Report of the Independent Expert on the proposed transfer of the EEA businesses of Sompo Japan Nipponkoa Insurance Company of Europe Limited and Endurance Worldwide Insurance Limited to SI Insurance (Europe), SA and the non-EEA business of Sompo Japan Nipponkoa Insurance Company of Europe Limited to Endurance Worldwide Insurance Limited

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16 August 2018

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1. PURPOSE AND SCOPE

PURPOSE OF THE REPORT

1.1 It is proposed that the EEA (excluding UK) businesses of Sompo Japan Nipponkoa Insurance Company of Europe Limited ("SJNKE") and Endurance Worldwide Insurance Limited ("EWIL") be transferred to SI Insurance (Europe), SA ("SIIE") and that the non-EEA (including UK) business of SJNKE be transferred to EWIL by an insurance business transfer scheme (the "Scheme") as defined in Section 105 of the Financial Services and Markets Act 2000 ("FSMA").

1.2 Section 109 of FSMA requires that an application to the High Court of Justice in England and Wales (the "Court") for an order sanctioning an insurance business transfer scheme must be accompanied by a report on the terms of the transfer (the "FSMA Report") by an independent person ("the Independent Expert") having the skills necessary to make the report and who is nominated or approved by the Prudential Regulation Authority ("PRA"), having consulted with the Financial Conduct Authority ("FCA"). The FSMA Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.

1.3 SJNKE, EWIL and SIIE have nominated me to act as Independent Expert to provide the FSMA Report in respect of the Scheme, and the PRA has approved my appointment in consultation with the FCA (see paragraph 1.13 below).

1.4 This report (the "Report") describes the proposed Scheme and discusses its possible effects on the policyholders of SIIE, EWIL and SJNKE (in respect of all business of SIIE, EWIL and SJNKE), including effects on security and levels of service. As such, the Report fulfils the requirements of the FSMA Report.

1.5 SJNKE and EWIL are domiciled and regulated in the UK, while SIIE is domiciled and regulated in Luxembourg.

1.6 SJNKE, EWIL and SIIE are indirect subsidiaries of Sompo Holdings, Inc. In this Report I refer to Sompo Holdings, Inc. and its direct and indirect subsidiaries collectively as the "Sompo Group".

1.7 A list of terms defined in the Report is shown in Appendix A. Otherwise I use the same defined terms as are in the document that sets out the terms of the Scheme. Further, unless stated otherwise, the rates of exchange[1] used in the Report are £1.00 = $1.35 = €1.13 (as at 31 December 2017).

THE PROPOSED SCHEME

1.8 In a national referendum held in June 2016, the UK voted to leave the EU (otherwise known as "Brexit"). Although the terms of Brexit, including any transitional arrangements, are still being negotiated by the UK and the EU members who will remain, there is a risk of those UK insurers (including SJNKE and EWIL), who have hitherto been able to provide services to their policyholders elsewhere in the EEA through the UK's membership of the EU, being unable to provide continuity of service to those policyholders post-Brexit. To mitigate this risk, the Sompo Group has decided to restructure its operations in Europe. As part of this restructuring, a Framework Agreement between SJNKE, EWIL and SIIE (expected to be signed by end-August 2018) is to be put in place, which approves the:

- Renewal of SJNKE EEA policyholders with SIIE (with effect from September 2018);
- Renewal of EWIL EEA policyholders with SIIE (with effect from September 2018);
- Appointment by SIIE of Sompo Japan Nipponkoa Martin Et Boulart SAS ("M&B") as its underwriting agent in France;
- Appointment by SIIE of Canopius B.V. as its underwriting agent in the Netherlands;

[1] Source: Lloyd's Market Bulletin Y5149, dated 2 January 2018.

- Transfers of the remaining SJNKE EEA (excluding UK) (re)insurance business (the "Transferring SJNKE EEA (excluding UK) Business", as defined in Appendix A) and EWIL EEA (excluding UK) (re)insurance business (the "Transferring EWIL EEA (excluding UK) Business", as defined in Appendix A) to SIIE, and the transfer of the remaining UK and non-EEA (re)insurance business of SJNKE (the "Transferring SJNKE UK and non-EEA Business", as defined in Appendix A) to EWIL, all at a mutually convenient date (i.e. the Scheme).

1.9 Under the Scheme:

- all of the Transferring EWIL EEA (excluding UK) Business and all of EWIL's related liabilities and assets (including all external and intra-group reinsurance contracts protecting the Transferring EWIL EEA (excluding UK) Business) are to be transferred into SIIE;
- all of the Transferring SJNKE EEA (excluding UK) Business (including that arising from business transferred into SJNKE via earlier insurance business transfer schemes as defined in FSMA) and all of SJNKE's related liabilities and assets (including all external and intra-group reinsurance contracts protecting the Transferring SJNKE EEA (excluding UK) Business and any surplus assets in SJNKE) are to be transferred into SIIE; and
- all of the Transferring SJNKE UK and non-EEA Business (including that arising from business transferred into SJNKE via earlier insurance business transfer schemes as defined in FSMA) and all of SJNKE's related liabilities and assets (including all external and intra-group reinsurance contracts protecting the Transferring SJNKE UK and non-EEA Business) are to be transferred into EWIL.

1.10 The date on which the Scheme is to be implemented (the "Effective Date") is expected to be 1 January 2019. The transfers under the Scheme are therefore intended to have the effect that all the EEA (excluding UK) liabilities and assets (including reinsurance) of SJNKE and EWIL will pass under the Scheme to SIIE; and all the UK and non-EEA liabilities and assets (including reinsurance) of SJNKE will pass under the Scheme to EWIL.

1.11 The Scheme is to be carried out in conjunction with a cross border merger of SJNKE into SIIE (the "CBM"). Assuming that the Scheme and CBM proceed as planned, after the Effective Date, there remain no assets or liabilities within SJNKE and (as a consequence of the CBM) SJNKE will be dissolved without going into liquidation.

1.12 The business involved, the arrangements for the transfers and the effect of the transfers are discussed in more detail in Sections 3 to 10 of this Report.

THE INDEPENDENT EXPERT

1.13 I, Gary Wells, have been appointed by SJNKE, EWIL and SIIE as the Independent Expert to consider the Scheme under Section 109 of FSMA. My appointment has been approved by the PRA in consultation with the FCA; this was confirmed in a letter dated 30 November 2017.

1.14 I am a Principal of Milliman LLP ("Milliman") and I am based in its UK General Insurance practice in London. I am a Fellow of the Institute and Faculty of Actuaries which was established in 2010 by the merger of the Institute of Actuaries and the Faculty of Actuaries. I became a Fellow of the Institute of Actuaries in 1986. My experience of general insurance includes the (reserved) roles as Chief Actuary (non-life including Lloyd's) and Signing Actuary to Irish non-life insurance companies, as well as acting as the Independent Expert in a number of insurance business transfer schemes. A list of previous schemes for which I have acted as independent expert under the terms of FSMA, and as an independent actuary under the Insurance Companies Act 1982, the legislation replaced by FSMA, can be found in Appendix B.

1.15 To the best of my knowledge I do not have, and have never had, any policies issued by any part of the Sompo Group, of which SJNKE, EWIL and SIIE are ultimately subsidiaries. I am not a shareholder of any entity that is part of the Sompo Group. I have undertaken no work for SIIE, EWIL or for SJNKE – save for two Part VII transfers under FSMA as follows:

- I was the Independent Expert for the transfer of the Italian branch business of SJNKE to Transfercom Limited. The transfer was approved by the Court on 17 December 2012; and
- I was the Independent Expert for the transfer of the business of Nipponkoa Insurance Company (Europe) Limited to SJNKE. The transfer was approved by the Court on 24 July 2015.

1.16 I note that Milliman is part of Milliman, Inc., a global consulting firm and, as such, Milliman Inc. practices have worked with parts of the Sompo Group on assignments globally. Milliman Inc.'s worldwide annual revenue in respect of the Sompo Group (including former entities of Endurance Speciality Holdings Limited) has not, however, exceeded 0.1% of the firm's total fee income over each of the last 5 years. In addition, I was the Independent Expert for the transfer of the UK branch business of Sompo Japan Nipponkoa Insurance, Inc. ("SJNKI") to Transfercom Limited. The transfer was approved by the Court on 26 February 2016, and has no connection with the proposed Scheme.

1.17 I do not believe that my involvement or that of other consultants within the Milliman Group with the Sompo Group subsidiaries affects my ability to act independently in my assessment of the Scheme.

1.18 The Scheme is subject to sanction by the Court under Section 111 of FSMA.

1.19 SJNKE and EWIL will equally meet the costs of my work as Independent Expert. No costs of the Scheme will be borne by any of the policyholders of any of SJNKE, EWIL and SIIE.

THE SCOPE OF MY REPORT

1.20 My terms of reference have been reviewed by the PRA and are set out in Appendix C.

1.21 I have considered the terms of the Scheme only and have not considered whether any other scheme or alternative arrangement might provide a more efficient or effective outcome.

1.22 The Report describes the Scheme and the likely effects on policyholders of SJNKE, EWIL and SIIE, including effects on security and levels of service.

1.23 The Report should be read in conjunction with the full terms of the Scheme.

1.24 My work has required an assessment of the liabilities of SJNKE, EWIL and SIIE for the purposes of describing the effect of the Scheme. My review of the liabilities was based on the actuarial reserve assessments conducted by internal and/or external actuaries of SJNKE, EWIL and SIIE. I have reviewed the methodology and assumptions used in their work and assessed the key areas of uncertainty in relation to these liabilities. I have not attempted to review in detail the calculations performed by the internal actuaries of SJNKE, EWIL or SIIE or to produce independent estimates of the liabilities.

1.25 In addition to the liabilities, I have assessed the appropriateness in nature and amount of any assets to be transferred under the Scheme, and the capital position of SJNKE, EWIL and SIIE pre and post Scheme. Again, I have not attempted to review in detail the calculations of the capital position performed by SJNKE, EWIL or SIIE or to produce independently my own estimates.

1.26 As far as I am aware, there are no matters which I have not taken into account in undertaking my assessment of the Scheme and in preparing the Report, but which nonetheless should be drawn to the attention of policyholders in their consideration of the Scheme.

1.27 In reporting on the Scheme as the Independent Expert, I recognise that I owe a duty to the Court to assist the Court on matters within my expertise. This duty overrides any obligation to SJNKE, to EWIL and / or to SIIE. I confirm that I have complied with this duty.

1.28 I have taken account of the requirements regarding experts set out in Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Protocol for Instruction of Experts to give Evidence in Civil Claims.

1.29 I confirm that I have made clear which facts and matters referred to in the 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.

1.30 Shortly before the date of the Court hearing at which an order sanctioning the Scheme will be sought, I will prepare a supplementary report (the "Supplementary Report") covering any relevant matters which might have arisen since the date of the Report.

1.31 It is intended that both this Report and the Supplementary Report will be published on the SJNKE, EWIL and SIIE websites, on pages dedicated to the Scheme, and that copies of this Report and the Supplementary Report will be sent to any policyholders who request them. The Report will be made available in this way immediately following the directions hearing relating to the Scheme (or as soon thereafter that the dedicated pages on the SJNKE, EWIL and SIIE websites have been set up) and the Supplementary Report will likewise be made available at least one week before the date of the final Court hearing.

THE STRUCTURE OF MY REPORT

1.32 The remainder of the Report is set out as follows:

- Section 2: I provide an executive summary of the Report (I have also provided a separate summary of the Report as described in paragraph 1.40 below).
- Sections 3 & 4: I provide some background information regarding the regulatory environments in which SJNKE, EWIL and SIIE (collectively, the "Companies") operate, and then regarding the Companies themselves.
- Section 5: I summarise the key provisions of the Scheme.
- Section 6: I consider the likely impact of the Scheme on those policyholders whom the Scheme would move from SJNKE and from EWIL to SIIE, and on those policyholders whom the Scheme would move from SJNKE to EWIL.
- Section 7: I consider the likely impact of the Scheme on the policyholders who would remain within SJNKE and EWIL after the transfers have taken place.
- Section 8: I consider the likely impact of the Scheme on the current policyholders of SIIE.
- Section 9: I cover more general issues relating to the Scheme and the management of SJNKE, EWIL and SIIE.
- Section 10 I summarise my conclusions.

RELIANCES AND LIMITATIONS

1.33 In carrying out my review and producing the Report, I have relied, without detailed verification, upon the accuracy and completeness of the data and information provided to me, in both written and oral form, by SIIE, EWIL and SJNKE. I note that the data and information has been provided to me by PRA and FCA approved persons or other members of the senior management of the Companies or by responsible professionals from the Companies' advisors.

1.34 I have been assisted in my review of the information and my analyses by my colleagues at Milliman, but I have not relied on their work or their advice. Further, I have met in person or conducted conference calls with representatives of the Companies to discuss the information provided to me and specific matters arising out of the considerations and analysis conducted.

1.35 Reliance has been placed upon, but not limited to, the information detailed in Appendix D. My opinions depend on the substantial accuracy of this data, information and the underlying calculations. I am unaware of any issue that might cause me to doubt the accuracy of the data and other information provided to me. All information that I have requested in relation to my review has been provided.

1.36 I have also relied upon the draft witness statements made on behalf of SJNKE, EWIL and SIIE that confirm all information that has been provided to me by the Companies is correct and complete in all material aspects; and there has been no material adverse change to the financial position of the Companies since that information was provided to me.

1.37 The Report has been prepared for the purposes of the Scheme in accordance with Section 109 of FSMA. A copy of the Report will be sent to the FCA and PRA, and will accompany the Scheme application to the Court.

1.38 The Report must be considered in its entirety as individual sections, if considered in isolation, may be misconstrued.

1.39 Neither the Report, nor any extract from it, may be published without me having provided my specific written consent, save that copies of the Report may be made available for inspection by policyholders and by the financial regulatory authorities in Luxembourg (the Commissariat aux Assurances or "CAA"), and copies may be provided to any person requesting the same in accordance with legal requirements. I also consent to the Report being made available on the SJNKE, EWIL and SIIE websites, on pages dedicated to the Scheme.

1.40 No summary of the Report may be made without my express consent. I will provide a summary of the Report (the "IE Summary") for inclusion in a document that will be made available to the policyholders of SIIE, EWIL and SJNKE, to the reinsurers of EWIL and SJNKE, and to others affected, e.g. anyone with an interest in the policies being transferred who has notified SJNKE, EWIL or SIIE of their interest. That document will be sent to the FCA and PRA, will accompany the Scheme application to the Court, will be available for inspection by the CAA, and will be available on the SJNKE, EWIL and SIIE websites, on pages dedicated to the Scheme.

1.41 The Report has been prepared within the context of the assessment of the terms of the Scheme, and must not be relied upon for any other purpose. No liability will be accepted by Milliman or me, for any application of the Report to a purpose for which it was not intended or for the results of any misunderstanding by any user of any aspect of the Report. In particular, no liability will be accepted by Milliman or me under the terms of the Contracts (Rights of Third Parties) Act 1999, as may be amended from time to time.

1.42 Actuarial estimates are subject to uncertainty from various sources, including changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, economic and investment conditions. Therefore, it should be expected that the actual emergence of claims, premiums, expenses and investment income will vary from any estimate. Such variations in experience could have a significant effect on the results and conclusions of the Report. No warranty is given by Milliman or me that the assumptions, results and conclusions on which the Report is based will be reflected in actual future experience.

1.43 This review does not comprise an audit of the financial resources and liabilities of SJNKE, EWIL or SIIE.

1.44 The Report should not be construed as investment advice.

1.45 Nothing in the Report should be regarded as providing a legal opinion on the effectiveness of the Scheme. For the avoidance of doubt, where I have repeated the legal opinion of external lawyers, these are lawyers of the parties to the proposed Scheme and, while the contents of such legal opinion has informed my view, I am not expressing a personal legal opinion

1.46 In considering the background to the Companies involved in the Scheme, and in considering the likely impact of the Scheme, I have made extensive use of financial information as at 31 December 2017 as that is, in general, the most recent date at which audited financial information is available. I have also taken into account updated financial information which has been made available to me, although I note that this updated information has not been audited. I have asked the managements of SJNKE, EWIL and SIIE for information regarding any developments since 31 December 2017 that would have affected those companies, in particular any development that might have affected the security of their policyholders and the standards of service provided to them. I have referred in the Report to the developments that they have reported to me. The managements of SJNKE, EWIL and SIIE have assured me that there have been no other such developments. At the date of the Report, I am not aware of any material changes in circumstances since 31 December 2017 other than those referred to in the Report. The Report also takes no account of any information that I have not received, or of any inaccuracies in the information provided to me. I will review all further audited financial statements as at 31 December 2017 and other financial updates of SJNKE, EWIL and SIIE as and when they become available, and will comment (as appropriate) on this information in my Supplementary Report.

1.47 I have relied on the currency exchange rates found in the financial statements and in other information provided. Unless otherwise stated the rates of exchange used are as set out in paragraph 1.7 above.

1.48 The Report has been seen by the Companies (i.e. by PRA and FCA approved persons or other members of the senior management of the Companies and by responsible professionals from the Companies' advisors) and each entity has agreed it is correct in terms of all factual elements of the Scheme.

1.49 The use of Milliman's name, trademarks or service marks, or reference to Milliman directly or indirectly in any media release, public announcement or public disclosure, including in any promotional or marketing materials, websites or business presentations, is not authorised without Milliman's prior written consent for each such use or release, which consent shall be given in Milliman's sole discretion.

PROFESSIONAL AND REGULATORY GUIDANCE

1.50 I am required to comply with relevant professional standards and guidance maintained by the Financial Reporting Council ("FRC") and by the Institute and Faculty of Actuaries, including *TAS 100: Principles for Technical Actuarial Work* and *TAS 200: Insurance*. I confirm that I have complied with such standards, subject to the principles of proportionality and materiality.

1.51 In accordance with Actuarial Profession Standard ("APS") X2, as issued by the Institute and Faculty of Actuaries, I have considered whether this Report should be subject to review ("Work Review"). I concluded that it should and I have also decided that the Work Review should be conducted by an individual who has not otherwise been involved in the analysis underlying this Report or in the preparation of the Report, but who would have had the appropriate experience and expertise to take responsibility for the work himself. In other words I have decided that the Report should be subject to Independent Peer Review. I confirm that this Report has been subject to Independent Peer Review prior to its publication.

1.52 The Report has been prepared under the terms of the guidance set out in the Statement of Policy entitled *The Prudential Regulation Authority's approach to insurance business transfers* (the "Policy Statement"), issued in April 2015 (see Appendix E), and in Section 18 of the FCA Supervision Manual ("SUP18") contained in the Handbook of Rules and Guidance to cover scheme reports on the transfer of insurance business.

2. EXECUTIVE SUMMARY

CONCLUSION

2.1 In my opinion, provided the proposed Scheme operates as intended, and I have no grounds for believing that it will not do so:

- The security of benefits to policyholders of SJNKE, EWIL and SIIE will not be materially adversely affected by the implementation of the Scheme on the Effective Date; and
- The Scheme will not materially adversely impact on the service standards experienced by the policyholders of SJNKE, EWIL and SIIE.

2.2 I have explained in Appendix F what I mean by "materially adversely" and how I have evaluated whether I would consider something to be "materially adverse".

2.3 I summarise below the key aspects of the Scheme, the aspects of the Scheme that I considered, and the conclusions that I reached in respect of those aspects.

2.4 I will review my analyses and conclusions in the light of any relevant information of which I become aware prior to the Court hearing to sanction the Scheme, and I will summarise my additional review and conclusions, explaining any revisions to those contained within this Report, in a Supplementary Report.

THE SCHEME

2.5 Under the Scheme, the Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business, in each case together with all associated rights, benefits, powers and liabilities, in concert with the transferring assets (including external and intra-group reinsurances modified as described in paragraph 2.22 below), plus the surplus assets of SJNKE (other than £4 million of retained assets that are to transfer under the CBM) will be transferred to SIIE from SJNKE and EWIL. Further, the Transferring SJNKE UK and non-EEA Business, together with all associated rights, benefits, powers and liabilities, in concert with the transferring assets (including external and intra-group reinsurances modified as described in paragraph 2.24 below), will be transferred to EWIL.

Motivation for the Scheme

2.6 The vote by the UK to leave the EU (i.e. Brexit) puts SJNKE and EWIL at risk of being unable to provide continuity of service to some of its clients. As a result, Sompo International Holdings Ltd ("SIH") has established a new company in Luxembourg (i.e. SIIE) from which renewal terms may be offered to SJNKE's and EWIL's current EEA (excluding UK) risks on or after 1 September 2018 (or thereabouts). Further, SIH has chosen EWIL to be its sole carrier for UK and non-EEA risks, from which renewal terms may be offered to SJNKE's current UK and non-EEA risks on or after 1 September 2018 (or thereabouts).

2.7 In order that the remaining EEA (excluding UK) (re)insurance business of SJNKE and the remaining EEA (excluding UK) (re)insurance business of EWIL is also moved to SIIE, and the remaining UK and non-EEA (re)insurance business of SJNKE is also moved to EWIL, the Scheme needs to be implemented, subject to the Court's consent, on the Effective Date (prior to Brexit).

2.8 Further, the Scheme is to be carried out in conjunction with a cross-border merger of SJNKE into SIIE (the "CBM"). As a consequence of the CBM, SJNKE will be dissolved without going into liquidation.

2.9 The proposed Scheme is therefore part of an internal reorganisation of the EEA subsidiaries of the Sompo Group, that enables SIH to continue to provide policy servicing, administration, claims management and handling, and underwrite EEA (excluding UK) business and UK and non-EEA business, as well as to ensure compliance with EEA laws and regulations following the departure of the UK from the EU.

Policyholders Affected

2.10 I have considered the effects of the Scheme on the following five groups of policyholders:

- those holders of Direct Policies issued by SJNKE either (1) through its branches in Belgium, France, Germany, Italy or Spain, or by its agent, Canopius BV in the Netherlands, or (2) through its head office where such policies include a risk or policyholder situated in an EEA state other than the UK; and those holders of Assumed Reinsurance Policies issued by SJNKE either (1) as facultative reinsurance policies administered through its branches in Belgium, France, Germany, Italy or Spain, or by its agent, Canopius BV in the Netherlands, or (2) with cedants in Croatia, Greece, Latvia, Liechtenstein, Luxembourg, Poland or Slovakia – the "Transferring SJNKE EEA (excluding UK) Policyholders";
- those holders of Direct Policies issued by EWIL through its UK head office where such policies include a risk or policyholder situated in an EEA state other than the UK; and those holders of Assumed Reinsurance Policies issued by EWIL with cedants in Croatia, Greece, Latvia, Liechtenstein, Luxembourg, Poland or Slovakia – the "Transferring EWIL EEA (excluding UK) Policyholders";
- those holders of policies issued by SJNKE under which SJNKE is the insurer or reinsurer other than the holders of Transferring SJNKE EEA (excluding UK) Policies – the "Transferring SJNKE UK and non-EEA Policyholders";
- the current policyholders of EWIL who have policies that are not being transferred – the "Non-Transferring EWIL Policyholders"; and
- the current (as at the Effective Date) policyholders of SIIE – the "SIIE Policyholders".

