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

12 August

Building a better working world

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Use of this report

This report has been prepared for, and is addressed to, the High Court of England and Wales for the purpose of the terms agreed in the letter between Ernst & Young LLP and The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited ('UKE'), dated 29 January 2020. This report has been prepared to describe the Transfer of insurance business from UKE to UK P&I Club N.V ("UKNV") which will be effected under Section 109 of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012 (together the 'FSMA').

A copy of this report will be made available to competent regulatory authorities, the High Court of England and Wales, policyholders, and any other person entitled to receive a copy under the FSMA.

I assume no responsibility whatsoever in respect of, or arising out of or in connection with the contents of this report to parties other than those mentioned above. If other parties choose to rely in any way on the content of this report then they do so entirely at their own risk. This report has been prepared solely for the purposes of the FSMA requirements for insurance business transfer schemes and should not be relied upon for any other purposes by any party.

Draft versions of this report and any other interim working papers must not be relied on by any person for any purpose.

Judgements about the conclusions drawn in this report should be made only after considering the report in its entirety as parts read in isolation may be misleading.

The responsibilities of Ernst & Young LLP shall also be limited as stated above.

Signatory

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Fellow of the Institute and Faculty of Actuaries
Associate Partner
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1. Introduction

Purpose of this report

1.1 The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited (‘UKE’) is proposing to transfer part of its insurance and reinsurance business to UK P&I Club N.V. (‘UKNV’) by means of an insurance business transfer scheme (the 'Transfer'). After the Transfer is effected, the relevant policyholders of UKE will become policyholders of UKNV.

1.2 UKE and UKNV are part of the UK P&I Club (‘the Club’) together with three other insurance entities:

- the United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited (‘UKB’);
- the United Kingdom Mutual Steam Ship Assurance Association Limited (‘UKL’); and
- the Club’s cell of Hydra Insurance Company Limited (‘Hydra’).

1.3 The Club, operating under the trading name UK P&I Club, is a mutual marine insurance business managed by Thomas Miller providing Protection & Indemnity cover to its policyholders. The parent company of the Club is UKE.

1.4 The Club is proposing to restructure its business by means of two interdependent insurance business transfer schemes. These consist of:

► The Transfer of UKE policies (including those transferred from UKL) that have insured risks located within the EEA from UKE to UKNV which is considered in this report;

► Together with a preceding interdependent transfer which will occur immediately prior to this Transfer from UKL to UKE which is considered in a separate report I have written 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’).”.

1.5 The Transfer will be effected under Section 109 of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012 (together the 'FSMA'). The High Court of England and Wales (the ‘Court’) must approve such insurance business transfer schemes at a sanctions hearing. The FSMA requires that a scheme report must accompany any application to the Court to approve an insurance business transfer scheme. This scheme report (the ‘Report’) should be produced by a suitably qualified independent person (the 'Independent Expert', ‘IE’) who has been nominated or approved for this purpose by the Prudential Regulatory Authority ('PRA'). The Report should address the likely effects of the insurance business transfer on policyholders.

1.6 This Report has been prepared for, and is addressed to, the Court. The purpose of this Report is to describe the Transfer, and to inform the Court and the affected policyholders of the likely effect of the Transfer. This Report is not suitable for any other purpose. A copy of this Report will be made available to competent regulatory authorities, the Court, policyholders, and any other person entitled to receive a copy under the FSMA. This Report has been prepared solely for the purposes of the FSMA requirements for insurance business transfer schemes and should not be relied upon for any other purposes by any party. Judgements about the conclusions drawn in this Report should be made only after considering the Report in its entirety as parts read in isolation may be misleading.

1.7 The Transfer is intended to be effected on 31 December 2020 (the 'Transfer Date'). This is after the date for the sanctions hearing of the Transfer, which is currently scheduled for 17 December 2020.

1.8 Insurance and reinsurance companies in the UK are authorised to carry out contracts of insurance and reinsurance by the PRA. Insurance and reinsurance companies in the UK are regulated by a combination of the PRA and the Financial Conduct Authority ('FCA'). The PRA and FCA replaced the Financial Services Authority ('FSA') as the regulator of the UK insurance industry on 1 April 2013. In this Report, the term PRA/FCA shall mean the combination of the PRA and the FCA carrying out their roles as the regulator of the UK insurance industry and/or the FSA carrying out its role as the regulator of the UK insurance industry prior to 1 April 2013.

1.9 My Report considers the effect of the Transfer upon:

- All policyholders of the companies involved in the Transfer.
- Any other group of policyholders which I believe could be affected, or potentially affected, by the Transfer.
- Any other interested party which could be affected by the Transfer (for example, reinsurers of the firms involved in the Transfer).

1.10 I will consider various groups of policies. In particular, the following three groups:

- The UKE policies that have insured risk located within the EEA who will transfer to UKNV (the 'Transferring Policies' and the holders of which are the 'Transferring Policyholders'). This group includes UKL policies with an insured risk located within the EEA who will have transferred to UKE as part of the interdependent UKL to UKE transfer.
- The UKE policies that have insured risk not located within the EEA who will remain in UKE (the 'Remaining Policies' and the holders of which are the 'Remaining Policyholders'). This group includes UKL policies with an insured risk not located within the EEA who will have transferred to UKE as part of the interdependent UKL to UKE transfer.
- The existing policies of UKNV (the 'Transferee Policies') at the time of the Transfer.

1.11 My Report contains a description of the Transfer, the methodology I have used to analyse the Transfer, the opinions I have formed and reasons why I have formed those opinions.

1.12 The use of 'I' and 'my' in this Report generally refers to the work done by myself and the team operating under my direct supervision during the course of this review. However, when it is used in reference to an opinion, it is mine and mine alone.

Independent Expert appointment

1.13 The Club has nominated Alex Lee ('I', 'me') of Ernst & Young LLP ('EY') to act as the Independent Expert for this Transfer. This nomination has been approved by the PRA in consultation with the FCA. I have also been nominated and approved for the role of Independent Expert for the interdependent UKL to UKNV transfer. I am a Fellow of the Institute and Faculty of Actuaries and am an associate partner in the Actuarial Services practice of Ernst & Young LLP. I have more than 24 years' experience in general insurance. I have skills in all areas of general insurance actuarial work (including reserving, capital, Solvency II compliance, pricing, and transactions) and have previously worked on a number of other insurance business transfer schemes. Full details of my experience can be found in Appendix C. Ernst & Young LLP is a part of the global network of EY firms.

1.14 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. I confirm that I have made clear which facts and matters referred to in this report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

1.15 I can confirm that I have no direct or indirect connections with UKL, UKE, UKNV or the Club as a whole that I believe would affect my ability to act as the Independent Expert for the Transfer. In particular, I have never worked on any project involving UKL, UKE or UKNV. I have no shareholding, investment or any other financial connection with any of the parties to the Transfer.

1.16 EY have performed some previous work for the parties involved in the Transfer, and related entities, although that work was all prior to 2015. My assessment of the Transfer is not in any way affected by this previous work and so I do not believe that this affects my independence for this engagement. The PRA/FCA were aware of the services that EY have performed for the parties involved in the Transfer when approving my appointment as Independent Expert.

1.17 The costs of producing this report will be borne by UKE.

Professional guidance

1.18 This report complies with the applicable rules on expert evidence and with the guidance for Scheme Reports set out by the PRA in the PRA's Statement of Policy and by the FCA in SUP 18 of the FCA Handbook. I have also taken into account the FCA's guidance on portfolio transfers, 'FG18/4: The FCA's approach to the review of Part VII insurance business transfers', issued in May 2018.

1.19 This report complies with Technical Actuarial Standards TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance as issued by the Financial Reporting Council ('FRC'), which is responsible for setting UK actuarial standards. The review performed on this work complies with Actuarial Profession Standard X2: Review of Actuarial Work issued by the Institute and Faculty of Actuaries. The work complies with Actuarial Profession Standard X3: The Actuary as an Expert in Legal Proceedings issued by the Institute and Faculty of Actuaries.

1.20 I believe that this compliance has been achieved with no major deviations from the guidelines.

Scope of my work

1.21 The scope of my work is detailed in the extract from my terms of reference provided in Appendix B. There are no areas where the actual work performed differs from this agreed scope.

1.22 My report considers the effect of the Transfer upon all policyholders of the companies involved in the Transfer, and any other group of policyholders which I believe could be affected, or potentially affected, by the Transfer. It contains a description of the Transfer, the methodology I have used to analyse the Transfer, the opinions I have formed and reasons why I have formed those opinions.

Use of data and reports

1.23 My view on the insurance liabilities of the companies involved is based upon my review of the actuarial reports and documentation produced by the Club.

1.24 I have not audited nor independently verified the data and information supplied to me. However, I have reviewed it for reasonableness and for internal consistency. I have relied on my own professional judgement to assess the quality of the data and whether it is suitable for the purposes of this review. This judgement is based on my wide experience of carrying out claims reserving work, capital modelling work and other financial analyses for companies similar to those involved in the Transfer. Based on my review I concluded that the data provided to me was reasonable given the purposes of my review. The data was prepared and provided to me in accordance with the working practices I would expect for organisations similar to the Club.

1.25 A summary of the data provided to me can be found in Appendix C.

1.26 I have placed reliance upon the data when carrying out my work. I have not considered potential future claims arising from causes not substantially recognised in the historical data except insofar as such claims (and their impact) are included incidentally in the data. I consider this approach to be reasonable and in line with accepted actuarial practice.

1.27 Monetary amounts shown in this report are shown in millions of US Dollars. I have chosen this currency for convenience, as it is the financial reporting currency of the Club, and the majority of communications to date with regulators and policyholders have been stated in US Dollars. Claim settlement amounts and assets held by the Club's entities will be in a mixture of different currencies, predominantly USD, GBP and EUR. Where applicable I have converted to US Dollars at the rate of $1 USD = £0.75 GBP = €0.85 EUR. These are the exchange rates used for the production of the financial statements of the Club as at 20 February 2019.

Peer review process

1.28 In accordance with the internal control processes of EY, the work documented in this report has been peer reviewed by a suitably qualified person (an Actuary within my own firm who has acted as the Independent Expert in other insurance business transfer schemes). The peer review process has included review of the methodology used and discussion of the key elements of the analysis.

Layout of this report

1.29 My report is structured as follows:

- Section 1: Introduction.
- Section 2: Summary, with a description of the Transfer, my conclusions, and my reasons for reaching those conclusions.
- Section 3: Summary of the approach I have taken.
- Section 4: Assessment of assets and liabilities transferring, including balance sheets of the companies involved in the Transfer.
- Section 5: Assessment of Technical Provisions.
- Section 6: Assessment of Capital Requirements.
- Section 7: Assessment of other issues.
- Section 8: Reliances and limitations.
- Appendix A – Glossary of technical terms.
- Appendix B – Extract from my terms of engagement letter.
- Appendix C – List of data and materials reviewed.
- Appendix D - Checklist against the guidance on scheme reports as set out in the PRA's 'Statement of Policy, the PRA's approach to insurance business transfers – April 2015' ('PRA's Statement of Policy') and Chapter 18 of the Supervision Manual of the FCA Handbook ('SUP18 of the FCA Handbook').

- Appendix E - Curriculum vitae of Alex Lee.

2. Summary

Overview

2.1 Following the decision of the UK to leave the EU, the Club decided to use an alternative model to ensure business continuity, given that there is a risk that the existing model would not be viable after the transitional arrangements. Therefore, the Club has carried out, or is carrying out, the following steps as part of two interdependent insurance business transfer schemes:

- Set up a new company, UKNV, domiciled in the Netherlands. Since 20 August 2019 UKNV has written any new or renewal policies of the Club where an insured risk is located within the EEA.
- Transfer the whole of the insurance business of UKL to UKE ('Transfer 1'). I am the independent expert for Transfer 1 and comment on the details of Transfer 1 within my report 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')*.
- On the day following the UKL to UKE Transfer, transfer the policies of UKE to UKNV (the Transfer or 'Transfer 2'), where an insured risk is located within the EEA. This is the focus of this report.
- De-authorise and wind-up UKL at some point after both Transfer 1 and Transfer 2 have taken place.

2.2 The policies transferring to UKNV are those where the risk location is in the EEA (I will refer to a policy with a risk location in the EEA as an 'EEA Policy' or 'EEA Policies'). The Club only insures ship owners and charterers for risks arising from the operation of ships. The risk location for ships is the place where the ship is registered and for owners and charterers it is the country where the owner or charterer is established.

2.3 In this report we refer to Transfer 1 and Transfer 2 collectively as the 'Transfers'. Transfer 1 is currently planned to be effected on 30 December 2020 and Transfer 2 is planned to be effected on 31 December 2020. The Transfers are interdependent and will only be effected if both Transfers are approved.

In summary:

– Transfer 1: All Policies of UKL will transfer to UKE.

– Transfer 2: On the day after Transfer 1, various policies of UKE (including those transferred from UKL) will transfer to UKNV. The transferring policies are those where the risk insured is located within the EEA and will include any such policies which have transferred from UKL pursuant to Transfer 1. (This is the focus of this report).

– No other policies of UKE and UKNV will transfer.

2.4 This report will exclusively cover the Transfer (i.e. Transfer 2). All affected policyholders should read this report in conjunction with the report covering Transfer 1 to obtain a view of the combined impact of the interdependent Transfers.

2.5 Below I provide a description of the Transfer, the background to the entities involved and my conclusions on how the Transfer affects policyholders and other parties involved in the Transfer.

2.6 As a result of my work, I conclude that there is no reason that the Transfer should not go ahead.

Background

2.7 The UK voted to leave the European Union ('EU') on 23 June 2016 and then notified the European Commission of its intention to withdraw from the EU. The UK ceased to be a member state of the EU on 31 January 2020 ('Brexit'). The UK is currently subject to transitional arrangements which will expire on 31 December 2020 (unless extended by both the UK and EU). The nature of the arrangements after the transitional arrangements are currently unknown and it is not guaranteed that there will be any arrangements after the transitional arrangements have expired.

2.8 The Club currently uses various legislation set out in European law to be able to write and administer insurance policies in the EEA. UKE and UKL, both UK companies, wrote and administered insurance business across the EEA using the passporting mechanism of the EU set out in Solvency II, and implemented in the UK through the Passporting Regulations. This was enabled using a Freedom of Services basis; i.e., writing and administering EEA insurance business directly from UKE and UKL. At the end of the transitional arrangements there is a risk that the Club will lose the right to carry out these activities.

2.9 I believe that it is unlikely that UKE and UKL would be able to continue to use Freedom of Services, in its current form, as a means of writing and servicing insurance business in the EEA.

2.10 UKL ceased writing business in 1971 and all its insurance business is currently reinsured to UKE (a much larger company).

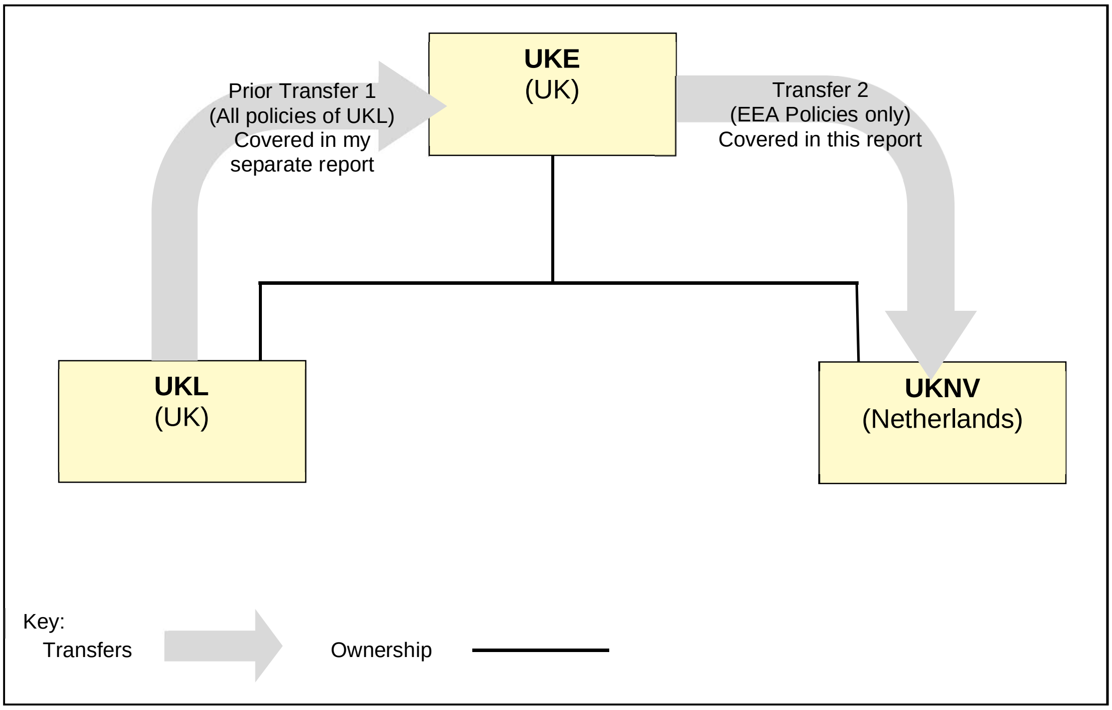
Description of the Transfer

2.11 Transfer various policies of UKE (including those transferred from UKL) to UKNV. The transferring policies are those where the risk insured is located within the EEA. After the Transfer the transferring policies will be administered by UKNV, and UKNV would pay claim amounts. The Transfer is currently planned to be effected on 31 December 2020.

