Report and outline the additional information I have considered to be able to do this. In particular, I have considered whether any of the developments since the Scheme Report have been sufficiently different from my expectations for my conclusions as presented in the Scheme Report to change.
4. The Supplementary Report must be read in conjunction with the Scheme Report in order to be taken in its proper context. It represents an addition to the Scheme Report and does not contain the full background to the Transfer as contained within that document. Therefore, considering the Supplementary Report in isolation may be misleading. All terms used in the Supplementary Report

are as defined in the Scheme Report. In combination with the Scheme Report, it complies with the actuarial guidance and standards set out in sections 1.18 to 1.20 of the Scheme Report. In line with the Scheme Report (section 1.28), the work documented in this Supplementary Report has been peer reviewed by a suitably qualified person (an Actuary within my own firm who has skills in all areas of general insurance actuarial work, including reserving, capital, Solvency II compliance, pricing and transactions) and so complies with Actuarial Standard of Practice X2.

5. I note the reliance and limitations described in Section 1 and Section 8 of the Scheme Report, as these apply equally to the Supplementary Report. In particular, the parties that may have access to this Supplementary Report and those who may place reliance on this Supplementary Report, and the extent to which they may do so, are identical to those described in the Scheme Report.
6. Note that figures within this Supplementary Report have been rounded, and therefore there may be rounding differences within tables.

## Updated information considered

7. I have based my findings in this Supplementary Report on the following information supplied by UKE and UKNV, together with the information used in preparing the Scheme Report:
  - ▶ Audited UKE accounts as at 20 February 2020
  - ▶ Audited UKNV accounts as at 20 February 2020
  - ▶ UKE SFCR and standard formula SCR calculation for year ended 20 February 2020
  - ▶ UKNV SFCR and standard formula SCR calculation for year ended 20 February 2020
  - ▶ UKE reserves report (prepared by UKE) as at 20 February 2020
  - ▶ Summary of the Occupational Disease Reserve Review of the Club as at 11 February 2020
  - ▶ UKE external actuarial reserves report as at 20 February 2020
  - ▶ Internal report entitled: 'Impact of the proposed Part VII transfer of EEA insurance liabilities on UK P&I Club N.V.'
  - ▶ Internal report entitled: 'Impact of the proposed Part VII transfer of EEA insurance liabilities on The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited'
8. My assessment of the information received has been supplemented by discussions with staff from the Club.

## Financial developments since the issue of the Scheme Report

10. The analysis presented in the Scheme Report was based on various data as at 20 February 2019. Subsequent to this analysis, the Club has carried out further claims reserving and capital modelling work for UKE and UKNV based on information up to 20 February 2020. In this section I will describe the main changes from the schedules presented in the Scheme Report to the updated information described above.
11. The expected impact of the Transfer on UKE remaining policyholders, UKE transferring policyholders and UKNV existing policyholders was shown in Section 2.73 to 2.89 in the Scheme Report. Following the developments since 20 February 2019, my opinion on the Transfer is unchanged, because I do not believe there are any material changes to the financial positions of UKE and UKNV.
12. I do not believe that the Covid-19 pandemic has had a significant financial impact on the Club (see Scheme Report paragraphs 2.70 to 2.72). Also, as UKNV is 100% reinsured to UKE, there will be no impact on UKNV due to Covid-19 claims.

### Effect of the Transfer on the Club balance sheet

13. The table below shows indicative balance sheet positions before the Transfer for UKL, UKE, UKNV and the consolidated Club Total (which includes UKB and other Club subsidiaries) using 20 February 2020 as a proxy for the effective Transfer date. The total available capital of the consolidated Club is \$559m, Row [9].