2.11 In relation to the five groups of policyholders identified in paragraph 2.10 above I have, where necessary, also considered a split on a more granular basis, in particular:

- Policyholders eligible for protection under the Financial Services Compensation Scheme ("FSCS") and/or eligible for dispute resolution services provided by the Financial Ombudsman Service ("FOS"). Some of the personal business of the Companies is protected under the FSCS. Policyholders eligible for protection under the FSCS will receive at least 90% of any claim incurred in the unlikely event of the insolvency of SJNKE, EWIL or SIIE (as appropriate). Policyholders not covered under the FSCS may have less security than those covered under the FSCS and I comment herein on the impact within each of the Companies. In a similar manner, some of the personal business of the Companies is eligible for dispute resolution services as provided by the FOS. Policyholders not covered under the FOS may have less access to adequate complaint handling procedures and I comment herein on the impact within each of the Companies;
- Direct and Reinsurance policyholders – under the laws of both the UK and Luxembourg, inwards reinsurance policyholders rank behind direct policyholders in the event of insolvency. This means that, in the unlikely event that SJNKE, EWIL or SIIE is declared insolvent, all valid direct policyholders' claims will be paid in full before any inwards reinsurance policyholders' claims start to be paid. Direct and Reinsurance policyholders therefore have different rights and need to be considered separately; and
- ILU guaranteed policyholders – some of the business of the Companies was written within the ILU and benefitted from a parent company guarantee that was a condition of writing ILU business. Policyholders protected by this guarantee therefore have access to an additional level of security.

2.12 It is intended that all of the outstanding (re)insurance liabilities of SJNKE will be transferred as part of the Scheme and that therefore, post-Scheme, there will be no remaining policyholders of SJNKE.

Administration

2.13 The Scheme is primarily a legal and financial reorganisation of the EEA businesses operating under the Sompo International brand and will not result in any significant changes to the administration of the SJNKE, EWIL or SIIE businesses. Nonetheless, I note that SIIE plans to establish a UK (third country) branch, subject to approval by the PRA/FCA, ahead of Brexit in order that policies that involve exposures across both the UK and the rest of the EU (and possibly the EEA) can be serviced if needed in the UK. If, for whatever reason, approval of a UK (third country) branch by the PRA/FCA is not forthcoming on or before Brexit, then any UK risk component will be administered by SIIE's offices outside the UK (as there is no UK legal requirement for UK risks to be serviced in the UK).

THE IMPACT OF THE SCHEME UPON THE TRANSFERRING POLICYHOLDERS

2.14 I am satisfied that the proposed Scheme does not affect in a materially adverse way either the security or the policy servicing levels of the Transferring SJNKE UK and non-EEA Policyholders, the Transferring SJNKE EEA (excluding UK) Policyholders or the Transferring EWIL EEA (excluding UK) Policyholders. I have reached this conclusion by considering:

2.14.1 the reserves of the Companies as at 31 December 2017 (and subsequently where available);

2.14.2 the excess assets of the Companies as at 31 December 2017 (and subsequently where available);

2.14.3 the guarantees provided to the Companies pre- and post-Scheme;

2.14.4 the risk exposures in the Companies and the impact that the Scheme might have on those; and

2.14.5 the impact of the Scheme on non-financial aspects (e.g. standards of policy servicing in each of the Companies).

2.15 I concluded that:

2.15.1 the reserves of SJNKE and EWIL appeared reasonable as at 31 December 2017;

2.15.2 SIIE is expected to be reasonably reserved with effect from 1 September 2018 (or thereabouts) as it will follow SIH’s reserving policy (as do SJNKE and EWIL);

2.15.3 there is no reason to think that the reserve strength of SJNKE, EWIL or SIIE will be impacted by the Scheme;

2.15.4 as at 31 December 2017, SJNKE is a very well-capitalised company and EWIL is a very well-capitalised company (I have defined these terms in paragraph 6.5 below);

2.15.5 as at the Effective Date (of the Scheme), SJNKE is forecast to be a well-capitalised company (as it anticipated that SJNKE will make a significant intra-group capital distribution prior to the Effective Date), EWIL is forecast to be a very well-capitalised company and SIIE is forecast to be a very well-capitalised company;

2.15.6 for the holders of the Transferring SJNKE EEA (excluding UK) Policies moving to SIIE under the Scheme:

- the additional security that they currently enjoy under the Net Worth Agreement (“NWA”) provided by SJNKI (the “SJNKE NWA”) will cease on the Effective Date (as that agreement applies to SJNKE, which itself will cease as a result of the Scheme and the CBM) but such policyholders will enjoy the additional security under a NWA provided by Endurance Specialty Insurance Ltd (“ESIL”) to SIIE (the “SIIE NWA”) to be implemented prior to the Effective Date. I note that the SIIE NWA replacing the SJNKE NWA is structured so as to maintain SIIE’s capital resources at 150% of its SCR rather than at 130% as per the SJNKE NWA;

- the additional security that certain policyholders of SJNKE enjoy (over and above the capital resources held within SJNKE) provided by an ILU guarantee (whereby SJNKI guarantees the payment of valid claims for policies written via the ILU) will continue on the same terms and will continue to operate in the same way in respect of SIIE after the Scheme;

- that, pre-Scheme, were eligible for FSCS protection and/or eligible for dispute resolution services provided by the FOS may lose such eligibility from the Effective Date. Nevertheless, as SIIE is forecast to be a very well-capitalised company, its insolvency appears to be only a remote possibility and so a call on the protection provided by the FSCS likewise appears to be remote. If policyholders lose access to the FOS from the Effective Date then they will be able to have their complaints heard by the Luxembourg ombudsman service, and any access to dispute resolution schemes that they may have in their own country will not be affected by the Scheme;
- that are reinsurance policyholders, they will continue to rank behind direct policyholders upon winding-up. Nonetheless, as SIIE is forecast to be a very well-capitalised company its insolvency appears to be only a remote possibility.

2.15.7 for the holders of the Transferring EWIL EEA (excluding UK) Policies moving to SIIE under the Scheme:

- the additional security (over and above the capital resources held within EWIL) that they enjoy under the NWA (that is scheduled to replace the Surety Bond before the Effective Date) provided by ESIL (the "EWIL NWA") will cease on the Effective Date (as that agreement applies to EWIL) but such policyholders will enjoy the additional security under the SIIE NWA provided (on essentially equivalent terms) by ESIL to SIIE, to be implemented prior to the Effective Date;
- that pre-Scheme were eligible for FSCS protection and/or eligible for dispute resolution services provided by the FOS may lose such eligibility from the Effective Date. Nevertheless, as SIIE is forecast to be a very well-capitalised company its insolvency appears to be only a remote possibility and so a call on the protection provided by the FSCS likewise appears remote. If policyholders lose access to the FOS from the Effective Date then they will be able to have their complaints heard by the Luxembourg ombudsman service, and any access to dispute resolution schemes that they may have in their own country will not be affected by the Scheme;
- that are reinsurance policyholders, they will continue to rank behind direct policyholders upon winding-up. Nonetheless, as SIIE is forecast to be a very well-capitalised company its insolvency appears to be only a remote possibility.

2.15.8 for the holders of the Transferring SJNKE UK and non-EEA Policies moving to EWIL under the Scheme:

- the additional security (over and above the capital resources held within SJNKE) that certain policyholders of SJNKE enjoy under the SJNKE NWA will cease on the Effective Date, but such policyholders will enjoy the additional security under the EWIL NWA, to be implemented prior to the Effective Date. I note that the EWIL NWA replacing the SJNKE NWA is structured so as to maintain EWIL's capital resources at 150% of its SCR rather than at 130% as per the SJNKE NWA;
- the additional security (over and above the capital resources held within SJNKE) that they enjoy provided by an ILU guarantee (whereby SJNKI guarantees the payment of valid claims for policies written via the ILU) will continue on the same terms and will continue to operate in the same way in respect of EWIL after the Scheme.

2.15.9 the holders of the Transferring SJNKE EEA (excluding UK) Policies and the holders of the Transferring EWIL EEA (excluding UK) Policies will not be materially adversely affected due to relative differences in the financial strength of SIIE post-Scheme to those of SJNKE and EWIL pre-Scheme;

2.15.10 the holders of the Transferring SJNKE UK and non-EEA Policies will not be materially adversely affected due to relative differences in the financial strength of EWIL post-Scheme to that of SJNKE pre-Scheme;

2.15.11 although the proposed Scheme will lead to a change to the risk exposures of the Transferring SJNKE UK and non-EEA Business, the Transferring SJNKE EEA (excluding UK) Business, and to the Transferring EWIL EEA (excluding UK) Business, this will not have a materially adverse impact on the security of policyholder benefits; and

2.15.12 the proposed Scheme will not result in any significant changes to the standards of policy servicing experienced by holders of the Transferring SJNKE UK and non-EEA Policies, the holders of Transferring SJNKE EEA (excluding UK) Policies, and the holders of Transferring EWIL EEA (excluding UK) Policies compared to their current position.

THE IMPACT OF THE SCHEME UPON THOSE POLICYHOLDERS REMAINING WITHIN EWIL

2.16 I have concluded that the Scheme will have negligible impact on those policyholders remaining within EWIL.

2.17 In reaching this conclusion I have noted that the net effect of transferring the Transferring SJNKE UK and non-EEA Business into EWIL and transferring the Transferring EWIL EEA (excluding UK) Business out of EWIL is projected to represent a very small part of EWIL's portfolio at the Effective Date (i.e. around 1% of the forecast gross UPR and Claims reserves as at 31 December 2018). The proposed Scheme will therefore result in a small decrease to the liabilities of EWIL and with a *de minimis* net effect on the capital (and regulatory capital position) of EWIL. Further, the policy servicing of the non-transferring business of EWIL will be unchanged by the proposed Scheme.

2.18 I also note that for the Non-Transferring EWIL Policyholders, the additional security they enjoy under the Surety Bond provided by ESIL to EWIL (as outlined in paragraph 4.106 below) is to be replaced by the EWIL NWA (as described in paragraphs 4.110 to 4.114 below) that is to be implemented prior to the Effective Date. I further observe that the EWIL NWA is structured to maintain EWIL's capital resources at 150% of its SCR rather than at 100% as per the Bond.

THE IMPACT OF THE SCHEME UPON THOSE POLICYHOLDERS CURRENTLY WITHIN SIIE

2.19 I am satisfied that the Scheme will not have a materially adverse impact on the security of existing SIIE policyholders or the service levels provided to the policyholders of SIIE.

2.20 In reaching this conclusion I have taken account of the fact that SIIE is scheduled to commence underwriting business with effect from 1 September 2018 (or thereabouts) and received additional capital of €85.5 million (paid-in on 31 May 2018). Therefore, while the Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business will be large compared to the existing portfolio at the Effective Date (of the Scheme), SIIE is projected to be a very well-capitalised company over the projection period (2018 – 2022). Further, there will be no change to the administration or policy servicing of the existing SIIE policyholders as a result of the Scheme.

2.21 I also note that the current SIIE policyholders will enjoy the additional security under the SIIE NWA, both pre- and post-Scheme.

THE IMPACT OF THE SCHEME UPON REINSURERS OF SJNKE AND EWIL

2.22 SIH intends to modify the outwards reinsurance contracts that currently provide reinsurance protection to the business written by SJNKE. This means that SIH will reach agreement with each reinsurer that the reinsurance that they provide will continue to apply both to all of the Transferring SJNKE EEA (excluding UK) Business that transfers to SIIE, and to all of the Transferring SJNKE UK and non-EEA Business that transfers to EWIL. Therefore, after the modification of reinsurance is completed there would be no material change to the reinsurance protecting the business written by SJNKE.

2.23 I am informed that SIH has already reached an internal agreement in principle to proceed with modifications with those reinsurers of SJNKE that are part of the Sompo Group. There is a small number of reinsurers of SJNKE external to the Sompo Group, and SIH is currently carrying out a project to identify such reinsurance contracts and to reach agreement with the providers of those contracts by 1 November 2018.

2.24 SIH also intends to modify certain of the outwards reinsurance contracts that currently provide reinsurance protection to the business written by EWIL. This means that SIH will reach agreement with each reinsurer that the reinsurance that they provide will continue to apply to all of the Transferring EWIL EEA (excluding UK) Business that transfers to SIIE. Therefore, after the modification of reinsurance is completed there would be no material change to the reinsurance protecting the business written by EWIL.

2.25 I am informed that SIH has already reached an internal agreement in principle to proceed with modifications with those reinsurers of EWIL that are part of the Sompo Group. There are a number of reinsurers of EWIL external to the Sompo Group, and SIH is currently carrying out a project to identify such reinsurance contracts of EWIL and to reach agreement with the providers of those contracts by 1 November 2018.

2.26 I am informed by SIH that all necessary modifications of both internal and external reinsurance treaties of SJNKE and EWIL are expected to be completed by 1 November 2018 (i.e. prior to the Effective Date).

THE IMPACT OF THE SCHEME IN RESPECT OF OTHER MATTERS

2.27 I have been informed that the Scheme is not expected to have tax implications that would affect any of the Companies or any of the groups of policyholders identified in paragraph 2.10 above.

2.28 I have been provided with an estimate of the external costs of the Scheme. I consider it unlikely that the costs of the Scheme will be such as to jeopardise the security of any of the groups of policyholders.

APPROACH TO COMMUNICATION WITH POLICYHOLDERS

2.29 The Companies intend to communicate details of the Scheme to their policyholders. I have set out my understanding of the proposed approach to communicating the Scheme to policyholders in Section 9.

2.30 When thinking through the proposed approach to communicating the Scheme to policyholders, I have considered a number of factors, including whether the policyholders in SJNKE, EWIL or SIIE are likely to be interested in being informed of the proposed Scheme. In this context, I believe that the approach to policyholder notifications needs to consider the likelihood of a policyholder having a claim, whether the policyholder's policy is transferring and the impact of the Scheme on security. I have therefore weighed these issues up against the risk of policyholder notifications causing confusion or annoyance in relation to an issue that policyholders may consider to be insignificant, and the practicability of notifying policyholders.

2.31 I consider the proposed approach to communicating the Scheme to be appropriate, reasonable and proportionate, but note and accept that the Court is the final arbiter on this issue.

KEY ASSUMPTIONS

2.32 In conducting my analysis I have made the following key assumptions:

2.32.1 SIIE (authorised by the CAA) is to commence writing (re)insurance business with effect from 1 September 2018 (or thereabouts), and accept the business moving to SIIE under the Scheme on the Effective Date (expected to be 1 January 2019);

2.32.2 SIIE will have set up branches in Belgium, France, Germany, Italy, Spain and the UK (on a Freedom of Establishment basis) with effect from 1 September 2018 (or thereabouts) as approved by the CAA (and the host country regulators);

2.32.3 SIIE will have established a third country branch in the UK, subject to approval from the PRA, on or before the end of the Brexit Transition Period (as described in Appendix A);

2.32.4 it is not planned that there will be an increase in the aggregate liability or risk exposures in the Companies as an immediate consequence of the Scheme that would not have occurred were the Scheme not to proceed;

2.32.5 the same level of assets and liabilities will exist in the Companies in aggregate after the Scheme as immediately before the Scheme (when valued on the same accounting basis before and after);

2.32.6 all the necessary modifications (as described above) of both internal and external reinsurance treaties of SJNKE and EWIL are completed prior to the Effective Date;

2.32.7 no significant additional tax liabilities will arise as a result of the Scheme for any of the Companies;

2.32.8 both EWIL and SIIE have no current intention to cease underwriting or carry out further restructuring of their businesses as a result of the Scheme;

2.32.9 there will be no policyholders left in SJNKE after the Scheme, as all existing policyholders of SJNKE will become policyholders of EWIL or SIIE as a result of the Scheme; and

2.32.10 while the Scheme allows for Excluded Policies, none are expected at this time, and any Excluded Policies would be known before the date of the final Court hearing. In the event that such policies are identified I will address them in a Supplementary Report.

2.33 The above assumptions underlie the analysis and conclusions in my Report. If these assumptions were to change, my opinion may also change. At the time of writing my Report, the above assumptions are the current intentions for the Scheme and the Companies, as informed to me by SIH.

3. BACKGROUND REGARDING THE REGULATORY ENVIRONMENTS

3.1 In this section I describe the general insurance markets and the regulatory regimes that operate in the UK and in Luxembourg, the latter being where SIIE is domiciled and regulated.

OVERVIEW OF THE UK INSURANCE MARKET

Background

3.2 UK insurers, as well as other financial services organisations, are regulated by both the PRA and the FCA using a system of dual regulation. The PRA and the FCA are statutory bodies set up under FSMA and the Financial Services Act 2012; their roles and objectives are defined by FSMA (as amended).

3.3 The PRA is part of the Bank of England and is responsible for:

- Prudential regulation of banks, building societies and credit unions, insurers and major investment firms;
- Promoting the safety and soundness of the firms it regulates, seeking to minimise the adverse effects that they can have on the stability of the UK financial system; and
- Contributing to ensuring that insurance policyholders are appropriately protected.

3.4 The FCA is a separate institution and is responsible for:

- Ensuring that the markets that it regulates function well;
- Conduct regulation of all financial firms; and
- Prudential regulation of those financial services firms that are not supervised by the PRA.

3.5 A Memorandum of Understanding has been established between the PRA and the FCA, which sets out the high level framework by which these two regulatory bodies will co-ordinate. In particular, the Memorandum of Understanding requires the PRA and FCA to co-ordinate with each other in advance of insurance business transfers under Part VII of FSMA.

3.6 The PRA sets the regulations governing the amount and quality of solvency capital held by firms; these are summarised below. The solvency regime is designed to protect the security of policyholders, as well as the stability of the insurance industry.

3.7 The FCA is concerned with achieving fair outcomes for consumers and seeks to ensure that firms adhere to its conduct principles. Its strategic objective is to ensure that the relevant markets function well. To support this, it has three operational objectives, which are:

- To secure an appropriate degree of protection for consumers;
- To protect and enhance the integrity of the UK financial system; and
- To promote effective competition in the interests of consumers.

Taxation

3.8 In the UK, general insurance companies are taxed on profits achieved at the main rate of corporation tax (currently 19%[2] for the financial year ending 31 March 2018).

[2] The UK Corporation Tax rate is expected to reduce to 17% with effect from 1 April 2020.

Financial Services Compensation Scheme

3.9 As well as through the PRA and FCA regulations, consumer protection is also provided by the FSCS. This is a statutory "fund of last resort" which compensates customers in the event of the insolvency (or other defined default) of a financial services firm authorised by the PRA or FCA, subject to certain eligibility rules. Insurance protection exists for private policyholders and small businesses[3] that hold eligible policies in the situation when an insurer is unable to meet fully its liabilities. For general insurance business, the FSCS will pay 100% of any claim incurred before the default:

- in respect of a liability subject to compulsory insurance (such as employers' liability cover); or
- that arises in respect of a liability subject to professional indemnity insurance; or
- that arises from the death or incapacity of the policyholder due to injury, sickness, or infirmity compulsory insurance;

and at least 90% of the claim incurred before the default for other eligible types of insurance (such as home insurance). These limits have been effective since 3 July 2015; prior to that date, for general insurance business, only claims in respect of compulsory insurance were eligible for 100% payment by the FSCS in the event of the default of an authorised firm. The FSCS is funded by annual levies on all firms regulated by the PRA and by the FCA, with separate tariffs for each of five broad classes of activity (deposits, life and pensions, general insurance, investments and home finance).

Financial Ombudsman Service

3.10 The FOS provides private individuals (and micro enterprises[4]) with a free, independent service for resolving disputes with financial companies. 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 FOS; it is necessary for the insurance policy concerned to be, or have been, administered from within the UK.

FCA Conduct Principles

3.11 Within its document "*Fair treatment of customers*", the FCA sets out six consumer outcomes that firms should strive to achieve to ensure fair treatment of customers. These remain core to what the FCA expects of firms. These are as follows:

- Outcome 1: Consumers can be confident that they are dealing with insurers where the fair treatment of customers is central to the corporate culture;
- Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly;
- Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale;
- Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances;
- Outcome 5: Consumers are provided with products that perform as insurers have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect; and
- Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by insurers to change product, switch provider, submit a claim or make a complaint.

3 In accordance with Section 382 of the Companies Act 2006, a small business is defined as one for which two of the following three conditions apply over the preceding financial year: turnover not more than £10.2 million; balance sheet not more than £5.1 million; and not more than 50 employees.

4 Micro-enterprises (an EU term covering smaller businesses) can bring complaints to the FOS as long as they have an annual turnover of less than €2 million and fewer than ten employees.

3.12 These principles, which are often summarised as "Treating Customers Fairly" ("TCF"), apply even for firms that do not have direct contact with retail customers. The FCA's rationale is that risks and poor conduct can be carried from wholesale to retail markets.

3.13 The UK (like all other European Union ("EU") Member States) will also be obliged to implement the Insurance Distribution Directive (see paragraph 3.18 below) by 1 October 2018 (following transposition into local regulations/laws by 1 July 2018).

The Insurers (Reorganisation and Winding-Up) Regulations 2004

3.14 Under English law, the winding-up of an insurance undertaking is governed by the Insurers (Reorganisation and Winding-Up) Regulations 2004 (as amended under the Solvency II Regulations 2015). Under these regulations, insurance claims have precedence over any claim on the insurance undertaking with the exception of certain preferential claims (e.g. claims by employees, etc.) with respect to the whole of the insurance undertaking's assets. Therefore, direct policyholders rank equally and above inwards reinsurance policyholders and all other unsecured/non-preferential creditors in the event that an insurer is wound up.

OVERVIEW OF THE LUXEMBOURG INSURANCE MARKET

Background

3.15 Luxembourg is a small country with a population of around 0.6 million (less than 1% of that of the UK). Its insurance industry is focused on distributing products under the EU freedom to provide services rules, with around 90% of business being conducted outside of Luxembourg. In 2014 total gross insurance premiums written in Luxembourg amounted to €2.9bn. Around €0.9bn (or 30%) of these premiums related to non-life insurance business. As of 2014, there were 95 insurance companies authorised in Luxembourg.

3.16 Luxembourg's insurance and reinsurance regulator is the CAA. The CAA was established pursuant to the insurance sector legislation enacted on 6 December 1991. The CAA is a public body under the authority of the Minister of Treasury and Budget, but with a distinct legal personality and financial autonomy.

3.17 The CAA's remit includes:

- the examination of applications for the approval of insurance and reinsurance businesses and insurance intermediaries (agents and brokers);
- the prudential supervision of these same companies and people;
- providing assistance to international and European meetings for the development of common standards; and
- the elaboration of draft laws and regulations relating to the insurance sector and coordinating the efforts of the Luxembourg government for the orderly expansion of the activities of the Luxembourg insurance sector.

Conduct Principles

3.18 On 20 January 2016, the Council of the EU issued Directive (EU) 2016/97, the Insurance Distribution Directive (the "IDD"), which is to be implemented by Luxembourg (and all other EU Member States) by 1 October 2018 (following transposition into local laws by 1 July 2018).

3.19 The key requirements of the IDD are:

- Product oversight and governance arrangements ("POG") aimed at ensuring customers' interests are taken into consideration throughout the whole life cycle of an insurance product;
- Transparency of inducement schemes aimed at ensuring respect of customers' interests;
- The insurance undertaking (or insurance intermediary) providing advice to a customer is responsible for the assessment as to whether the insurance product(s) is/are suitable and appropriate having regard to the customer's profile; and
- A conflict of interest policy to facilitate customers' understanding of an insurance undertaking's actions taken on their behalf.