2.12 There will also be a prior interdependent transfer from UKL to UKE where all of UKLs policies will be transferred to UKE. This is currently planned to be effected on the 30 December 2020 and is covered in a separate report.

2.13 The diagram below shows a summary of the Transfers (with ownership denoted by black lines, and the Transfers as grey arrows).

Diagram 2a: The Transfer



Purpose of the Transfer

2.14 The purpose of the Transfer is to enable the EEA policyholders of UKE after Transfer 1 to continue to be serviced post Brexit by moving these policyholders to UKNV.

Entities involved in the Transfer

The Club

2.15 The Club is a mutual insurance business providing cover for marine P&I risks to its members and certain other covers to policyholders. The Club currently issues insurance policies through UKE in the UK, and UKNV in the Netherlands. The terms of insurance cover offered by UKE and UKNV are identical. The Club has also issued policies up to 1971, through UKL in the UK. The Club generally writes cover on an annual basis with policy years commencing and ending on 20 February each year.

2.16 The Club is managed on a day-to-day basis by companies within the Thomas Miller Group ('Thomas Miller'), a professional services group.

Mutual members of the Club

2.17 The Club is organised as a mutual association and does not pay dividends to external shareholders. Instead, the companies of the Club are owned by, and exist for the benefit of, their members. These are (with the exception of certain individual directors) the various current policyholders (i.e. holders of policies for the current policy year) of UKE or UKNV (the 'Club Members'). They are generally ship owners and other entities that have ships insured with the Club in the current policy year. All of the companies of the Club are ultimately owned by the Club Members. As the transfer is purely an internal reorganisation (and no material funds are leaving the mutual society) there is no requirement to have Members vote on the Transfer.

2.18 Club Members pay a mutual premium to the club for their policies. The Club can vary the premium charged to Club Members from one policy year to the next, and this is the mechanism through which the Club Members share in the profits and losses of the Club. There will be no change to the mutual status of any policyholder as a result of the Transfer.

2.19 Club Members might also be required to make an additional premium payment (an ‘Additional Premium Call’) if the Club needs additional funds. If there is a need for additional capital, the Board of UKE, will consider whether an Additional Premium Call is required and, if so, the level at which such call will be made.

Fixed Premium Business

2.20 Both UKE and UKNV also issue policies to policyholders on fixed premium terms. The Club's chartered business is written on this basis. In theory they do have a share in the surplus of the Club which could be reflected within their premium, but in practice it is accepted that it is negligible.

The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited (‘UKE’)

2.21 UKE was incorporated in England as an unlimited company in 1886 as Sunderland Steamship Protecting and Indemnity Association and renamed to The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited in 2007. UKE is authorised by the PRA and regulated by the FCA and the PRA in the UK

2.22 UKE writes P&I business for ship-owners and charterers. The gross premium amount written for the 2019 policy year was $307m. UKE also currently provides 100% reinsurance to both UKL and UKNV.

2.23 UKE has various external reinsurance in place and one material intra-club reinsurance contract; namely, a 90% quota share of all its insurance liabilities with UKB. The intra-club reinsurance applies to the net amount after other external reinsurance.

2.24 Immediately prior to the Transfer the business of UKL will have transferred into UKE (this business is described in 2.31 to 2.33.

UK P&I Club N.V (‘UKNV’)

2.25 UKNV is a company limited by shares incorporated in the Netherlands on 28 November 2018. UKNV is authorised by De Nederlandsche Bank (‘DNB’) in the Netherlands. Its principal activity is to act as a fronting insurer for the Club. These policies are all 100% reinsured to UKE. The planned gross premium income for the 2021 policy year is $92m.

2.26 UKNV also acts as a fronting insurer for two other mutual insurance companies managed by Thomas Miller: ITIC (writing professional indemnity policies for professionals working in the transport industry) and UKWR (writing policies covering war risks for the shipping industry). These policies will not be reinsured to UKE, but instead, 100% reinsured to ITIC and UKWR respectively. The forecast gross premium income from ITIC and UKWR business for the policy year 21 February 2020 to 20 February 2021 is $17m.

2.27 UKNV has various external reinsurance in place (this is identical to UKE's program as UKNV is a beneficiary of the Club’s reinsurance programme). UKNV has one material intra-club reinsurance contract: a 100% quota share of all its insurance liabilities (except for ITIC and UKWR) with UKE. The intra-club reinsurance applies to the net amount after other external reinsurance and covers bad debts and non-payment of other external reinsurance.

The United Kingdom Mutual Steam Ship Assurance Association (Bermuda) Limited (‘UKB’)

2.28 UKB is a reinsurer incorporated in Bermuda and regulated by the Bermuda Monetary Authority (‘BMA’) in Bermuda. UKB is a wholly owned subsidiary of UKE.

2.29 The only policy issued by UKB is the reinsurance contract with UKE (as described below). UKB operates through a branch office in the Isle of Man.

The United Kingdom Mutual Steam Ship Assurance Association (London) Limited ('UKL')

2.30 UKL is an insurance company limited by guarantee incorporated in England in 1876 as The United Kingdom Mutual Steam Ship Assurance Association, which was renamed to The United Kingdom Mutual Steam Ship Assurance Association (London) Limited in 2015. UKL is authorised by the PRA and regulated by the FCA and the PRA in the UK.

2.31 UKL ceased writing new business with effect from 20 February 1971. Prior to that it had written P&I business for ship-owners and charterers. The gross claim liabilities transferring to UKE as part of the UKL Transfer are US$54m. The claims liabilities of UKL primarily relate to occupational disease claims made against its policyholders in their capacity as employers (e.g., exposure to asbestos).

2.32 UKL is 100% reinsured by UKE and is a wholly owned subsidiary of UKE.

2.33 Immediately prior to the Transfer the UKL policies will be transferred to UKE as part of the separate Transfer 1.

Intra-club reinsurance

2.34 As described above, there are various important intra-club reinsurance contracts ('Group Quota Shares') in place. The overall effect of these contracts is that:

- The net claims liability of UKL is zero because there is 100% reinsurance in place with UKE (and 90% of those claims are subsequently reinsured to UKB).
- A very high proportion (overall, 90%) of the net claims liabilities of the Club (after other external reinsurance) are ultimately reinsured to UKB.

2.35 The diagram below shows the group structure, with UKB included. The red dotted lines represent the Group Quota Shares. The Group Quota Shares are currently in place, will remain in place after the Transfer, and will function in the same way.

Figure 1: The Club structure prior to both the UKL to UKE transfer (Transfer 1) and UKE to UKNV transfer (the subject of this report)

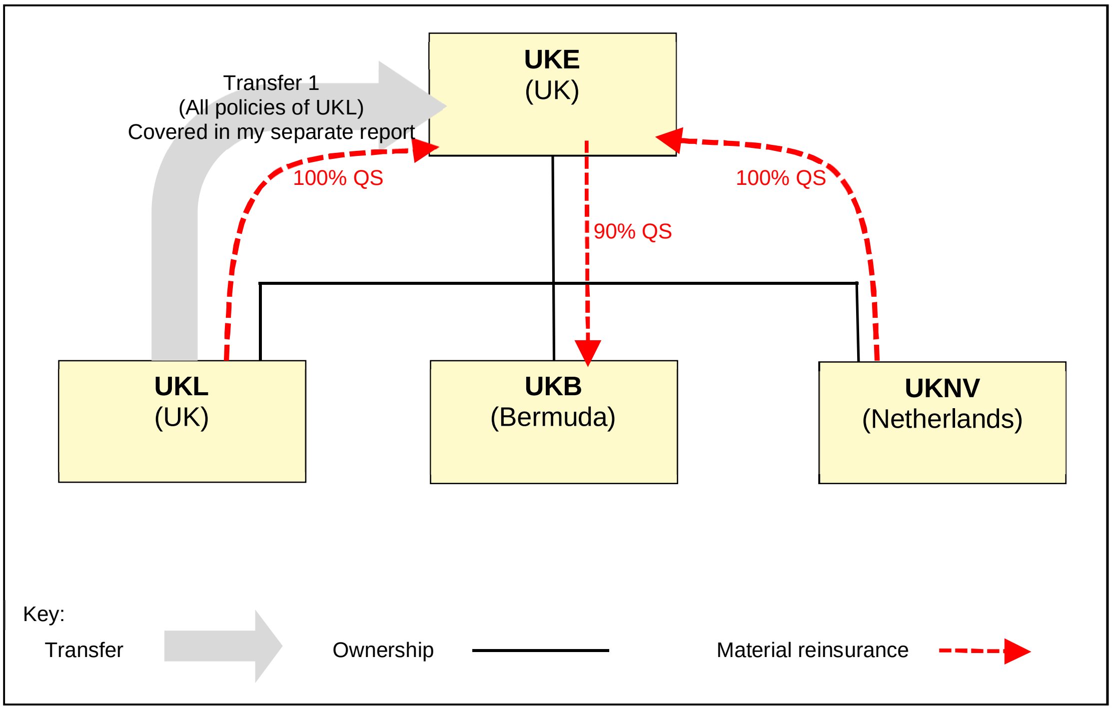
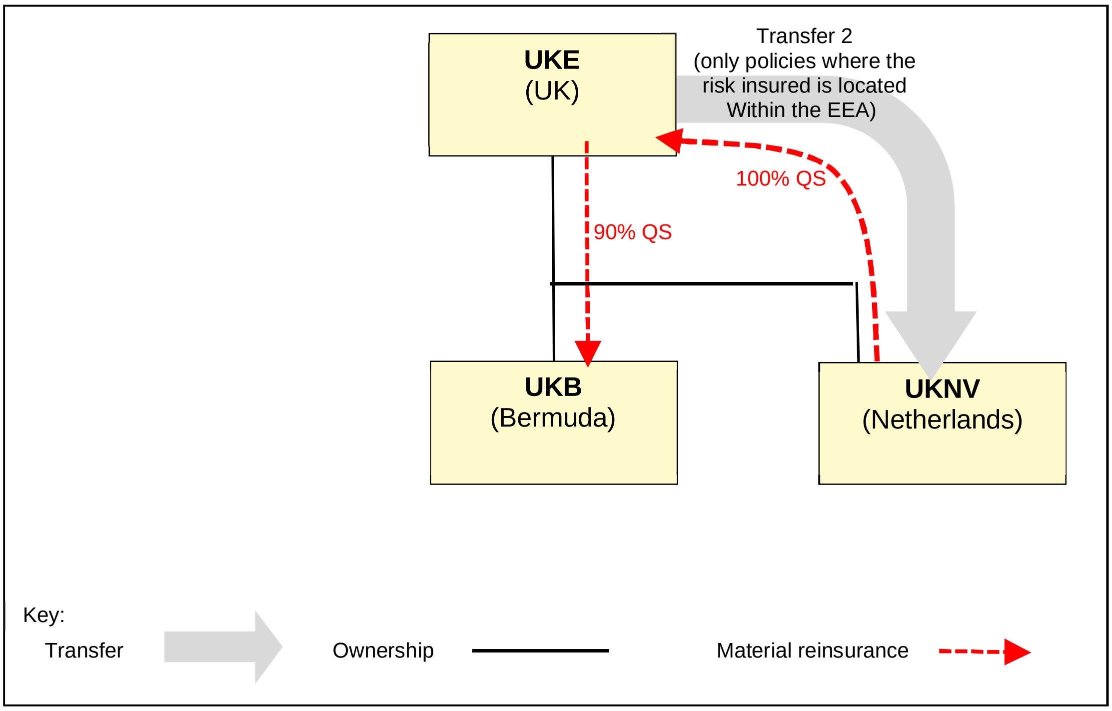


Figure 2: The Club structure post the UKL to UKE transfer (Transfer 1) but prior to the UKE to UKNV transfer which is the subject of this report



The International Group

2.36 The International Group is a group of 13 P&I clubs that collectively provide 90% of P&I cover to the global shipping industry. The members of the International Group have an agreement to share losses in a "pooling" arrangement for claims against owners of ships. If a claim incurred by a particular club is above the club retention for a given year, then the agreement would mean that the excess over this retention would be shared amongst the members of the International Group (including the club against which the original claim was made). The International Group also purchases reinsurance from the external reinsurance market to provide protection to its 13 P&I club members.

2.37 The Club is a member of the International Group and participates in the International Group pool.

2.38 Hydra Insurance Company Limited (‘Hydra’) is a reinsurance captive created by the Members of the International Group in Bermuda. It is a segregated cell company established to provide reinsurance for its members (i.e., a company with a number of cells, each of which acts as an account to reinsure a particular Member of the International Group). The Club’s cell provides reinsurance to the Club, and the funds within that cell cannot be accessed by any of the other members of the International Group, nor can the Club access funds within any other cell. The Club’s cell in Hydra is held by UKB and will continue to be held by UKB after the Transfer (UKB will be jointly and severally liable for the obligations of UKE).

Chain of security for policyholders

2.39 The 'chain of security' is the order in which the assets of the Club can be used to make a claim payment to a policyholder. In forming my conclusions, I have considered the relative strength of each component of this chain of security and considered whether there will be any change after the Transfer. I will first discuss the position pre-Transfer for UKE and UKNV, then the position post-Transfer for each company.

<u>Position pre-Transfer</u>

2.40 From the point of view of the policyholders of UKE and UKNV, the pre-Transfer chain of security has the following five key components:

(i) **Unencumbered assets of UKE and UKNV.** UKE and UKNV hold various liquid assets (mostly cash and bonds) which can be used to pay the claims of the policyholders of UKE and UKNV respectively.

(ii) **External Reinsurance.** UKE has various external reinsurance arrangements in place. UKE would pay the insurance claim, and then be able reclaim all or part of the cost from those external reinsurers. These contracts include the International Group pooling and Hydra arrangements (see paragraphs 2.36 to 2.38 inclusive).

(iii) **Intra-club Reinsurance.** There is 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). There is 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). This intra-group reinsurance covers any non-payment of reinsurance by the external reinsurers.

(iv) **Unencumbered assets of UKB**. There are additional unencumbered assets of UKB. There is a Deed of Guarantee (the 'UKB Guarantee') between UKB and UKE in which UKB has guaranteed to meet the liabilities of UKE to the extent that UKE is unable to do so (this includes UKB providing capital to UKE in order to meet its regulatory capital requirements). This UKB Guarantee is legally binding on both parties.

(v) **Unencumbered assets of UKE**. UKE and UKNV have entered into a keep-well agreement pursuant to which UKE will ensure that UKNV has a Capital Adequacy Ratio above 150% (see paragraph 6.12). This ensures that the ratio of available capital to regulatory required capital is above 150%. UKNV will, pursuant to its capital management policy, consider distributing dividends to its parent, UKE, once its Capital Adequacy Ratio exceeds 200%.). This keep-well agreement is legally binding on both parties.

(vi) **Additional Premium Call.** The Board of UKE can, if necessary, levy an Additional Premium Call on the Club Members (who include both policyholders of UKE and UKNV). Those members would then be asked to pay an additional premium amount.

2.41 This shows that the security provided to policyholders essentially derives from the financial strength of the Club as a whole. In particular, the 90% quota share between UKE and UKB is a very important part of the security for policyholders, because this reinsurance asset makes up a large part of the overall assets of UKE (see balance sheets in paragraph 4.5).

2.42 The Additional Premium Call also provides mutuality between policyholders of the Club, because the additional premium would be levied across all mutual policyholders of the Club.

Position post-Transfer for UKE remaining policyholders

2.43 The chain of security for UKE's remaining policyholders will be the same after the Transfer**.**

Position post-Transfer for UKE transferring policyholders

2.44 The chain of security for UKNV's transferring policyholders changes so that they now have an additional step where their liabilities will be 100% reinsured to UKE through the intra-group reinsurance.

Position post-Transfer for existing UKNV policyholders

2.45 The chain of security for existing UKNV policyholders will be unchanged after the Transfer.

Materiality

2.46 As Independent Expert, I have considered the effect of the Transfer on the policyholders involved, and in particular, I have considered whether any group of policyholders is adversely affected to a material extent by the Transfer. I will explain below what I mean by a "material extent".

2.47 Firstly, it is important to note that an insurance business transfer can have different effects on different groups of policyholders. There may be some effects of a transfer that are positive to a particular policyholder, and some effects that are negative (i.e., adverse). If some of the effects of a transfer are adverse, this does not necessarily mean that the transfer is unfair, because the adverse effect might be insignificant, or it might be outweighed by other positive effects.

2.48 Secondly, my conclusions are partly based on various statistical estimates of future events, and those estimates will always be subject to some uncertainty (because they are estimates of future, unknown events). I have used my professional judgement to weigh up the conclusions from those statistical estimates, bearing in mind the uncertainties involved.

2.49 For the purpose of this report, I have used the term "material" where I believe a matter could, either individually or collectively, influence the decision to be taken by the user of the report. Assessing this materiality requires reasonable judgement on the context of the work and the way in which it is reported. I have considered the overall effect of the Transfer on each group of policyholders, after considering the aggregate effect of all of the various issues.

2.50 There might be some matters described in this report which are not material, but which I believe would be of interest to policyholders.