**Table 1: Balance sheets pre-Transfer – UK GAAP basis – 20 February 2020**

|                                  | Balance sheets Pre-Transfer |              |           |              |            |              | The Club*    |
|----------------------------------|-----------------------------|--------------|-----------|--------------|------------|--------------|--------------|
|                                  | UKL                         | UKE          | UKNV      | UKB          | Hydra      | Consol. Adj  |              |
| [1] Financial Investments        | 3                           | 120          | 38        | 1,014        | 131        | 0            | 1,306        |
| [2] Investment in Subsidiaries   | 0                           | 40           | 0         | 15           | 0          | (54)         | 0            |
| [3] RI Tech. Prov. (External)    | 0                           | 142          | 0         | 0            | 1          | 0            | 143          |
| [4] RI Tech. Prov. (Intra-Club)  | 57                          | 742          | 2         | 0            | 0          | (799)        | 2            |
| [5] Receivables and other assets | 1                           | 149          | 0         | 4            | 1          | (73)         | 81           |
| <b>[6] Assets</b>                | <b>61</b>                   | <b>1,192</b> | <b>40</b> | <b>1,033</b> | <b>133</b> | <b>(926)</b> | <b>1,532</b> |
| [7] Technical Provisions         | 57                          | 955          | 2         | 501          | 96         | (654)        | 957          |
| [8] Other creditors              | 0                           | 12           | 0         | 75           | 1          | (73)         | 16           |
| [9] Available capital            | 3                           | 225          | 37        | 457          | 36         | (199)        | 559          |
| <b>[10] Liabilities</b>          | <b>61</b>                   | <b>1,192</b> | <b>40</b> | <b>1,033</b> | <b>133</b> | <b>(926)</b> | <b>1,532</b> |
| [11] Net Technical Provisions    | 0                           | 71           | 0         | 501          | 94         | 145          | 812          |

14. Note, Row [1] shows the amount of financial investments (which for all companies is mostly held in cash and bonds). Row [2] shows the value of the investment in subsidiaries (which for UKE, as parent company, shows the value of investments in UKL, UKNV and other Club subsidiaries). Rows [3] and [4] show the value of the Reinsurance Technical Provision amount, split by external reinsurance and Intra-Club reinsurance. Row [11] shows the Net Technical Provision Amount,

equivalent to 'Gross' (Row [7]), less 'Reinsurance' (Rows [3] and [4]). The column 'Consol. Adj' shows consolidation adjustments for the total Club balance sheet (which includes adjustments for various intra-club reinsurance, debts, and ownership).

15. The main observations to make from the table above are:

- ▶ UKE has Financial Investments of \$120m. The largest component of the assets of UKE is the Intra-Club Reinsurance (\$646m).
- ▶ UKNV has \$2m of gross liabilities at this date (as it had only just started writing business)
- ▶ The Club as a whole has Financial Investments of \$1,306m, and the majority of this is held by UKB (rather than UKE and UKNV).
- ▶ UKB also holds the majority of the Net Technical Provision Amount (\$501m), with only \$71m held by UKE, and zero by UKL and UKNV. This is as I would expect, given the Intra-Club Reinsurance in place, which comprises:
  - ▶ a 90% quota share from UKE to UKB (so that UKB would pay 90% of the amount of any claims paid after the amounts collected from the other external reinsurers) – this QS existed prior the Transfer and this relationship will be maintained post-Transfer.
  - ▶ a 100% quota share from UKNV to UKE (so that UKE pays 100% of the amount of any claims paid by UKNV after amounts collected from other external reinsurers).

### Effect of the Transfer on UKE and UKNV balance sheets

16. The table below shows the balance sheets for UKE and UKNV, both before and after the Transfer (using 20 February 2020 as a proxy for the position at the effective Transfer data).