3.20 Business carried-on through a branch is subject to the conduct of business regulations, including consumer protection rules, of the host country of each respective branch. The regulator in the country hosting each branch oversees the compliance of that branch with its insurance laws and regulations, implementing, *inter alia*, the relevant EU Directives.

Consumer Protection

3.21 In Luxembourg:

- there is a non-life insurance protection scheme; however, it only covers motor third-party liability ("MTPL") policyholders in the event of an insurer's insolvency; and
- the Médiateur en Assurances provides a free complaints mediation service for eligible complainants. This scheme will assist the parties to help reach a negotiated settlement and will issue a decision upholding or rejecting the complaint, although the decision is a recommendation only and is not binding on either party.

3.22 Further, where an entity based in Luxembourg operates in other EEA territories (in whole or part) on a Freedom of Establishment ("FoE") basis, policyholders of that entity may be eligible to make complaints via the host state regulator or other organisation in the country that their respective branch is located in.

Winding-up legislation

3.23 My understanding is that in the event of the winding-up of an insurance company under Luxembourg regulations, insurance claims take absolute precedence over any other claim on the insurer, with respect to assets representing the Technical Provisions (subject to certain rules). Therefore, direct insurance creditors rank ahead of inwards reinsurance creditors and all other unsecured/non-preferential creditors in the event that an insurer is wound-up.

3.24 It follows, therefore, that, in the case of a winding-up of an insurance company where there are sufficient assets to cover the Technical Provisions, the Luxembourg regime in respect of the priority of insurance debts generally would be expected to be at least as favourable to policyholders and beneficiaries as the UK regime.

3.25 Conversely, in the situation of a winding-up of an insurance company where there are insufficient assets to cover the Technical Provisions, the UK regime would be expected to be at least as favourable to policyholders and beneficiaries as the Luxembourg regime.

3.26 The comparative position of policyholders in a UK insurer versus policyholders in a Luxembourg insurer in a winding-up situation is therefore a function of the assets available (and their size relative to the Technical Provisions) and the proportion of inwards reinsurance business relative to direct business.

SOLVENCY CAPITAL FRAMEWORK (SOLVENCY II)

3.27 The current regulatory solvency and reporting requirements for (re)insurers regulated within the EU came in to effect from 1 January 2016. The regime, which is commonly referred to as Solvency II, has introduced, consistently across the EU, solvency requirements that reflect the risks that individual (re)insurers actually face.

3.28 Under Solvency II, EU (re)insurers are now required to adhere to a set of risk-based capital requirements, some of the results of which will be shared with the public.

3.29 Solvency II is a principles-based regime, based on three so-called pillars:

- Under Pillar I, quantitative requirements define a market consistent framework for valuing the company's assets and liabilities, and determining the Solvency Capital Requirement ("SCR").
- Under Pillar II, insurers must meet minimum standards for their corporate governance, and also for their risk and capital management. There is a requirement for permanent internal audit and actuarial functions. Insurers must regularly complete an Own Risk and Solvency Assessment ("ORSA").
- Under Pillar III, there are explicit requirements governing disclosures to supervisors and policyholders.

3.30 A key change under Solvency II, compared to GAAP, is that the liabilities are valued on a market consistent basis, which gives rise to a number of differences in the determination of Technical Provisions (as discussed in paragraph 3.32 below).

3.31 I set out in Appendix G simplified details for the balance sheet, and the calculation of Technical Provisions (in respect of claims incurred and losses arising from unexpired exposures), for an insurer under Solvency II.

3.32 The Technical Provisions required under Solvency II as relating to general insurance business are:

- the premium provision – the expected present value (with no allowance for optimism or prudence) of all future cash-flows (claim payments, expenses and future premiums due) relating to future exposures arising from policies that the insurer is obligated to at the valuation date;
- the claims provision – the expected present value (with no allowance for optimism or prudence) of all future cash-flows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date; and
- the risk margin – the risk margin is intended to be the balance that another (re)insurer taking on the liabilities at the valuation date would require over and above the sum of the premium provision and claims provision. Under Solvency II, the risk margin is calculated using a cost-of-capital approach (presently employing a 6% cost of capital parameter as set out in EU regulation[5]).

3.33 The Technical Provisions in respect of claims required under Solvency II differ from the GAAP claims reserves as follows:

- The Technical Provisions contain no element of conservatism above a best estimate that may be held in the undiscounted GAAP reserves;
- The Technical Provisions include an allowance for events not in data ("ENID"), which are events or future developments that might occur but which are not represented in the historical data upon which the actuarial projections are based;
- The Technical Provisions include a discount to account for the time value of money in the future cashflows; and
- The Technical Provisions include a risk margin.

[5] Commission Delegated Regulation (EU) 2015/35 dated 10 October 2014

I discuss the impact of these differences in Appendix H.

3.34 The SCR under Solvency II is the amount of capital required to ensure continued solvency over a one-year time frame with a probability of 99.5%. There are two main approaches to calculating the SCR:

- Using an internal model approved by the local supervisor: an internal model calculation of the SCR is based upon an assessment of the risks specific to an insurer, and is calibrated so as to correspond to a confidence level of 99.5% over a one-year trading period that net assets remain positive (i.e. the insurer remains solvent); or

- Using the standard formula specified in detail in the Solvency II legislation: the standard formula is designed to be applicable to all insurers and is not therefore tailored to the circumstances of an individual insurer. In summary, the basic SCR consists of 5 risk modules (non-life, life, health, market and counterparty) that are in turn further sub-divided into 18 sub-modules (e.g. premium and reserve risk, catastrophe risk and currency risk). The results for each sub-module are aggregated using a correlation matrix to arrive at a capital charge for each of the 5 main modules, which in turn are aggregated using a further correlation matrix to determine the basic SCR. A further module is used to calculate operational risk which is added to the basic SCR to produce the (standard formula) SCR.

3.35 The Minimum Capital Requirement under Solvency II ("MCR") defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over a one-year time frame (compared to 99.5% for the SCR). The MCR is calculated as a linear function of the Technical Provisions and written premium but must be between 25% and 45% of the firm's SCR, subject to an absolute floor of €2.5 million (or €3.7m for (re)insurers writing liability, credit or suretyship classes).

3.36 If an insurer's available resources fall below the SCR, then supervisors are required to take action with the aim of restoring the insurer's finances back to the level of the SCR as soon as possible. If, however, the financial situation of the insurer continues to deteriorate, then the level of supervisory intervention will be progressively intensified. The aim of this "supervisory ladder" of intervention is to capture any ailing insurers before their situation becomes a serious threat to policyholders' interests. If the available resources of the insurer were to fall below the level of the MCR, then "ultimate supervisory action" would be triggered, i.e. the insurer's liabilities would be transferred to another insurer and the license of the insurer would be withdrawn, or the insurer would be closed to new business and its in-force business run-off. In practice, supervisors would be expected to have determined earlier on whether or not the insurer's finances could be restored to above the level of the SCR – an insurer whose supervisor determined would not be able to restore its solvency position would be placed into run-off before it breached its MCR.

3.37 Article 30 of the Solvency II Directive states that "*the financial supervision of insurance and reinsurance undertakings, including that of the business they pursue either through branches or under the freedom to provide services, shall be the sole responsibility of the home Member State*". The financial supervision of all the business written by or transferred to SJNKE and EWIL is currently the responsibility of the PRA. If the Scheme is sanctioned then the Luxembourg regulator (the CAA) will assume responsibility for the financial regulation of the Transferring SJNKE EEA (excluding UK) Business and Transferring EWIL EEA (excluding UK) Business, while the PRA will continue to have responsibility for the financial regulation of the Transferring SJNKE UK and non-EEA Business (as well as the Non-Transferring EWIL Business).

Brexit

3.38 In the UK Referendum on Continuing EU Membership in June 2016, the majority of participants voted for the UK to leave the EU. On 29 March 2017, in a letter to the EU Council, the UK Government triggered Article 50 of the Lisbon Treaty and formally started the process by which the UK will leave the EU (commonly referred to as "Brexit"). Article 50 of the Lisbon Treaty gives both sides two years to reach agreement on the terms of such an exit so, unless the UK and all of the remaining EU Member States agree to extend the deadline for negotiating those terms, the UK will cease being a Member State of the EU on or before 29 March 2019.

3.39 I consider some of the other possible impacts of Brexit as they might affect the Scheme later in this Report, but at this stage I note that, following Brexit, the UK Government might seek to cancel certain pieces of legislation that were enacted in accordance with EU Directives. One such legislative item might be that which implemented Solvency II. However, I note the following:

- The UK played a prominent role in the development of Solvency II;
- The costs for the insurance industry of implementing Solvency II were considerable and it is likely that the costs of implementing a replacement solvency regime that was materially different from Solvency II would also be very large;
- Solvency II took many years to develop and to implement, and it is likely that any materially different replacement solvency regime would also take a long time to develop and to implement; and
- There is a strong desire within the UK insurance industry that the UK solvency and prudential regime maintains “equivalence” with the Solvency II regime that will remain in place throughout the remaining countries of the EU, to facilitate cross-border operations without unnecessary duplication of regulation.

3.40 Therefore, notwithstanding Brexit, I believe it to be very unlikely that there will be any material change to the UK solvency capital regime in the short to medium term. I have therefore not considered further this possibility in this Report.

COMPARISONS BETWEEN THE UK AND LUXEMBOURG

Capital and Reserve Requirements

3.41 The majority of EU insurers have implemented the solvency regime, known as Solvency II (see paragraph 3.27 above) from 1 January 2016. This has had the effect of putting regulatory capital and reserve requirements in the UK and Luxembourg onto essentially the same basis.

Security under Winding-Up

3.42 The rules governing the winding-up of an insurance or reinsurance company are broadly similar in the UK and Luxembourg. In both cases, where assets are insufficient to meet fully the company’s liabilities, holders of reinsurance policies would rank behind direct policyholders and certain preferential claims, but ahead of other claimants such as holders of unsecured debt and equity investors.

3.43 In the case of a winding-up of an insurance company based in Luxembourg, where there are sufficient assets to cover the Technical Provisions the winding-up regime in respect of the priority of insurance debts generally would be expected to be at least as favourable to policyholders and beneficiaries as the UK regime.

3.44 Conversely, in the situation of a winding-up of a UK insurance company where there are insufficient assets to cover the Technical Provisions, the UK winding-up regime would be expected to be at least as favourable to policyholders and beneficiaries as the Luxembourg winding-up regime.

3.45 The comparative position of policyholders in a UK insurer versus policyholders in a Luxembourg insurer in a winding-up situation is therefore a function of the assets available (and their size relative to the Technical Provisions) and the proportion of inwards reinsurance business relative to direct business.

3.46 I discuss further the implications of the differences in winding-up regulations between the UK and Luxembourg in Section 6.

Consumer Protection

3.47 In the UK, the FSCS compensates eligible customers of authorised financial firms (including insurers) in the event that the firm has insufficient assets to meet claims. The FOS provides eligible customers with a free, independent service to help settle disputes with financial firms (including insurers). The FOS has compulsory jurisdiction in respect of complaints raised by eligible policyholders (as identified in paragraph 3.10 above).

3.48 There are no directly equivalent bodies in Luxembourg, although a scheme run by the Médiateur en Assurances will assist the parties to a complaint reach a negotiated settlement and will issue a decision upholding or rejecting the complaint; and there is a policyholder protection scheme[6] for MTPL policyholders in the event of insurer insolvency.

[6] A policyholder protection scheme is an arrangement to guarantee, partially or in full, payments made pursuant to insurance contracts in the event that an insurer fails.

4. BACKGROUND REGARDING THE ENTITIES CONCERNED IN THE SCHEME

SJNKE

Background

4.1 SJNKE is a UK insurance company registered in England (registered number: 2846429). It is authorised and regulated by the PRA/FCA with permission under Part 4A of FSMA to effect and carry out contracts of general insurance for the following classes of business of Part I of Schedule I of Financial Services and Markets Act 2000 (Regulated Activities) Order 2001 (the "RAO"): Accident, Aircraft, Aircraft Liability, Credit, Damage to Property, Fire and Natural Forces, General Liability, Goods in Transit, Land Vehicles, Legal Expenses, Liability for Ships, Miscellaneous Financial Loss, Motor Vehicle Liability, Ships, Sickness and Suretyship.

4.2 The immediate parent company of SJNKE is Endurance Specialty Insurance Ltd. ("ESIL"), a Class 4 Bermuda insurance company, which in turn is a direct, wholly-owned subsidiary of Sompo International Holdings Ltd. ("SIH"), a Bermuda exempted company, which in turn is a direct, wholly-owned subsidiary of Sompo Japan Nipponkoa Insurance Inc. ("SJNKI"), a property and casualty insurance company organised under the laws of Japan, which in turn is a direct, wholly-owned subsidiary of Sompo Holdings, Inc. ("Sompo Holdings"), a publicly-traded financial services company organised under the laws of Japan, which is the ultimate parent company of SJNKE. (Prior to change in control approval by the PRA on and from 1 May 2018, SJNKE was a wholly-owned direct subsidiary of SJNKI.)

4.3 SJNKE was formed from the combination of Sompo Japan Insurance Company of Europe Limited and Nipponkoa Insurance Company (Europe) Limited ("NKE") following the merger of the parent entities on 1 September 2014. During 2013, the business written by NKE was renewed into SJNKE, with the remaining business of NKE subsequently transferred into SJNKE under Part VII of FSMA.

4.4 SJNKE's core activity relates to the underwriting of general insurance risks of Japanese-owned commercial enterprises located in the EU (also known as Japanese relationship business) and to providing a stable supply of general insurance services to such businesses from its UK headquarters and European branch network (see paragraph 4.5 below). SJNKE also writes non-Japanese corporate business.

4.5 SJNKE has branches established across mainland Europe in Belgium, Italy, Germany, Spain and France, through which it writes business on a FoE basis. SJNKE also conducts insurance business in EEA territories on a Freedom of Services ("FoS") basis from its head office in the UK.

4.6 The main classes of the on-going Japanese relationship business written (over many years) by SJNKE are:

- Accident;
- Employers' Liability;
- Marine (mainly Cargo, also Hull from the 2008 underwriting year);
- Pecuniary Loss;
- Property; and
- Public/Product Liability.

4.7 SJNKE (re)started writing non-Japanese corporate business during the 2011 underwriting year (having previously written Italian non-Japanese corporate business that was discontinued after the 2003 underwriting year as explained further in paragraph 4.8 below). The classes written are:

- Accident;
- Employers' Liability;
- Marine Cargo (also Hull from the 2008 underwriting year);
- Pecuniary Loss;
- Property (including Construction / Erection All Risks – "CAR / EAR"); and
- Public/Product Liability.

4.8 The Italian non-Japanese corporate business was discontinued after the 2003 underwriting year, except for a small number of medical expenses policies which contained an unlimited option to renew. SJNKE transferred certain lines of its Italian branch business to Berkshire Hathaway International Insurance Limited ("BHIIL") under Part VII of FSMA effective 31 March 2013. The business transferred to BHIIL comprised contracts of insurance written and issued by the Italian branch of SJNKE during the 2003 and prior underwriting years; and medical expenses business originally underwritten in the 2003 and prior underwriting years that continued to be renewed on a compulsory basis after 2003 (renewal being compulsory in the sense that SJNKE had no right to cancel the policy if an insured sought renewal). The business transferred did not include insurance policies relating to the commercial risks of Japanese entities (and two medical expenses contracts in-force at the time).

4.9 As mentioned in paragraph 4.3 above, from 1 October 2013, business previously written by NKE was renewed/transferred into SJNKE. This business consisted of three main components:

- Japanese relationship business written in the main on a direct basis within the UK, German, French, Belgian, Dutch, Italian and Spanish branches. The bulk of the business comprised Cargo, Property and Liability (although some territories have also written Consequential Loss and Personal Accident risks). All territories ceased writing business under NKE in October 2013, with the exception of Germany which ceased in December 2013 (due to German regulatory requirements);
- From 1 January 2013, Dutch Non-Japanese corporate business (Cargo, Engineering, Liability and Property) was written through a delegated underwriting authority to a Dutch agent (Canopius B.V. – formerly known as Sompo Japan Canopius B.V.) – the business is 100% reinsured with SJNKI, so the net claims impact on SJNKE is zero; similarly, from 1 January 2012, French Non-Japanese corporate business (Cargo only) was transacted through an agency agreement delegating underwriting authority to a French agency, M&B – the business is again 100% reinsured with SJNKI, so the net claims impact on SJNKE is zero. The Agency (Canopius B.V. and M&B) business began renewing into SJNKE from 1 October 2013 and went into run-off as of 31 December 2014 (the renewals being directed to a former Sompo Group company, Canopius AG, with effect from 1 January 2015);
- On 15 October 2013, NKE accepted a transfer of policies under Part VII of FSMA from Nippon Insurance Company of Europe Limited ("NICE"). Following this transfer NICE was dissolved. Most of the remaining reserves are for UK employers' liability risks. Parts of the NICE business transferred in to NKE and subsequently transferred in to SJNKE (see paragraph 4.10 below) were written through the Institute of London Underwriters ("ILU") which required that a guarantee be provided in support of the business written. The current guarantee states that in the event that SJNKE is unable to make the full payment to policyholders covered by the guarantee, SJNKI (acting as the guarantor) will pay the outstanding balance.

4.10 SJNKE acquired the remaining (run-off) business of NKE by a transfer under Part VII of FSMA implemented as at 31 July 2015. Assets of £63.4 million and liabilities of £27.7 million were transferred to SJNKE at said date. The net assets transferred of £35.7 million were taken to SJNKE's Capital Contribution Reserve in 2015. The run-off business of NKE is therefore now also included within SJNKE.

4.11 As at 31 December 2017, the authorised share capital of SJNKE was £173,700,000 divided into 17,370,000 ordinary shares of £10 each, all of which was issued and fully paid.

4.12 As of 19 December 2017, SJNKE enjoyed a Standard & Poor's credit rating of A, while its immediate parent company, SJNKI, enjoys a Standard & Poor's credit rating of A+.

Key financial information

4.13 During 2017, SJNKE wrote gross premiums of £104.2 million (split 27:73 between the UK and Europe (excluding UK)) and net premiums of £7.9 million. On an earned basis, gross premiums were £103.0 million and net premiums were £8.7 million. The net incurred loss ratio was 56.4%, and the combined ratio was 85% (in each case relative to net earned premiums) producing an underwriting profit of £1.3 million (2016: underwriting profit of £3.9 million). Allowing for investment returns and other charges SJNKE made a profit after tax of £3.4 million (2016: profit £3.0 million).

4.14 As reported in SJNKE's financial statements[7] as at 31 December 2017, SJNKE's assets and liabilities amounted to £346.7 million and £204.2 million respectively, thereby producing net assets (capital and reserves) of £142.5 million (it should be noted that this is not the same as the Eligible Own Funds available to meet the solvency requirements under Solvency II).

4.15 As reported in SJNKE's Solvency and Financial Condition Report[8] ("SFCR") as at 31 December 2017, on a Solvency II basis, SJNKE had assets of £281.4 million, (gross) Technical Provisions of £126.1 million and other liabilities of £11.7 million, thereby producing Eligible Own Funds ("EOF") of £143.6 million. As SJNKE's SCR as at 31 December 2017 was calculated to be £28.9 million, it follows that the corresponding solvency ratio (EOF : SCR) was close to 500%.

4.16 SJNKE's EOF were therefore £1.1 million higher than the UK GAAP net assets reported in SJNKE's 31 December 2017 financial statements. This was primarily due to the different basis of valuation of Financial Investments and Technical Provisions within UK GAAP and Solvency II, as follows:

- The fair value of financial investments in the Solvency II Balance Sheet was £5.2 million higher than the amortised cost reported in SJNKE's financial statements as at 31 December 2017; and tangible fixed assets of £0.6 million recognised in SJNKE's financial statements are revalued to zero in arriving at the Solvency II EOF.
- Allowing for valuation differences between the UK GAAP and Solvency II balance sheets (see Appendix H) Solvency II Technical Provisions were £21.0 million higher than their GAAP counterparts as at 31 December 2017.

4.17 As at 31 December 2017, SJNKE booked UK GAAP technical provisions equal to £115.3 million (gross of reinsurance) in respect of the Transferring SJNKE EEA (excluding UK) Business; and £39.0 million (gross of reinsurance) in respect of the Transferring SJNKE UK and non-EEA Business. The booked reserves in respect of the Transferring SJNKE EEA (excluding UK) Business and the Transferring SJNKE UK and non-EEA Transferring Business are the equivalent of 75% and 25% of SJNKE's total gross technical provisions (as at 31 December 2017) respectively.

Investment Policy

4.18 As at 31 December 2017, on a UK GAAP basis, SJNKE held investment assets[9] valued at £122.8 million, made up of £89.1 million held in listed fixed interest securities (bonds), and the remainder of £33.6 million held as deposits with credit institutions (typically banks).

4.19 The strategy for the SJNKE portfolio has been focused on managing an investment grade fixed income portfolio (of government and agency bonds) with a moderate duration of approximately 3 years. The portfolio is diversified across different investment grade sectors of the market and is compliant with local regulations. The objective of the portfolio is to preserve capital, maintain sufficient liquidity and earn a return consistent with the modest risks taken.

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7 Based on SJNKE's balance sheet as at 31 December 2017 as reported in SJNKE's draft financial statements prepared on a UK GAAP basis.

8 Based on SJNKE SFCR as at 31 December 2017

9 Based on SJNKE financial statements as at 31 December 2017

4.20 SJNKE's defined benefit pension scheme investment strategy, by the nature of the scheme's liabilities, differs from that of SJNKE which is intended to support SJNKE's insurance business. This results in an increased capital requirement due to greater market risk.

Reinsurance

4.21 All Japanese relationship business and non-Japanese corporate (including CAR/EAR) business, whether underwritten by SJNKE branches or the Dutch or French agencies, is covered principally by three reinsurance programmes, one each for Property, Marine and Casualty (Liability) risks.

4.22 Under the three reinsurance programmes, SJNKI takes an 80% quota share ("QS") on all risks written. There is then Excess of Loss ("XL") protection on all classes with SJNKI (the renewal for these treaties is 1 January). For property business there are additional XL treaties placed with external companies (which renew on 1 April).

4.23 Under the Property programme, as per paragraph 4.22 above, SJNKE has an 80% QS arrangement with SJNKI. For the remaining portion of the risks there is reinsurance protection from a whole account XL arrangement with SJNKI providing cover of 20% of £37.5 million excess £5.0 million (or 20% of €56.25 million excess €7.5 million). Above the whole account XL arrangement with SJNKI there is comprehensive per risk XL coverage placed with SJNKI and a number of external reinsurers (20% of £318.8 million excess £37.5 million). The effect of such reinsurance arrangements is that SJNKE should not suffer total net insurance losses beyond its Maximum Net Retention per risk per event of £1.0 million / €1.5 million.

4.24 Under both the Marine and Casualty programmes, as per paragraph 4.22 above, SJNKE has an 80% QS arrangement with SJNKI. For the remaining portion of the risks there is reinsurance protection from a whole account XL arrangement with SJNKI providing cover of: 20% of £22.5 million excess £5.0 million (or 20% of €33.75 million excess €7.5 million) for Casualty; and 20% of £22.5 million excess £2.5 million (or 20% of €33.75 million excess €3.75 million) for Marine. The effect of such reinsurance arrangements is that SJNKE should not suffer total net insurance losses beyond its Maximum Net Retention per risk per event of £1.0 million / €1.5 million for Casualty, and £0.5 million / €0.75 million for Marine.