Conclusion

2.51 I have considered the Transfer and its likely effects on the policyholders of UKE and UKNV and any other parties affected by the Transfer. I confirm that I understand my duty to the Court.

I conclude that the security provided to policyholders will not be materially adversely affected after the Transfer, that no group of policyholders would be adversely affected to a material extent by the Transfer, that the level of customer service provided to policyholders would be unaffected by the Transfer.

I also conclude that there are also no other parties (e.g. reinsurers) who will be materially adversely affected by the Transfer.

As a result, I conclude that there is no reason that the Transfer should not go ahead.

Key reasons for reaching my conclusion

2.52 I set out below the key reasons for reaching my conclusions. This is not an exhaustive list of the issues I have addressed, but rather a summary of the parts that I believe are most relevant to policyholders.

2.53 I will discuss below the following six areas:

- Mutual relationships between UKE and UKNV.
- The sufficiency of the Technical Provisions.
- The level of capitalisation of UKE and UKNV and the associated financial strength of those entities.
- The considerations of changes to the servicing of policies.
- The impact of Brexit.
- Other issues (including the Covid-19 pandemic).

Mutual relationships between UKE and UKNV

2.54 My primary reason is that it is the Club as a whole which is providing security to its policyholders: although individual policyholders hold their policy with either of UKE or UKNV, a large part of that security provided to policyholders is derived from the intra-club reinsurance and the mutual relationships between UKE, UKNV and UKB. In particular:

- The ‘chain of security’ (as described in paragraph 2.39) is unchanged after the Transfer (except that the transferring policies will be 100% reinsured with UKE rather than being directly insured by UKE).
- The same reinsurance will be in place after the Transfer, and the contracts will operate in the same way. In particular, the Group Quota Shares will operate in the same way; a very large proportion of the liability of UKE is reinsured with UKB, and so those contracts are a key part of the overall security provided to policyholders.
- In addition, UKB provides additional solvency protection to UKE through the UKB Guarantee. UKB has guaranteed to meet the liabilities of UKE to the extent that UKE is unable to do so; this includes UKB providing capital to UKE in order to meet its regulatory capital requirements.
- The mechanism for making an Additional Premium Call (if this is required) from Club Members will not change after the Transfer. If UKE require additional funds to meet claim payments, then this can be achieved from an Additional Premium Call. The call is made across all Club Members (i.e., policyholders who hold mutual policies from any of the group companies).
- The total amount of capital in the Club is unchanged after the Transfer.

Sufficiency of Technical Provisions

2.55 The Technical Provision is the money set aside by an insurance company to pay future claim amounts. It is an important part of the security offered to policyholders; it is important that an insurance company has sufficient money available to pay these future claims. I have reviewed the Technical Provisions of UKE and UKNV pre and post transfer.

2.56 My review has included an assessment of the approach, methodology and governance that are used to determine the Technical Provision levels. I have also assessed key assumptions used in determining the Technical Provisions and also carried out a benchmark review for the most material and uncertain aspects of the Technical Provisions.

2.57 I have concluded that the Technical Provisions are set on an appropriate and consistent basis for UKE and UKNV, both before and after the Transfer.

Capitalisation position of entities post transfer

2.58 I have reviewed the regulatory capital position of UKE and UKNV pre and post the Transfer. Post Transfer, both entities would meet regulatory capital requirements by a large margin. The regulatory capital is calibrated at a 1 in 200 level of sufficiency. This suggests that the overall level of security provided to the policyholders of UKE and UKNV is good.

2.59 The Club and UKE is rated ‘A’ by Standard & Poor’s, and I would expect that this would be maintained after the Transfer as UKE will continue to have the same Technical Provisions as it will be providing 100% reinsurance of the Transferring policyholders. This rating is defined as *“strong capacity to meet its financial commitments”*. This suggests a good level of financial strength.

2.60 A significant proportion of the assets held by UKE will be in the form of a reinsurance asset with UKB (this is unchanged by the Transfer). This continues to be the case and so doesn’t impact the counterparty default risk for UKE. This is a strong source of security, given the size and financial strength of UKB. UKB is also rated ‘A’ by Standard & Poor’s.

2.61 A significant proportion of the assets held by UKNV will be in the form of a reinsurance asset with UKE (for existing UKNV policyholders this is unchanged by the Transfer, for the transferring policyholders this will be a change as they are currently directly insured by UKE). This increases the counterparty default risk for UKNV, but it is a strong source of security, given the size and financial strength of UKE and noting that UKE benefits from its reinsurance with UKB (both UKE and UKB are rated ‘A’ by Standard & Poor’s).

Servicing of policyholders

2.62 UKE and UKNV are currently managed on a day-to-day basis by respectively TMPI (as defined in paragraph 7.2) and TMBV (as defined in paragraph 7.3). After the Transfer, the transferring policyholders will start being served by TMBV which will be able to draw upon TMPI's expertise as and when required, and so will be able to ensure continuity of customer experience.

2.63 As TMPI and TMBV will operate on the same basis, I do not anticipate any changes to the level of customer care provided. TMPI and TMBV have entered into a Co-operation agreement enabling TMBV to obtain TMPI’s co-operation in order to ensure that there are no changes to the level of customer care provided.

The impact of Brexit

2.64 Brexit has introduced or exacerbated a number of risks for insurers operating in the UK, particularly for those that trade across EU borders. There is also the potential that after the transition period expires, UK insurers lose the ability that currently exists to service risks in the EU without being authorised by local regulators. Not proceeding with the Transfer give the potential, depending on the outcome of ongoing negotiations between the EU and the UK, of policyholders not legally being able to have their claims paid or policies serviced (this will particularly be the case for existing UKE policyholders based in the EEA and any UKL policyholders based in the EEA who will have transferred to UKE).

2.65 There are some Brexit risks which cannot be avoided in any practical way; however, I believe that the most material risks, relating to how services can be provided to EEA policies, can be mitigated by transferring those policies to UKNV (i.e., by effecting the Transfer).

Proprietary rights of Members

2.66 I have considered the effect of the Transfer on the proprietary rights of the Club Members of UKE and UKNV. Paragraph 2.54 summarises the impact of the Transfer and highlights that there is no impact on the rights of the Club Members after the Transfer as UKE Club

Members remain members post-transfer. The right to make Additional Premium Calls remains.

2.67 Therefore, there is no compensation to Club Members as part of the Transfer for any diminution of proprietary rights.

Effect on other parties

2.68 The arrangements between the Club and the International Group of P&I Clubs would be the same after the Transfer, and so I do not believe that those other P&I clubs are adversely affected by the Transfer. I did not identify any other third parties that I believe would be materially adversely affected by the Transfer.

Considerations for external reinsurers of the Club

2.69 I have considered any possible effect on the reinsurers of the Club, where the underlying business is transferred. The total amount payable by those reinsurers to UKE and UKNV in respect of that reinsurance would not change as a result of the Transfer. I did not identify any set off rights. Therefore, I conclude that these reinsurers are not materially affected.

Other issues

Covid-19 Pandemic

2.70 The Covid-19 pandemic could have a significant adverse effect on the global economy and the insurance industry. These effects could, in some scenarios, reduce the financial strength of the Club and have an adverse effect on its day-to-day operation. For example:

- **Financial Investments**. There is now a risk of a global recession and wider financial problems which would reduce the value of assets and currencies, and make those values more volatile. Equity values fell significantly by March 2020 but have since risen in value. There is a risk of further falls in equity values, falls in the value of fixed income investments and there is now a greater risk of currency fluctuations. This has been considered within an analysis by the Club which shows that the Club continues to be well capitalised.

- **Counterparty Risk**. There is likely to be a greater risk of default of payment from third parties, notably, from the reinsurers of the Club. The reinsurance of the Club is spread between a wide range of reinsurers which does offer some benefits of diversification (so that there is no large exposure to a single counterparty).

- **Shipping and Transport**. The pandemic is likely to reduce the demand for shipping and transport, at least in the short term. This will change the requirements of the members of the Club and might require a change to the business plan of the Club (for example, in terms of premium written in the medium and long term).

- **Insurance Claims**. It is still too early to assess how the pandemic will affect the level of insurance claims. A lower global shipping volume could, in theory, lead to fewer accidents and claims; conversely, with a fall in demand, owners often take the opportunity to carry out repairs and maintenance work which can increase the level of insurance claims.

- **Operations**. As with all businesses, the pandemic is likely to put a strain on operations, and the ability to carry out the normal day-to-day activities of the Club. At the time of writing this report I am not aware of any specific problems in any function of the Club (for example, in underwriting, policy and claims administration, finance, human resources etc.).

2.71 I have reviewed an analysis performed by the Club on the impacts up May 2020 and UKE and UKNV continue to be well capitalised.

2.72 At the time of writing this report the pandemic is ongoing, and its longer-term effects are unknown and uncertain. However, I do not believe that any of the pandemic issues I have identified would be made any worse by effecting the Transfers, and therefore this does not affect my conclusion on the Transfer. I will comment again on the effect of the pandemic in my Supplementary Report.

Effect of the Transfer on specific policyholder groups

2.73 The section below shows a summary of the reasons for reaching my conclusion, for each of the groups of policies. A policyholder might hold a policy in one or both of the two categories.

- UKE policyholder that has an insured risk located within the EEA (this includes existing UKL policyholders with an insured risk located within the EEA who will Transfer as part of the immediately preceding Transfer between UKL and UKE)
- UKE policyholder that has an insured risk located outside the EEA (this includes existing UKL policyholders with an insured risk located outside the EEA who will Transfer as part of the immediately preceding Transfer between UKL and UKE)
- UKNV's existing policyholders

UKE policyholder that has an insured risk located within the EEA

2.74 These are UKE policies (including those transferred from UKL immediately prior to this Transfer) where the policyholder has an insured risk that is located within the EEA. These policies will transfer from UKE to UKNV as part of the Transfer. After the Transfer, UKNV will be responsible for paying claims and administering these policies.

2.75 Based on my review, I conclude that both UKE and UKNV are strongly capitalised companies, and that they provide an equivalent level of security. As described above from paragraph 2.54, the nature of the relationship between the companies of the Club means that there is mutuality, and the security is provided to policyholders by the Club as a whole.

2.76 Based on my review, I conclude that the Technical Provisions of UKNV will be set on a reasonable basis, and that UKNV would meet its regulatory capital requirement after the Transfer.

2.77 The policy terms and conditions will be the same, and the policies will be serviced in the same manner as prior to Transfer. The policyholders will belong to a different legal entity; but the governance structure and regulatory framework is not materially different.

2.78 Without the Transfer, I believe that there are some key risks related to Brexit; in particular, that UKE could be prevented by law from paying claims and servicing policies. This would be detrimental to policyholders.

2.79 For these reasons, my conclusion is as follows:

> I **conclude that the security provided to a transferring UKE policyholder that has an insured risk located within the EEA will be equivalent after the Transfer.**
>
> **I also conclude that the service provided to these transferring UKE policyholders and claimants will be equivalent after the Transfer.**

UKE policyholder that has an insured risk located outside the EEA

2.80 These are UKE policies (including those transferred from UKL immediately prior to this Transfer) where the policyholder has an insured risk that is located outside the EEA. These policies will not transfer. After the Transfer, UKE will still be responsible for paying claims and administering these policies.

2.81 There will be no change to the financial position and financial strength of UKE after the Transfer because the transferring liabilities (i.e. the EEA Policies of UKE, including those EEA Policies of UKL which have transferred to it pursuant to Transfer 1) are reinsured back to UKE through the quota share contract. This means that there is no change to the insurance risks to which UKE is exposed. In particular, the technical provision amount and the amount of capital for UKE will be the same after the Transfer.

2.82 Based on my review, I conclude that the Technical Provisions of UKE are set on a reasonable basis, and that UKE would meet its regulatory capital requirement after the Transfer.

2.83 The policyholders will belong to the same legal entity, with exactly the same governance structure, regulatory framework, policy terms and conditions, and their policies will be serviced in the same manner as prior to Transfer.

2.84 For these reasons, my conclusion is as follows:

I conclude that the security provided to remaining UKE policyholder that has an insured risk located outside the EEA will be equivalent after the Transfer.

I also conclude that the service provided to these remaining UKE policyholders and claimants will be equivalent after the Transfer.

UKNV's existing policyholders

2.85 These are the UKNV policies prior to the Transfer. These policies will not transfer. After the Transfer, UKNV will still be responsible for paying claims and administering these policies.

2.86 Based on my review, I conclude UKNV is a strongly capitalised company, and that it will remain so after the Transfer. As described above from paragraph 2.54, the nature of the relationship between the companies of the Club means that there is mutuality, and the security is provided to policyholders by the Club as a whole.

2.87 Based on my review, I conclude that the Technical Provisions of UKNV will be set on a reasonable basis, and that UKNV would meet its regulatory capital requirement after the Transfer.

2.88 UKNV write some policies as a fronting insurer for ITIC and UKWR (see paragraph 2.26). There will be no change to the arrangements for these policies, and they will continue to be 100% reinsured by ITIC and UKWR.

2.89 For these reasons, my conclusion is as follows:

I conclude that the security provided to existing policies of UKNV will be equivalent after the Transfer.

I also conclude that the service provided to existing UKNV policyholders and claimants will be equivalent after the Transfer.

Alternative arrangements

2.90 I am aware that an alternative arrangement would be to:

A. Transfer the UKL policies that have insured risk located within the EEA to UKNV

B. Transfer the UKL policies that have insured risk located outside the EEA to UKE

C. Transfer the UKE policies that have insured risk located within the EEA to UKNV (which could have been combined with A into one Scheme)

2.91 However, there are two reasons why the Club has not proceeded with the alternative arrangement aforementioned:

1. The proposed arrangements only involve one cross-border Transfer which is expected to be simpler

2. For a cross-border transfer to be enacted it would need to have been applied for to the PRA by 31 January 2020. As the Club was still determining the most effective approach for the UKL policyholders with insured risks within the EEA this application was not made and hence this alternative approach is not possible.

2.92 Consequently, I am not aware of any other alternative arrangements to the Transfers proposed by any party, so I have not considered it necessary to discuss alternative proposals within this report.

Supplementary report

2.93 My conclusions are based on the information available to me at the time of writing this report. I will produce a Supplementary Report prior to the Transfer Date, and this will comment on the most recent information available. I expect that this will include details of movements in claims paid and claims incurred since the date of this report. There may be other data that I will request for the purposes of the Supplementary Report, depending on the circumstances and any changes to the financial positions of the companies involved.

Future Relevant Transactions

2.94 Following the Transfer there are several following steps that are planned which will impact on some of the UKE (including existing UKL policyholders which will transfer to UKE as part of Transfer 1 in the interdependent transfer) and UKNV policyholders.

1. There is a planned future insurance business transfer which will transfer all occupational disease claims arising during the period prior to 20 February 2001 which reside in UKE to R&Q Gamma Limited (‘R&Q’), an English company. These will be the occupational disease claims which are not based in the EEA. This will include the UKL liabilities transferring under this Transfer. This UKE to R&Q transfer will be subject to a court process in a similar way to this Transfer and as a result I believe that this does not represent a reason for the Transfer not to go ahead. I will comment on the latest position on this proposed Transaction within my Supplementary Report.

2. There is also a plan to transfer all occupational disease claims arising during the period prior to 20 February 2001 which reside in UKNV post Transfer 1 and Transfer 2 to Accredited Insurance (Europe Limited, a Maltese company. These will be the occupational disease claims which are based in the EEA. Any such subsequent transfer will be subject to a court process in a similar way to this Transfer and as a result I believe that this does not represent a reason for the Transfer not to go ahead. I will comment on the latest position on this proposed Transaction within my Supplementary Report.

Independent Expert declaration

2.95 In reaching the conclusions set out below, I have applied the following principles. I have sought to adhere to:

a. Exercise my judgement in a reasoned and justifiable manner;

b. Describe the impact on all classes of beneficiaries (principally the policyholders of UKE and UKNV) and the reinsurers of UKE whose contracts will form part of the Transfer;

c. Indicate how the Transfer might lead to any changes in the material risks to the benefits of different classes of beneficiaries;

d. Indicate (in broad terms) the impact on the actuarial information of adopting alternative plausible assumptions;

e. Assess the impact on all classes of beneficiaries;

f. Indicate the proposed rationale for the Transfer to proceed;

g. Include (in summary) the most material information on which my opinion is based; and,

h. Describe the rationale for my opinion.

2.96 I confirm that I have made clear which facts and matters referred to in this report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed and conclusions I have drawn represent my true and complete professional opinions on the matters to which they refer.

2.97 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.

2.98 I do however consider it necessary that I review the most recent information, up to the date of the Transfer, when this becomes available later in the year, before confirming my opinion and conclusions.

3. Summary of my approach

3.1 The section below sets out my approach for assessing the Transfer.

Gain a thorough understanding of the Transfer and identify the groups of policyholders that would be affected.