**Table 2: UKE and UKNV balance sheets – 20 February 2020 - \$ms**

|                                  | UKE          |                    |               | UKNV         |                    |               |
|----------------------------------|--------------|--------------------|---------------|--------------|--------------------|---------------|
|                                  | Pre Transfer | Effect of Transfer | Post Transfer | Pre Transfer | Effect of Transfer | Post Transfer |
| [1] Financial Investments        | 120          | 0                  | 120           | 38           | 5                  | 43            |
| [2] Investment in Subsidiaries   | 40           | 5                  | 45            | 0            | 0                  | 0             |
| [3] RI Tech. Prov. (External)    | 142          | (44)               | 98            | 0            | 44                 | 44            |
| [4] RI Tech. Prov. (Intra-Club)  | 742          | (1)                | 741           | 2            | 141                | 143           |
| [5] Receivables and other assets | 149          | 0                  | 149           | 0            | 12                 | 12            |
| <b>[6] Assets</b>                | <b>1,192</b> | <b>(40)</b>        | <b>1,152</b>  | <b>40</b>    | <b>202</b>         | <b>241</b>    |
| [7] Technical Provisions         | 955          | (45)               | 910           | 2            | 185                | 187           |
| [8] Other creditors              | 12           | 0                  | 12            | 0            | 12                 | 12            |
| [9] Available capital            | 225          | 5                  | 230           | 37           | 5                  | 42            |
| <b>[10] Liabilities</b>          | <b>1,192</b> | <b>(40)</b>        | <b>1,152</b>  | <b>40</b>    | <b>202</b>         | <b>241</b>    |
| [11] Net Technical Provisions    | 71           | 0                  | 71            | 0            | 0                  | 0             |

17. I do not believe that there has been any material change to the balance sheet of UKE and UKNV between 20 February 2019 (as set out in the Scheme Report paragraphs 4.9 to 4.15) and 20 February 2020 that would affect my conclusion on the Transfer.
18. I believe that the overall strength of the UKE and UKNV balance sheets are not materially different to the position set out in the Scheme Report. Therefore, the changes to the balance sheets between 20 February 2019 and 20 February 2020 does not affect my conclusion on the Transfer, as set out in the Scheme Report (paragraph 4.17).

## **Developments since 20 February 2020 and the date of this supplementary report**

### **Change to the balance sheets of UKE and UKNV**

19. I have reviewed updated management accounts for the Club, UKE and UKNV as at 31 August 2020. I am satisfied that there are no material changes to the financial position of the Club since 20 February 2020 (the date at which the latest audited accounts were available). In particular, there have been no material reductions in asset values nor material changes to claims or technical provisions as a result of the uncertainty in the financial markets since the start of the Covid-19 pandemic.

### ***Update on technical provisions analysis***

20. As part of the work I carried out when producing the Scheme Report I received and reviewed reports prepared by both the Club and their Advisors that described the analysis they carried out. I discussed the methodology and key assumptions with them, and also compared the reserves with my wider market benchmarks as stated in Section 5 of the Scheme Report. Based on this, I concluded that the claims reserves are set on a reasonable basis. The methodology and process adopted by the Club to set claims reserves for UKE and UKNV is unchanged since my previous review.
21. There will be no change to the reserving process itself after the Transfer. The same team of actuaries will be performing the analysis, and there will be no changes to the existing claims reserving process.
22. As stated in paragraphs 5.8 and 5.9 of the Scheme Report, the Club commission an external actuarial review of claims reserves, performed by their actuarial advisors on an annual basis. The booked claims reserve of the Club includes a margin for prudence above the Advisor's estimate. As at 20 February 2020 the margin held above the Advisors' best estimate is currently equivalent to the 73rd percentile (based on the Advisors' model) or the 76th percentile when allowing for the Occupational Disease reinsurance. In my experience, this continues to be an appropriate level of margin, in comparison to the peer group of the Club.
23. The actual claims experience between 20 February 2019 and 20 February 2020 has been slightly better than expected, with an overall \$10m improvement for the Club. There was a small deterioration of \$8m on occupational disease claims (due to a change in interest rates which affected the discounted values), but this was offset by better experience on other UKE claims.