4.25 In addition to the aforementioned reinsurance arrangements, there is a ceding scheme which may be used in certain situations, namely Facultative Proportional and/or Facultative XL. Business which is covered under the Facultative Proportional or Facultative XL is reinsured to SJNKI and/or other companies. Furthermore, there is a Catastrophe Event cover providing extra protection to the above per risk reinsurance arrangements.

4.26 Historically, catastrophe XL cover is in place, where SJNKE's net retention is £100,000 (€150,000) for catastrophes outside the EEA and £1.6 million (€2.4 million) for catastrophes within the EEA. These retentions apply per catastrophe. For Property related catastrophes occurring in 2016, SJNKE's net retention has been revised to (for any region) £1.0 million / €1.5 million.

4.27 The XL Treaties also provide protection for risks incepting prior to 1 January 2016 that were written under the previous 40% QS arrangement between SJNKE and SJNKI.

4.28 All reinsurance (with a few exceptions, in particular in respect of fronting for captives) is placed with reinsurers with a Standard & Poor's credit rating of A- or better (including SJNKI).

System of Governance

4.29 Under SJNKE's corporate governance arrangements, overall responsibility for risk management resides collectively with the Board of Directors. Certain activities in relation to risk management are delegated to the Audit & Risk Committee (as may be reviewed and restructured from time to time), the Executive Committee (as may be reviewed and restructured from time to time), the Risk Management Function, and Functional Leader Units (risk management, compliance, internal audit and actuarial). Each function has defined Terms of Reference which set out its respective risk management responsibilities.

4.30 The Board records its Risk Strategy within its annual Strategy Statement. The Risk Strategy defines SJNKE's risk appetite(s). The risk appetite(s) are documented in SJNKE's Risk Register and actual exposure to risk is regularly monitored against the risk appetite(s) and tolerance(s) defined by the Board.

4.31 The Risk Management Function provides a focal point for activities related to the risk assessment, management, and reporting, and is structured using a three lines of defence model (1st line – day-to-day risk management by Function Leader; 2nd line – risk management and compliance oversight, monitoring and validation; and 3rd line – internal audit of the adequacy and effectiveness of the internal risk and control management systems).

Risk Management

4.32 SJNKE is exposed to a large number of risks in the course of its operations. The key risks may be classified under the headings of insurance (underwriting and reserving), financial (market, liquidity, credit and currency), operational, group and pension scheme risk.

Insurance risk

4.33 Insurance risk refers to fluctuations in the timing, frequency and severity of insured events, relative to the expectations of the firm at the time of underwriting and/or reassessment. Insurance risk can also refer to fluctuations in the timing and amount of claim settlements. This risk arises out of ongoing underwriting ('underwriting risk') and risks associated with running off claims to settlement ('reserving risk').

4.34 Risk appetites and tolerances are set annually and monitored and adjusted where necessary. Ongoing assessment of insurance risk is conducted through the Risk Register which is reported to the Executive Committee (as may be reviewed and restructured from time to time) and Audit & Risk Committee (as may be reviewed and restructured from time to time) on a quarterly basis and covers:

- Underwriting risk – the underwriting director produces a quarterly underwriting report for the Board outlining, *inter alia*, underwriting related issues, including pricing and risk assessment;
- Reserving risk – the IBNR provision is reported to the Board within the Management accounts on a quarterly basis. Large claims or significant claim developments are reported to the Board as part of the quarterly claims report;
- Reinsurance – the underwriting director reports to the Board of treaty renewals or new treaty placements for review and authorisation to proceed to contract.

4.35 Particular risks include the impact on the cost of personal injury claims from a change in the discount rates used by UK courts in settling such claims (while such a change occurred with effect from 20 March 2017 in England and Wales, and slightly later in the remainder of the UK there remains a risk of further changes that could have a material effect), and the potential impact of Brexit.

Financial risk

4.36 Financial risk refers to risks arising for SJNKE from credit, market, currency, interest and/or liquidity matters as follows:

- Credit risk – the risk of default by counterparties, principally insurance debtors (including brokers, policyholders), reinsurance debtors, issuers of securities within SJNKE's investment portfolio, and banks with whom SJNKE has monies on deposit.

  SJNKE has a credit risk policy setting out the assessment and determination of what constitutes credit risk for SJNKE. Compliance with the policy is monitored through the Risk Register which is reported to the Executive Committee (as may be reviewed and restructured from time to time) and Audit & Risk Committee (as may be reviewed and restructured from time to time) on a quarterly basis;
- Liquidity risk – the risk that SJNKE may be unable to meet its obligations as they fall due or can secure such resources only at excessive cost.

  SJNKE has a liquidity management policy (including arrangements with SJNKI to mitigate liquidity risk in a scenario where a temporary cash-flow problem arises). No liquidity issues have been reported to the Board, with all SJNKE's liabilities having been paid as and when they fell due. Liquidity risk is therefore not considered to be significant.

- Market risk – the risk that as a result of market movements a firm may be exposed to fluctuations in the value of its assets, the amount of its liabilities or the income from its assets. Sources of general market risk include interest rates, equity prices, currency rates and property prices. For SJNKE, market risk is comprised primarily of currency risk and interest risk (since SJNKE holds little, if any, assets in the form of equities or property).
  - Currency risk arises in respect of certain liabilities under policies of insurance written through SJNKE's branch network. SJNKE seeks mitigate the risk by matching estimated foreign currency (primarily Euro) denominated liabilities with assets denominated in the same currency.
  - Interest risk arises from SJNKE's financial investments that comprise fixed interest securities (bonds) and deposits held with credit institutions (mainly banks) as the value of future cash-flows fluctuate due to changes in market interest rates.

  SJNKE monitors market risk through a number of reports including market risk reports presented by the Chief Financial Officer and the Investment Department to the Board. Ongoing assessment of market risk is conducted through the Risk Register which to the Executive Committee (as may be reviewed and restructured from time to time) and Audit & Risk Committee (as may be reviewed and restructured from time to time) on a quarterly basis. Policy changes in respect of market risk are reported to the Board annually when SJNKE's investment policy is reviewed and updated (for the coming year).

Operational risk

4.37 Operational risk refers to the risk of direct or indirect loss resulting from inadequate or failed internal processes, people and systems or from external events. Risks not considered within the other risk categories mentioned above arising in relation to administration, control, compliance, disaster recovery, governance, HR, strategic and technological (IT) risks are reported within this risk category.

4.38 SJNKE manages operational risk by actively monitoring key processes, by conducting scenario reviews to identify and quantify potential exposures for mitigation, including (but not limited to):

- Legal Risk (Contract) – risk of unenforceable or otherwise defective contracts being written, or inadvertent or unauthorised legally binding commitments or unforeseen liabilities in relation to contracts;
- Legal Risk (Legal Environment) – risk of uncertainties arising in relation to the legal environment, including adverse changes to the law, its interpretation, or its application;
- Compliance Risk – risks associated with failure to comply, whether through misconduct, error, or incompetence, with applicable laws and/or regulations;
- Inaccurate financial statements – risk that SJNKE's financial reports to third parties including the Report & Accounts, Regulatory returns, tax or other authorities are inaccurate due to human, methodology, data and/or systems error;
- Ineffectual budgetary control – risk that expenditure exceeds budgets as a result of management failure to control costs or to ensure expenditure is and properly assessed and consistent with business objectives;
- Fraud – risks associated with an employee defrauding SJNKE regarding expenses, or a claimant making a fraudulent claim/s, etc.
- Erroneous claims – risk associated with SJNKE paying invalid or excessive claims;
- Employee Incompetence – risk that employee(s) fail to perform effectively in safeguarding SJNKE's reputation (with clients and/or the regulator) and/or business and financial interests
- Information Technology – risks related to the security of SJNKE's IT systems, including unauthorised access virus attack; back-up failure, etc.
- Key Man / Succession – risks associated with reliance on a small number of key individuals responsible for the delivery of business or operational objectives;

- Fit and Proper – risks related to the fitness and probity (including competence) of holders of key management or professional positions;
- Brexit – the unknown impacts of Brexit on insurers.

4.39 Ongoing assessment of operational risk is conducted through the Risk Register which is reported to the Executive Committee (as may be reviewed and restructured from time to time) and Audit & Risk Committee (as may be reviewed and restructured from time to time) on a quarterly basis. Where risk management processes are identified as weak and/or controls are deficient or do not exist, the risk owner is required to put in place corrective action plans and report progress against them at monthly ("Integrated Action Log") meetings.

4.40 It is noted that SJNKE provided an indemnity to BHIIL in relation to the transfer under Part VII of FSMA effective 31 March 2013 (as outlined in paragraph 4.8 above), which expired on 27 March 2018.

Group risk

4.41 SJNKE is a member of the Sompo Group and therefore exposed to group risk, i.e. the current or prospective risk to earnings and capital arising from adverse perception of the image of the Sompo Group (and/or to other members of the Sompo Group) on the part of customers, shareholders, investors or regulators.

4.42 Most of Sompo Group's business and profits originate in the domestic Japanese market, and the Sompo Group is principally reliant on the financial strength and stability of Sompo Holdings, the ultimate parent undertaking of SJNKE. It is unlikely that failure of any Sompo Group firm other than SJNKI could materially affect the ability of Sompo Holdings to support SJNKE. Were SJNKI to fail the major risks to SJNKE in relation to membership of the Sompo Group are: (1) failure of the Sompo Group to pay reinsurance claims to SJNKE; (2) the inability on the part of SJNKI to honour the Net Worth Agreement under which SJNKI agrees to cause SJNKE to have adequate capital resources to meet its obligations as they fall due (see paragraph 4.56 below); (3) the potential loss of resources or loss of access to services or benefits provided to SJNKE by or through the Sompo Group; and (4) the potential for reputational risk affecting the Sompo Group causing the loss of clients.

4.43 As the Sompo Group has considerable financial resources (as demonstrated by its Standard & Poor's Rating of A+), the risk of the Sompo Group's insolvency is remote. However, should one or more of the major risks referred to in paragraph 4.42 above crystallise, the strong solvency position of SJNKE as at 31 December 2017 (see paragraph 4.15 above, and forecast to continue through to 2022 as per SIH's 5-year financial forecast plan – see paragraph 6.73 below), together with the Letter of Credit in favour of SJNKE to help manage the risk of group reinsurance debt default (see paragraph 4.60 below), should provide the financial resources to mitigate (at least in part) any emerging Group Risk.

4.44 In relation to non-financial facilities currently provided by the Sompo Group (i.e. resources, functions and/or services), SJNKE believes that these could be readily replaced, on average, at similar or lower cost. In particular, should the Board decide to put SJNKE into run-off, it is anticipated that the majority of resources provided by the Sompo Group would become redundant.

4.45 Going forward, it is noted that Sompo Holdings has begun a wide-ranging restructuring of its international operations under the brand of SIH, and that SJNKE falls within the scope of these plans. In particular SJNKE is a party to the transfers under the proposed Scheme and the CBM with SIIE. In addition, following change in control approval by the PRA on and from 1 May 2018, SJNKE became a wholly-owned direct subsidiary of ESIL.

Pension Scheme risk

4.46 SJNKE operates a defined benefit scheme in the UK, which was closed to new members on 1 January 2007. Pension scheme risk refers to the effect on SJNKE's capital of the pension scheme asset liability duration mismatch, the capital charge, and the funding requirement. SJNKE monitors pension risk in accordance with its Risk Management Policy.

4.47 In accordance with EIOPA's June 2014 consultation paper SJNKE has taken the pension scheme into account in the standard formula calculation of the capital requirements for counterparty default risk and the sub-modules for market risk.

Capital Policy and Risk Appetite

4.48 The objectives of the SJNKE capital management policy are to:

- Document how SJNKE is capitalised to meet both its and the regulator's requirement in terms of available capital;
- Describe the process of monitoring and review of capital levels; and
- Describe the framework for preventing and/or rectifying appropriately any capital shortfall in an orderly way.

4.49 SJNKE is subject to Solvency II capital requirements as enforced by the PRA. Throughout 2017 SJNKE has complied with these requirements. SJNKE has a risk appetite in respect of the available capital resources of at least 130% of the solvency capital requirement over a one-year time horizon.

4.50 At 31 December 2017, SJNKE had a regulatory surplus of £114.7 million, i.e. EOF above SJNKE's SCR calculated using the Standard Formula ("SF") of £28.9 million. SJNKE's solvency coverage ratio (i.e. the ratio of SJNKE's EOF to its SCR) was therefore 497%.

4.51 Economic capital (as measured by the ORSA under the Solvency II regime – see paragraph 4.52 below) is SJNKE's preferred measure of capital sufficiency. It is SJNKE's own assessment of the amount of capital it needs to hold to meet its obligations given SJNKE's risk appetite.

4.52 SJNKE's risk appetite in respect of coverage by available capital to required capital (i.e. the capital cover ratio) is currently set at a minimum of 130% of SCR (including a capital charge for the BHIIL indemnity) over a one-year time horizon, i.e. as per the ORSA. SJNKE furthermore sets thresholds (i.e. intervention levels if the capital cover ratio falls below a certain level) and specifies actions SJNKE will take if and when these thresholds are breached over a one-year time horizon.

4.53 To make sure of continuous compliance with the capital management policy, SJNKE monitors key performance indicators (such as premium volumes, loss ratios, reinsurance recoverables, investment returns and expense ratios) on an ongoing basis. Where review of these indicators reveals a potential problem or breach that may impact SJNKE's compliance with its capital management policy, SJNKE is obliged to take appropriate urgent action to mitigate any capital shortfall while keeping the Regulator informed of SJNKE's position.

4.54 As part of the ORSA process, SJNKE assesses compliance with SJNKE's capital management policy on a continuous basis. SJNKE has defined thresholds and specific actions upon the breach of a threshold, as follows:

Threshold	Action
Capital > 130% of Required Capital as determined in the ORSA	Monitor capital levels quarterly
Capital between 120% and 130% of Required Capital as determined in the ORSA	Detailed analysis of all possible actions to ensure capital coverage exceeds 120% of the Required Capital (as determined in the ORSA)
Capital < 120% of Required Capital as determined in the ORSA	Emergency Board meeting to be convened to trigger the SJNKE NWA (see paragraph 4.56 below) and approve immediate action to be taken to restore threshold to above 130% of the Required Capital (as determined in the ORSA)

4.55 SJNKE conducts its ORSA which covers its overall solvency needs, taking into account the current and future business plan, risk profile, overall business strategy and approved risk appetite and tolerance limits.

SJNKE Net Worth Agreement

4.56 SJNKE has entered into a NWA with SJNKI, dated 2 December 2015 (the "SJNKE NWA"). Under the terms of this agreement, SJNKI agrees to cause SJNKE to have capital resources in amount equal to the higher of:

- 250% of SJNKE's MCR; and
- 120% of SJNKE's SCR (Clause 2.1 of the SJNKE NWA).

4.57 SJNKI also agrees to cause SJNKE to have sufficient cash funds or liquid assets to satisfy valid claims under policies issued by SJNKE and valid claims of financial creditors as they fall due for payment (Clause 3.1 of the SJNKE NWA).

4.58 The agreement cannot be varied unless agreed in writing by both parties (SJNKI and SJNKE). The parties cannot vary or terminate the Agreement to the detriment of the accrued rights of existing SJNKE policyholders and financial creditors as at the date of such variation or termination prior to that date, unless:

- Such policyholders and financial creditors agree to such variation or termination;
- The credit worthiness of SJNKE becomes at least as strong as SJNKI's rating at that time; or
- SJNKE is sold to an insurer with the same or higher creditworthiness as SJNKI at the time of sale (Clause 5.4 of the SJNKE NWA).

4.59 The SJNKE NWA is governed by the laws of Japan.

Letter of Credit

4.60 SJNKE benefits from a significant amount of reinsurance cover from SJNKI. In particular, the percentage of reinsurance placed with SJNKI exceeds the guide limit of 20% of gross earned premium set by the PRA (pre Solvency II) for the amount of reinsurance to be placed with a single company. SJNKE has continued to operate according to this guide limit (even though not specifically required under Solvency II) and presently has in place a £70 million letter of credit ("LOC") (computed as the projected ceded premium to SJNKI less 20% of the projected gross earned premium) arranged by SJNKI, which provides cover for amounts due from SJNKI to SJNKE if not paid by SJNKI. The LOC is issued by Bank of Tokyo - Mitsubishi, and renews at 1 April annually. The LOC thus mitigates SJNKE's exposure to concentration risk in respect of intra-group reinsurance with SJNKI.

Administration

4.61 The policy servicing and claims handling processes for SJNKE are as follows:

Policy Servicing

4.62 Policy servicing (new business, renewals, mid-term adjustments, etc.) within SJNKE is performed in each branch office. SJNKE uses the software platform, *AeGIS*, as SJNKE's policy administration system. At the date of this Report there are 66 staff members involved in policy servicing (including those involved in claims handling) as follows:

- German Branch – 20
- French Branch – 4
- Belgian Branch – 5
- Italy Branch – 4
- Spain Branch – 3
- UK Head office – 30

4.63 In Spain, policies are issued by Mapfre, an insurance company (based in Madrid) and fronting partner in the country. SJNKE assumes 100% of the risks as a Facultative Reinsurer.

4.64 In France, some parts of the policy servicing are supported by Sompo Japan Nipponkoa Martin & Boulart SAS ("M&B") which is a wholly owned subsidiary of SIH and whose Paris branch co-locates with SJNKE's French Branch in Paris.

4.65 In the Netherlands, Canopius B.V. conducts policy servicing as the underwriting agency of SJNKE. The procedures and IT systems are the same as those used in the branches.

4.66 As of 1 April 2018 the SJNKE UK staff transferred to EBSL.

Claims handling

4.67 Claims are validated and settled in each branch except Italy where there are no claims personnel, where they are referred back to SJNKE head office in London. Claims procedures and level of authority are defined by SJNKE head office in London and the Claims functional business unit based in London conducts reviews of the claims files to monitor compliance with such procedures and levels of authority. The *AeGIS* software platform is also used for claims handling.

4.68 In the Netherlands, Canopius B.V. conducts claims handling as the underwriting agency for SJNKE. The procedures and IT systems are as used in the branches.

Fair Treatment of Customers – TCF

4.69 SJNKE has in place a framework for treating customers fairly that comprises the same components as listed in paragraph 4.126 below for EWIL. In particular, the SJNKE framework has a significant cultural dimension (SJNKE has a similar cultural emphasis to EWIL on the importance of treating customers fairly), while it also comprises relevant policies and procedures, product governance and oversight.

4.70 SJNKE has undertaken a risk assessment on conduct risk across SJNKE's end to end operating model and mapped this to the TCF outcomes. Furthermore the processes and the management information ("MI") relating to conduct risk at SJNKE are designed to deliver good customer outcomes. To that end SJNKE reports on TCF outcomes, within a conduct risk dashboard (on a RAG[10] basis). Further, SJNKE has adopted a risk sensitive approach to managing conduct risk that has led to an increased focus on high risk business, with product governance involving a focus upon more high conduct risk business as assessed by factors such as customer type, distribution channels and product risk.

Brexit

4.71 The Sompo Group formed a new (re)insurance entity which is authorised in Luxembourg (i.e. SIIE) and which will establish a network of EEA branches replicating those currently writing business for SJNKE along with the addition of a UK branch. It then intends to transfer SJNKE's current EEA (excluding UK) business to SIIE and SJNKE's current UK and non-EEA business to EWIL each via an insurance business transfer scheme as defined in Section 105 of FSMA. I have been further told that the Sompo Group has shared this plan with the PRA and FCA and is regularly updating the PRA and FCA on progress made.

4.72 As a consequence of the cross-border merger, SJNKE will be dissolved without going into liquidation by the time that Brexit takes place. Therefore, it is expected that SJNKE will be unaffected by Brexit and it has made no other Brexit-related plans. Section 9 describes what would happen were the Scheme not to take place.

EWIL

Background

4.73 EWIL is an insurance company, registered as a private limited company in England and Wales (registered number 4413524) under the Companies Act 2006. EWIL's immediate parent company is Endurance Worldwide Holdings Limited ("EWHL"), which is itself a wholly owned subsidiary of Endurance Specialty Insurance Ltd ("ESIL"), a Bermudian company, which in turn is a direct, wholly-owned subsidiary of SIH.

[10] RAG is an abbreviation for Red Amber Green.

4.74 EWIL's principal activity relates to the underwriting of general (re)insurance business in/from the UK and reinsurance business written from Switzerland via a branch established in 2016 and based in Zurich. The main classes of business written by EWIL are:

- Accident and Health (personal accident; contract protection insurance; travel benefits; medical expenses and war);
- Aviation (airlines, aerospace, aviation products, airports and general aviation):
- Casualty (split roughly 80% on SME risks, and 20% on larger risks such as transportation, manufacturing, public sector and construction);
- Energy (Offshore – oil lease operator business and service companies / Onshore – refining, petrochemical and fractionation);
- Financial & Political Risks (cover for banks and corporates against credit default and political risk perils, with the majority of the business is in respect of export and trade finance);
- Financial Institutions (banks and non-banks);
- Global Property (focused on commercial property risks);
- Management Liability (focused on non-financial institutions, industrial and non-industrial commercial sectors);
- Marine (Hull, Liability, Cargo and Specie);
- Professional Indemnity (primary and excess layers);
- Transaction Risks (warranty and indemnity cover); and
- Reinsurance (Non-proportional, including agriculture, aviation and engineering).

4.75 As at 31 December 2017, the authorised share capital of EWIL was £215,967,826, divided into 215,967,826 ordinary shares of £1 each, all of which was allotted, called-up and fully paid.

4.76 As of 19 December 2017, EWIL enjoyed a Standard & Poor's credit rating of A (positive).

Key financial information

4.77 During 2017, EWIL wrote gross premiums of £269.5 million (split 22% UK, 28% US, 5% France, 2% Belgium, 1% Brazil, 1% Venezuela and 41% the rest of the world). On an earned basis, gross premiums were £233.3 million and net premiums were £57.6 million. The net incurred loss ratio was 94%, and the combined ratio (based on net earned premiums) was 141% producing an underwriting loss of £23.7 million (2016: underwriting loss of £19.7 million) driven by the hurricane and wildfire losses during the third and fourth quarters of 2017. Allowing for investment returns and other charges EWIL made a loss after tax for 2017 of £33.9 million (2016: profit £49.8 million).

4.78 As reported in EWIL's financial statements[11] as at 31 December 2017, EWIL's assets and liabilities amounted to £1,015.3 million (2016: £946.3 million) and £643.4 million (2016: £540.3 million) respectively, thereby producing net assets (capital and reserves) of £371.8 million (2016: £406.0 million), (it should be noted that this is not the same as the EOF available to meet the solvency requirements under Solvency II).

4.79 As reported in EWIL's SFCR as at 31 December 2017, on a Solvency II basis, EWIL had assets of £789.6 million, (gross) Technical Provisions of £366.1 million and other liabilities of £64.2 million, thereby producing EOF of £359.3 million. As EWIL's SCR as at 31 December 2017 was calculated to be £132.7 million, it follows that the corresponding solvency cover ratio (EOF : SCR) was calculated to be close to 270%.