3.2 This was achieved through discussions with the Club and their advisors to understand the Transfer, together with reviewing the documents agreed between the parties for the implementation of the Transfer. The documents I reviewed included:

- ► The UKE PRA (regulatory) returns, to understand UKE's balance sheet on a UK GAAP basis.
- ► The Club's Risk Appetite statement, Capital Management policy, Underwriting policy, Actuarial policy and Investment policy outlining the various functional policies.
- ► A structure diagram of the Club, to understand the relationships between the entities involved in the Transfer.
- ► Extract from the Scheme of Operations financial projections for UKNV to understand UKNV's financial position.
- ► The Clubs' annual report and financial statements, to understand their financial position on a UK GAAP basis.
- ► The Group Solvency Self-Assessment ('GSSA') Report and signed Financial Condition Report to understand the Club's capital position and balance sheet on Solvency II basis as well as rules prescribed by the BMA.
- ► An external actuarial report for review of claims reserve for UKE as at February 2019, to understand how the claims reserves adequacy for UKE.
- ► Reserving model for UKE as at February 2019, to understand how the claims reserves have been estimated.
- ► A reinsurance structure diagram for the Club to understand the reinsurance programmes in place.
- ► Schedules showing the investment portfolios of the Club to understand how the assets are invested.
- ► Plans for the UKNV business and capital requirements.

Review of the claims reserves of UKE and UKNV

3.3 The claims reserve of an insurance company is an estimate of the amount of money that the company will need to pay out to its policyholders as claim payments in the future. It is an unknown amount of money (because future claim amounts are unknown and uncertain) but it can be estimated by the company by using various statistical methods.

3.4 An important question when considering the security provided to policyholders of a company is whether the estimation of the claims reserves has been carried out in an appropriate way. This is because there is a risk that the company has underestimated the amount of money that it will need to pay future claim amounts to policyholders, and therefore a risk that it will not be able to pay those claim amounts.

3.5 As part of my work I have checked that the probability of both UKE's and UKNV's future claim payments being met is not materially affected by the Transfer, and that UKE's and UKNV's ability to meet the regulatory capital requirements is not materially affected by the Transfer. This is described in section 5.

3.6 Therefore, I have considered the adequacy of significant parts of the claims reserves of UKE and UKNV. This is described in Section 5.

Review of the assets and capital requirements of UKE and UKNV

3.7 A second important aspect of the modelling work I have reviewed relates to the uncertainty in the amount of the future claim amounts. The amount of capital in an insurance company is the difference between the value of the assets of the company (e.g., investments, cash and amounts due from debtors), and the value of the liabilities of the company (e.g., future claim payments and amounts due to creditors). This amount is also sometimes referred to the amount of ‘available capital’ or the amount of ‘surplus’ of a company. It is one measure of the financial strength of the company.

3.8 Insurance regulators require that an insurance company has at least a certain minimum amount of capital (i.e., so that it has a level of buffer to help make future claim payments). The capital requirement is needed because the future amount of the claim payments is uncertain; the insurance company and the regulator wish to be confident that the company is able to meet all future claim payments, even in an unlikely adverse scenario. However, this does not mean that a company will be able to meet all claim payments in all circumstances; only that there is a higher probability of being able to do so.

3.9 I have considered the approach taken by UKE and UKNV in calculating their regulatory capital requirements. I discuss this in Section 6 .

Consider the level of security offered to each group of policyholders, assuming existing arrangements, and assuming the Transfer are effected

3.10 I have considered the balance sheets of UKE and UKNV, both before and after the Transfers, as part of my assessment of their relative financial positions, including the net assets of the companies and the level of capital. This is discussed in Section 4.

Consider any other factors that might affect policyholders

3.11 I have considered other factors that might affect policyholders. These are set out in Section 7:

- Customer service
- Impact of Brexit
- Policyholder communication strategy
- Direct and reinsurance policyholders
- Governance
- The Financial Services Compensation Scheme
- Financial Ombudsman Service
- Tax implications of the Transfers
- Implications of the Transfers on ongoing expense levels
- Regulatory protection
- Set-off rights

Materiality

3.12 Throughout my work I have applied the concept of materiality, as set out from paragraph 2.46 above.

Use of benchmarks in my work

3.13 At various points in my review I have used ‘benchmarks’ to test the assumptions used in the Club claims reserving and capital modelling analysis. This includes claim development patterns (i.e., the assumptions used to calculate the level of future claim payments) and loss ratio picks (i.e., the profitability of the business being written by the Club). These benchmarks are derived from the data and analysis of other firms or groups of firms in the insurance market. This is a valuable exercise because it compares the assumptions used by Club to those used by other firms in the wider insurance market.

3.14 As part of claims reserving and capital modelling work it is useful, in the first instance, to consider the firm’s own data, and the results of the analysis using that data. This is because this data, by definition, relates entirely to the firm’s own business and is relevant to the firm’s own specific characteristics (in terms of the exact type of business written and the way that the firm manages and pays claims). It is then useful to compare the assumptions and results with benchmarks from the wider market. I believe that the benchmarks I have used are appropriate for my analysis of UKE and UKNV because they are based on a wide range of firms, which are of a similar size to the Club, and which write similar types of business to UKE and UKNV.

Legal Opinions

3.15 There are no areas of my work where I have needed to obtain an independent legal opinion.

3.16 However, I have reviewed advice on the tax implications of the Transfer (see paragraph 7.45) obtained from the legal advisors of UKE. I did not deem those issues to be sufficiently material to require an independent legal opinion. The legal advisors have a good professional reputation and I am relying on their own professional independence. For that reason, I am comfortable with the conclusions I have reached for the matters set out above.

4. Assessment of assets and liabilities transferring

4.1 In order to show the effect of the Transfer on the assets and liabilities I have reviewed the balance sheets of UKE and UKNV. These balance sheets are based on a scenario where the Transfer were notionally effected on 20 February 2019. This is not the date of the Transfer; however, it is instructive to consider the financial positions at this date because this is the most recent date at which audited financial information is available. I believe that this is the most appropriate basis to view the Transfer, because it is based on the most recent set of audited financial statements. For clarity, I have not shown the detailed balance sheets, and have grouped together various line items.

4.2 The starting balance sheet for UKE is based on the audited UK GAAP (the Generally Accepted Accounting Principles) financial statements as at 20 February 2019. This is the standard basis for the preparation of accounts of UK insurance companies.

4.3 UKNV is a new company, established on 28 November 2018 in the Netherlands, with an amount of $36m in assets, injected from UKE. For the purpose of this balance sheet comparison I have produced a notional starting balance sheet for UKNV, with this starting amount of capital. I believe that this will show the best currently available view of the Transfer on the balance sheet of UKNV.

4.4 I expect that the normal activities of the Club will continue in the period between 20 February 2019 and the Transfer Dates (for example, paying policyholder claims and writing or renewing policies). The actual position of the companies will be different to that represented below due to the actual experience between those dates. However, I believe that this gives the best currently available picture of the Transfer. I will produce a Supplementary Report prior to the Transfer Dates, and this will comment on the most recent information available. I expect that the updated financial information will be based on data as at 20 February 2020, with an adjustment for the recapitalisation of UKNV.

The Club prior to the Transfers

4.5 The table below shows the balance sheet position before the Transfers (as described above) for UKL, UKE, UKNV and the consolidated Club Total (which includes UKB and other Club subsidiaries). The total available capital of the consolidated Club is $504m.

4.6 We have shown Table 4a which shows the position prior to both Transfers (UKL to UKE and UKE to UKNV). We then show the position in Table 4b post the UKL to UKE transfer (Transfer 1) but prior to the UKE to UKNV transfer which is the focus of this report.

Table 4a: Balance sheets pre-Transfers – UK GAAP basis – 20 February 2019

		Balance sheets Pre-Transfer						
		UKL	UKE	UKNV	UKB	Hydra	Consol. Adj	The Club*
[1]	Financial Investments	3	221	36	928	100	0	1,288
[2]	Investment in Subsidiaries	0	36	0	15	0	(51)	0
[3]	RI Tech. Prov. (External)	0	140	0	0	3	0	143
[4]	RI Tech. Prov. (Intra-Club)	54	768	0	0	0	(821)	0
[5]	Receivables and other asssets	1	71	0	14	0	(10)	76
[6]	**Assets**	**58**	**1,235**	**36**	**957**	**103**	**(882)**	**1,506**
[7]	Technical Provisions	54	984	0	686	82	(821)	984
[8]	Other creditors	0	23	0	1	0	(6)	18
[9]	Available capital	4	228	36	271	20	(55)	504
[10]	**Liabilities**	**58**	**1,235**	**36**	**957**	**103**	**(882)**	**1,506**
[11]	Net Technical Provisions	0	77	0	686	79	0	842

Table 4b: Balance sheets post-Transfer1 immediately prior to UKE to UKNV transfer–UK GAAP basis – 20 February 2019

	Balance sheets post UKL to UKE Transfer but prior to UKE to UKNV Transfer						
	UKL	UKE	UKNV	UKB	Hydra	Consol. Adj	The Club*
[1] Financial Investments	0	221	36	928	100	3	1,288
[2] Investment in Subsidiaries	0	36	0	15	0	(51)	0
[3] RI Tech. Prov. (External)	0	140	0	0	3	0	143
[4] RI Tech. Prov. (Intra-Club)	0	768	0	0	0	(768)	0
[5] Receivables and other asssets	0	71	0	14	0	(9)	76
[6] Assets	**0**	**1,235**	**36**	**957**	**103**	**(825)**	**1,506**
[7] Technical Provisions	0	984	0	686	82	(768)	984
[8] Other creditors	0	23	0	1	0	(6)	18
[9] Available capital	0	228	36	271	20	(51)	504
[10] Liabilities	**0**	**1,235**	**36**	**957**	**103**	**(825)**	**1,506**
[11] Net Technical Provisions	0	77	0	686	79	0	842

4.7 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).

4.8 The main observations to make from Table 4b are:

- UKE has large Financial Investments ($221m), but this is still less than the value of the Gross Technical Provision amount ($984m). The largest component of the assets of UKE is the Intra-Club Reinsurance ($685m) with UKB.
- The Club as a whole has Financial Investments of $1,288m, and the majority of this is held by UKB (rather than UKE or UKNV).
- UKB also holds the majority of the Net Technical Provision Amount ($686m), with only $77m held by UKE, and zero by UKNV. This is as I would expect, given the Intra-Club Reinsurance in place.
- UKNV had not started writing business at 20 February 2019 and so has no gross liabilities at this date.

Effect of the Transfer on UKE balance sheet

4.9 The table below shows the balance sheets for UKE, both before and after the proposed Transfer. Prior to the Transfer, UKE has available capital of $228m and Net Technical Provisions of $77m.

4.10 A reinsurance asset (with external reinsurers) of $64m will transfer to UKNV. There will be no change to the Net Technical Provision after the Transfer, because all liabilities transferred to UKNV (post external reinsurance) are reinsured back to UKE. The Gross Technical Provision transferring from UKE to UKNV is $209m (not shown in table 4c). This consists of $3m in respect of EEA Policies that were originally transferring from UKL to UKE (as part of Transfer 1), and $206m in respect of EEA Policies transferring from UKE.

4.11 At some point prior to the Transfer UKE will make a capital injection currently estimated to be $20m to UKNV, so that UKNV will meet its regulatory capital requirement (see paragraph

4.14 below). I will comment more on the progress on this within my Supplementary Report later in the year. This will be made as a cash payment. The effect on the UKE balance sheet will be to reduce Financial Investments by $20m, and increase the value of investments in subsidiaries by an equivalent amount. There will be no change to the total Available Capital of UKE after the Transfer.

Table 4c: UKE balance sheets – 20 February 2019 - $ms

		UKE		
		Pre Transfer	Effect of Transfer	Post Transfer
[1]	Financial Investments	221	(20)	201
[2]	Investment in Subsidiaries	36	20	56
[3]	RI Tech. Prov. (External)	140	(63)	77
[4]	RI Tech. Prov. (Intra-Club)	768	(1)	767
[5]	Receivables and other asssets	71	0	71
[6]	**Assets**	**1,235**	**(64)**	**1,171**
[7]	Technical Provisions	984	(64)	920
[8]	Other creditors	23	0	23
[9]	Available capital	228	0	228
[10]	**Liabilities**	**1,235**	**(64)**	**1,171**
[11]	Net Technical Provisions	77	(0)	77

Effect of the Transfer on UKNV balance sheet

4.12 The table below shows the balance sheets for UKNV, both before and after the Transfers. Prior to the Transfer, UKE has available capital of $36m.

4.13 The Gross Technical Provision transferring from UKE to UKNV is $209m. There will also be a reinsurance asset (with external reinsurers) of $64m transferring to UKNV. The Intra-club Reinsurance with UKE contributes a further $145m reinsurance asset. The Net Technical Provision Amount will be zero.

4.14 At some point prior to the Sanctions hearing (expected to be October 2020) UKNV will be recapitalised, so as to be able to meet its regulatory capital requirement, and to have sufficient capital for its own risk appetite. The size of this recapitalisation will be set at a level so that the capital adequacy ratio (as shown in table 6a in paragraph 6.12) will be 175%. Based on these pro-forma balance sheets, this implies an amount of $20m in additional capital. I have shown this as an effect of the Transfer (even though the recapitalisation will occur prior to the Transfer Date) as I believe that the two events are clearly linked. The recapitalisation will be made as a transfer of cash from UKE to UKNV. The amount of available capital of UKNV will increase from $36m to $56m as a result of the recapitalisation and the Transfers. Without this capital injection UKNV would be likely to meet its regulatory capital requirement but would have only a small buffer and so would not meet its own internal risk appetite. I will discuss the latest position on this recapitalisation in my Supplementary Report.

Table 4d: UKNV balance sheets – 20 February 2019 - $ms

	UKNV		
	Pre Transfer	Effect of Transfer	Post Transfer
[1] Financial Investments	36	20	56
[2] Investment in Subsidiaries	0	0	0
[3] RI Tech. Prov. (External)	0	63	63
[4] RI Tech. Prov. (Intra-Club)	0	146	146
[5] Receivables and other asssets	0	13	13
[6] Assets	**36**	**242**	**278**
[7] Technical Provisions	0	209	209
[8] Other creditors	0	0	0
[9] Available capital	36	33	69
[10] Liabilities	**36**	**242**	**278**
[11] Net Technical Provisions	0	0	0

4.15 The long-term investment strategy of UKNV will be to hold a portfolio of assets similar to UKE. Therefore, there would be no change to the investment strategy of the insurer of the Transferring Policies, and this does not affect my conclusion on the Transfer. The UKNV policy on the currency of assets held is the same as the policy for UKE; i.e., to hold assets in a mixture of currencies which match the currencies of the underlying claim liabilities. UKNV will periodically adjust the balance of assets held in different currencies as and when the mix of liabilities changes.

Liquidity

4.16 The financial assets of UKE and UKNV are mostly held as cash and bond type investments. I am satisfied that this mix of assets held by UKE and UKNV is appropriate for firms of this type, and that the Transfer will not materially affect the level of liquidity risk.

Conclusion on balance sheet comparisons

4.17 For the above reasons my conclusions on the balance sheets are as follows:

The analysis of balance sheets shows no material change to the net asset position of any of the entities as a result of the Transfer. In particular:

The amount of available capital for the Club as a whole, and for each of UKE and UKNV does not change as a result of the Transfer.

The amount of Net Technical Provisions for UKE and UKNV does not change as a result of the Transfer.

The mix of assets (except for reinsurance assets) held by UKE and UKNV does not change as a result of the Transfer.

5. Assessment of Technical Provisions

5.1 The Technical Provision amount is the money set aside by an insurance company to pay future claim amounts. It is an important part of the security offered to policyholders; it is important that an insurance company has sufficient money available to pay these future claims. A firm will carry out some form of actuarial analysis to estimate the amount of the Technical Provisions required. I have carried out a review of this analysis. I have reviewed the Technical Provisions of UKE, and the Technical Provisions associated with the Transferring Policies (which will become the Technical Provisions of UKNV after the Transfer).

5.2 I will use the term Technical Provisions to refer to the total provision set aside for all of the future claim payments on a GAAP basis. Some of the intermediate calculations in the actuarial work will not be on a GAAP basis and in those circumstances I will use, for convenience, the term ‘claims reserve’.

5.3 I will use the term 'best estimate' when referring to an estimate of the claims reserve, where that estimate has no intended margin for prudence or optimism, and where it is a reasonable estimate of the claims reserve given the data and information available. There are inherent risks in insurance business, and there are uncertainties when estimating a claims reserve amount. The methods used by actuaries to estimate a claims reserve often involve subjective judgements. Given that there is a range of assumptions that can be reasonably justified, there is also a range of best estimates that can be considered to be reasonable.

The Club methodology for claims reserves

5.4 The claims reserving work for the Club is carried out by a team of Club actuarial staff based in the UK. They are responsible for various actuarial activities, including claims reserving and capital modelling for various parts of the business. The claims reserving work is carried out on a quarterly basis. The methods used are standard actuarial methodologies including the Chain Ladder Method, the Bornhuetter-Ferguson Method and the Expected Loss Ratio Method (these methods are described at the foot of the Glossary in Appendix A). The assumptions used in the models are based on analysis of the historical data and on actuarial judgement as appropriate. They also separately use industry data to derive industry wide benchmarks, as a cross check against their own analysis.

5.5 Actuarial judgement is also applied to select estimates where these methods are not appropriate (for example, where there is a change in the underwriting, claim patterns or legal environment). The actuaries review the results of the various methods, based on both paid claim and incurred claim data, and select the most appropriate estimate based on judgement.