### **Occupational Disease future transfer**

24. As set out in paragraph 2.94 of the Scheme Report, the Club intends, at some point in the future, to transfer policies with an element of occupational disease to R&Q, by means of an insurance

business transfer scheme. Based on the Club's reserve review report 72% of the IBNR relates to UKL exposures and 28% relates to UKE. As preparation for this future transfer, the Club entered into a reinsurance contract with R&Q on 27 February 2020, which covers the Club for losses beyond \$95m up to a limit of \$50m. The effect of this new reinsurance contract is not included in the balance sheets shown in this Supplementary Report because the effective date of the reinsurance contract is after 20 February 2020. However, the effect of the new reinsurance contract would be to increase the Reinsurance Asset of UKE by approximately \$6.8m on a discounted basis, with a \$5.6m reduction of assets for the payment of the premium. These developments do not affect my conclusion on the Transfer because:

- a. There have been no changes to the Club's plans (in respect of these policies) since the date of the Scheme Report. In particular, the placement of the reinsurance contract with R&Q was part of the Club's original plan.
- b. The reinsurance contract with R&Q is now in place and provides additional protection to UKE in the event that there is a deterioration in claims experience in respect of the occupational disease claims.
- c. The future insurance business transfer to R&Q would be subject to its own regulatory approval process.

### **UKE Capital Requirements**

25. UKE continues to calculate their capital requirement using a Partial Internal Model (where UKE uses a specific model for the underwriting risk component of the calculation and the Standard Formula for all other components). The table below sets out UKE's forecast Solvency Capital Requirement as at 20 February 2021 before and after the Transfer.

**Table 3: Club Solvency II capital requirements – (The Club and UKE based on Partial Internal Model) - \$Ms**

|                                   | The Club<br>Pre-<br>Transfer<br>[A] | UKE<br>Pre-<br>Transfer<br>[B] | UKE<br>Post-<br>Transfer<br>[C] | Change<br>[D] |
|-----------------------------------|-------------------------------------|--------------------------------|---------------------------------|---------------|
| [1] Insurance Risk                | 144                                 | 11                             | 11                              | 0             |
| [2] Counterparty Default Risk     | 62                                  | 75                             | 75                              | 0             |
| [3] Operational Risk              | 31                                  | 29                             | 29                              | 0             |
| [4] Market Risk                   | 189                                 | 216                            | 215                             | (1)           |
| [5] Diversification               | (97)                                | (52)                           | (52)                            | 0             |
| <b>[6] SCR</b>                    | <b>329</b>                          | <b>279</b>                     | <b>279</b>                      | <b>0</b>      |
| <b>[7] Solvency II Own Funds</b>  | <b>714</b>                          | <b>684</b>                     | <b>684</b>                      | <b>0</b>      |
| <b>[8] Capital Adequacy Ratio</b> | <b>217%</b>                         | <b>245%</b>                    | <b>245%</b>                     | <b>0%</b>     |

26. UKE meets the capital requirement before and after the Transfer and the SCR amount would stay the same. This is because the UKE business transferred to UKNV will be 100% reinsured back into UKE, and there would be no material change to the financial position of UKE.
27. I believe that the coverage ratio for UKE of 245% can be seen as strong. As a sensitivity test to the level of capitalisation I have considered some extreme 'downside' scenarios, and the corresponding effect on the coverage ratio of UKE. The two sensitivity tests I considered are each scenarios which are estimated to occur at a probability level less than 0.5% (i.e., the 1 in 200 level):

- ▶ A 100% increase in the claim reserve amount. This is an extreme downside scenario because the Solvency II basis (calibrated at the 99.5<sup>th</sup> percentile) suggests an increase of approximately 12% (based on the Club's Partial Internal Model).
  - ▶ A fall in the value of investments of 20%. This is an extreme downside scenario because UKE only holds corporate and government bonds and the risk assessment suggests that this scenario would occur with a probability less than 0.5%.
28. In each case the coverage ratio would still be approximately 200%. I believe that this shows that UKE is well capitalised (i.e., that it holds a high amount of capital relative to the risks involved, and there is a high probability that UKE would meet its insurance and other obligations in the future).
29. My conclusion on the financial strength of UKE, as the parent company of the Club, and the chain of security provided to the policyholders of UKNV and UKE is unchanged since my previous review. As at 20 February 2020, the Club (with UKE as parent) meets the regulatory capital requirement.
30. The capital objectives of UKE and the Club remain unchanged since the Scheme Report.