[11] Based on EWIL's balance sheet as at 31 December 2017 as reported in EWIL's financial statements prepared on a UK GAAP basis.

4.80 EWIL’s EOF were therefore £12.5 million lower than the UK GAAP net assets reported in EWIL’s 31 December 2017 financial statements. This was primarily due to the different basis of valuation of Technical Provisions within UK GAAP and Solvency II (see Appendix H), as follows:

- The impact of the revaluation of the UK GAAP premium receivables, unearned premium reserve (“UPR”), loss and loss expense provisions and related items to reflect values based on best-estimate cash-flows, adjusted to reflect the time value of money using a risk-free discount rate term structure;
- The inclusion of (explicit) risk margins determined under the cost of capital approach to allow for the uncertainty associated with the probability-weighted cash flows or the compensation EWIL needs in order to bear the risk of holding additional funds to meet cash flows; and
- The deferred tax asset valuation difference due to the tax impact of the above two technical provisions adjustments.

4.81 As at 31 December 2017, EWIL booked UK GAAP technical provisions equal to £14 million (gross of reinsurance) in respect of the Transferring EWIL EEA (excluding UK) Business; and £467 million (gross of reinsurance) in respect of the Non-Transferring EWIL Business. The booked reserves in respect of the Transferring EWIL EEA (excluding UK) Business and the Non-Transferring EWIL Business are the equivalent of 3% and 97% of EWIL’s total gross technical provisions (as at 31 December 2017) respectively.

Investment Policy

4.82 As at 31 December 2017, on a UK GAAP basis, EWIL held investment assets[12] valued at £459.7 million, made up of: £450.8 million held in British government securities (gilts), debt securities and other fixed interest securities; and the remainder of £8.9 million held as deposits with ceding undertakings. In addition, EWIL held £53.6 million of cash at bank and in hand (as at 31 December 2017).

4.83 The strategy for the EWIL investment portfolio is to manage an investment grade fixed income portfolio with a moderate duration of approximately 3 years. The portfolio is diversified across different investment grade sectors of the market and compliant with local regulations. The objective of the portfolio is to preserve capital, maintain sufficient liquidity and earn a return consistent with the modest risks taken.

Reinsurance

4.84 The EWIL outwards reinsurance plan for 2018 reflects EWIL’s best-estimate of reinsurance coverage that will be in place to limit EWIL’s net retention, including shared covers across SIH, to protect EWIL business from 1 January 2018. Consistent with previous years, SIH purchases a mixture of XL and QS covers. The key characteristics of EWIL’s ceded reinsurance purchasing strategy are as set out below:

Product Specific XL Covers

4.84.1 Purchased to protect against classes with the highest stand-alone variability and accumulation risk (i.e. Property, Marine & Energy, Aviation and Financial & Political Risk). The aim is to provide cost efficient peak risk reduction in line with the overall risk appetite of EWIL and its affiliates, and provide earnings stabilisation.

Product Specific QS Covers

4.84.2 Purchased to protect against classes where sideways accumulation risk is the main driver of tail risk. They are also used to: support expansion into profitable products and preserve market presence whilst keeping retained risk within appetite; leverage the underwriting position of EWIL and its affiliates in setting terms and operating as a lead market; and to generate fee/commission income from the provision of underwriting services to partner (re)insurers.

12 Based on EWIL financial statements as at 31 December 2017

Whole Account QS Covers

4.84.3 Purchased to protect SIH's insurance business on a worldwide basis, excluding multi-peril crop insurance.

Whole Account Catastrophe XL Covers

4.84.4 Purchased to mitigate the impact of significant natural or man-made disasters that could accumulate across several product lines within EWIL and its affiliates.

Intra-Group Whole Account QS Covers

4.84.5 Purchased to make efficient use of the Sompo Group's capital resources in supporting EWIL's gross underwriting plan.

4.85 The reinsurance strategy outlined above is deemed to be executed in a manner to complement both the gross underwriting plan and EWIL's overarching risk appetites as set out below:

- EWIL seeks to create sustained value from its underwriting business by establishing a long-term presence and achieving scale in all (re)insurance product lines and markets that demonstrate sound long-term fundamentals;
- EWIL seeks to manage its (re)insurance exposures by territory, coverage type and line of business, retaining more risk where return prospects permit and less where opportunities are poor and/or result in undesirable accumulations. EWIL limits its net exposure to a single event to avoid such a loss from threatening the on-going viability, or relative competitive positioning, of the business; and
- EWIL maintains sufficient assets to meet regulatory capital requirements and support planned prospective year business growth ensuring that those requirements are consistent with the latest risk profile of the business.

4.86 The overall level of reinsurance purchased by EWIL is significant with circa 45% of gross premium expected to be ceded to third-party reinsurers and 70% ceded to third-party and intra-group reinsurers. This reflects a consistent reinsurance purchasing strategy that has been executed over the last few years, helping EWIL to balance opportunities for growth against the preference to limit downside potential while risk-adjusted pricing levels remain depressed.

4.87 For the 2018 Accident Year, circa 98% of EWIL's ceded premium (roughly 66% of corresponding gross premiums) is forecast to be placed with reinsurers with a Standard & Poor's credit rating of A- or better (including SJNKI) and/or on a collateralised basis. Further, around 94% of EWIL's ceded reserves on Accident Years 2017 & prior (roughly 56% of corresponding gross reserves) are in respect with reinsurers with a Standard & Poor's credit rating of A- or better (including SJNKI) and/or on a collateralised basis.

System of Governance

4.88 The Board of Directors is the governing body of EWIL. The Board is responsible for the strategic oversight of EWIL and, *inter alia*, for the establishment and maintenance of a governance environment. The Board is supported by four oversight committees; the Audit Committee, the Risk & Compliance Committee, the Nomination Committee and the Remuneration Committee.

4.89 The Board has documented terms of reference in place, which includes a list of matters reserved to the Board. In addition, the Board is supported by four Board oversight committees:

- An Audit Committee, which is chaired by and includes non-executive directors and is responsible, *inter alia*, for oversight and challenge of the financial and internal controls of EWIL and the integrity of statutory reporting and financial statements;
- A Risk & Compliance Committee, which is chaired by and includes non-executive directors and is responsible, *inter alia*, for the oversight of EWIL's framework of risk management and compliance with regulatory requirements and expectations;
- A Nomination Committee, which is chaired by and includes independent non-executive directors and is responsible, *inter alia*, for the selection of directors, reviewing the structure, size and composition of the Board of Directors, for considering the adequacy of succession planning for the board and senior management of EWIL; and

- A Remuneration Committee, which is chaired by and includes independent non-executive directors and is responsible, *inter alia*, for setting and reviewing the ongoing appropriateness of the remuneration policy for all employees as well as for the non-executive directors.

4.90 EWIL has also established certain management committees, made up of executive management, namely an Underwriting Committee and an Operations Committee which provide more granular oversight and review of the business and operations of EWIL

4.91 The four Key Functions identified by the Board as those that are effectively running the firm are:

- The Risk Management Function, which is responsible, *inter alia*, for the implementation of EWIL's system of risk management, as well as designing and developing EWIL's risk register. The Risk Management Function reports to the Risk & Compliance Committee and the Board of EWIL on a regular basis;
- The Compliance Function, which is responsible, *inter alia*, for advising the Board of EWIL on compliance with all relevant regulations and legislation to which EWIL is subject; as well as for assessing and advising on the impact of any changes in such provisions on the operations of EWIL, and for the identification and assessment of compliance and regulatory risk. The Compliance Function reports to the Risk & Compliance Committee and the Board of EWIL on a regular basis;
- The Internal Audit Function, which is responsible, *inter alia*, for the evaluation of the adequacy and effectiveness of EWIL's internal control system. The Internal Audit Function reports to the Audit Committee and the Board of EWIL on a regular basis; and
- The Actuarial Function, which is responsible, *inter alia*, for the calculation of Technical Provisions, the appropriateness of the methodologies and assumptions used in the calculation of Technical Provisions, for the assessment of the data used in the calculation of Technical Provisions, for expressing various opinions as required by the Solvency II Directive, and for contributing to the effective implementation and operation of EWIL's system of risk management. The Actuarial Function reports to the Audit Committee and the Board of EWIL on a regular basis.

Risk Management

4.92 The Board of Directors reviews risk appetite annually with regard to both strategic objectives of EWIL and the broader economic climate. The EWIL Risk & Compliance Committee meets quarterly to provide oversight of the risk framework and to monitor performance against risk appetite using a series of risk and performance indicators. The principal risks (and uncertainties) facing EWIL are as set out in the following paragraphs.

Insurance risk

4.93 Insurance risk is described in paragraph 4.33 above. The Board manages insurance risk by agreeing its appetite annually through the business plan, which sets out targets for volumes, pricing, line sizes, and retention by class of business. Performance against the business plan is monitored regularly throughout the year by the Underwriting Committee and the Board. Reserve adequacy is monitored by quarterly reviews by the EWIL actuary who reports to the Audit Committee and the Board.

4.94 The particular risks identified in paragraph 4.35 above apply also to EWIL, while noting that the impact on the cost of personal injury claims from a change in the discount rates used by UK courts in settling such claims that occurred with effect from 20 March 2017 in England and Wales, and slightly later in the remainder of the UK, was estimated by EWIL to be immaterial to EWIL.

Financial risk

4.95 Financial risk refers to risks arising for EWIL from credit, market, currency, interest and/or liquidity matters as follows:

- Credit risk – described in paragraph 4.36 above. EWIL's policies are aimed at minimising credit related losses and require that clients demonstrate creditworthiness before entering into a business relationship. EWIL uses a range of techniques to manage this risk as set out below:
    - The purchase of ceded reinsurance is coordinated by the Ceded Reinsurance Officer who works with the business and various functional areas to determine coverage needs, develop an appropriate reinsurance structure and build the submission to present to market. The Ceded Reinsurance Officer ensures that the data contained within the submission is both accurate and that the narrative outlining the business' strategy is relevant. All draft contracts undergo a legal review prior to binding;
    - EWIL avoids excessive and non-diversified use of reinsurance by doing business only with reinsurers of sufficient credit or financial strength. All reinsurance purchases are made through a pre-approved counterparty panel with the constituents selected on the basis of their financial strength rating (minimum A- rating required) and other background criteria. In the event of credit downgrades below the minimum required, approved counterparties may be removed from the panel;
    - EWIL additionally maintains intra-group reinsurance agreements with ESIL, which includes quota-share and stop-loss reinsurance. EWIL regularly monitors the credit risk assumed through these intra-group transactions assessing what impact cessation of this protection would have on the capital and/or liquidity position of EWIL under both normal and stressed conditions. This is reviewed by the Board at least annually; and
    - Outwards reinsurance and other counterparty risk levels are monitored by the Risk & Compliance Committee quarterly through a series of quantitative and qualitative risk metrics. Material deviations in the risk levels from pre-determined risk tolerances are notified to the Board and remedial action to bring risk levels within appetite are considered.
- Liquidity risk – described in paragraph 4.36 above. EWIL aims to mitigate liquidity risk by managing cash generation from its operations, in addition to maintaining a highly liquid investment portfolio.
- Market risk – described in paragraph 4.36 above. For EWIL, market risk is comprised primarily of currency risk and interest rate risk (since EWIL holds little, if any, assets in the form of equities or property).
    - Currency risk arises from fluctuations in non-Sterling denominated currencies in which EWIL operates. EWIL periodically buys and sells non-Sterling denominated currencies or investment securities in an attempt to match non-Sterling assets and liabilities. EWIL does not use currency hedges; however, as part of its matching strategy it may consider the use of hedges when it becomes aware of probable significant losses that will be paid in non-Sterling currencies.
    - Interest rate risk arises primarily from changes in the value of EWIL's fixed interest securities portfolio as a result of fluctuations in interest rates. In an effort to mitigate this risk EWIL maintains a high quality investment portfolio with a relatively short duration to reduce the effect of interest rate changes on value. A significant portion of the investment portfolio matures each year, allowing for reinvestment at current market rates. The portfolio is also actively managed, and trades are made to balance EWIL's exposure to interest rates.

Operational risk

4.96 Operational risk is described in paragraph 4.37 above. EWIL seeks to manage this risk through the use of detailed procedures and a structured programme of testing processes and systems by internal audit.

4.97 Regulatory and compliance risk forms part of operational risk (as per paragraph 4.38 above). EWIL manages this risk through ongoing constructive engagement with the Regulators, investment in an experienced and knowledgeable Compliance function, and monitoring of market-wide developments in relation to regulation.

Group risk

4.98 EWIL is a member of the Sompo Group and therefore exposed to group risk, i.e. the current or prospective risk to earnings and capital arising from adverse perception of the image of the Sompo Group (and/or to other members of the Sompo Group) on the part of customers, shareholders, investors or regulators.

4.99 As the Sompo Group has considerable financial resources (as demonstrated by its Standard & Poor's Rating of A+), the risk of the Sompo Group's insolvency is remote. However, were SJNKI (whose financial status ultimately provides Sompo Holdings with the resources to support ESIL and hence EWIL) to fail the major risks to EWIL in relation to membership of the Sompo Group are: (1) failure of the Sompo Group to pay reinsurance claims to EWIL; (2) the inability on the part of SJNKI to support the Net Worth Agreement under which ESIL agrees to cause EWIL to have adequate capital resources to meet its obligations as they fall due (see paragraph 4.111 below); (3) the potential loss of resources or loss of access to services or benefits provided to EWIL by or through the Sompo Group; and (4) the potential for reputational risk affecting the Sompo Group causing the loss of clients. Should one or more of these major risks crystallise, the strong solvency position of EWIL as at 31 December 2017 (see paragraph 4.79 above, and forecast to continue through to 2022 as per SIH's 5-year financial forecast plan – see paragraph 6.73 below) should provide the financial resources to mitigate (at least in part) any emerging group risk.

4.100 Going forward, as noted in paragraph 4.45 above, Sompo Holdings has begun a wide-ranging restructuring of its international operations under the brand of SIH, and that EWIL falls within the scope of these plans. In particular EWIL is a party to the transfers under the proposed Scheme with SIIE and SJNKE.

Capital Policy and Risk Appetite

4.101 The objectives of the EWIL capital management policy are to:

- comply with the insurance capital requirements required by the PRA, and safeguard EWIL's ability to continue as a going concern so that it can maintain policyholder protection;
- ensure that there are sufficient capital resources available to support planned business growth both for the prospective year and over the medium term; and
- hold sufficient 'face' capital to demonstrate its continuing and long-commitment to London Market clients.

4.102 EWIL is subject to Solvency II capital requirements as enforced by the PRA. Throughout 2016 EWIL has complied with these requirements. As at 31 December 2017, EWIL had a regulatory surplus of £229.8 million, i.e. EOF above EWIL's SCR of £129.3 million (calculated using the SF). EWIL's solvency coverage ratio (i.e. the ratio of EWIL's EOF to its SCR) was therefore 278%.

4.103 EWIL's preferred measure of capital sufficiency is a target capital adequacy ratio of between 100% and 115% of SCR supplemented by regular (at least annual) work to affirm the appropriateness of the SF SCR given the risk profile of EWIL.

4.104 EWIL conducts its ORSA (i.e. an assessment of all of the current and possible future risks EWIL has within its business to determine the level of capital needed to mitigate these risks) on a quarterly basis to assist the Board in making strategic decisions. The reports are presented to the Risk & Compliance Committee and the Board of Directors quarterly, and approved for regulatory submission annually.

4.105 The ORSA process allows the Board to assess the current and potential future risks facing EWIL to better understand the risk profile and to ensure that EWIL is operating within its risk profile. The ORSA also informs the Executive Team and the Board on the level of capital resources needed to support the business plan. The information provided within the ORSA guides any risk mitigation actions, reassessment of risk profile and strategy, and decisions in relation to capital management.

Surety Bond

4.106 EWIL has purchased a "Bond" from ESIL, dated 19 March 2003 (the "Bond"). Under the terms of the Bond, ESIL agrees to provide capital to EWIL if at any time the net worth (i.e. shareholders' funds determined in accordance with UK GAAP *less* goodwill and other intangibles) of EWIL is less than the greater of £25 million or the required minimum solvency requirement in accordance with applicable laws and regulations.

4.107 The Bond also has a liquidity provision should EWIL have insufficient funds to make a required payment for any Covered Product (i.e. any insurance, reinsurance or surety contract issued or executed and delivered on or after 19 March 2003 involving any policyholder or body that is party to, or is entitled to payment or performance by EWIL under any such insurance, reinsurance or surety contract, other than EWIL).

4.108 The Bond cannot be amended or terminated unless agreed in writing by EWIL and ESIL, provided, however, that:

- No such amendment or termination shall be effective prior to 90 days following the execution and delivery of such amendment or termination by EWIL and ESIL;
- No such amendment shall be effective with respect to any Covered Product involving any party that did not receive such notice of amendment prior to the date of execution and delivery of such Covered Product by the parties thereto; and
- No such termination shall be effective with respect to a Covered Product involving any party that did not receive such notice of termination prior to the date of execution and delivery of such Covered Product by the parties thereto.

4.109 The Bond is governed by the laws of Bermuda.

4.110 I am informed by SIH that the Bond will be replaced with a Net Worth Agreement between ESIL and EWIL (the “EWIL NWA”) that will become effective in mid-to-late September 2018 on the terms set out in paragraph 4.111 below.

4.111 Under the terms of the EWIL NWA, ESIL agrees to cause EWIL to have capital resources in amount equal to the higher of:

- 100% of EWIL’s MCR; and
- 150% of EWIL’s SCR.

4.112 ESIL also agrees to cause EWIL to have sufficient cash funds or liquid assets to satisfy valid claims under policies issued by EWIL and valid claims of financial creditors as they fall due for payment.

4.113 The Agreement cannot be varied unless agreed in writing by both parties (ESIL and EWIL). The parties cannot vary or terminate the EWIL NWA to the detriment of the accrued rights of existing EWIL policyholders and financial creditors as at the date of such variation or termination prior to that date, unless:

- The parties provide a notice in writing at least 365 days prior to any such variation or termination to each of the credit rating agencies that has assigned to EWIL a financial strength rating at the time of delivery of such notice; or
- The credit worthiness of EWIL becomes at least as strong as ESIL’s supported rating at that time; or
- EWIL is sold or transferred to a third party.

4.114 The Agreement is governed by Bermudian law (on which I have reviewed a legal opinion on enforceability as outlined in paragraph 4.168 below).

4.115 I also note that ESIL has entered into a Net Worth Agreement with SJNKI, dated 28 March 2017 (the “ESIL NWA”). Under the terms of this agreement, SJNKI agrees to cause ESIL to have capital resources in amount equal to the higher of:

- 100% of ESIL's Minimum Margin of Solvency (as applied by the Bermuda Monetary Authority); and
- 150% of ESIL's ECR (enhanced capital requirement as applied by the Bermuda Monetary Authority).

4.116 SJNKI also agrees to cause ESIL to have sufficient cash funds or liquid assets to satisfy valid claims under policies issued by ESIL and valid claims of financial creditors as they fall due for payment.

4.117 The agreement cannot be varied unless agreed in writing by both parties (SJNKI and ESIL). The parties cannot vary or terminate the Agreement to the detriment of the accrued rights of existing ESIL policyholders and financial creditors as at the date of such variation or termination prior to that date, unless:

- SJNKI/ESIL provide a notice in writing at least 365 days prior to any such variation or termination to each of the credit rating agencies that has assigned to ESIL a financial strength rating at the time of delivery of such notice; or
- the financial strength rating assigned by either A.M. Best Company or Standard & Poor's Corporation to ESIL after the variance or termination of the agreement is at least as strong as ESIL's financial strength rating assigned by either A.M. Best Company or Standard & Poor's Corporation prior to such variance or termination; or
- ESIL is sold or transferred to a third party.

4.118 The ESIL NWA is governed by the laws of Japan.

4.119 I note that the excess assets[13] of SJNKI (circa £14 billion as at 31 December 2017) are substantial and, while they cannot be assumed to provide absolute security, provide very significant financial resources to support the ESIL NWA.

Administration

4.120 The policy servicing and claims handling processes for EWIL are as follows:

Policy Servicing

4.121 All policy servicing is conducted in London. EWIL is migrating onto the *Guidewire* software platform as the primary policy administration system for its insurance operations, while it is still using the *Duck Creek* system in some classes which are not yet supported on *Guidewire*. EWIL also uses *Polaris* (a reinsurance policy system) for its reinsurance operations. Policies recorded in both the *Guidewire* (and *Duck Creek*) and *Polaris* systems are entered into *Genius* (a financial software package) once bound, as the financial system of record. At the date of this Report there are 71 staff members working in several functions for policy servicing as follows:

- Underwriters – 42
- Underwriting Assistants – 12
- Catastrophe Modelling – 4
- Exposure Management – 2
- Pricing Actuarial – 4
- Operations – 7

4.122 In addition, EWIL outsources data entry work to Xchanging.

4.123 The procedures and controls are defined in EWIL's 'Underwriting Guidelines', 'Global Procedures Manual' and 'SOX Control Document'. All key performance indicators are monitored and reported to the Operations Committee by all Function Heads every quarter.

[13] Excess (solvency margin) assets are calculated in accordance with Japanese law under Articles 86 and 87 of the Ordinance for Enforcement of the Insurance Business Act and Public Notice No. 50 of the Ministry of Finance (1996) year.

Claims handling

4.124 All claims handling is conducted in London (along with policy servicing). EWIL utilises *Guidewire* as EWIL's primary claims administration system, but also uses "Image Right" as a document repository. In addition, EWIL employs a panel of approved experts to assist on larger/problematic claims and outsources certain claims handling responsibilities to Xchanging.

The Fair Treatment of Customers

4.125 EWIL has adopted a risk sensitive approach when developing a conduct risk framework for the business. A key component (and outcome) of the conduct risk framework is the desire to treat customers fairly. While this is a regulatory requirement for EWIL, the fair treatment of customers is considered by EWIL to be embedded within the culture of the business and viewed as being a central driver for the commercial development of EWIL (through deeper and more long-standing relationships with customers).

4.126 In this context the key elements of EWIL's conduct risk framework comprise:

- *Culture* – To adhere to the highest standards of ethics and integrity and be committed to being consistently honest, candid and forthright in all customer relationships. In particular, EWIL believes that it has a strong culture of compliance, demonstrable ethical behaviour and a track record in delivering fair outcomes for policyholders, (all of which is driven by the Board and Senior Management);
- *Policies and Procedures* – EWIL has in place a Conduct Risk Policy and associated procedures (which staff must attest to on an annual basis). Treating customers fairly is central to the Conduct Risk policy. In addition to this policy and the associated procedures other policies within EWIL's wider policy framework touch on TCF (e.g. the Gifts and Entertainment Policy).
- *Training and Awareness* – EWIL has instituted a firm wide programme of training on Conduct Risk with a particular focus on TCF. In addition to a series of seminars EWIL has also required all staff to take part in a Conduct Risk online training programme. This training complements the regular management briefings that cover the importance of the fair treatment of policyholders; and
- *Product Governance and Oversight* – All new products are assigned a Conduct Risk Rating based on customer type, distribution channel, commissions, whether there is a delegation of claims handling authority and so on. Products with a higher conduct risk rating are reviewed by EWIL's Product Oversight Group and Compliance.