5.6 The net reserves are calculated from the gross reserves by deducting the calculated reinsurance recoveries for known claims and making relevant assumptions about the reinsurance recoveries on potential future claims. For some specific unusual events, the actuarial team has built models to calculate the reinsurance recoveries explicitly.

5.7 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.

5.8 The Club also commissions an external actuarial review of claims reserves, performed by their actuarial advisors (the ’Advisors’) on an annual basis.

5.9 The booked claims reserve of the Club includes a margin for prudence above the Advisor’s estimate. The margin held above the Advisors’ best estimate is currently equivalent to the 80th percentile (based on the Advisors’ model), which is similar to the percentile of margin held by the Club in the previous year. In my experience, this is an appropriate level of margin, in comparison to the peer group of the Club.

5.10 The table below shows a summary of the claims reserve amounts for UKE, the Club's parent company, and a reconciliation to the balance sheets shown in Section 4. For ease of understanding we show the UKL exposures separately but note that these will become direct liabilities of UKE post the immediately preceding interdependent UKL to UKE transfer.

Table 5a: UKE Technical Provisions – 20 February 2019 - $ms

		UKE		
		Pre Transfer	Effect of Transfer	Post Transfer
[1]	UKE EEA	199	(61)	138
[2]	UKE ROW	648	0	648
[3]	UKL EEA	3	(3)	0
[4]	UKL ROW	51	0	51
[5]	GAAP Adjustment	31	0	31
[6]	Margin	53	0	53
[7]	**Gross Technical Provision**	**984**	**(64)**	**920**
[9]	External RI	140	(63)	77
[10]	Intra-group RI	768	(1)	767
[11]	**RI Technical Provision**	**908**	**(64)**	**844**
[12]	**Net Technical Provision**	**77**	**0**	**77**

5.11 Lines [1] and [2] show the claims reserve for the EEA and Rest of World ('ROW') business written by UKE. The majority of the claims reserve is in respect of ROW. Lines [3] and [4] show the claims reserve for the EEA and Rest of World ('ROW') business originally written by UKL and currently ceded to UKE (which will become direct liabilities post the immediately preceding UKL to UKE transfer). UKL has been in run-off since 1971, and nearly all these liabilities are in respect of occupational diseases claims. Line [4] includes various other adjustments to convert the amounts to a UK GAAP basis; the majority is a provision for the future expenses of settling claims. Line [6] shows the margin above the best estimate, as described in paragraph 5.9. Lines [9] and [10] show the reinsurance recoverable; the majority is Intra-club reinsurance, from UKB.

5.12 At 20 February 2019 UKNV did not have any technical provisions.

My review of the Club's claims reserves

My approach and materials reviewed

5.13 I have held meetings with the Club actuarial team to understand the claims reserving process. I have also been provided with and reviewed the Advisors' report on the claims reserves. This report complies with the relevant professional actuarial standards, and includes a full description of the reserving methodology, main assumptions used, and main uncertainties.

5.14 I have not independently audited the data provided to me. I have, however, carried out reconciliation checks to the reported audited accounts and have carried out various diagnostics on the data. This has led me to believe that the data is appropriate for the purposes of my exercise.

5.15 My approach was then to carry out testing on the key parts of the claims reserves. This included a review of the key assumptions in the Club analysis; I checked those assumptions for consistency with the historical data, and also compared them against my own market benchmarks.

Overall methodology and process

5.16 The overall methodology is based on standard actuarial methods which I believe are appropriate for these types of liabilities. The type, and range of methods used, is as I would expect for the Club.

5.17 The standard and depth of work that I have reviewed is at a level that I would expect for firms such as UKE and UKNV. My interactions with the actuarial team suggest to me that they have the required level of competence.

5.18 The business is reviewed in approximately eight categories / lines of business (with some analysis carried out for sub-classes as appropriate). I have reviewed the class of business categorisation for reserving purposes, and am satisfied that this is an appropriate basis. In particular, it provides a sufficient level of granularity by type of business, and has sufficiently homogeneous categories, with sufficient volume of data in each category.

Case reserves

5.19 I have considered the process used by the Club claims team to set the level of case reserves for individual claim events. It is important that this process is on a consistent basis from year to year because this data is used in the actuarial methods to make projections for the future claims development. From my discussions with the actuarial team and from reading their report, I am not aware of any material changes to the way that case reserves have been set. From my review of the claims development patterns described below, and from diagnostics of paid and incurred claim data I did not identify any issues.

Review of material assumptions

5.20 I have identified and reviewed what I believe to be the key assumptions in the claims reserving analysis. The key areas are the assumptions used for the future claims development and the assumption for the loss ratio on the later underwriting years.

5.21 I have reviewed the future claims development pattern for a sample of claim categories, predominantly those with the largest claims reserves and with the most uncertainty. This included transferring business and non-transferring business and made up 80% of the transferring business. I have checked that these assumptions are consistent with the historical claim development data of the Club. I have also checked these against benchmark claim development patterns from my own wider experience of these type of liabilities (see paragraphs from 3.13 for an explanation of the source of these benchmarks). I have therefore concluded that these assumptions are set on an appropriate basis.

5.22 I have reviewed the assumed loss ratio for the latest underwriting year for the most material classes of business. I have cross checked these assumptions are consistent with the historical loss ratios of UKE. I have also checked these against benchmark loss ratios from my own wider experience of these types of liabilities (see paragraphs from 3.13 for an explanation of the source of these benchmarks). I have also checked loss ratios for the total UKE and transferring business components, to check that there are no material differences except in a few cases where a difference is justified by the claims experience. I therefore concluded that these assumptions are set on an appropriate basis.

Reserve margin and Technical Provisions presented in the financial statements

5.23 The discussion in the preceding sections considers the best estimate of the claims reserve. This is the estimate that is used, after an appropriate conversion, as the basis for demonstrating regulatory solvency under Solvency II (see Section 6).

5.24 The Technical Provisions included in the GAAP financial statements includes a margin for prudence, which is effectively an additional buffer for uncertainty, added by the management of the Club. The total margin for the Club, as at 20 February 2019 was $53m (representing approximately 6% of the total net Technical Provision amount of the Club). Of the total margin amount, $5m was included the Technical Provision of UKE, and the remainder in the Technical Provision of UKB. There is no reserve margin for UKNV (I believe that this is reasonable given that there is full reinsurance in place, and the Net Technical Provision amount is zero for UKNV).

Conclusion on Technical Provisions

5.25 My conclusion is as follows:

I believe that the methodology and assumptions used are reasonable, and that the actuarial best estimate of the claims reserve is set on a reasonable basis. This applies to UKL, UKE, UKNV, and to the components in respect of the Transferring Policies.

5.26 The reasons for reaching my conclusion are as follows:

- The Club commission a full actuarial analysis of the claims reserve, which uses methods and assumptions that I believe are consistent with standard actuarial practice and are suitable for reviewing these types of liabilities.
- The booked statutory claims reserve of UKE is slightly higher than the actuarial best estimate, so that there is a margin for prudence included within the booked reserve amount.
- The best estimate reserves of the Advisors and the margin for prudence in the booked reserves of UKE have been stable over the last three years.
- The planned loss ratio (i.e., the ratio of claims to premiums) for UKE and UKNV from their business plan for 2020 is in line with the recent historical performance of each company, and I believe that the planned assumptions for future premium volumes and profitability are therefore realistic. Therefore, I am satisfied that the assumed level of profitability of the ongoing business is reasonable. . I note that the impact of Covid-19 will potentially impact on premium volumes and loss ratios but as noted in 2.70 I do not believe this will lead to any policyholders being materially disadvantaged by the Transfer.
- The level of Technical Provisions for UKNV at the time of the Transfer will be very low (relative to the size of the transferring liabilities), given that UKNV has only recently starting writing business. The Technical Provisions for UKNV will be calculated using the same methodology as for UKE; therefore, I believe that this is reasonable.

Key uncertainties in claims reserves

5.27 I believe that the key uncertainties in the claims reserves of the Club are as follows:

- There is uncertainty for the most recent year because the claims are at an early stage of development. The Club mitigates this risk by managing its exposure to large losses (both incidence and accumulation) through reinsurance arrangements. UKE also holds a margin within the claims reserves to provide a high probability of sufficiency.
- There is uncertainty relating to the occupational disease claims. The majority of these liabilities arise specifically from mesothelioma claims and, to a lesser extent, lung cancer claims. The actual outcomes may differ substantially from the reserves estimates.

- There is exposure to other bodily injury (i.e. non occupational disease) claims which can be long tail in nature (i.e., can take many years to report and settle insurance claims). These exposures have uncertainty arising from possible future legislative changes.

- There is a risk of future new latent claim types emerging (for example, a new set of claims, similar to the asbestos problem which emerged for the insurance industry in the 1980s). Whilst I believe that this is very unlikely, should a new latent claim issue arise, the settlement cost of the claims could be higher than the current booked claims reserve.

5.28 I have considered the above identified uncertainties and considered sensitivities of the actuarial judgements made in relation to these uncertainties to confirm my understanding of the reserves. I believe that they are uncertainties that would be typical for insurance firms such as UKE and UKNV. For any insurance company, the future financial position will depend on the outcome of future unknown events. There is no particular uncertainty identified which should preclude the Transfer from being effected. I believe that the methods used to quantify the claims reserves are appropriate and these uncertainties do not affect the conclusion I reached on the level of the claims reserve.

6. Assessment of capital requirements

6.1 A key consideration is whether the companies involved in the Transfer are sufficiently secure, and whether that level of security changes as a result of the Transfer. The level of security provided to the policyholders of an insurance company depends on the available assets of the company, and in particular on the probability that this level of assets is sufficient to make all claim payments as they fall due.

6.2 One measure of this security is the level of the regulatory capital requirement, and the extent to which the available capital of the firm is greater than that capital requirement. The European Commission has developed the regulatory requirements for insurance and reinsurance undertakings within the EU (known as 'Solvency II'). UKE and UKNV are currently subject to the regulatory requirements of Solvency II, and will remain subject to those requirements after the Transfer.

6.3 In this section I will:

- ► Set out some background on Solvency II.
- ► Explain the regulatory capital position for UKE and UKNV.
- ► Explain the review I have undertaken on the capital amounts.
- ► Explain my overall conclusion on the capital strength of UKE and UKNV.

Background to Solvency II

6.4 The key metric to trigger regulatory intervention under Solvency II is the Solvency Capital Requirement ('SCR'). This is determined as the economic capital to be held by an insurance firm in order to ensure that the probability of not meeting their obligations in the coming year is less than 1 in 200. It is intended to represent a normal target level of capital for the insurer, and capital falling below this level would trigger a response from the insurer's regulator. This ‘1 in 200’ level would represent a relatively remote event, and an insurer with that level of capital can be considered to have a very good level of security.

6.5 Insurers can choose one of three methods on which to base their SCR calculations; a Standard Formula approach, an Internal Model approach or a Partial Internal Model approach:

- ► The Standard Formula approach entails a prescribed basis for calculation and a prescribed set of parameters to use in working out the capital requirement.
- ► The Internal Model approach involves the insurer using their own capital model to calculate their regulatory capital requirement. Both the approach to calculating available capital (via the Solvency II balance sheet) and the approach to calculating the capital required are different to the Standard Formula approach.
- ► The Partial Internal Model approach is a mixture of the Standard Formula approach and the Internal Model approach. An Internal Model is used to calculate parts of the regulatory capital, and the Standard Formula to calculate the remainder.

6.6 The choice of which of these three approaches to use is made by the insurer themselves; however, the form and structure of Internal Models and Partial Internal Models are subject to approval by the relevant regulator (generally the regulator in the home country of the insurer). In cases where the regulator does not approve an Internal Model or Partial Internal Model, the Standard Formula will be applied by default.

6.7 In my discussion of the capital requirements I will refer to the individual components of the risks; namely:

- Insurance Risk: The risks relating to the upcoming year of insurance business and the uncertainties relating to the claims reserves (i.e., the uncertainty that the cost of settling these liabilities could be higher or lower than the booked reserve amount). The firm will need to pay some insurance claims to their policyholders over the coming years, but the amount of those payments and the timing of those payments is uncertain. There is a risk that the amount to be paid is more than expected.

- Market Risk: This describes the risk of loss or of adverse change in the financial situation resulting, directly or indirectly, from fluctuations in the level and in the volatility of market prices of assets, liabilities and financial instruments. This includes the uncertainties relating to investment performance (the investment return achieved and the value of the assets held by the firm could go up or down, and the amount by which they go up or down is uncertain). This risk type is further subdivided into interest rate risk, equity risk, property risk, currency risk and concentration risk.

- Counterparty Default Risk: The risk of any defaults of counterparties or reinsurers. This includes any institution or individual that is a debtor to the firm, and in particular includes the reinsurers of the firm.

- Operational Risk: This includes uncertainties relating to failures in operational procedures. For example, IT systems failure or fraud.

6.8 The basis for calculating the value of the available capital is slightly different between Solvency II and UK GAAP. I will refer to the amount of available capital on a Solvency II basis as ‘Solvency II Own Funds’. The amount of available capital as shown on the balance sheets in tables 4a to 4d in Section 4 is essentially the same concept as Solvency II Own Funds, but calculated using a different set of rules.

6.9 It is important to note that even if an insurer does not have sufficient eligible Solvency II Own Funds to meet the required capital level then this does not necessarily mean that it would not be able to settle all its claims in full. In those circumstances the balance sheet strength of the insurer would be sufficient to pay its liabilities, even though the regulatory capital amount would not be met.

6.10 The insurer is also required to submit an Own Risk and Solvency Assessment (‘ORSA’) to the regulator, which sets out their own views on the risk of the firm and the appropriateness of the SCR calculation.

Summary of regulatory capital requirements of UKE and UKNV

6.11 UKE uses a Partial Internal Model for the purpose of the Solvency II capital requirement and UKNV uses a Standard Formula model. There is no plan for UKNV to move to using a Partial Internal Model following the Transfer.

6.12 The table below shows a summary of the regulatory capital requirements for the Club as a whole, UKE, and UKNV. I will discuss these calculations in further detail in the following paragraphs. These amounts shown for UKNV include the planned capital injection expected in October 2020 for UKNV as discussed in 4.14 which is likely to be in the region of $20m.

Table 6a: Club Solvency II capital requirements – (The Club and UKE based on Partial Internal Model, UKNV based on Standard Formula) - $Ms

	The Club Pre-Transfer [A]	UKE Pre-Transfer [B]	UKNV Pre-Transfer [C]	UKNV Post-Transfer [D]	Change [E]
[1] Insurance Risk	151	11	2	2	0
[2] Counterparty Default Risk	55	71	16	21	5
[3] Operational Risk	29	29	5	6	2
[4] Market Risk	157	163	2	3	1
[5] Diversification	(89)	(47)	(3)	(3)	(1)
[6] SCR	**303**	**228**	**23**	**30**	**7**
[7] Solvency II Own Funds	**638**	**601**	**40**	**53**	**12**
[8] Capital Adequacy Ratio	**211%**	**264%**	**177%**	**178%**	**1%**

* Columns [A] and [B] are based on a forecast to 20 February 2020 and columns [C] to [E] are based on a forecast to 20 February 2021

6.13 The first four rows in the table shows the part of the total capital requirement relating to each of the components of risk for Insurance, Counterparty and Operational. So, for example, we can see that Market Risk is the largest component of risk for the Club (Row [4], Column [A]), with a contribution of $157m to the total. Row [5] is the effect of the diversification between the different risks. Not all adverse events are likely to happen all at once, and so there is an effect of pooling the risk together so that the total capital requirement is less than the sum of the parts (the diversification amount is shown as a negative). The totals of lines [1] to [5] makes up the SCR.

6.14 Comparing this with the Own Funds amount in line [7] gives a comparison of the amount by which the firm meets the regulatory capital requirement, shown as a percentage in Row [8].

6.15 The figures shown in the table are based on the most recent calculations of the SCR. For the Club and UKE, these are based on data forecast as at 20 February 2020. The UKNV calculation is based on roll-forward data as at 20 February 2021. I believe that this gives the best available view of the SCR of UKNV, given that UKNV is a new company, and it is instructive to show the calculation based on the ongoing company, after the Transfer.

UKE regulatory capital assessment

6.16 UKE is regulated by the PRA in the UK and falls under the Solvency II capital regime. UKE has elected to use a Partial Internal Model for the purpose of the Solvency II capital requirement. The key difference between the UKE Partial Internal Model and the Standard Formula is in respect of Underwriting Risk. The Partial Internal Model is calibrated to the Club as a mono-line insurer focusing on P&I liabilities, whereas the Standard Formula is calibrated to the whole of the European marine, aviation and transport insurance sector. The UKE Partial Internal Model has been approved by the PRA.

6.17 The figures in table 6a for UKE are based on a forecast to 20 February 2020. Prior to the Transfer, UKE meets the capital requirement by a large margin, with a 264% coverage ratio.

6.18 At the time of writing this report, UKE have not yet re-performed the SCR calculation for the post-transfer position. They are currently working out a timetable to do this, and I expect that this will be available for me to review as part of my Supplementary Report. I do not believe that it is of value here to carry out proxy calculations for this SCR post transfer. However, I can say with some certainty the SCR amount would remain broadly similar to levels prior to the Transfer. 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. Therefore, I believe that UKE would continue to meet that capital requirement after the Transfer.