### **UKNV Capital Requirements**

31. UKNV is regulated by the DNB in the Netherlands and falls under the Solvency II regime. UKNV uses a Standard Formula Model for the purpose of the Solvency II capital requirement. The table below sets out UKNV's forecast Solvency Capital Requirement as at 20 February 2021 on both a before and after the Transfer basis. We have used this forecast date as this is more representative of UKNV than 20 February 2020 as it has only recently started writing business.

**Table 4: Club Solvency II capital requirements – (UKNV based on Standard Formula Model) - \$Ms**

|                                   | UKNV                    |                          | Change<br>[E] |
|-----------------------------------|-------------------------|--------------------------|---------------|
|                                   | Pre-<br>Transfer<br>[C] | Post-<br>Transfer<br>[D] |               |
| [1] Insurance Risk                | 19                      | 19                       | 0             |
| [2] Counterparty Default Risk     | 15                      | 19                       | 4             |
| [3] Operational Risk              | 5                       | 5                        | 0             |
| [4] Market Risk                   | 3                       | 4                        | 0             |
| [5] Diversification               | (7)                     | (8)                      | (1)           |
| <b>[6] SCR</b>                    | <b>36</b>               | <b>39</b>                | <b>3</b>      |
| <b>[7] Solvency II Own Funds</b>  | <b>55</b>               | <b>59</b>                | <b>4</b>      |
| <b>[8] Capital Adequacy Ratio</b> | <b>152%</b>             | <b>150%</b>              | <b>-1%</b>    |

32. Based on the Keep Well Agreement between UKE and UKNV, capital injections will be made by the Club (UKB and UKE) to ensure that UKNV's SCR solvency ratio is above 150% when the Transfer takes place. The Club has transferred \$29m from UKB, via UKE to UKNV in November 2020, part of which was to ensure that the SCR solvency ratio would be above the 150% target.
33. The capital objectives of UKNV remain unchanged since the Scheme Report.



## **Other aspects of the Transfer**

### ***Impact of the Covid-19 pandemic***

34. In the Scheme Report I have reviewed an analysis performed by the Club on the impact up to May 2020. This continues to be the most up to date analysis performed by the Club in relation to the impact of the Covid-19 pandemic.
35. To date there has been no impact of Covid-19 on standards of service provided to customers and operational performance of the Club. No complaints have been received regarding operational efficiency or service provided since the Covid-19 lockdown in the UK.
36. At the time of writing this Supplementary Report the pandemic is still ongoing, and its longer-term effects are unknown and uncertain. However, I do not believe that any of the pandemic issues I have identified in the Scheme Report would be made any worse by effecting the Transfer, and therefore this does not affect my conclusion on the Transfer.

### ***Policyholder communication strategy***

37. Planned communication with policyholders is described in paragraphs 7.15 to 7.22 of the Scheme Report and has been carried out as described.
38. I have also been kept informed by the Club of responses to the communications exercise, and I have reviewed the communication logs which record any queries made by policyholders. At the time of writing this Supplementary Report the Club has had no material responses to date (and only four general enquiries from policyholders as at 27 November 2020). In light of that, I am not aware of any objection to the Transfer or anything to affect my conclusions as set out in the Scheme Report.
39. UKE were required by the Court to post notice of the Transfer in the certain newspapers not less than 21 days before the date fixed for the hearing of the petition. This was performed with these notices appearing in:
  - ▶ London, Belfast and Edinburgh Gazettes – 11 September 2020
  - ▶ Financial Times – 8 September 2020
  - ▶ Guardian – 12 September 2020

### ***The Financial Services Compensation Scheme***

40. For the avoidance of doubt, the Club is not aware of UKL and UKE ever having written any Employer's Liability policies or any other policy that would be protected by the Financial Services Compensation Scheme. In the Scheme Report I mentioned in paragraph 2.31 that the liabilities of UKL related to "claims in their capacity as employers" which should have said "claims by policyholders in their capacity of employers". The business we were describing here was all Marine business (as discussed in paragraph 7.35) and would be excluded from FSCS protection.