Post-Brexit

4.127 Assuming that the Scheme takes place as planned, the (pre-Scheme) EEA (excluding UK) insurance liabilities (and associated assets) will have been transferred from EWIL to SIIE, and the (pre-Scheme) UK and non-EEA insurance liabilities (and associated assets) of SJNKE will have been transferred from SJNKE to EWIL. Further, the (pre-Scheme) UK and non-EEA insurance liabilities (and associated assets) of EWIL will have remained in EWIL.

4.128 EWIL will continue (post-Scheme and Brexit) to use *Guidewire* (and *Duck Creek*) *and Polaris* as EWIL's administration systems for policy servicing and claims handling. However, it will also maintain the data of transferred policies from SJNKE in *AeGIS* as long as policy liabilities exist.

SIIE

Background

4.129 SI Insurance (Europe), SA (i.e. SIIE) is an insurance company registered in Luxembourg (registered number B221096). It is authorised and regulated by the CAA and, with effect from 1 September 2018 (or thereabouts), is anticipated to be in a position (subject to regulatory approval in respect of its branches in Belgium, France, Germany, Italy, Spain and the UK) to carry out contracts of non-life insurance for the following classes: Accident (including industrial injury and occupational disease), Sickness, Land Vehicles (other than rolling stock), Railway Rolling Stock, Aircraft, Ships (sea, lake and river and canal vessels), Goods in Transit (including merchandise, baggage and all other goods), Fire and Natural Forces, Other Damage to Property, Motor Vehicle Liability, Aircraft Liability, Liability for Ships (sea, lake and river and canal vessels), General Liability, Credit, Suretyship, Miscellaneous Financial Loss, Legal Expenses, and Assistance.

4.130 SIIE has been founded to conduct (re)insurance business in EEA territories on both an FoE basis via branches established with effect from 1 September 2018 (or thereabouts) in Belgium, France, Germany, Italy, Spain and the UK; and SIIE will also apply to the PRA for direct authorisation of the UK branch, so that (even assuming that passport rights will cease to apply after the UK leaves the EU and/or after the Brexit Transition Period) the PRA and FCA will directly regulate SIIE's UK (third country) branch – I note that SIH plan to submit a preliminary branch application to the PRA by the end of 2018); and on an FoS basis from its head office in Luxembourg (and its established branches) for 21 other EEA territories not served by a branch of SIIE. For those policyholders with policies containing UK and EEA (excluding UK) exposures, I am informed by SIH that their brokers will split policies into a UK part and another part relating to the other EEA state in the first instance. The other EEA state part will be written in SIIE (and the UK part will be written in EWIL). The SIIE UK branch (established initially on an FoE basis, but subsequently to be established as a third country branch of SIIE, subject to the prior approval by the PRA/FCA) will be used to write the risks that are traded in London, and, where policies are written with UK and EEA (excluding UK) exposures, the UK branch will be eligible to service the UK component after Brexit.

4.131 SIIE is a direct, wholly-owned subsidiary of Sompo International Holdings (Europe) Limited, an English domiciled holding company, which is in turn a direct, wholly-owned subsidiary of ESIL.

Lines of Business

4.132 The main lines of business to be written by SIIE are:

- Accident and Health (personal accident; contract protection insurance; travel benefits; medical expenses and war);
- Aviation (airlines, aerospace, aviation products, airports and general aviation):
- Casualty (split roughly 80% on SME risks, and 20% on larger risks such as transportation, manufacturing, public sector and construction);
- Energy (Offshore – oil lease operator business and service companies / Onshore – refining, petrochemical and fractionation);
- Financial & Political Risks (cover for banks and corporates against credit default and political risk perils, with the majority of the business is in respect of export and trade finance);
- Financial Institutions (banks and non-banks);
- Global Property (focused on commercial property risks);
- Management Liability (focused on non-financial institutions, industrial and non-industrial commercial sectors);
- Marine (Hull, Liability, Cargo and Specie);
- Professional Indemnity (primary and excess layers);
- Transaction Risks (warranty and indemnity cover);
- JIA (Property, Casualty, Marine Cargo and Personal Accident, including business travel); and

- Reinsurance (Non-proportional and Proportional, including agriculture, aviation and engineering).

Distribution Channels

4.133 SIIE will utilise the already established distribution networks of EWIL and SJNKE comprising extra-group brokers (i.e. European insurance brokers and London market insurance brokers), and agents (i.e. Canopius B.V. in the Netherlands, and Sompo Japan Nipponkoa Martin and Boulart SAS insurance agents in France).

4.134 SIIE will also directly distribute its products in the EEA (including the UK).

Transfers of Business

4.135 The transfer of EWIL's and SJNKE's EEA business to SIIE will follow a two stage approach outlined as follows:

4.135.1 Renewal Rights – In the third quarter of 2018, EWIL and SJNKE will transfer to SIIE the renewal rights to their existing EEA (excluding UK) business. From 1 September 2018 (or thereabouts) SIIE will commence the underwriting of all incumbent EEA (excluding UK) risks incepting from that date. It is anticipated that approximately €35 million of premium will be written in 2018, increasing to €138 million in 2019 and €154 million in 2020;

4.135.2 Part VII Transfers – On the Effective Date (anticipated to be 1 January 2019), EWIL and SJNKE will transfer to SIIE their remaining EEA (excluding UK) insurance assets and liabilities by way of transfers under Part VII of FSMA, subject to the approval of the Court. SIIE will administer the run-off of this business until all liabilities are extinguished.

Management Expenses

4.136 SIIE will manage its expenses in a manner consistent with the Sompo Group's overall expense management policy. The approach taken by SIH is to maintain general and administrative expenses at a level commensurate with the amount and type of business being underwritten. While variations within SIH exist, SIH generally seeks to achieve a 10% or better general and administrative expense ratio. The responsibility for the management of SIIE's expenses shall reside with SIIE's *Dirigeant Agréé* (see paragraph 4.148 below), subject to oversight by SIIE's Board of Directors.

Capital Policy and Risk Appetite

4.137 The initial authorised share capital of SIIE was €6,030,000, divided into 30,001 ordinary shares of €1 each, all of which was issued, authorised and fully paid, plus additional paid-in capital of €5,999,999. I am informed by SIH that a further €85.5 million of capital was injected into SIIE on 31 May 2018 (in the form of one ordinary share of €1 and the remainder as additional paid-in capital). SIIE's dividend policy will be conditional, i.e. capable of being cancelled and withheld at any time prior to payment.

4.138 SIIE's basic own fund items are immediately available to absorb losses and have no duration restrictions. All of SIIE's own funds are eligible to cover both the SCR and the MCR. Changes to SIIE's own funds over time will therefore be a result of operating and/or investing activities; no changes are anticipated as a result of redemption, repayment or maturity of basic own fund items.

4.139 SIIE manages its regulatory capital by reference to the risk-based capital determined under Solvency II. Specifically, SIIE calculates its SCR using the SF and aims to maintain capital at a level giving a circa 80% surplus over and above the corresponding SF SCR.

4.140 As part of the ORSA process, SIIE assesses compliance with the capital management policy on a continuous basis. SIIE has defined thresholds and specific actions upon the breach of a threshold, as follows:

Threshold	Action
Capital > 160% of Required Capital as determined in the ORSA	Monitor capital levels quarterly
Capital between 150% and 160% of Required Capital as determined in the ORSA	Detailed analysis of all possible actions to ensure capital coverage exceeds 150% of the Required Capital (as determined in the ORSA)
Capital < 150% of Required Capital as determined in the ORSA	Emergency Board meeting to be convened to trigger the SIIE NWA (see paragraph 4.164 below) and approve immediate action to be taken to restore threshold to above 160% of the Required Capital (as determined in the ORSA)

4.141 SIIE conducts its ORSA which covers its overall solvency needs, taking into account the current and future business plan, risk profile, overall business strategy and approved risk appetite and tolerance limits.

4.142 At the date of this Report, Required Capital as determined in the ORSA is calculated using the SF SCR.

4.143 In order to ensure the risk appetite remains aligned with SIIE's strategy, risk appetite and risk tolerances are reviewed annually and updated as part of the ORSA process. SIIE's risk appetite aligns with the risk management framework described below.

Risk Management

4.144 SIIE has adopted the risk analysis framework and risk strategy currently employed at SIIE's affiliated operating companies located in the UK (i.e. SJNKE and EWIL) as described above. The risk analysis framework and risk strategy to be employed by SIIE is overseen by the *Dirigeant Agréé* (see paragraph 4.148 below) and the Board of Directors of SIIE in Luxembourg.

4.145 SIIE's Enterprise Risk Management ("ERM") framework is designed to support SIIE's business in meeting its strategic objectives while also providing criteria against which to assess current and proposed business activities. Furthermore, the Sompo Group ERM framework more generally includes sophisticated modelling technology, with a strong risk-based focus, and a detailed internal control structure that leverages the Sompo Group's competitive strength for managing risks across its operating companies. In particular:

- SIH and its operating subsidiaries has been externally recognised by Standard & Poor's as having a "Strong" ERM framework;
- SIIE's ERM activities are overseen by a Chief Risk Officer, who will report directly to the *Dirigeant Agréé* of SIIE (see paragraph 4.148 below), with secondary reporting to the SIH Chief Risk Officer;
- The objectives of SIIE's ERM framework that drive its day-to-day activities are as follows:
  - To preserve financial soundness by:
    - (1) Assessing and monitoring on-going capital and reinsurance adequacy;
    - (2) Advising the business on key risks and risk management strategies; and
    - (3) Maintaining compliance with prevailing risk management standards / requirements and to support the business in minimising the otherwise avoidable costs of compliance.
  - To maintain strategic focus and alignment by:
    - (1) Embedding a clear and specific statement of business strategy and objectives;
    - (2) Maintaining statements of the business' risk preferences and embedding these across the decision making system; and
    - (3) Maintaining a proactive and creative approach to understanding and responding to threats and opportunities over the strategic planning time horizon.
  - To provide performance optimisation insight by:

(1) Providing targeted and timely risk analytics insights to inform specific risk taking or mitigation decision making;

(2) Monitoring control effectiveness and facilitate optimisation of risk mitigation strategies and processes; and

(3) Advising on the allocation or capital resources to maximise risk adjusted return in light of risk appetite preferences.

Investment Management

4.146 SIIE's investments will be managed by SIH's centralised investment management function in accordance with SIIE's Investment Policy and subject to the oversight of SIIE's Board of Directors. SIIE's investments are managed based upon the following goals and objectives:

- *Investment performance*
  - Protect shareholder equity, provide needed liquidity;
  - Build book value via strong risk adjusted returns;
  - Execute target portfolio plan – continue managing exposures in the context of market conditions and business needs; and
  - Effective risk management
- *Corporate and constituent relations*
  - Support management and the Board;
  - Support enterprise risk management, capital modelling and Solvency II initiatives;
  - Support underwriting on capital markets related activities; and
  - Rating agency and client relations.

Governance

4.147 SIIE will initially operate with a staff of five employees in its head office in Luxembourg. SIH will seek to augment the staff of SIIE over time, commensurate with the growth of SIIE's book of business and the availability of qualified personnel.

4.148 The following functions will be undertaken in Luxembourg:

- **CEO *("Dirigeant Agréé")***: responsible for the day-to-day management of SIIE, and a member of the Board of Directors of SIIE. Further, all of SIIE's staff (as outlined below) report to the *Dirigeant Agréé*;
- **CRO**: responsible for risk governance; risk strategy; operational risk management; exposure assessment and management; ORSA; risk reporting and compliance; technical provisions and actuarial opinions;
- **Head of Legal & Compliance**: responsible for in-house legal counsel; company secretarial function; regulatory filing & reporting; setting and maintaining company policies; ensuring compliance with all relevant laws and regulatory requirements; setting and running a complaints procedure; and data management;
- **Financial Controller**: responsible for reporting and regulatory requirements; financial reporting governance; treasury and expenses; planning and budgeting; liaison with other finance functions (internally and externally); and the development of an internal control environment around all finance matters;
- **HR and Office Co-ordinator**: responsible for office and facilities administration, local HR for Luxembourg office members; liaison with global HR function to ensure an efficient and effective HR platform which supports the business plan in Luxembourg and Europe; and the provision of administrative support to the senior leadership of the Luxembourg office.

4.149 As mentioned above, all of SIIE's staff report to the *Dirigeant Agréé*, who in turn reports to the Board of Directors of SIIE. The Luxembourg headquarters also carry out group reporting to SIH, as needed. The activities not directly performed by SIIE in Luxembourg are performed by personnel at one of the SIH service companies – a role that is concurrently performed by such service companies on behalf of SIH's UK operating companies.

Overview of the Operation of the Branches

4.150 Following its establishment, SIIE will set up six branches:

(1) Brussels, Belgian Branch (8 employees)

(2) Dusseldorf, German Branch (32 employees)

(3) Barcelona, Spanish Branch (9 employees)

(4) Milan, Italian Branch (6 employees)

(5) Paris, French Branch (7 employees)

(6) London, UK Branch (5 employees).

4.151 The group policies of SIH, including its underwriting guidelines, have been adopted and implemented by the Board of SIIE. The level of authority for each individual (branch) underwriter and financial signatory are set and controlled in SIIE's information technology systems. Policy data underwritten in branch offices is reviewed and monitored in SIIE's headquarters in Luxembourg. All branch managers report to the *Dirigeant Agréé* of SIIE, and are evaluated by key performance indicators based on the strategy of SIIE. Internal audit will periodically confirm the effectiveness of the underwriting, operational and financial controls implemented by SIIE.

Underwriting Process

4.152 The location of underwriting process varies depending on the distribution channel. Risks sourced in EEA (excluding UK) countries by EEA brokers or directly with clients are processed in branch offices, while the risks traded in the London market are processed in SIH's London service companies through outsourcing agreements primarily with DXC Technology Company (formerly Xchanging) for the capture, validation and updating of bound policy data into SIH's core underwriting tools. In both cases, SIH's London service companies will provide the applicable services. While SIIE outsources to the service companies the underwriting support for each policy covering risks traded in the London market, the overall framework for underwriting, such as limit of risk acceptance, and the general rules of pricing are maintained in the Luxembourg headquarters of SIIE. The *Dirigeant Agréé* of SIIE monitors the service companies' compliance with these rules and has access to any information and documents with respect to each underwritten policy.

Claims Process & Reserving

4.153 Claims and reserving will be processed by SIH's London service companies, including through outsourcing agreements, primarily with DXC Technology Company (formerly Xchanging) for the recording of claims activity and settlement of claims within limits and authority determined and monitored by the Luxembourg headquarters of SIIE. SIH's Actuarial Function supports the reserving process including conducting quarterly actuarial reviews and reporting to the Board and senior management of SIIE for its review and approval.

Reinsurance Arrangements

4.154 The underwriting portfolio of SIIE, except for Japanese relationship business, will be a part of SIH's global reinsurance treaty program consisting of excess of loss, quota-share and whole account treaties with third party reinsurers (as outlined for EWIL in paragraph 4.84 above). For Japanese relationship business, third-party excess of loss and intra-group QS reinsurance with SJNKI will apply (as outlined for SJNKE in paragraphs 4.21 to 4.28 above). After the cessions to the aforementioned treaties, intra-group QS and stop-loss reinsurance with ESIL will operate. The retention ratio of SIIE is to be managed to be approximately 10% of its overall portfolio premium.

Custody Arrangements

4.155 Assets equal to or greater than the technical provisions of SIIE are to be deposited with one or more EEA credit institutions (and such deposits are required to be governed by a deposit agreement that has been approved by the CAA prior to the commencement of underwriting in SIIE).

IT Arrangements

4.156 SIIE's IT processes and procedures are based upon, comply with and utilise SIH's IT organisation, strategy, systems and security, subject to the oversight and direction of the *Dirigeant Agréé* and the Board of Directors of SIIE.

4.157 SIIE uses *Guidewire* and *Polaris* for policy administration and *SAP GL* (a financial software package) for accounting respectively. These are the core systems of SIH globally. At the same time, the current systems of SJNKE, which are *AeGIS* for policy administration and *Sompo GL* for accounting, will co-exist for the first few years of transition period. SIIE has full access to the foregoing systems, while maintaining full control over its own data. Initially, SIH's existing IT systems supporting SIIE will be located in London and the New York City metropolitan areas.

4.158 SIIE has adopted and operates SIH's information security policy. SIIE has also adopted SIH's IT business continuity policy that provides a defined set of processes for the planning, testing and implementation of business continuity and disaster recovery.

Outsourcing Arrangements

4.159 Due to initial resource constraints, SIIE is to outsource the following functions, activities and services to its affiliates:

- Underwriting support (UK Service Companies, including DXC Technology Company, formerly Xchanging)
- Policy administration (UK Service Companies, DXC Technology Company, formerly Xchanging)
- Claims handling (UK Service Companies, DXC Technology Company, formerly Xchanging)
- Actuarial and reserving (UK Service Companies)
- Investments (US Service Company)
- Finance and accounting (UK Service Companies)
- Risk management (UK Service Companies)
- Compliance (UK Service Companies)
- HR / Admin (UK Service Companies as needed)
- IT (UK Service Companies)
- Regulatory reporting (UK Service Companies as needed)
- Internal Audit (UK Service Companies)
- Solvency II Key functions and operational critical/important functions.

4.160 The above functions, activities and services have been outsourced in compliance with the applicable provisions of Article 44 of the law of 7 December 2015 on the insurance sector, as amended (the "Law of 2015").

4.161 As SIIE grows and develops its Luxembourg employee base, it is expected that functions, activities and services that SIIE initially outsources to its affiliates will be incorporated into SIIE's activities in Luxembourg.

4.162 While SIIE may delegate certain of its day-to-day operational duties to one or more third party service providers, the responsibilities for effective due diligence, oversight and management of outsourcing and accountability for all outsourcing decisions, rests with SIIE, the Board and the *Dirigeant Agréé*. The Board, or a committee delegated by it, is responsible for:

- Approving a framework to evaluate the risks and materiality of all existing and prospective outsourcing and the policies that apply to such arrangements;

- Setting out the appropriate approval authorities for outsourcing depending on the nature of risks in, and materiality of the outsourcing;
- Assessing management competencies for developing sound and responsive outsourcing risk management policies and procedures as commensurate with the nature, scope and complexity of the outsourcing arrangements;
- Undertaking regular review of outsourcing strategies and arrangements for their continued relevance, and safety and soundness; and
- Reviewing a list of all material outsourcing and relevant reports on outsourcing.

4.163 SIIE's *Dirigeant Agréé* is responsible for:

- Evaluating the risks and materiality of all existing and prospective outsourcing, based on the framework approved by the Board;
- Developing and implementing sound and prudent outsourcing policies and procedures commensurate with the nature, scope and complexity of the outsourcing;
- Reviewing periodically the effectiveness of policies and procedures;
- Communicating information pertaining to material outsourcing risks to the Board in a timely manner;
- Ensuring that contingency plans, based on realistic and probable disruptive scenarios, are in place and tested; and
- Ensuring that there is independent review and audit for compliance with set policies.

SIIE Net Worth Agreement

4.164 SIIE entered into a Net Worth Agreement with ESIL, dated May 2018 (the "SIIE NWA"). Under the terms of this agreement, ESIL agrees to cause SIIE to have capital resources in amount equal to the higher of:

- 100% of SIIE's MCR; and
- 150% of SIIE's SCR.

4.165 ESIL also agrees to cause SIIE to have sufficient cash funds or liquid assets to satisfy valid claims under policies issued by SIIE and valid claims of financial creditors as they fall due for payment.

4.166 The Agreement cannot be varied unless agreed in writing by both parties (ESIL and SIIE). The parties cannot vary or terminate the Agreement to the detriment of the accrued rights of existing SIIE policyholders and financial creditors as at the date of such variation or termination prior to that date, unless:

- The parties provide a notice in writing at least 365 days prior to any such variation or termination to each of the credit rating agencies that has assigned to SIIE a financial strength rating at the time of delivery of such notice; or
- The credit worthiness of SIIE becomes at least as strong as ESIL's supported rating at that time; or
- SIIE is sold or transferred to a third party.

4.167 The Agreement is governed by Bermudian law.

Legal Opinions

4.168 I have received two Bermudian law opinions directly from ESIL's attorneys in Bermuda regarding:

- The enforceability of the Net Worth Agreement entered in to by ESIL and SIIE (i.e. the SIIE NWA). This advice confirms that the maintenance of net worth and appropriate liquidity as contained in the SIIE NWA (i.e. ESIL will cause SIIE to have capital resources as per paragraph 4.164 above, and sufficient cash funds as per paragraph 4.165 above) constitutes a legal, valid and binding obligation of ESIL enforceable against it in accordance with its terms; and

- The enforceability of the Net Worth Agreement entered in to by ESIL and EWIL (i.e. the EWIL NWA). This advice confirms that the maintenance of net worth and appropriate liquidity as contained in the EWIL NWA (i.e. ESIL will cause EWIL to have capital resources, as per paragraph 4.111 above, and sufficient cash funds as per paragraph 4.112 above) constitutes a legal, valid and binding obligation of ESIL enforceable against it in accordance with its terms.

4.169 Based on my review of the opinions I have been presented with, and my related discussions with SIH's internal lawyers, I am satisfied that these opinions make sense to me and do not raise any questions or concerns. In the light of this, and the professionalism and integrity of SIH's legal advisers (retained in relation to the Net Worth Agreements), I have not felt a second independent legal opinion is warranted.

Administration

4.170 SIIE will use *Guidewire* and *Polaris* as its administration systems for policy servicing and claims handling. However, it will also maintain the data of transferred policies from SJNKE in *AeGIS* and that from EWIL in both *Guidewire* and *Duck Creek* as long as policy liabilities exist. Since the administration arrangement in the SJNKE branches will be taken over and replicated by SIIE, there will be consistency for both policy servicing and claims handling for all the transferred policies.

Conduct Risk – TCF

4.171 SIIE will be required to meet the conduct-focused regulatory requirements of the host state regulator in each jurisdiction within which it operates. Further, as with SJNKE and EWIL, SIIE will adopt a risk based approach to monitoring and managing the conduct risks associated with ensuring that the business treats customers fairly.

4.172 Certain aspects of best practice, such as cultural drivers of good behaviour, tone from the top, and senior management engagement, will also be adopted by SIIE. Further, SIIE will adopt and adapt policies and procedures used as described above for SJNKE, including training, product governance and oversight (e.g. a risk based monitoring plan, with associated risk tolerances being implemented that focus upon more high conduct risk business).

4.173 The Transferring SJNKE EEA (excluding UK) Business written on an FoE basis is currently subject to the conduct of business regulations, including consumer protection rules, of the host country of each respective branch. The regulator in the country hosting each branch oversees the compliance of that branch with its insurance laws and regulations, implementing, *inter alia*, the relevant EU Directives. As the business of each of the Belgian, French, German, Italian and Spanish branches of SJNKE will transfer to respective branches of SIIE, the host country regulator in relation to conduct of business will not change as a result of the Scheme.

Post-Brexit

4.174 As noted in paragraph 4.129 above, SIIE is a Luxembourg company, authorised and regulated by the CAA (with effect from 29 March 2018). Its existing licence would not be impacted by Brexit.