6.19 The Solvency II Own Funds amount for UKE ($601m) is significantly higher than the Available Capital on a UK GAAP basis ($228m), as shown in table 4a. This is because the Solvency II Own Funds amount includes an allowance for the value of the Additional Premium Call, and also for the value of the investment in subsidiaries (UKE is the parent company of the group). The latter contribution also means that the market risk component of the SCR is relatively large.

6.20 The coverage ratio for UKE of 264% can be seen as strong as even if the reserves were to double or the value of financial investments fell by say 20% then the coverage ratio would still exceed 200%. This shows that UKE is well capitalised and able to meet its regulatory requirements.

UKNV regulatory capital assessment

6.21 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.

6.22 The figures in table 6a for UKNV are based on a forecast to 20 February 2021. I believe that it is instructive to use this date for the SCR of UKNV, because this gives a better indication for this new company.

6.23 Based on these projections, UKNV would meet the capital requirement by a large margin, with coverage ratios of 177% and 178% for the positions before and after the Transfer. The ratios are very similar; indeed, the amount of the recapitalisation of UKNV prior to the Transfer will be such that the Capital Adequacy Ratio will be maintained at this level.

6.24 I expect that if UKNV did implement a Partial Internal Model, then the SCR derived would be lower than the Standard Formula, given that the underwriting risk for the marine risks written by the Club are modelled as generally having less risk than that mandated by the Standard Formula calculation. Therefore, I believe that it is somewhat prudent to use the Standard Formula basis, and so this does not affect my conclusion on the Transfer.

My review of SCR calculations for UKE

6.25 I have reviewed the summary output and documentation from the Solvency II calculations of UKE and discussed the methodology used in this calculation with the management team.

6.26 The Partial Internal Model for UKE uses a specific model for the underwriting risk component of the calculation; all other components are based on the Standard Formula.

6.27 I have also considered the complexity of the risks inherent in UKE and whether the respective basis will capture those risks in an appropriate way. For each of Insurance, Counterparty Default, Market, and Operational Risks I consider that there is nothing unusual in the risk profile that would invalidate the approach; in particular:

- Insurance Risk: The Club only writes one specific type of marine insurance business (i.e., P&I) which might have different characteristics compared to the much wider Standard Formula definition of marine insurance business. By using their own model, UKE can allow for the specific features of the risk of their business in a model which uses the own historical data of the Club. This model can also allow for the specific features of the Club reinsurance programs.

- ► Market Risk: UKE do not hold any unusual types of investments (e.g., derivative instruments) that would give higher levels of risk than estimated by the Standard Formula.
- ► Counterparty Default Risk: UKE do not have any material counterparty default risk issues that would invalidate the Standard Formula approach. I am satisfied that the model gives sufficient allowance for the intra-club reinsurance.
- ► Operational Risks: I do not believe that there are any particular operational risks for UKE that would mean a higher than average level of operational risk.

6.28 Based on my review I believe that the SCR calculations for UKE is materially correct and has been calculated in an appropriate way.

My review of SCR calculations for UKNV

6.29 I have reviewed the summary output and documentation from the Solvency II calculations of UKNV and discussed the methodology used in this calculation with the management team. UKNV uses a Standard Formula Model for the purpose of the Solvency II capital requirement

6.30 The split of risk types for UKNV after the Transfer are as I would expect, with a large contribution from Counterparty Default risk, due to the materiality of the Intra-club reinsurance.

6.31 Based on my review I believe that the SCR calculations for UKNV is materially correct and has been calculated in an appropriate way.

Assessment of risk over longer time periods

6.32 For UKE and UKNV, the uncertainty over the eventual cost of the amount of claims will not be resolved until all claims are paid which will take longer than one-year and so there is more uncertainty around the ultimate payment of the reserves than is captured within the UKE and UKNV SCR calculations.

6.33 This additional uncertainty is one of the reasons why UKE and UKNV will hold a capital amount in excess of the SCR. As the SCR coverage ratio for UKE and UKNV will remain broadly unchanged following the Transfer, the allowance for these additional risks can be also be seen as broadly unchanged and so does not affect my conclusion on the Transfer.

6.34 Based on this I am satisfied that the SCR is a suitable basis to compare the impact on policyholders before and after the Transfer.

Capital objective for the Club and rating agency assessment

6.35 The Club has an overall target level of capital that they would like to maintain. This target is set not only to meet the regulator’s required capital (i.e., the SCR), but also to achieve an overall credit rating for the Club which is sufficiently high. Specifically, the Club aim to achieve an A rating from Standard & Poor’s, and to be reasonably sure (with a probability of 90%) that they would continue to have this rating over a future one-year period.

6.36 Therefore, the Club meets the SCR requirement (which, based on the Solvency II calibration, is intended to provide a high, 1 in 200 level of protection); but the Club then aims for an even higher level of protection, one which would gain an A rating from Standard & Poor’s, and be reasonably sure of keeping that A rating over time. The capital of the Club is almost fully fungible between UKE, UKNV and UKB meaning that almost all of the capital of the Club could be used by either UKE or UKNV (after the Transfer).

Overall conclusion on capital strength

6.37 My conclusion is as follows:

I believe that UKE and UKNV will both have a strong balance sheet after the Transfers, and that the probability of either firm becoming insolvent or otherwise unable to pay policyholders' claims is remote.

6.38 A summary of my reasons are as follows:

- Both UKE and UKNV are expected to meet their regulatory capital requirements by a large margin, both before and after the Transfer. The regulatory capital is calibrated at a 1 in 200 level of sufficiency over a one-year period. The fact that UKE and UKNV are expected to meet that requirement by a large margin suggests that there is a very high probability that the policyholders would have claim payments made as they fall due.
- The credit ratings provided by the rating agencies also suggest that UKE and UKNV are strongly capitalised.

6.39 As mentioned above, UKE and UKNV hold Own Funds well above the regulatory requirements, due to their desire to provide additional security to policyholders, which contributes to its high rating-agency grade. Although the present balance sheet positions of UKE and UKNV are sufficiently strong enough to comfortably cover expected liabilities, there always remains an inherent risk posed by a possible deterioration in the relative value of assets to liabilities. If a deterioration of this nature were to occur, then Own Funds may fall below the SCR. It is also important to note that even if an insurer does not have sufficient eligible Own Funds to meet the required capital level then this does not necessarily mean that it would not be able to settle all its claims in full. The balance sheet strength of the insurer may still be sufficient to pay its liabilities even if the regulatory capital amount is not met.

7. Assessment of other issues

7.1 In this section I will set out the issues relevant to each group of policyholders; these are:

- Customer service
- Impact of Brexit
- Policyholder communication strategy
- Direct and reinsurance policyholders
- Governance
- Other issues (pension arrangements, Financial Services Compensation Scheme, Ombudsmen Services, tax implications, ongoing regulation, accounting basis and set-off rights)

Customer service

7.2 UKE is currently managed on a day-to-day basis by Thomas Miller P&I (Europe) Limited (‘TMPI’), a company from the Thomas Miller Group based in the UK. There will be no change to this arrangement for UKE after the Transfer, and the same personnel and systems will provide the same level of customer service (including the treatment of any complaints) to policyholders of UKE.

7.3 Thomas Miller B.V. (“TMBV”) a company from the Thomas Miller Group based in the Netherland, provides resources and services UKNV, and in particular the underwriting and claims services. TMBV has a licence as an authorised insurance agent in the Netherlands.

7.4 I have reviewed the UKNV Corporate Governance Manual which lays out how the UKNV policyholders will have a similar level of customer service as UKE. TMBV has entered into a consultancy agreement with TMPI to be able to seek underwriting and claims handling consultancy services from TMPI. Additionally, the chairman of TMPI has been seconded to TMBV to join the management board of UKNV as the Chief Executive Officer. TMBV is and will remain be responsible for the interaction with policyholders (underwriting, claims and sales and distribution) drawing upon TMPI’s expertise and resources as and when required, and so will be able to ensure continuity of customer experience. There will be no change to the overall number of policies or the workload required to manage the policies and claims across UKE and UKNV

7.5 Overall, I believe this will ensure that the same level of service is provided to the customers of UKNV after the Transfers.

7.6 For Occupational Disease claims from 2001 and prior underwriting years the management of this business has been delegated to a R&Q subsidiary in anticipation of a future insurance business transfer. This effectively covers all of UKL business which will have transferred into UKE in the prior transfer and also the relevant claims from UKE. This arrangement will remain in place after the Transfer and as a result there is no change for these claims.

7.7 I do not, therefore, anticipate any detrimental changes to the customer service provided to policyholders after the Transfers.

Impact of Brexit

7.8 The UK voted to leave the EU on 23 June 2016 and then notified the European Commission of its intention to withdraw from the EU. The UK ceased to be a member state of the EU on 31 January 2020 (‘Brexit’). Brexit has introduced or exacerbated a number of risks for UK insurers conducting business across the EU. In particular, there is also a potential risk that after Brexit, UK insurers lose the ability to conduct such business through the loss of passporting rights (which remove the need to be authorised by local European regulators). Some potential areas of concern are market volatility with a particular emphasis on exchange rate volatility, a higher risk of negative interest rates in the future, and the impact of a changing regulatory environment.

7.9 This is currently a significant amount of interaction between UKE and clients located in the EEA, with different services moving across the border between the UK and the EEA. I set out below some of the main areas that I have identified; this is not an exhaustive list, but does cover, I believe, the most important areas of activity:

(i) UKE providing services to policyholders, where those policyholders are located in the EEA or have a part or all of their risk located in the EEA. These activities include, for example, paying claims, receiving and paying premium, dealing with customer queries and complaints, policy amendments and lapses, and liaising with insurance brokers. This also includes advertising and selling new policies.

(ii) UKE personnel and other resources in the UK providing services across Europe (for example, providing underwriting, finance, actuarial and claims handling expertise).

(iii) Data sharing (for example, of customer data) between UKE and other offices based in the EU.

(iv) Staff of the Club and Thomas Miller working and moving between office locations.

7.10 Most of those activities are regulated to some extent; the question is, to what extent those activities will still be permitted after Brexit. It is not currently clear what the outcome of the Brexit negotiations will be. However, it appears likely that passporting will not continue in its current form and so UKE is unlikely to be able to conduct regulated activities in the EEA after the transitional arrangements have expired. There may be a deal reached between the EU and the UK in respect of existing contracts (known as ‘contract continuity’). However, the EU and the European Insurance and Occupational Pensions Authority’s public positions to date have been that businesses should plan on the basis that existing EEA business cannot be serviced from the UK post-Brexit.

7.11 In the absence of a wider deal, it may be unlawful for UKE to provide services to Transferring Policyholders. The ability of UKE to provide services (including payment of claims or policy amendments etc.) in respect of the Transferring Policies is of vital importance to such policyholders. UKE being unable to provide these services to policyholders would clearly be detrimental to those policyholders. By effecting the Transfers, I believe that the Club will achieve some certainty in this area because these activities will be performed by a legal entity domiciled in the EEA (i.e., UKNV). UKNV would be legally able to provide those services to policyholders regardless of the outcome of the future relationship between the EU and the UK.

7.12 Many of the risks associated with Brexit are either unavoidable for insurance firms or could only be avoided with an unreasonable amount of time and resources, given the current state of knowledge. For example, post-Brexit, depending on the nature of the deal reached with the EU, there is a risk that employees of EEA member states would not be permitted to work in the UK. Given the current state of knowledge of the arrangements post Brexit, I think it would be unreasonable to expect the UKE to immediately begin contingency planning for this eventuality. Furthermore, this is a risk to UKE regardless of whether the Transfers are effected. Dependent on the nature of the deal, there are other activities that might not be permitted and it is possible that this could cause disruption to the Club and have some negative effect on policyholders. For example, there might be additional restrictions on sharing policyholder data between offices in the UK and offices in the EEA. However, the problem will arise regardless of whether the Transfers are effected; indeed, the problem of data sharing will actually be much worse in a scenario without the Transfer. For these reasons I believe that no policyholder will be made materially worse off due to the effect of these other Brexit related risks.

7.13 I have considered the overall approach taken by UKE in respect of Brexit. The primary course of action has been to effect the Transfer, which as I described above, will ensure continuity of service for those risks located in the EEA. I do not believe that it is reasonable at this stage to expect that UKE has effected other detailed plans to remedy other Brexit risks. I expect that UKE would be able to address some of those risks should they arise. I believe that this is consistent with the approach taken by other peer group companies of UKE with operations across the EEA, and this does not affect my conclusion on the Transfer.

7.14 Given all the above arguments, I believe that the most pragmatic solution to the Brexit related issues is to effect the Transfers. There are some Brexit risks which cannot be avoided in any practical way. However, I believe that the most material risks, relating to how services can be provided to EEA policies, can be mitigated by transferring those policies or parts of policies to UKNV.

Policyholder communication strategy

7.15 The regulations under the FSMA require that a communication is sent to every policyholder of the parties of an insurance business transfer scheme, unless the Court waives this requirement. Consideration is usually given to the practicalities and cost of this process, whilst having in mind the relevance of the scheme to policyholders. Ultimately, it is for the Court to grant these waivers.

7.16 UKE and UKNV propose to undertake procedures to notify policyholders and other interested parties of the Transfers. I have reviewed the material to be distributed to these parties, and am satisfied that this documentation is appropriate and that it includes sufficient detail on the Transfers. I understand that the following actions will be undertaken:

1. Notify various policyholders via email (where UKE and UKNV have an email address, or by post where it does not), directly and, if applicable, through a broker. Where a broker is also used UKE and UKNV will make arrangements with the broker that they receive regular updates on which policyholders have been notified. I believe that this is an appropriate method of notifying these policyholders because it is effective as it will reach all policyholders by either e-mail or post and using email as the primary notification approach when available should be easiest for the policyholders (and reduces the risk of postal addresses being out of date). Where email addresses are not valid this will be identified and postal notification provided in these circumstances.. UKE and UKNV will notify all policyholders except for those excluded by waivers (see below).

2. Notify the relevant reinsurers via email, directly and, if applicable, through a broker (where UKE and UKNV has an email address, or by post where it does not). Where a broker is used then UKE and UKNV have made arrangements with the broker that they receive regular updates on which reinsurers have been notified. I believe that this is an appropriate method of notifying these reinsurers because it is effective as it will reach all policyholders by either e-mail or post and using email as the primary notification approach when available should be easiest for the policyholders (and reduces the risk of postal addresses being out of date). Where email addresses are not valid this will be identified and postal notification provided in these circumstances.. UKE and UKNV will notify all reinsurers except for those excluded by waivers (see below).

3. Make relevant information, including this report, available on its website.

4. Advertise in the press.

7.17 UKE and UKNV intend to request that the Court grants certain waivers in relation to the notification requirements. In considering these requests I have considered the relevance of the Transfers to the policyholder, the extent to which they might be disadvantaged by not receiving further notification, the extent to which they might be inconvenienced by the notification, and the practicalities and costs of making the notification. The most material waivers requested are for:

1. Policyholders who entered into their policies before 20 February 2010, and do not have an outstanding claim. This assumption is consistent with the UKE and UKNV claims reserving analysis (which anticipates that there are not likely to be material future payments on those years of account in respect of claims which are currently unreported). I believe that this is a reasonable approach since it would be impractical to notify all of these policyholders, and they are very unlikely to make further insurance claims on those policies.

2. Reinsurers with whom UKE (or a reinsurance broker on its behalf) has placed reinsurance prior to 20 February 2010, where there are no outstanding claims. This is consistent with the approach to [1] above, and so I believe that this is reasonable.

3. Certain groups of beneficiaries and other groups where UKE and UKNV do not have contact details. The details of these parties are unknown and either cannot be notified or it would be very difficult to directly notify them. It is not possible to compile a list of all persons who fall within the statutory definition of 'policyholder' because, for example, a certificate may provide benefits to unnamed affiliates, and in any event the policy records do not provide names and addresses of all persons who potentially fall within the wider statutory definition. This is because many policies taken out by a policyholder of the Club also provide benefits for affiliates of that policyholder and/or other assureds. Typically, a policyholder will notify the Club of the names of affiliates or other assureds who should be listed on their policy but do not provide the Club with contact details for such affiliates or other assureds. In the course of the Club's dealings in respect of such policies, the policyholder named on the relevant certificate of entry will normally act as the representative for any affiliates or other assureds listed on its policies. UKE and UKNV have therefore requested that the Court grant a waiver from the requirement to notify all of its policyholders where such policyholders are affiliates or other assureds of a policyholder. In these circumstances, UKE and UKNV proposes to send one notification to the policyholder which shall be deemed to be notice to such policyholder's affiliates or other assureds. In this notification UKE and UKNV will request that the policyholder provide a copy of the notification to its affiliates or other assureds named on the relevant certificate of entry. I would not expect UKE and UKNV to hold the contact details of these parties and I do not believe that there is any practical way of identifying them. Therefore, I believe that this is a reasonable approach.

7.18 I also note that the contact details which policyholders should use will not change after the Transfers, and that UKE and UKNV have agreed to share any relevant communications from policyholders in relation to the Transferring Policies.

Gazettes, United Kingdom newspapers, newspapers in EEA states and other publications

7.19 In accordance with the Financial Services and Markets Act 2000 (Control of Business Transfers) Regulations 2001 (the 'FSMA Regulations'), it is proposed that a notice regarding the Transfers should be published in the London, Edinburgh and Belfast Gazettes and in two national newspapers in the UK. It is proposed that those two national newspapers should be 'The Financial Times' (both in its UK and International editions) and 'The Guardian' newspapers, in part, because these newspapers circulate in the rest of the world as well as the UK.