### ***Financial Ombudsman Service***

41. As discussed in paragraphs 7.40 to 7.44 of the Scheme report, very few policyholders will be impacted due to the following reasons:

- ▶ Most of the Transferring Policyholders are large commercial enterprises with €2m or more annual turnover and/or with more than ten employees, and hence do not qualify for the UK Financial Ombudsman Service.
- ▶ The mutual nature of the Club and the relative bargaining power of its insureds mean that it is more likely to arrive at a negotiated settlement in the event of a complaint. Over the past seven years, there has not been any dispute with UKE which was referred to the UK Financial Ombudsman Service.

42. I also note the following with regard to any complaints or claims relating to any acts or omissions to in respect of the Transferring Business which occur before the Effective Date that UKNV will (to the extent it is permitted to do so by law/regulations) comply with
- (i) the provisions of Dispute Resolution: Complaints Sourcebook (as issued by the FCA) which relate to the complaint handling procedures and;
  - (ii) any judgement, settlement, order or award (or any relevant part thereof) handed down by the FOS.
43. After the Transfer any European micro-enterprise policyholders would lose FOS rights, and there is no equivalent scheme for small businesses in the Netherlands. However, this does not affect my conclusion on the Transfer, as explained in paragraph 7.43 of the Scheme Report.
44. Policyholders have been notified of this through the communication pack, as described in 7.15 of the Scheme Report.

### ***Brexit***

45. Nothing has changed in relation to Brexit which affects my opinion on the Transfer since I wrote the Scheme Report (paragraph 7.8).
46. I note that on the 9 November 2020 that the UK Chancellor announced that the UK will be granting a package of equivalence decisions to the European Economic Area States. This eliminates any residual risk that could have arisen in relation to equivalence not being granted which could have impacted capital requirements and tax positions.

### ***Other issues***

47. I have also conducted a continuous review of the remaining issues discussed in Section 7 of my Scheme Report. There have been no developments that would have any effect on those topics since the date of the Scheme Report and my conclusions on these issues remain unchanged. Therefore, I have not discussed those topics again in this Supplementary Report.
48. There have been some minor changes to the definition of “Transferred Policies” in the Scheme Document. I have reviewed these minor changes and they do not impact my conclusions on the Transfer.
49. I have not identified any other issues in relation to the Transfer since the date of the Scheme Report.

## Overall Conclusion

50. I confirm that I am aware of the requirements of Part 35 of the Civil Procedure Rules and the Protocol for Instruction of Experts to give Evidence in Civil Claims. As required by Part 35 of the Civil Procedure Rules, I hereby confirm that I understand my duty to the Court, I have complied with that duty and I will continue to comply with that duty.
51. I have considered the Transfer and its likely effects on the policyholders that I believe could be affected, or potentially affected, by the Transfer. I have considered each of the different groups of policyholders which I identified in the Scheme Report. In particular, I have considered:
- ▶ The remaining policyholders of UKE;
  - ▶ The transferring policyholders from UKE to UKNV; and
  - ▶ The existing policyholders of UKNV.
52. I have considered the possible effects on the Transfer of developments such as changes in the balance sheet, the capital position, policyholder relations and the political environment that have occurred since the date of the Scheme Report, and my conclusion is unchanged from that stated in the Scheme Report.

Signatory



Alex Lee  
Fellow of the Institute and Faculty of Actuaries  
Associate Partner  
Ernst & Young LLP

27 November 2020