4.175 With effect from 1 September 2018 (or thereabouts) SIIE will outsource most of the administration of the Transferring SJNKE EEA (excluding UK) Business and Transferring EWIL EEA (excluding UK) Business, as well as all other business that SIIE writes, to EBSL. EBSL is a member company of the Sompo Group and based in the UK. Although EBSL will consider and adjust claims on behalf of SIIE, its role is advisory. SIIE management will ultimately decide whether liability should be accepted, claims should be settled and the level of appropriate reserves to maintain. The authority to conclude commutations also rests wholly with SIIE. Therefore, EBSL will not provide services that are subject to regulation. This will remain so post-Brexit.

4.176 There are currently data protection rules that preclude certain types of data, including personal details, being transferred from inside to outside the EU. Post-Brexit, SIIE would have to ensure that no such data was transferred electronically from within the EU to (or even via) a server based outside the EU. I am informed that SIIE (and the wider Sompo Group) is working with its outsourced IT service providers to ensure that its IT practices, processes and procedures are wholly EU-compliant throughout the Sompo Group.

4.177 Although the terms of Brexit are currently far from being settled, there is a strong possibility that UK (re)insurers will lose passporting rights to undertake business within the EU and that EU (re)insurers, including SIIE, will similarly lose their passporting rights to undertake business within the UK.

5. THE PROPOSED SCHEME

MOTIVATION FOR THE SCHEME

5.1 SIIE has been established in order to improve the ability of SIH to access and underwrite EEA business, as well as to ensure compliance with EEA laws and regulations following the departure of the UK from the EU.

5.2 SIIE is planned to be a licensed operating entity in Luxembourg with 6 branches able to underwrite EEA business as from 1 September 2018 (or thereabouts).

5.3 In the third quarter of 2018, EWIL and SJNKE will transfer to SIIE the renewal rights to their existing EEA business. From 1 September 2018 (or thereabouts), SIIE will commence the underwriting of all of the Sompo Group's incumbent EEA risks incepting from that date.

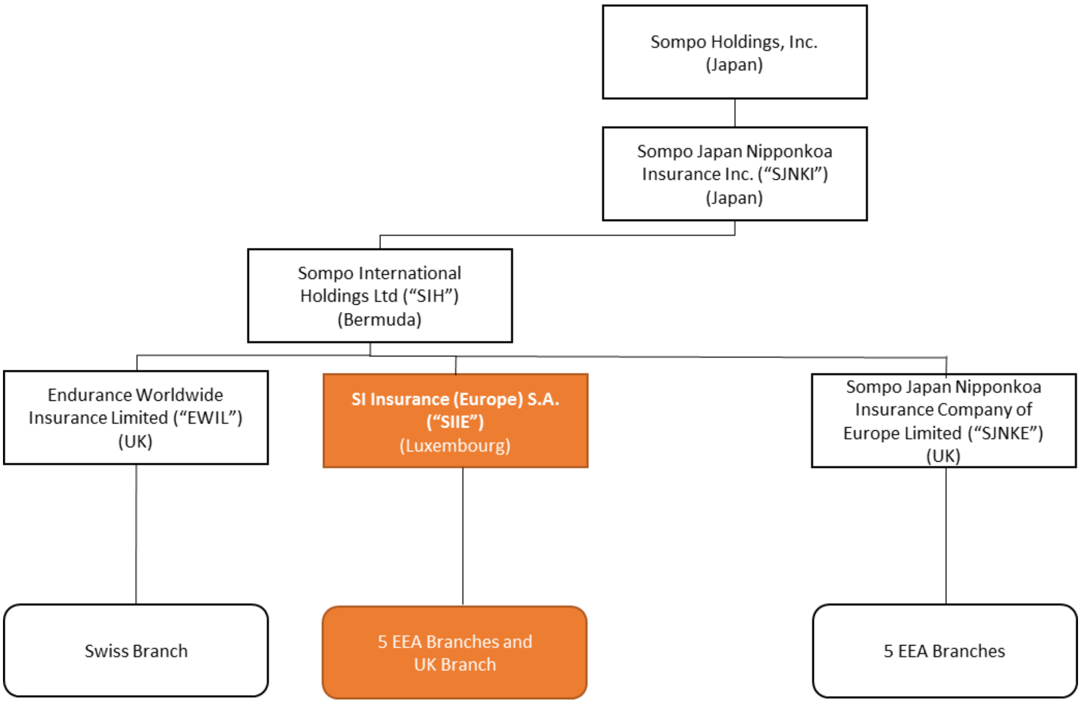
5.4 On the Effective Date EWIL and SJNKE will each transfer to SIIE their remaining EEA (excluding UK) insurance assets and liabilities by way of transfers under Part VII of FSMA; and, at the same time, SJNKE will transfer to EWIL its remaining UK and non-EEA insurance assets and liabilities by way of a transfer under Part VII of FSMA – together the three transfers make-up the proposed Scheme (for the avoidance of doubt the Scheme is a single instrument and there is no option for the Court to approve only one or two of the three transfers). The Scheme will be carried out in conjunction with a cross-border merger of SJNKE into SIIE (i.e. the CBM). As a consequence of the cross-border merger SJNKE will be dissolved without going into liquidation.

5.5 To accomplish the transfers contemplated under the Scheme the Court's consent is needed.

OUTLINE

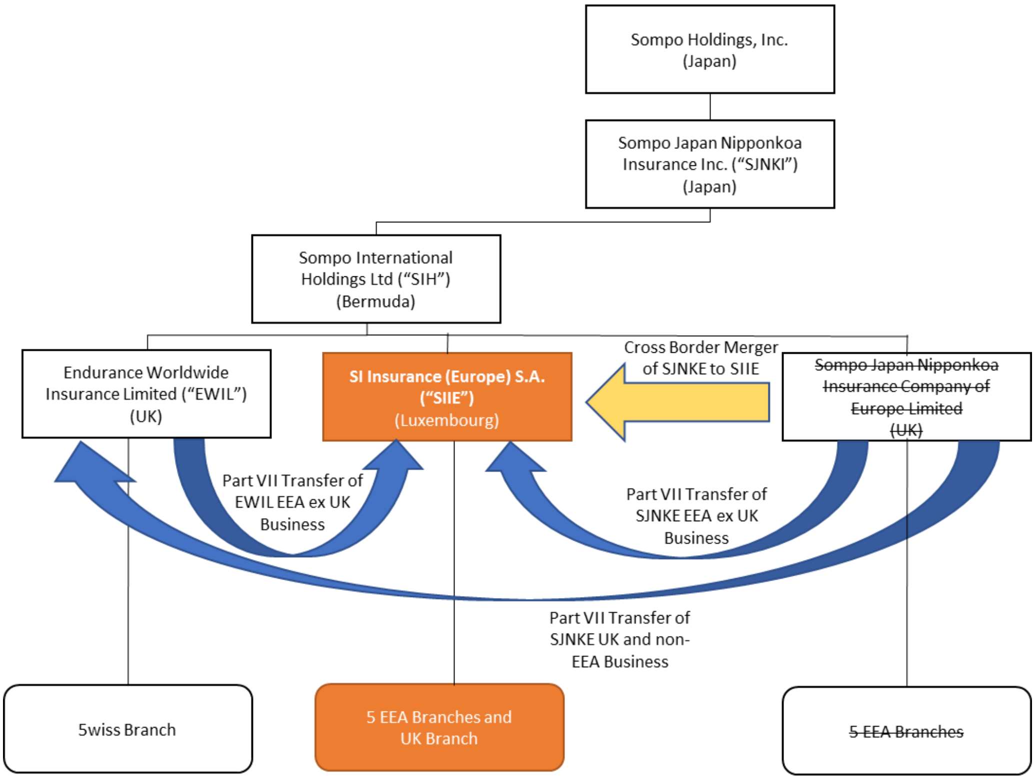
5.6 A summary of the pre-Scheme position of SJNKE, EWIL and SIIE within the Sompo Group is shown in Figure 5.1 below.

Figure 5.1
Simplified Pre-Scheme Corporate Structure for the Sompo Group



5.7 Under the proposed Scheme (and Framework Agreement): the Transferring SJNKE EEA (excluding UK) Business will be transferred to SIIE; the Transferring EWIL EEA (excluding UK) Business will be transferred to SIIE; and the Transferring SJNKE UK and non-EEA Business will be transferred to EWIL, in each case on or with effect from the Effective Date (expected to be 1 January 2019). A summary of the post-Scheme position of SJNKE, EWIL and SIIE within the Sompo Group after the Scheme and CBM is shown in Figure 5.2 below.

Figure 5.2
Simplified Post-Scheme Corporate Structure for the Sompo Group



5.8 Specifically, by order of the Court, the following shall be transferred to and vested in SIIE on or with effect from the Effective Date:

5.8.1 the rights, benefits and powers of SJNKE in relation to the Transferring SJNKE EEA (excluding UK) Business or arising as a result of SJNKE having carried on the Transferring SJNKE EEA (excluding UK) Business;

5.8.2 all assets (including reinsurance) relating directly to the Transferring SJNKE EEA (excluding UK) Business, plus the surplus assets of SJNKE (other than £4 million of retained assets that are to transfer under the CBM), and all the interest and title of SJNKE in them;

5.8.3 all liabilities of SJNKE under or in respect of the Transferring SJNKE EEA (excluding UK) Policies or attributable to the Transferring SJNKE EEA (excluding UK) Business (which will then cease to be liabilities of SJNKE);

5.8.4 the rights, benefits and powers of EWIL in relation to the Transferring EWIL EEA (excluding UK) Business or arising as a result of EWIL having carried on the Transferring EWIL EEA (excluding UK) Business;

5.8.5 all assets (including reinsurance) relating directly to the Transferring EWIL EEA (excluding UK) Business and all the interest and title of EWIL in them; and

5.8.6 all liabilities of EWIL under or in respect of the Transferring EWIL EEA (excluding UK) Policies or attributable to the Transferring EWIL EEA (excluding UK) Business (which will then cease to be liabilities of EWIL).

5.9 Further, and specifically, by order of the Court, the following shall be transferred to and vested in EWIL on or with effect from the Effective Date:

5.9.1 the rights, benefits and powers of SJNKE in relation to the Transferring SJNKE UK and non-EEA Business or arising as a result of SJNKE having carried on the Transferring SJNKE UK and non-EEA Business;

5.9.2 all assets (including reinsurance) relating directly to the Transferring SJNKE UK and non-EEA Business and all the interest and title of SJNKE in them;

5.9.3 all liabilities of SJNKE under or in respect of the Transferring SJNKE UK and non-EEA Policies or attributable to the Transferring SJNKE UK and non-EEA Business (which will then cease to be liabilities of SJNKE).

5.10 All costs and expenses incurred in connection with the preparation and carrying into effect of the Scheme, whether before or after the Effective Date, shall be paid by SJNKE, EWIL and SIIE (and not by the policyholders of the Transferring Business).

5.11 The Scheme is severable in that if an order to transfer any specific policies cannot be obtained, the other policies can nonetheless be transferred.

5.12 The terms of the Scheme are governed by English law.

5.13 Table 5.1 below shows the effect of the Scheme on SJNKE's balance sheet (on a GAAP basis) at the Effective Date (taken to be as at 31 December 2018 for illustrative purposes) assuming an intra-group capital distribution of circa £95 million is made by end-2018 (prior to the Effective Date) as outlined in paragraph 6.95 below, and as reflected in the amount of Shareholder's Equity shown in the SJNKE pre-Scheme column.

Table 5.1
Simplified Balance Sheets for SJNKE at the Effective Date

£m	SJNKE Pre-Scheme	Transferring Business-out			SJNKE Post-Scheme (pre-CBM)
		EEA ex UK[1]	UK and Non-EEA	Facultative Reinsurance[2]	
Assets					
Premium & Other Debtors	14.2	8.5	4.5	1.2	-
Ceded UPR	16.1	10.5	4.4	1.2	-
Reinsurance Recoveries on Claims Reserves	63.7	49.6	11.0	3.1	-
Reinsurance Recoveries on Paid Claims	27.5	23.4	3.2	0.9	-
Investments & Cash	39.3	35.3	-	-	4.0
Total Assets	160.9	127.4	23.0	6.5	4.0
Liabilities					
Shareholder's Equity	41.4	37.4	-	-	4.0
UPR	18.5	11.2	5.7	1.6	-
Claims Reserves	78.6	59.5	14.9	4.2	-
Reinsurance Creditors	12.0	9.3	2.1	0.6	-
Accruals & Other Creditors	10.4	10.0	0.3	0.1	-
Total Liabilities	161.0	127.4	23.0	6.5	4.0

[1] The Shareholder's Equity in the Transferring Business-out EEA ex UK column represents the surplus assets of SJNKE, i.e. those assets over andabove the assets needed to meet estimated policyholder (and creditor) obligations, other than £4m of assets retained by SJNKE (to meet the absolute minimum capital requirement of €3.7m) that are to transfer under the CBM.

[2] The Facultative Reinsurance column represents the facultative reinsurance business of SJNKE administered through its branches or by its agent, Canopius BV in the Netherlands, transferred out to SIIE.

5.14 If the Scheme is sanctioned, all the assets and liabilities of SJNKE will transfer to either SIIE (i.e. in respect of the Transferring SJNKE EEA (excluding UK) Business, including the surplus assets of SJNKE, less £4.0 million retained by SJNKE in order to maintain the minimum solvency margin of €3.7 million prior to the CBM[14]) or EWIL (i.e. in respect of the Transferring SJNKE UK and non-EEA Business). Table 5.1 above shows an illustration of the balance sheet of SJNKE post-Scheme.

5.15 Post the proposed Scheme and the CBM, SJNKE will have no assets or liabilities (and no policyholders) and will be dissolved without going into liquidation.

5.16 No compensation will be paid to the policyholders (or to the shareholders) of SJNKE in consideration of the transfers of the Transferring SJNKE EEA (excluding UK) Business to SIIE and the Transferring SJNKE UK and non-EEA Business to EWIL, although SIIE and EWIL will assume the (re)insurance liabilities in respect of the Transferring SJNKE EEA (excluding UK) Business and Transferring SJNKE UK and non-EEA Business respectively.

5.17 There will be no changes to the terms and conditions of any policy included within the Transferring SJNKE EEA (excluding UK) Business or the Transferring SJNKE UK and non-EEA UK Business as a result of the Scheme. SJNKE's rights and obligations under the Transferring SJNKE EEA (excluding UK) Policies will be transferred, without alteration, to SIIE, and SJNKE's rights and obligations under the Transferring SJNKE UK and non-EEA Policies will be transferred, without alteration, to EWIL.

5.18 Similarly, all holders of Transferring SJNKE EEA (excluding UK) Policies and all holders of Transferring SJNKE UK and non-EEA Policies will be entitled to the same rights against SIIE and EWIL respectively as were available to them against SJNKE under such policies and will be accountable to either SIIE or EWIL (as the case may be) for any further or additional premiums or other amounts attributable or referable thereto as and when the same become due and payable.

5.19 Any pending or current proceedings or complaints issued or served before the Effective Date by or against SJNKE in connection with either the Transferring SJNKE EEA (excluding UK) Business or the Transferring SJNKE UK and non-EEA UK Business shall be continued by or against SIIE or EWIL respectively in place of SJNKE, and SJNKE shall cease to have any liability under those proceedings following the Effective Date. Any proceedings or complaints issued or served on or after the Effective Date that would hitherto have been by or against SJNKE will instead be by or against either SIIE or EWIL (as the case may be). SIIE and EWIL shall each be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to SJNKE in respect of the Transferring SJNKE EEA (excluding UK) Business and the Transferring SJNKE UK and non-EEA Business respectively.

5.20 Any judgment, order or award in respect of the Transferring SJNKE EEA (excluding UK) Business which is not fully satisfied before the Effective Date will become enforceable by or against SIIE in the place of SJNKE. Likewise, any judgment, order or award in respect of the Transferring SJNKE UK and non-EEA Business which is not fully satisfied before the Effective Date will become enforceable by or against EWIL in the place of SJNKE.

5.21 SIIE will indemnify SJNKE against any loss or expense incurred by SJNKE, whether before or after the Effective Date, that is attributable to the Transferring SJNKE EEA (excluding UK) Business. Likewise, EWIL shall indemnify SJNKE against any loss or expense incurred by SJNKE, whether before or after the Effective Date, that is attributable to the Transferring SJNKE UK and non-EEA Business.

[14] The assets of £4.0 million retained by SJNKE prior to the CBM will be moved to SIIE under the CBM of SJNKE into SIIE.

5.22 For the holders of the Transferring SJNKE EEA (excluding UK) Policies moving to SIIE under the Scheme, the additional security that they enjoy under the NWA provided by SJNKI (the SJNKE NWA) will cease on the Effective Date (as that agreement applies to SJNKE, which itself will cease as a result of the Scheme and the CBM) but such policyholders will enjoy the additional security under a NWA provided (on better terms) by ESIL to SIIE (the SIIE NWA) to be implemented prior to the Effective Date. Similarly, for the holders of the Transferring SJNKE UK and non-EEA Policies moving to EWIL under the Scheme, the additional security (over and above the capital resources held within SJNKE) that they enjoy under the SJNKE NWA will cease on the Effective Date, but such policyholders will enjoy the additional security under a NWA provided (on better terms) by ESIL to EWIL (the EWIL NWA) to be implemented prior to the Effective Date.

5.23 Table 5.2 below shows the effect of the Scheme on EWIL's balance sheet (on a GAAP basis) at the Effective Date (assumed to be 31 December 2018 for illustrative purposes). Specifically, if the Scheme is sanctioned, the assets and liabilities of the Transferring SJNKE UK and non-EEA Business will transfer to EWIL, while the assets and liabilities of the Transferring EWIL EEA (excluding UK) Business will transfer to SIIE.

Table 5.2
Simplified Balance Sheets for EWIL at the Effective Date

£m	EWIL Pre-Scheme	Transferring Business		EWIL Post-Scheme
		EWIL EEA ex UK out	SJNKE UK and Non-EEA in	
Assets				
Premium & Other Debtors	92.3	1.9	4.5	94.9
Ceded UPR	81.6	1.3	4.4	84.7
Reinsurance Recoveries on Claims Reserves	271.4	12.3	11.0	270.1
Reinsurance Recoveries on Paid Claims	19.0	0.3	3.2	21.9
Investments & Cash	629.4	7.0	-	622.4
Total Assets	1,093.7	22.9	23.0	1,093.8
Liabilities				
Shareholder's Equity	390.0	-	-	390.0
UPR	199.0	2.8	5.7	201.9
Claims Reserves	410.4	16.2	14.9	409.1
Reinsurance Creditors	78.1	3.9	2.1	76.3
Accruals & Other Creditors	16.3	-	0.3	16.6
Total Liabilities	1,093.7	22.9	23.0	1,093.8

5.24 All (post-Scheme) future income and outgoings arising from the Transferring SJNKE UK and non-EEA Business will pertain to EWIL (together with all future income and outgoings of the Non-Transferring EWIL Business).

5.25 No compensation will be paid to the policyholders (or to the shareholders) of EWIL in consideration of the transfer of the Transferring EWIL EEA (excluding UK) Business to SIIE, although SIIE will assume the (re)insurance liabilities in respect of the Transferring EWIL EEA (excluding UK) Business.

5.26 There will be no changes to the terms and conditions of any policy included within the Transferring EWIL EEA (excluding UK) Business as a result of the Scheme. EWIL's rights and obligations under the Transferring EWIL EEA (excluding UK) Policies will be transferred, without alteration, to SIIE.

5.27 Similarly, all holders of Transferring EWIL EEA (excluding UK) Policies will be entitled to the same rights against SIIE as were available to them against EWIL under such policies and will be accountable to SIIE for any further or additional premiums or other amounts attributable or referable thereto as and when the same become due and payable.

5.28 Any pending or current proceedings or complaints issued or served before the Effective Date by or against EWIL in connection with the Transferring EWIL EEA (excluding UK) Business shall be continued by or against SIIE in place of EWIL, and EWIL shall cease to have any liability under those proceedings following the Effective Date. Any proceedings or complaints issued or served on or after the Effective Date that would hitherto have been by or against EWIL will instead be by or against either SIIE. SIIE will be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to EWIL in respect of the Transferring EWIL EEA (excluding UK) Business.

5.29 Any judgment, order or award in respect of the Transferring EWIL EEA (excluding UK) Business which is not fully satisfied before the Effective Date will become enforceable by or against SIIE in the place of EWIL.

5.30 SIIE shall indemnify EWIL against any loss or expense incurred by EWIL, whether before or after the Effective Date, that is attributable to the Transferring EWIL EEA (excluding UK) Business.

5.31 For the holders of the Transferring EWIL EEA (excluding UK) Policies moving to SIIE, the additional security (over and above the capital resources held within EWIL) that they enjoy under the NWA (the EWIL NWA, which will become effective in mid-to-late September 2018 and will replace the Surety Bond before the Effective Date) provided by ESIL will cease on the Effective Date (as that agreement applies to EWIL) but such policyholders will enjoy the additional security under a NWA provided (on essentially equivalent terms) by ESIL to SIIE (the SIIE NWA) to be implemented prior to the Effective Date.

5.32 Table 5.3 below shows the effect of the Scheme on SIIE's balance sheet (on a GAAP basis) at the Effective Date (assumed to be 31 December 2018 for illustrative purposes). Specifically, if the Scheme is sanctioned, the assets and liabilities of the Transferring SJNKE EEA (excluding UK) Business, plus the surplus assets of SJNKE (other than £4 million of retained assets which are to transfer under the CBM) will transfer to SIIE, and the assets and liabilities of the Transferring EWIL EEA (excluding UK) Business will also transfer to SIIE. Table 5.3 below further reflects that additional capital of €85.5 million was paid into SIIE on 31 May 2018 (i.e. prior to the commencement of underwriting scheduled for 1 September 2018, or thereabouts).

Table 5.3
Simplified Balance Sheets for SIIE at the Effective Date

€m	SIIE Pre-Scheme[1]	Transferring Business-in			SIIE Post-Scheme (pre-CBM)
		SJNKE EEA ex UK[2]	EWIL EEA ex UK	Facultaive Reinsurance[3]	
Assets					
Premium & Other Debtors	5.1	9.6	2.2	1.4	18.3
Ceded UPR	12.8	11.9	1.5	1.4	27.6
Reinsurance Recoveries on Claims Reserves	3.0	56.1	13.9	3.5	76.5
Reinsurance Recoveries on Paid Claims	-	26.5	0.4	1.0	27.9
Investments & Cash	88.5	39.9	7.9	-	136.3
Total Assets	109.4	144.0	25.9	7.3	286.6
Liabilities					
Shareholder's Equity	79.2	42.3	-	-	121.5
UPR	23.2	12.7	3.2	1.8	40.9
Claims Reserves	3.6	67.2	18.3	4.7	93.8
Reinsurance Creditors	3.0	10.5	4.4	0.7	18.6
Accruals & Other Creditors	0.4	11.3	-	0.1	11.8
Total Liabilities	109.4	144.0	25.9	7.3	286.6

[1] The Shareholder's Equity shown in the SIIE pre-Scheme column is the capital available at the Effective Date allowing for the capital injection of €85.5 million paid into SIIE on 31 May 2018.