7.20 The records of UKE and UKNV have been carefully examined and they believe that it would be prudent to proceed on the basis that there is at least one direct policy and reinsurance policy in each of the current EEA states. A waiver has been requested from the Court of the requirement in the FSMA Regulations to publish a notice in two national newspapers in each such EEA state for direct policies and a notice in a business newspaper in each EEA state for reinsurance policyholders in favour of advertising in 'Lloyd's List' and 'Tradewinds'. UKE and UKNV estimate that the cost of advertising in two newspapers in every EEA state would be materially disproportionate. Further, UKE and UKNV believe that maritime industry publications which are widely read throughout the industry are far more likely to come to the attention of policyholders (past and present and whether direct policyholders or policyholders of entities reinsured by UKE), reinsurers and other interested parties than national daily newspapers within the relevant EEA states.

7.21 In the event that any regulator in an EEA state requires an additional publication to be made (e.g. in a national daily newspaper), it is intended that UKE and UKNV will comply with such requirements.

Conclusion on Communication Strategy

7.22 Given the above, I am not aware of anything in the proposed communication plan that would lead to a material adverse effect on any group of policyholders, and I therefore consider the proposed strategy to be reasonable.

Direct and reinsurance policyholders

7.23 A ‘direct policyholder’ is a corporate firm or an individual person who is insured by an insurance company. A ‘reinsurance policyholder’ is an insurance company which reinsures a part of their risks to a reinsurer. A changing mix of direct and reinsurance policyholders might have an impact on an insurance business transfer scheme because the ranking of creditors in the event of an insolvency is different for direct and reinsurance policyholders. In particular, direct policyholders would usually rank ahead of reinsurance policyholders.

7.24 The majority of the policyholders of UKE are ‘direct’ policyholders in the sense that they are individuals or owners of vessels and marine interests, as opposed to other insurance companies (in the latter case, an insurance company would insure some interests and then reinsure the risk to UKE). I have identified two sub-groups of policyholders to consider:

- Some of the business of the Club is fronted by another insurer. A local insurance company would write the underlying risk and would then reinsure to UKE. This typically arises where UKE do not have a license to write business in certain countries, and so require a fronting arrangement. These policyholders are ‘reinsurance policyholders’ before the Transfers, and will continue to be ‘reinsurance policyholders’ after the Transfers. Therefore, this issue does not affect my conclusion on the Transfers.

- The ‘direct’ policies transferring to UKNV will still be ‘direct’ after the Transfers. However, a large part of their security is derived from the intra-club reinsurance contract with UKE (and UKNV is a ‘reinsurance policyholder’ of UKE). Therefore, the transferring policyholders will effectively become ‘reinsurance policyholders’, and would rank behind direct policyholders of UKE in the event of an insolvency of UKE. In theory, this does reduce the level of security provided to those policyholders. However, as discussed from paragraph 6.35, there is a very high level of fungibility of capital in the Club, through the mechanisms created by the Intra-club Reinsurance and the Additional Call. Furthermore, as described in paragraph 6.38, I believe that it is very unlikely that UKNV would become insolvent. Therefore, this issue does not affect my conclusion on the Transfers.

7.25 For the above reasons I believe that the distinction between direct policyholders and reinsurance policyholders is of no practical significance, and this does not affect my conclusion on the Transfers.

Governance

7.26 I have been provided with and have reviewed the governance framework and policy documents for UKE. These documents describe the system of governance underpinning the management of the company.

7.27 For UKE, the documents set out the principles of governance, roles and responsibilities, governance structure, controls in place and escalation procedures. In my opinion, the governance framework for UKE contains all of the key elements that I would expect, and I consider this framework to be adequate for a company of this size and complexity. The governance structure for UKE will not change after the Transfers.

7.28 The governance structure for UKNV will be similar to UKE. This is as I would expect because there are similarities across the processes used. Some of the key differences between the UKE and UKNV frameworks are:

- There are fewer Key Function Holders and Board Reporting Committees for UKNV. However, given the smaller size and scope of UKNV compared to UKE, I consider this to be reasonable and that the structure is appropriate for the size of UKNV post the Transfer.
- The regulatory framework aspects of the governance structure are tailored to the requirements of DNB rather than PRA, which is as I would expect.

7.29 The governance frameworks for UKE and UKNV are as I would expect for firms of this size and complexity, and I did not identify any material differences between the two frameworks. Therefore, this does not affect my conclusion on the Transfers.

Other issues

The Financial Services Compensation Scheme

Background to the FSCS

7.30 Consumer protection is provided by the Financial Services Compensation Scheme ('FSCS') in the UK. This is a statutory 'fund of last resort' which compensates customers in the event of the insolvency of a financial services firm. Insurance protection exists for private policyholders and small businesses (with annual turnover of less than £1 million) in the situation where an insurer is unable to meet its liabilities.

7.31 The FSCS will pay 100% of any claim incurred for compulsory insurance (e.g., motor third party liability insurance or professional indemnity insurance) and 90% of the claim incurred for non-compulsory insurance (e.g., home insurance), without any limit on the amount payable. The FSCS is funded by levies on firms authorised by the PRA and FCA.

7.32 No protection is available for contracts of reinsurance or the following classes of insurance business:

- Aircraft: Contracts of insurance upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.
- Ships: Contracts of insurance upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.
- Goods in transit: Contracts of insurance against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.
- Aircraft liability: Contracts of insurance against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.
- Liability of ships: Contracts of insurance against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third party risks and carrier's liability.
- Credit: Contracts of insurance against risks of loss to the persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.

7.33 The FSCS covers risks located in the UK and EEA for insurance companies authorised in the UK.

The effect of a transfer on FSCS protection

7.34 The PRA has issued a policy statement (Policy Statement PS5/19: The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018) setting out the approach for its rules following Brexit, including those relating to the FSCS.

7.35 This paper explains that equivalent FSCS protection will be provided to transferring policyholders who transfer from a UK insurer to a "successor firm" (i.e., an insurance firm covering the policyholders following a transfer) if certain conditions are met. The same FSCS protection for eligible policyholders will be provided if the successor firm is a "relevant person". A "relevant person" may be loosely summarised in this context as an insurer with UK authorisation. Even if the successor firm is not a relevant person, the paper proposes that the transferring policyholders would retain some FSCS rights: specifically, claims arising from insured events which occur prior to the date of the transfer would be covered by the FSCS, but not claims arising from insured events occurring after the date of the transfer. In summary, the following cases would be covered by the FSCS after a transfer:

(i) If a policy is eligible for FSCS protection before the transfer, and the policy transfers to a successor firm which is a relevant person, then a claim on the policy would be eligible for FSCS protection after the transfer.

(ii) If a policy is eligible for FSCS protection before the transfer, and the policy transfers to a successor firm which is not a relevant person, then a claim on the policy is eligible for FSCS protection after the transfer only if the insured event which gave rise to the claim occurred before the date of the transfer.

Transferring Policies affected

7.36 I have considered the business written by UKE and do not believe there are policies protected by the FSCS given the FSCS does not cover "Liability of Ships" as described in 7.32. UKE has permission to write other business but to the best of their knowledge the management of UKE are not aware of writing anything other than "Liability of Ships" business. This also includes the UKL occupational disease claims which will have transferred immediately prior to the UKE to UKNV Transfer. Consequently, I do not expect any transferring policies to be affected.

7.37 Given that UKNV will not be classified as a relevant person, the Transferring Policies will fall under category (ii), as set out above in paragraph 6.18. Although I do not expect any transferring policies to be eligible for FSCS protection if for any reason a policy is eligible for FSCS protection before the Transfer (as UKE and UKL which will have transferred business to UKE before the Transfer had permission to write other business but we are not aware of any expected claims on any such policies), then a claim on the policy is eligible for FSCS protection after the Transfer only if the insured event which gave rise to the claim occurred before the Transfer Date.

Other compensation schemes available

7.38 My understanding is that in the Netherlands, there is no compensation scheme available to cover non-life insurance policies sold by UKE which are likely to offer protection.

Conclusion for Transferring Policyholders

7.39 I am satisfied that the Transferring Policyholders are not disadvantaged in relation to the FSCS arrangements for the following reasons:

- The Transferring Policies would be categorised as one of the classes of insurance business excluded from the scheme.

- The right to compensation arises only when an insurance company becomes insolvent. I describe in paragraph 6.37 the reasons why I consider that this is a remote possibility. Therefore, I believe that the scenario of needing to claim compensation under the FSCS or any other statutory compensation scheme is also remote.

- The Transfer is taking place in response to Brexit. There are other Brexit risks which have a greater impact than the loss of FSCS rights. However, without the Transfer those same policyholders would still be UKE policyholders and would have the corresponding Brexit risks as set out from paragraph 7.8. Of course, it is not possible to say with any certainty which of the many Brexit risks will materialise and which will turn out to be benign. But this does show that Brexit gives rise to advantages and disadvantages to both the Transfer and the status quo position; i.e., there are Brexit risks to various policyholders regardless of whether the Transfer is effected.

Financial Ombudsman Service

7.40 The Financial Ombudsman Service provides private individuals and micro-enterprises with a free, independent service for resolving disputes with financial companies. Micro-enterprises are defined to be businesses with less than €2m annual turnover and fewer than ten employees. It is not necessary for the private individual or micro enterprise to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the Financial Ombudsman Service. However, it is necessary for the insurance policy concerned to be, or have been, administered from within the UK and/or issued from the UK.

7.41 Following the Transfer, certain Transferring Policyholders who are currently eligible to refer a dispute with UKE to the UK Financial Ombudsman Service will lose such rights. However, based on UKE's analysis of the Transferring Policies, very few policyholders will be impacted due to the following reasons:

- Nearly all 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.

7.42 UKNV has also committed to the complaint handling procedures and any judgement, settlement or award of the Financial Ombudsman Service in relation to any acts or omissions made by UKE prior to the Transfer date.

7.43 There is a scheme in the Netherlands known as the Financial Services Complaints Board (Klachteninstituut Financiële Dienstverlening) (‘Kifid’). The Kifid only applies to policyholders who are consumers and would not cover the vast majority of transferring policyholders. UKNV has not applied for membership of Kifid as there would be few (if any) policyholders who would benefit and as a result no transferring UKNV policyholders will benefit from Kifid.

7.44 After the Transfer any European micro-enterprise policyholders would lose FOS rights for any acts or omissions made post Transfer, and there is no equivalent scheme for small businesses in the Netherlands. However, this does not affect my conclusion on the Transfer because:

  - In the last seven years, there have been no complaints made against UKE which were referred to the FOS.

  - I do not believe that there are any practical ways to provide replacement cover to the FOS.

  - Only a very small number of policies are affected.

Policyholders will be notified of this through the communication pack described in paragraph 7.15.

Tax implications of the Transfers

7.45 UKE has sought tax advice in respect of the Transfers from a law firm. They have reviewed the draft documents on the Transfers and have advised that neither transfer should give rise to a VAT charge. They have also advised that neither transfer should result in any other tax liability arising for any entity or for any other policyholder.

7.46 Therefore, any tax implications do not affect my conclusion on the Transfers.

Implications of the Transfers on ongoing expense levels

7.47 UKE will bear the cost of the Transfers; however, given the size of UKE, no material change is anticipated in its ongoing expense levels.

7.48 I therefore do not anticipate that this will create any adverse impact to policyholders as a consequence of the Transfers.

Regulatory protection

7.49 UKE is currently regulated by the PRA and the FCA in the UK, and UKNV is regulated by DNB in the Netherlands.

Prudential regulation

7.50 Prudential regulation considers the financial strength of insurance companies, and the need to manage risks and hold sufficient capital. These rules are regulated by the PRA in the UK and the DNB in the Netherlands. The prudential regulatory regimes in the UK and the Netherlands are based on Solvency II; this is an EU directive that sets out a single set of prudential and supervisory requirements for almost all European insurance companies. Solvency II does have some member state options in areas reserved for the home state supervisor; however, I do not believe that there are any material differences in the way that Solvency II is implemented in the UK and the Netherlands. Therefore, I consider that the prudential regulatory regimes in the UK and the Netherlands currently provide a broadly equivalent level of oversight to insurance firms in the respective countries.

7.51 Solvency II is written into UK Law, and therefore, immediately following the end of the transition period, there will be no change to the prudential regulatory regime in the UK. While it is possible that amendments could be made to the UK prudential regulatory regime following the end of the transition period, in my view the prudential regulatory protection provided by Solvency II within the UK will remain aligned with the prudential regulatory protection provided in the Netherlands in the foreseeable future.

Conduct regulation

7.52 The FCA is the conduct regulator in the UK. Its rules and guidance include conduct related requirements covering the way in which an insurance firm organises, manages and oversees and governs its business, including codes of conduct, fit and proper requirements and training and competence standards. In addition, conduct regulation covers the full product life cycle, from product design and development, sales and communications with customers, cancellations and claims handling, and complaints handling and compensation.

7.53 The Insurance Distribution Directive ('IDD') is EU legislation which sets out various regulatory requirements for designing and selling insurance products. This provides for some harmonisation of conduct rules across EEA states, although there is more flexibility for member states to create different local rules. The UK is subject to the requirements of IDD, and as such these were transposed into UK conduct regulation. In the UK, at the time of transposition, some of the existing rules were already 'gold plated versions' of the IDD requirements and in some cases during the transposition the UK regulator went further than required by the minimum harmonisation approach of IDD.

7.54 Conduct for insurance firms is regulated by the regulator in the country where a risk is located and by the regulator of the country where the business is carried out. The Transferring Policies will switch from a firm regulated in the UK to a firm regulated in the Netherlands; therefore, I have considered whether there are any differences in conduct regulation in the UK and the Netherlands, and whether this has any material adverse effect on policyholders.

7.55 The Autoriteit Financiële Markten ('AFM') is the conduct regulator in the Netherlands. I am not aware of any material differences in the way that the FCA and the AFM oversee conduct rules, and I am satisfied that the FCA and AFM provide a good level of oversight with regard to conduct regulation. In forming this conclusion, I have consulted with insurance professionals from the EY global network of firms who have expertise in insurance regulation in the UK and in the Netherlands.

7.56 There are some areas where the conduct regulations in the Netherlands differ from those in the UK; for example, the Netherlands does not have a formalised "section 166" regime (which allows the PRA and FCA to instigate a review from the third party into specific areas of an insurance firms business). However, we see that the AFM is actively pursuing the same conduct topics in their oversight and have demanded action from insurance companies that in effect leads to a fairly similar outcome from a conduct perspective (e.g., remediation of mis-selling, compensation of clients where required etc.). Given this, and the fact that there is a minimum level of conduct regulation provided by the requirements of the IDD, I am satisfied that there would be no material effect from the change in the conduct regulator.

7.57 To the extent that any conduct regulations apply in the location of an insurance risk, then the same conduct regulations will apply after the Transfer, because the location of risk will not change.

Conclusion on regulatory protection

7.58 For the above reasons I believe that the insurance regulatory regime in the Netherlands is broadly equivalent to the regime implemented in the UK, and that this will be the case for the foreseeable future. Furthermore, the Netherlands has a relatively large insurance industry, and a reputable regulator, commensurate in size for that industry. Therefore, I do not believe that a transfer to the Netherlands for the Transferring Policies has any material adverse effect in respect of regulatory protection.

Set-off rights

7.59 'Set-off' is a right that allows parties to cancel or offset mutual debts with each other by subtracting one from the other, and paying only the balance. I do not believe that there are any material set-off rights that can be exercised by cedants or reinsurers. I have not identified any set-off issues as part of my work, and so this does not affect my conclusion on the Transfers.

8. Reliances and limitations

Events following the modelling date

8.1 The conclusions in this report are based on various analyses that have been carried out on data as at different points in time (typically 20 February 2019). I have been informed by the Club that there have been no material changes between the modelling dates and the date of this report. However, future events could occur between the date of this report and the effective date of the Transfers that could change my conclusions. My supplementary report which I will provide prior to the sanction of the Transfers will update the Court on whether there have been any material changes since the issue of this report.

Reliance on other parties

8.2 In developing the conclusions in this report I have relied on the data and accompanying explanations supplied to me by and on behalf of the Club. I have received specific statements of data accuracy from UKE and UKNV. I have not specifically reviewed the data for accuracy and completeness, but I have reviewed it for reasonableness.

8.3 I have carried out investigations, as detailed in this report, to gain comfort on the appropriateness of the methodology and conclusions for the most significant liabilities. However, this has not amounted to a full re-estimation of every class of business, so by definition I have relied upon the reserving work performed on behalf of the Club for some components of the claims reserves. I believe that this is reasonable given the experience and professional qualification of the authors of the documents and the testing that I have carried out. The reviews that I have carried out on the reserves give no indication of any significant deficiency and I believe that appropriate methodologies have been adopted throughout.

8.4 I have also relied upon discussions that I have had with the management of the Club. Where appropriate, I have sought documentation from them to evidence the assertions made to me in these discussions.

8.5 Additionally, draft versions of this report have been reviewed by the management of the Club and challenged appropriately where they believed this report did not capture structural or contractual information in sufficient detail or clarity. The comments received are available for review if required.

