

Supplementary Report on the proposed insurance business transfer from Transfer of The United Kingdom Mutual Steam Ship Assurance Association (London) Limited to The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited

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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 1') from The United Kingdom Mutual Steam Ship Assurance Association (London) Limited ('UKL') to The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited ('UKE') entitled 'Transfer of The United Kingdom Mutual Steam Ship Assurance Association (London) Limited ('UKL') to The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited ('UKE') – Scheme Report of the Independent Expert under Part VII Section 109 of the Financial Services and Markets Act 2000' dated 7 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 UKL and UKE, together with the information used in preparing the Scheme Report:
 - ▶ Audited UKE accounts as at 20 February 2020
 - ▶ UKL Balance Sheet as at 20 February 2020
 - ▶ UKE 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
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

9. 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 UKL and UKE 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.
10. The expected impact of the Transfer on both the UKL transferring policyholders and UKE's existing policyholders was shown in Section 2.72 to 2.81 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 UKL.
11. I do not believe that the Covid-19 pandemic has had a significant financial impact on the Club (see Scheme Report paragraphs 2.69 to 2.71).

Effect of the Transfer on the Club balance sheet

12. 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.

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
[6] Assets	61	1,192	40	1,033	133	(926)	1,532
[7] Technical Provisions	57	955	2	646	96	(799)	957
[8] Other creditors	0	12	0	75	1	(73)	16
[9] Available capital	3	225	37	312	36	(54)	559
[10] Liabilities	61	1,192	40	1,033	133	(926)	1,532
[11] Net Technical Provisions	0	71	0	646	94	0	812

13. 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).

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

- ▶ The size of UKL is very small relative to UKE and the Club, with only \$3m of Financial Investments and \$3m of Available Capital. UKL has zero Net Technical Provisions, given the full reinsurance in place with UKE.
- ▶ UKE has Financial Investments of \$120m. The largest component of the assets of UKE is the Intra-Club Reinsurance (\$646m).
- ▶ The Club as a whole has Financial Investments of \$1,306m, and the majority of this is held by UKB (rather than UKL, 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.

Effect of the Transfer on UKL and UKE balance sheets

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

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

	UKL			UKE		
	Pre Transfer	Effect of Transfer	Post Transfer	Pre Transfer	Effect of Transfer	Post Transfer
[1] Financial Investments	3	0	3	120	0	120
[2] Investment in Subsidiaries	(3)	0	(3)	40	5	45
[3] RI Tech. Prov. (External)	0	0	0	142	(44)	98
[4] RI Tech. Prov. (Intra-Club)	57	(57)	0	742	(1)	741
[5] Receivables and other assets	1	0	1	149	0	149
[6] Assets	58	(57)	1	1,192	(40)	1,152
[7] Technical Provisions	57	(57)	0	955	(45)	910
[8] Other creditors	0	0	0	12	0	12
[9] Available capital	0	(0)	0	225	5	230
[10] Liabilities	58	(57)	1	1,192	(40)	1,152
[11] Net Technical Provisions	0	0	0	71	0	71

16. I do not believe that there has been any material change to the balance sheet of UKL between 20 February 2019 (as set out in the Scheme Report paragraphs 4.7 to 4.9) and 20 February 2020 that would affect my conclusion on the Transfer.
17. I believe that the overall strength of the UKE balance sheet is not materially different to the position set out in the Scheme Report. Therefore, the changes to the balance sheet of UKE between 20 February 2019 and 20 February 2020 does not affect my conclusion on the Transfer, as set out in the Scheme Report (paragraphs 4.10 to 4.12).

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

18. I have reviewed updated management accounts for the Club, UKE and UKL 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

19. 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 UKL and UKE is unchanged since my previous review.
20. 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.

21. 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.
22. 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

23. As set out in paragraph 2.86 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 claims 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 \$6.8mm, with a \$5.6 reduction in 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.

UKL Capital Requirements

24. As set out in paragraph 6.21 of the Scheme Report, UKL is not required to meet Solvency II requirements. As such, UKL is required to meet a capital requirement of \$3m. UKL continues to meet that requirement prior to the Transfer. UKL's capital requirements have not changed since the date of the Scheme Report, therefore this does not affect my opinion on the Transfer.

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). Since the Scheme Report, UKE have calculated their capital requirement as at 20 February 2020. This calculation has been audited.

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

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

* The UKE position post Transfer will be unchanged from the UKE position pre-Transfer.

26. 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., more extreme than 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 99.5th 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%.
27. 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).
28. UKL is 100% reinsured by UKE and is a wholly owned subsidiary of UKE, therefore I believe that the SCR calculation for UKE's post-transfer position would be the same as the pre-transfer position. Therefore, I believe that UKE would continue to meet that capital requirement after the Transfer.
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 UKL and UKE is unchanged since my previous review. As at 20 February 2020, the Club (with UKE as parent) meets the regulatory capital requirement by a large margin with a Capital Adequacy Ratio of 217%.
30. The capital objectives of UKE and the Club remain unchanged since the Scheme Report.

Other aspects of the Transfer

Impact of the Covid-19 pandemic

31. In the Scheme Report I have reviewed an analysis performed by the Club on the impacts up 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.
32. 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.
33. As at 6 November 2020, the Club has incurred approximately \$20m of Covid-19 related claims (mainly relating to Cruise business).
34. There have been no noticeable delays in claims reporting, or noticeable delay or change in the information received for appraising claims, and hence I do not believe there is any impact on the case reserve strength of UKE.
35. 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

36. Planned communication with policyholders is described in paragraphs 7.9 to 7.16 of the Scheme Report and has been carried out as described.
37. 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 three general inquiries 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.
38. 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 (“FSCS”)

39. 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 2.25 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 7.30) and would be excluded from FSCS protection.

Other issues

40. 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.
41. In the Scheme Report I noted in paragraph 2.74 that the UKL policyholders will change from being reinsured by UKE to being direct policyholders of UKE. They will then rank level with existing UKE direct policyholders should UKE become insolvent. I believe that this does not impair the position of the existing UKE direct policyholders as UKE is well capitalised so very unlikely to default and in the event of default the liabilities in relation to the UKL policies are small compared to the liabilities in relation to the existing UKE direct policyholders.
42. I have not identified any other issues in relation to the Transfer since the date of the Scheme Report.

Overall Conclusion

43. 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.
44. 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 transferring policyholders from UKL to UKE; and
 - ▶ The existing policyholders of UKE.
45. 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
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27 November 2020