Use of benchmarks

8.6 As well as analysing the trends of the historical claims development, I have also relied upon benchmarks from wider market experience. Whilst the Club's own claims development can be expected to vary from the benchmarks based on individual circumstances, I believe that the benchmarks are an appropriate check. However, benchmarks are revised periodically as new information and trends emerge, and it is likely that individual accounts will differ from the average. Therefore, it is possible that these benchmarks will not be predictive of the future claim reporting of the Club.

8.7 I have also used other benchmarks based on my wider market experience to assess the appropriateness of some of the assumptions used within the reserve estimations and capital modelling performed for the Club.

Other reliances

8.8 The underlying numbers contained in this report are calculated to many decimal places and so totals and summaries are subject to rounding differences.

8.9 In my judgement, the results and conclusions contained in this report are reasonable given the information made available to me. However, the actual cost of settling future claims and those still outstanding as at the valuation date is uncertain as, amongst other things, it depends on events yet to occur such as future court judgments. It could be different from the estimates shown in this report, and possibly materially so. Such differences between the estimated and actual outcome could possibly have a material impact upon the balance sheet strength of the companies involved, and therefore upon the Transfers.

8.10 At the time of writing this report the Covid-19 pandemic is ongoing, and its longer-term effects are unknown and uncertain. However, I do not believe that any of the pandemic issues I have identified would be made any worse by effecting the Transfers, and therefore this does not affect my conclusion on the Transfers.

8.11 I do not believe that there are any matters that are relevant to the policyholders' consideration of the scheme which I have not taken into account.

Appendix A Glossary

I have used the following key terms throughout this report:

Term	Definition
Additional Premium Call	An additional premium amount payable by the mutual policyholders of the Club, levied across all such policyholders when the Club needs to obtain additional capital.
Best Estimate	An estimate of claims reserves prepared with no margin for either prudence or optimism.
Counterparty Default Risk	The risk of any defaults of counterparties (i.e. any institution or individual that is a debtor to the undertaking).
Court	The High Court of England and Wales
Direct policyholders	A corporate firm or an individual person who is insured by an insurance company.
EEA	The European Economic Area (for the purpose of this report, this excludes the UK).
EU	European Union
External reinsurance	Reinsurance cover provided by reinsurers external to the Club.
FCA	The Financial Conduct Authority, one of the regulators of the insurance industry in the UK (in conjunction with the PRA).
FRC	The Financial Reporting Council, the body responsible for setting actuarial standards in the UK.
FSMA	Financial Services and Markets Act 2000
Gross Technical Provision	Total provision on a gross of reinsurance basis set aside for all of the future claim payments on a GAAP basis
IBNR	Incurred but not reported. Refers to the amounts an insurer will have to pay for claims that are reported in the future but relate to events that have already occurred.
Independent Expert	The suitably qualified person appointed by the court to produce an independent report on the Transfers, in accordance with the FSMA.
Insurance Risk	Risks relating to insurance policies sold, i.e., the risk that the cost of claims for which the insurer is responsible proves to be higher than expected.
Market risk	Risks relating to investment performance and changes in the value of investments.
MCR	Minimum Capital Requirement, a formulaic calculation of the capital requirement as part of the existing European Solvency II regulations for insurers.
Net Technical Provision	Total provision on a net of reinsurance basis set aside for all of the future claim payments on a GAAP basis
Operational risk	Risks relating to failure of operational procedures
Own Funds	Available capital to meet the capital requirements under Solvency II
PRA	The Prudential Regulatory Authority, one of the regulators of the insurance industry in the UK (in conjunction with the FCA).
QRT	Quantitative Reporting Template required to be completed by insurers and provided to regulators quarterly under Solvency II regulations (defined below).
SCR	Solvency Capital Requirement. The amount of capital insurers are required to hold under Solvency II regulations. If an insurer’s capital (i.e., the excess of its assets over its liabilities) falls below the SCR, it will trigger regulatory intervention, with the intention of remedying that position.

Term	Definition
SFCR	Solvency and Financial Condition Report – a report that the EU regulators require insurers to produce annually under Solvency II regulations (defined below) that is made publicly available.
Solvency II	An updated set of regulatory requirements for insurers that operate in the EU. These requirements apply to insurers from 1 January 2016.
Standard Formula	A prescribed approach under Solvency II for the calculation of capital based on an insurer's financial information (e.g. premium, claims reserves, etc.).
TAS 100	The Technical Actuarial Standard issued by the FRC which should be applied to all aspects of technical actuarial work.
TAS 200	The Technical Actuarial Standard issued by the FRC relating to matters where there is a high degree of risk to the public interest.
Transfers	The proposed insurance business transfers from (i) UKL to UKE (being Transfer 1) and (ii) from UKE to UKNV (being Transfer 2), with each being interdependent on the other. .
Transfer Dates	The date on which the Transfers become effective, currently expected to be 30 December 2020 in the case of Transfer 1 and 31 December 2020 in the case of Transfer 2.
UK GAAP	Generally Accepted Accounting Principles as defined in the UK
Underwriting Risk	The risks relating to the upcoming year of insurance business to be written, unexpired policies at the balance sheet date, and the uncertainties relating to the claims reserves at the balance sheet date.

Appendix B Extract from EY Terms of Engagement

This Statement of Work, dated 29 January 2020 (this “SOW”), is made by the UK firm of Ernst & Young LLP, a limited liability partnership incorporated under English Law with registered number OC300001 and registered office and principal place of business at 1 More London Place, London SE1 2AF (“we” or “EY”), The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited (“UKE”), UK P&I Club N.V (“UKNV”) and THE UNITED KINGDOM MUTUAL STEAM SHIP ASSURANCE ASSOCIATION (LONDON) LIMITED (“UKL”) (“you” or “Client”), pursuant to the Agreement, dated 9 April 2020 (the “Agreement”), between EY, UKE, UKNV and UKL.

Except as otherwise set forth in this SOW, this SOW incorporates by reference, and is deemed to be a part of, the Agreement. The additional terms and conditions of this SOW shall apply only to the advisory Services covered by this SOW and not to Services covered by any other Statement of Work pursuant to the Agreement. Capitalized terms used, but not otherwise defined, in this SOW shall have the meanings in the Agreement, and references in the Agreement to “you” or “Client” shall be deemed references to you.

Scope of services

This engagement will cover the appointment of Alex Lee as Independent Expert for the Part VII Transfer from The United Kingdom Mutual Steam Ship Assurance Association (Europe) Limited (“UKE”) to UK P&I Club N.V (“UKNV”) together with the Transfer of THE UNITED KINGDOM MUTUAL STEAM SHIP ASSURANCE ASSOCIATION (LONDON) LIMITED (“UKL”) to UKE (occurring just before the UKE to UKNV transfer) (all together the “Transfer”). We note that the primary duty of the Independent Expert in an insurance business transfer in the UK is to the High Court of England and Wales ("the Court").

We will:

- Analyse work you have carried out on the companies and portfolios of policies involved in the Transfer, including (but not limited to) the adequacy of the claims reserves and capital modelling analysis (under solvency rules) for each of the groups of policyholders who are affected by the Transfer.

- Supplement this with such additional calculations and investigations as the Independent Expert believes are necessary to enable him to form a view on the implications of the Transfer on the policyholders involved and communicate this to the Court.

We will prepare the following reports (together the “Reports”):

- A report (the ‘Report’) providing the Independent Expert's conclusions on the Transfer and explanation of those conclusions, to be presented in draft to the PRA and FCA (together the “UK financial regulators”) on a date agreed with the UK financial regulators and then updated as required following the feedback from both the UK financial regulators (PRA and FCA) and then delivered to the Court in sufficient time prior to the initial directions hearing.

- A supplementary report for each transfer (the ‘Supplementary Report’) to be presented to the Court at the final court hearing to consider the sanction of the Transfer. The Supplementary Report will discuss issues that have arisen between preparation of the Report and the final court hearing that the Independent Expert considers material to the Transfer, as well as any impact on his conclusions.

- A summary report for the transfer (the ‘Summary Report’). In accordance with the Financial Services and Markets Act 2000 and subordinate regulations, a summary of the Independent Expert's report will be provided to affected policyholders and any other person entitled to receive a copy to assist them with assessing the Transfer.

- Such further reports as may be required by the Court, the UK financial regulators or by you in connection with the Transfer, it being acknowledged that the preparation of such reports may incur additional costs which (if relevant) will be agreed in advance of the relevant work being undertaken.

We will ensure that the Reports comply with the requirements of the Financial Services and Markets Act 2000, PRA's Statement of Policy – "The Prudential Regulation Authority's approach to insurance business transfers", applicable case law, relevant professional guidance and requests made by the UK financial regulators and Part 35 of the Civil Procedure Rules (each as amended, supplemented or replaced from time to time). This includes any obligations we may have thereunder to evaluate and verify any information which you have provided to us in connection with the provision of the Services or the preparation of the Reports.

In performing the Services, we will use the skill, care, expertise and competence that could reasonably be expected from a highly reputable international consultancy firm or company providing to major multinational corporations the same or similar Services to those provided under the Agreement (including the particular skill and expertise of the Independent Expert selected for appointment to the Transfer).

Where the Independent Expert determines that he will require legal support in relation to any issues relating to the Transfer we will endeavour to use information produced by your legal advisors wherever possible. Where we do need to obtain an independent legal opinion on any matter we will agree with you the instructions for this legal advice and associated fees in advance.

As part of this engagement Alex Lee will be responsible for providing the report in his role as Independent Expert. In that role Alex will be undertaking the work on behalf of EY and EY takes responsibility for the work undertaken by its partners and employees. Specifically, in the context of clause 4 within Appendix B of this statement of work Alex will be personally responsible for the reports but that EY also takes responsibility for this work as a result of Alex being employed by EY.

Limitations on scope

As agreed with you, we will limit our advice to the matters outlined above and we will not consider any further implications of our advice. Our report will describe the methodologies that we have used and the reasoning behind our final conclusions but will not discuss in detail every assumption used in our analysis. Our report, advice and all correspondence will be addressed only to you. However, we have no objections to our reports being made available to your regulators in both the UK and other countries around the world, your auditors, your lawyers, parties entitled to a copy of the report under the FSMA/Regulations but only on the basis that if any of these parties choose to rely on its contents they do so entirely at their own risk. We would note that as is required under the FSMA/Regulations that the report will be publicly available during the Transfer. Should the report be requested by parties other than those listed above, a separate release letter for each request will be required, as per our standard terms of business.

The scope of our work will consist primarily of analytical procedures applied to data, using information and explanations provided to us by you. We will not be in a position to verify the accuracy of the data or the information or explanations provided and, consequently, our work will not constitute any form of audit of the information.

The methods we will use will be based on projecting aggregated claim data, and we believe that these methods conform to generally accepted actuarial methodology. It is possible that a more detailed approach, based on individual policy and claim data, would give a different result.

Interim working papers might be based on calculations or data that are not finalised or fully checked, and might require additional information to fully explain their context and implications. Therefore, interim working papers should not be relied on for any purpose unless accompanied by a signed statement from Ernst & Young LLP, stating the purpose for which they may be relied on.

Appendix C Curriculum vitae of Alex Lee

Background

Over 20 years' general insurance experience

Qualified as a Fellow of the Institute & Faculty of Actuaries in 1997

Joined Ernst and Young in 1999 and prior to this worked in the Commercial Insurance department of Eagle Star / Zurich Financial Services

Skills

Experienced in advising clients in the London & Bermuda markets

Focused on reserving, capital modelling, pricing, mergers and acquisitions and process review

Responsible for Research & Development and Knowledge Management

Professional Experience

Alex has been involved in many mergers and acquisitions of both ongoing companies and those in run-off working for both buyer and seller. As part of this work Alex has performed reviews of London Market, US and European business with significant experience in US Latent Claims reserving estimates and producing cash flow and business planning models to assess the viability of transactions.

He has significant reserving experience in the London Market and runs regular reserve reviews for some of the largest managing agencies in the Lloyd's of London market including performing the role of statutory signing actuary. In addition to this Alex has also performed many independent reserve reviews within the London market, Bermuda and UK retail markets. These reviews have included exposure to professional indemnity business through mutuals, companies and Lloyd's syndicates.

He has performed the role of independent expert on four previous transactions and also has worked on several Part VII transfers both producing information for the independent expert and as peer reviewer.

He assisted in the role of peer review actuary for two of the largest insolvencies in the London Market covering extensive US Latent claim exposures.

He has assisted with the production of ICA submissions for both Lloyd's and UK insurance entitles. In addition, Alex has also assisted in capital modelling for management for their internal clients.

He has been extensively involved in the audit of reserves for a wide range of EY audit clients both in the UK retail and London market area.

He has also been involved in pricing and process reviews. In particular, Alex was involved in a review of pricing processes for a large pan-European insurer.

He has also performed detailed reviews of reinsurance contracts and finite risk reinsurance arrangements for clients, in particular reviewing the accounting impact of these transactions on company's balance sheet and profit and loss statements.

Alex has the role in the actuarial leadership team of running the Research and Development function and the Knowledge Management area.

Appendix D Summary of data provided

Data area	File(s)
Financial information	UKE Financial Statements as at 20 February 2019
	UKE external actuarial report on reserves as at 20 February 2019
	UKE internal actuarial report on reserves as at 20 February 2019
	UKE internal actuarial report on occupational disease reserves as at 20 February 2019
	UKL Investment mandate with effective date 01 May 2018
	UKE Investment mandate with effective date 01 December 2018
	UKNV Investment mandate with effective date 01 March 2019
	Impact of Part VII transfer on UKNV
Reinsurance	Club reinsurance programme 2019
Capital and Risk	The Club ORSA, dated May 2019
	UKNV ORSA as at 20 February 2020
	UKE SFCR report as at 20 February 2019
	UKE SCR calculation as at 20 February 2019
Operational information	UKNV Corporate Governance Manual
	UKNV Recovery and Resolution Plan
	Keep well agreement between UKE and UKNV
	UKNV Reserving Policy

Appendix E Checklist against PRA's Statement of Policy and SUP18 of the FCA Handbook

The table below shows the relevant section references in this report where I have addressed each point in the guidance from Chapter 18 of the Supervision Manual of the FCA Handbook and the PRA's 'Statement of Policy - The PRA's approach to insurance business transfers – April 2015' with regards to the scheme report.

Guidance Reference	Guidance	Scheme Report reference
PRA 2.30 (1) FCA 18.2.33 (1)	Who appointed the independent expert and who is bearing the costs of that appointment	1.13, 1.17
PRA 2.30 (2) FCA 18.2.33 (2)	Confirmation that the independent expert has been approved or nominated by the PRA (or appropriate regulator);	
PRA 2.30 (3) FCA 18.2.33 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role;	1.13 and Appendix C
PRA 2.30 (4) FCA 18.2.33 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest;	1.15, 1.16
PRA 2.30 (5) FCA 18.2.33 (5)	The scope of the report;	1.21 to 1.22 and Appendix B
PRA 2.30 (6) FCA 18.2.33 (6)	The purpose of the scheme;	2.14
PRA 2.30 (7) FCA 18.2.33 (7)	A summary of the terms of the scheme in so far as they are relevant to the report;	2.11 to 2.13
PRA 2.30 (8) FCA 18.2.33 (8)	What documents, reports and other material information the independent expert has considered in preparing the report and whether any information that they requested has not been provided;	3.2 and Appendix D
PRA 2.30 (9) FCA 18.2.33 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgement of others;	1.23, 1.26, 3.16 and 8.2 to 8.5
PRA 2.30 (10) FCA 18.2.33 (10)	The people the independent expert has relied on and why, in their opinion, such reliance is reasonable;	1.23, 1.26, 3.16 and 8.2 to 8.5
PRA 2.30 (11) FCA 18.2.33 (11)	Their opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee;	2.73 to 2.88
PRA 2.30 (12) FCA 18.2.33 (11 A)	Their opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme;	2.40(ii)
PRA 2.30 (13) FCA 18.2.33 (12)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in their opinion, be relevant to policyholders' consideration of the scheme	8.10

PRA 2.30 (14) FCA 18.2.33 (13)	For each opinion that the independent expert expresses in the report, an outline of their reasons.	Throughout the report
PRA 2.33 (1) FCA 18.2.36 (1)	Include a comparison of the likely effects if it is or is not implemented;	2.65
PRA 2.33 (2) FCA 18.2.36 (2)	State whether they considered alternative arrangements and, if so, what;	2.90
PRA 2.33 (3) FCA 18.2.36 (3)	Where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences they consider may be material to the policyholders; and	2.73 to 2.88
PRA 2.33 (4) FCA 18.2.36 (4)	Include their views on: (a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer; (b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, claims handling, expense levels and valuation bases in relation to how they may affect: (i) the security of policyholders' contractual rights; (ii) levels of service provided to policyholders; or (iii) for long-term insurance business, the reasonable expectations of policyholders; and (c) the cost and tax effects of the scheme, in relation to how they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations.	Section 7
PRA 2.35 (1) FCA 18.2.38 (1)	For any mutual company involved in the scheme: Describe the effect of the scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes which could affect their entitlements as policyholders;	2.15
PRA 2.35 (2) FCA 18.2.38 (2)	State whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights; and	2.66
PRA 2.35 (3) FCA 18.2.38 (3)	Comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without	2.66