[2] The Shareholder's Equity shown in the Transferring Business-in SJNKE EEA ex UK column is the surplus assets transferred from SJNKE to SIIE under the Scheme (other than £4 million of assets retained by SJNKE that are to under the Scheme (other than £4 million of assets retained by SJNKE that are to transfer under the CBM).

[3] The Facultative Reinsurance column represents the facultative reinsurance business of SJNKE administered through its branches or by its agent, Canopius BV in the Netherlands, transferred into SIIE.

5.33 All (post-Scheme) future income and outgoings arising from the Transferring SJNKE EEA (excluding UK) Business and that from the Transferring EWIL EEA (excluding UK) Business will pertain to SIIE (together with all future income and outgoings of the current SIIE business).

POLICYHOLDERS AFFECTED

5.34 I have considered the effects of the Scheme on five main groups of policyholders (see paragraph 2.10 above) namely:

- those policyholders of SJNKE whose policies are to be transferred to SIIE, i.e. the holders of Transferring SJNKE EEA (excluding UK) Policies;
- those policyholders of SJNKE whose policies are to be transferred to EWIL, i.e. the holders of Transferring SJNKE UK and non-EEA Policies;
- those policyholders of EWIL whose policies are to be transferred to SIIE, i.e. the holders of Transferring EWIL EEA (excluding UK) Policies;
- those policyholders remaining in EWIL, i.e. the Holders of Non-Transferring EWIL Policies; and
- the current (as at the Effective Date) policyholders of SIIE.

COMPENSATION AND COMPLAINTS

5.35 After the implementation of the Scheme, as with all other insurance companies with an establishment in the UK, EWIL will continue to be required to participate in the FSCS. Therefore, to the extent they currently meet the qualifying criteria (as set out in in Section 2), the holders of the Transferring SJNKE UK and non-EEA Policies will continue to be protected by the FSCS if the Scheme is sanctioned.

5.36 Likewise, in terms of FSCS protection currently available to eligible Transferring SJNKE EEA (excluding UK) Policyholders and to eligible Transferring EWIL EEA (excluding UK) Policyholders there is not expected to be any change as a result of the Scheme. SIIE will have a UK branch, which will be established initially by the exercise of passport rights. SIIE will also apply to the PRA for direct authorisation of the UK branch, so that (even assuming that passport rights will cease to apply after the UK leaves the EU and/or after the end of the Brexit Transition Period) the PRA and FCA will directly regulate SIIE's UK branch. As a result of this, SIIE will be a "firm" for the purposes of the FSCS and so policyholders will have the same access to the FSCS that they may have had before. FSCS protection will continue to apply to claims under transferring policies arising before or after the Effective Date, because SIIE is a participant firm within the scope of the FSCS regime (initially, as an incoming EEA firm exercising passport rights and in future as an authorised UK branch). In respect of such claims, the Transferring SJNKE EEA (excluding UK) Policyholders and the Transferring EWIL EEA (excluding UK) Policyholders will not have access to any additional compensation scheme in Luxembourg. I note that SJNKE and EWIL policyholders are largely commercial policyholders and hence would mostly not be eligible for FSCS protection.

5.37 Since both SJNKE and EWIL are subject to the compulsory jurisdiction of the FOS, the Scheme will have no effect on the eligibility of the holders of Transferring SJNKE UK and non-EEA Policies to bring complaints to the FOS. If, as described in Section 2, they are currently able to bring complaints to the FOS, this will remain the case after the implementation of the Scheme. If they are currently not eligible to complain to the FOS this will also remain the case after the implementation of the Scheme.

5.38 Further, FOS compulsory jurisdiction covers complaints about the activities of a firm in the UK, which includes the UK branch activities of a pass-porting EEA insurer, such as SIIE, so there should be no change for Transferring SJNKE EEA (excluding UK) Policyholders and Transferring EWIL EEA (excluding UK) Policyholders as a result of the Scheme. In particular, activities carried on in an EEA establishment outside the UK are not covered by FOS before or after the Scheme, but activities carried on by an establishment in the UK (whether through a head office or branch of a firm) are covered by FOS both before and after the Scheme. In the event that there were an intention to shift activities that may become the subject of a complaint from the UK to outside the UK, policyholders may be able to bring complaints to the Médiateur en Assurances, as described in paragraph 3.21 above. I also note that the holders of Transferring SJNKE EEA (excluding UK) Policies may be eligible to make complaints via the host state regulator or other organisation in the country their respective branch is located in. As these policyholders will continue to be policyholders of a branch in the same country, their ability to make complaints in this way will not be affected by the Scheme.

5.39 In Luxembourg, the Médiateur en Assurances provides a free complaints mediation service for eligible complainants. This scheme will assist the parties to help reach a negotiated settlement and will issue a decision upholding or rejecting the complaint, although the decision is a recommendation only and is not binding on either party.

ADMINISTRATION

5.40 After implementation of the proposed Scheme, the EWIL Non-Transferring Business will continue to operate as it currently does, i.e. with most operations outsourced to EBSL in London. Such operations include underwriting, claims, operations, risk management and systems.

5.41 The administration (including claims handling) of the Transferring EWIL EEA (excluding UK) Business is currently undertaken with most operations outsourced to EBSL. Post-Scheme, these operations will be undertaken by SIIE in respect of the Transferring EWIL EEA (excluding UK) Business in the same manner as currently (i.e. with most operations outsourced to EBSL).

5.42 The administration (including claims handling) of the SJNKE business is currently undertaken by SJNKE staff based in company's London head office and/or branches in each case using the *AeGIS* system. During the first quarter of 2018 the SJNKE employees based in the UK were transferred to EBSL, while its employees in Belgium, France, Germany, Italy and Spain will be transferred to SIIE. Post-Scheme, these operations will be undertaken by SIIE in respect of the Transferring SJNKE EEA (excluding UK) Business in the same manner as currently (i.e. outsourced to EBSL and/or undertaken through corresponding branches).

EMPLOYERS' LIABILITY TRACING OFFICE

5.43 I am informed by SIH that at the time of writing this Report, the EWIL Compliance Team is working closely with the relevant SJNKE and EWIL internal functions, including the IT department(s), to ensure a seamless transition of SJNKE's Employers' Liability data and continued compliance with the FCA and Employers' Liability Tracing Office ("ELTO") reporting obligations that apply to SJNKE up to the Effective Date. In particular, that an Employers' Liability database is maintained in accordance with regulatory requirements, and Employers' Liability policies are uploaded to the ELTO database.

5.44 In practice, all new Employers' Liability policies will be uploaded by the respective underwriting team(s) on a monthly basis, and on a weekly basis, the EWIL Compliance Team will receive an e-mail from ELTO with a spreadsheet detailing records that need to be searched against customer information. I further note that the SJNKE Compliance Team and EWIL Compliance Team are essentially one and the same (as they have the same members) and they will be co-ordinating internally prior to the Effective Date to ensure that EWIL is in compliance with both FCA and ELTO requirements.

EXCLUDED POLICIES

5.45 Any policies which are not capable of being transferred for legal reasons will be treated as excluded policies and will remain with EWIL or SJNKE (as the case may be). I am informed by the lawyers advising SJNKE, EWIL and SIIE (in relation to the Scheme) that based on their experience on transfers it is not expected that there will be any such policies. I will update the position at the time of my supplemental report.

CAPITAL POLICY AFTER THE SCHEME

5.46 SJNKE, EWIL and SIIE are currently required to comply with the capital requirements of Solvency II. Compliance with solvency capital requirements is currently overseen by the CAA in respect of SIIE and the PRA in respect of SJNKE and EWIL.

5.47 SJNKE, EWIL, and SIIE each use the SF approach to calculating their respective regulatory Solvency II capital requirements.

5.48 I discuss in Section 6 the implications of the Scheme on the security of the holders of Transferring SJNKE EEA (excluding UK) Policies and on the holders of Transferring EWIL EEA (excluding UK) Policies as provided by the capital strength of SIIE as compared to SJNKE and EWIL respectively, and the security of the holders of Transferring SJNKE UK and non-EEA Policies provided by the capital strength of EWIL as compared to SJNKE.

APPROACH TO COMMUNICATION WITH POLICYHOLDERS

5.49 The intended approach that SJNKE, EWIL and SIIE plan to take in communicating information about the proposed Scheme to the affected policyholders and other parties is set out in Section 9.

5.50 The main objectives of the communications are to:

- Give affected policyholders the information that they need to understand the proposed changes;
- Inform affected policyholders about the implications for them of the proposed changes;
- Give affected policyholders access to further relevant information (beyond that in the communications pack);
- Let affected policyholders know what steps they should take if they object to any of the proposed changes;
- Maintain customers' confidence in SIIE's willingness and ability to continue to meet its obligations under transferring and non-transferring policies;
- Maintain customers' confidence in EWIL's willingness and ability to continue to meet its obligations under transferring and non-transferring policies; and
- Meet legal and regulatory requirements.

COSTS

5.51 All costs and expenses, including, without limitation, fees and disbursements of legal and financial advisers and accountants, incurred in connection with the Scheme and the transactions contemplated by the Scheme shall be paid equally by the SJNKE and EWIL. None of the costs of the Scheme will be borne by the policyholders.

6. THE IMPACT OF THE SCHEME ON THE TRANSFERRING POLICYHOLDERS

INTRODUCTION

6.1 Under the Scheme, the SJNKE EEA (excluding UK) Transferring Business and the EWIL EEA (excluding UK) Transferring Business will be transferred to SIIE, and the SJNKE UK and non-EEA Transferring Business will be transferred to EWIL.

6.2 The main issues affecting the transferring policyholders of SJNKE and EWIL as a result of the Scheme are likely to arise from relative differences in:

- The financial strength of SIIE and EWIL post-Scheme compared with that of SJNKE and of EWIL pre-Scheme. Financial strength is derived from:
    - the strength of the reserves held, relative to a best estimate of the outstanding liabilities;
    - excess assets or capital; and
    - specific financial support arrangements.
- The risk exposures in SIIE and EWIL post-Scheme compared with that of SJNKE and of EWIL pre-Scheme.
- The policy servicing levels provided by SIIE and EWIL post-Scheme compared with those currently provided by SJNKE and EWIL pre-Scheme.

6.3 In this Section I deal with each of these in turn.

6.4 I note that the reserves held on a GAAP basis differ from the Technical Provisions that help determine the own funds available to meet the SCR under Solvency II. However, the best estimate of the liabilities under GAAP is usually used as the base for the best estimate of the liabilities under Solvency II, which then forms a key part of the Solvency II Technical Provisions. Furthermore, I note that the process of estimating reserves for insurance liabilities is inherently uncertain due to unknown future events or circumstances and the effect these may have on the frequency and cost of claims. For example, future legal changes may increase the number of claims to which insurers are exposed, inflation may change the costs of remediation of insured events, and new types of claim may emerge that are not currently anticipated. Recent examples of uncertainty include the market-observed increases in the number of claims reported to Employers' Liability policies for Noise-Induced Hearing Loss ("NIHL"), or increasing costs to the market from the change in the Ogden discount rate to be applied on settlement to certain lump sum bodily injury claims.

6.5 While key metrics under Solvency II, such as the SCR, MCR and EOF, are intended to be made public as part of each insurer's annual SFCR, there are other relevant metrics (for example, projected values of own funds and of solvency capital requirements as set out in insurers' ORSAs) that are private matters between the entities and the relevant regulators. Therefore, I am not at liberty to disclose in the Report the actual values of those metrics, or figures by which those values could be calculated. In the Report I have considered the extent to which SJNKE, EWIL and SIIE each hold capital in excess of various solvency capital measures. I refer to the ratio of the actual capital that the entity under consideration holds to the regulatory solvency capital requirement as the "Capital Cover Ratio". Each entity will have different Capital Cover Ratios for different solvency measures. Where permitted I have expressed Capital Cover Ratios in numeric terms. In other instances, for comparative purposes in the Report, I have defined the following terms:

- "sufficiently capitalised" refers to a Capital Cover Ratio between 100% and 119%;
- "more than sufficiently capitalised" refers to a Capital Cover Ratio between 120% and 149%;
- "well-capitalised" refers to a Capital Cover Ratio between 150% and 199%; and
- "very well-capitalised" refers to a Capital Cover Ratio in excess of 200%.

RESERVE STRENGTH OF SJNKE (PRE AND POST SCHEME)

6.6 I have been provided with the following reserving reports for SJNKE:

- An external actuarial report – "Calculation of the Solvency II Technical Provisions as at 31 December 2017", dated 4 April 2018;
- Internal actuarial reports – "Review of technical reserves as at 30 September 2017", dated 8 November 2017 and "Review of technical reserves as at 31 December 2017", dated 5 February 2018; and
- An external actuarial presentation – "Results of *[external actuaries]* calculation of the Solvency II Technical Provisions for SJNKE – Updated Results as at 31 December 2017", dated 4 April 2018.

6.7 The internal actuarial reports referred to in paragraph 6.6 above details the methodology, assumptions and IBNR selections (as well as a comparison with the claims developments since the 31 December 2016 reserve review) for SJNKE's business as at 30 September 2017 and 31 December 2017.

6.8 The SJNKE actuaries have estimated ultimate claims amounts on best estimate and prudent best estimate[15] bases (the latter being used within financial statements under UK GAAP). Their actuarial prudent best estimates of outstanding claims gross and net of reinsurance as at 31 December 2017 were £116.3 million and £24.1 million respectively (excluding amounts of £2.0 million gross and net of reinsurance for unallocated loss adjustment expenses ("ULAE" – see paragraph 6.21 below). In booking reserves for outstanding claims liabilities in its management accounts as at 31 December 2017, SJNKE selected the actuarial prudent best estimate, which is estimated to contain a margin over and above the best estimate of £14.4 million gross of reinsurance and £3.9 million net of reinsurance. (For the avoidance of doubt, the actuarial estimated ultimate claims amounts, on both best estimate and prudent best estimate bases, make an allowance for the change in the discount rate to be applied on settlement to certain lump sum bodily injury claims announced, on 27 February 2017, by the Lord Chancellor.)

6.9 I have reviewed the work carried out by those responsible for estimating reserves for SJNKE, as set out in the aforementioned reports, in order to satisfy myself that it is reasonable for me to rely on their work.

6.9.1 I have noted the general methodology used by the actuaries within SJNKE, which was as follows:

- For claims with an accident date after 2005, other than Noise-Induced Hearing Loss ("NIHL") claims, the basic projection method used was the chain-ladder[16] method applied to the development of premiums, paid claims and incurred claims on a quarter of accident basis;
- Both the paid and incurred claims projections were modified for the more recent accident years where claims to date are at a relatively early stage of development. In these cases the Bornhuetter-Ferguson[17] ("B/F") technique was employed, i.e. a weighted average was taken of the chain-ladder method projected figure and a projected ultimate claim amount based on an initial expected loss ratio ("IELR");
- Gross of reinsurance projections were initially undertaken, with net of reinsurance IBNR obtained by applying the reinsurance programme in place; and

[15] A best estimate basis is one with no deliberate bias upwards or downwards, and not including any margins (see Appendix A for a fuller description). In the case of SJNKE, the gross and net prudent best estimates as at 31 December 2017 were roughly 14% and 17% greater than their corresponding best estimate counterparts (and furthermore these percentage differences have been broadly consistent over time). As at 31 December 2017, the adjustments to underlying prudent best estimate models to assess the correspnoding best estimates included: (1) reduced initial expected loss ratios for the Marine and UK Employers' Liability books; (2) reduced large/latent claim loadings; and (3) an increased allowance for reinsurance recoveries on large Property and Marine claims.

[16] The chain-ladder method is an actuarial technique commonly used for projecting claim amounts on more mature Accident Years. See Appendix A for a fuller description.

[17] The B/F technique is an actuarial technique commonly used for projecting claim amounts on more recent Accident Years. See Appendix A for a fuller description.

- For NIHL claims, a frequency-severity approach was used, i.e. the expected number of claims in each future year has been multiplied by the corresponding selected average size of claim for each future year (adjusted for inflation). The sum of the products of claim numbers and average claim sizes gives the expected total amount to settle claims reported in all future years.

6.9.2 I have noted that those responsible for the reserve estimates include suitably qualified actuaries within SJNKE, and I have also noted that their results and conclusions have been reviewed by the Reserving and the Audit and Risk Committees within SJNKE. As a result I have not attempted to review in detail the calculations performed by the SJNKE actuaries.

6.9.3 The reports have been in sufficient detail for me to understand the process by which reserves were set, the approach followed by SJNKE's actuaries, the key areas of reserve uncertainty and the apparent strength of the reserves based on these reviews. This has enabled me to consider the appropriateness of the methodologies and major assumptions used. I have concluded that the methodologies, major assumptions and results as at 31 December 2017 appear reasonable.

6.9.4 As a result I have concluded that it is reasonable for me to rely on the reserving work of the SJNKE actuaries.

6.10 As noted in paragraph 6.8 above, the reserves established by SJNKE as at 31 December 2017 include a margin over and above the actuarial best estimate. I therefore consider SJNKE's booked reserves to be on a basis higher than a 50% confidence level (as the claim distribution is expected to be positively skewed[18]). I note that, as SJNKE does not generally discount its reserves (on a GAAP basis), this gives rise to an off balance sheet asset (or margin) equivalent to the time value of money inherent in the undiscounted part of the reserves. Such a margin increases the security of the policyholders.

6.11 The SJNKE actuaries have analysed the business across 8 major cohorts within which detailed assessments of gross and net of reinsurance claims reserves have been made. By far the largest cohort modelled was the SJNKE business on the 2006 – 2017 Accident Years, which represented circa 90% of the estimated gross claim reserves as at 31 December 2017. Within this cohort, the most significant classes by estimated gross claim reserves as at 31 December 2017 were Liability (30%), Property (45%), Marine (24%), and Other (1%).

6.12 As at 31 December 2017, SJNKE's actuarial reserving report identifies the main sources of reserve uncertainty to be:

- uncertainties relating to NIHL exposures;
- delays in notification of large claims;
- the process for the selection of IELRs;
- lack of historical information on the NKE run-off agency business (while noting that it is 100% reinsured), and the older parts of the NKE run-off book (in particular the NICE business);
- uncertainties relating to future changes in legislation and the claims environment;
- uncertainties as to the impact of the general economic environment on claim frequency and claim severity;
- the availability and quality of data relating to claims, exposures and reinsurance arrangements for the NKE run-off business limit the type of actuarial projection and raise the uncertainty surrounding the results of the projections;
- the experience of large claims, which often demonstrate different characteristics to the general trend, are difficult to predict. Further, these claims may have proportionally an unduly large impact on the account given the size of the outstanding claims in the run-off portfolio; and

[18] A claims distribution of potential losses is said to be positively skewed as the loss cannot be less than zero, but can be many times larger than the mean loss (alternatively, this may be viewed as a distribution of potential losses having a higher frequency of lower value losses, and a lower frequency of higher value losses, e.g. observed losses of: 1, 2, 3, 4, 100).

- exposure to latent claims in some of the portfolios increases the uncertainties in the results of the portfolios concerned.

6.13 I would typically expect to see the above uncertainties in claims reserving for business of this nature.

6.14 In order to illustrate the degree of uncertainty in the actuarial projections, I note that SJNKE has carried out sensitivity tests (e.g. by a ±10% adjustment to a key assumption) in the following areas:

- the tail development factors for the main lability classes increased by 10%;
- the IELR selections used in the B/F method increased/decreased by 10%; and
- an alternate “best estimate” (rather than a prudent best estimate) reporting pattern for future NIHL claims (on UK Employers’ Liability business arising from Japanese Corporate Business).

6.15 Again, I would typically expect to see the above type of sensitivity tests in claims reserving for business of this nature.

6.16 The margins within SJNKE’s booked reserves, both explicit and implicit (in particular the general non-allowance for the time value of money in the reserves), gives me some assurance that the total reserves held provide a reasonable allowance given the uncertainty around the final cost of these liabilities, the main sources of which I have noted above. I have derived further assurance from the results of the 31 December 2017 actuarial review showing that, overall, experience was favourable compared with the previous review as at 31 December 2016 (although the run-off was not positive in all classes, in particular non-UK Liability).

6.17 I note that this unfavourable experience on the non-UK Liability class was principally attributable to two product liability claims reported with June 2015 occurrence dates in the third/fourth quarter of 2017. This source of uncertainty has already been identified above, and such occurrences can be expected from time to time.

6.18 The generally favourable reserve run-off experience and the general stability over time in the claim reserving approach and key assumptions gives me added comfort regarding the strength of SJNKE’s claim reserves.

6.19 I note that the SJNKE actuaries have also undertaken a high level review of (the adequacy of) the gross and net (of reinsurance) UPR held as at 31 December 2017 of £35.9 million and £3.3 million respectively (in each case as calculated by the finance function using a straight line earnings profile together with an additional amount for “pipeline” premiums[19]) by comparing it to the estimated value of claims and expenses likely to arise after 31 December 2017 from contracts concluded before that date. Their analysis indicated that the gross and net (of reinsurance) UPR was adequate, i.e. their estimated gross and net (of reinsurance) values did not exceed the corresponding provision for unearned premiums (after deduction of any acquisition costs deferred), and any premiums receivable under those contracts.

6.20 Based on my review of analysis undertaken by the SJNKE actuaries in relation to the UPR, I am satisfied that the results so determined appear reasonable.

6.21 Likewise, I note that the SJNKE actuaries have undertaken a high level review of the provision for ULAE as at 31 December 2017. The ULAE provision has been estimated using approximations rather than via a detailed analysis (e.g. as a proportion of the gross claims reserves, including IBNR). In the case of SJNKE the provision for ULAE as at 31 December 2017 is circa 2% of gross claims reserves, including IBNR. I would typically expect to see this level of ULAE associated with claims reserves for business of this nature.

[19] Pipeline premiums are premiums estimated to be received in the future in respect of business already incepted at the valuation date.

Transfer of Reserves

6.22 I am informed by SIH that the reserves moving from SJNKE to EWIL in respect of the Transferring SJNKE UK and non-EEA Business will do so (on the Effective Date) at the same balance sheet value, i.e. no credit is to be taken for any reserve strengthening or releases as a result of the Scheme. Likewise, the reserves moving from SJNKE to SIIE in respect of the Transferring SJNKE EEA (excluding UK) Business will do so (on the Effective Date) at the same balance sheet value, i.e. no credit is to be taken for any reserve strengthening or releases as a result of the Scheme. Furthermore, as SJNKE, EWIL and SIIE all follow SIH's reserving policy (see paragraph 6.63 below) I do not anticipate any associated change in reserve strength in respect of either the Transferring SJNKE UK and non-EEA Business or the Transferring SJNKE EEA (excluding UK) Business as a result of the Scheme.

Conclusion

6.23 ***Based on my review as described above, I have concluded that the methodologies and major assumptions underlying the reserve analyses as performed by the SJNKE actuaries as at 31 December 2017 are reasonable, that their best estimate of unpaid claim amounts also appear reasonable and that the reserves booked by SJNKE as at 31 December 2017 include some margins, both implicit and explicit, over those best estimates. Moreover, the reserving methodology has been largely stable over the last three years and emerging results have not indicated either material under-reserving or excessive over-reserving.***

6.24 ***Therefore I conclude that SJNKE's reserves appear reasonable at present. Furthermore, I have no reason to think that the reserve strength of SJNKE will be impacted by the Scheme.***

Solvency II Technical Provisions

6.25 The external actuarial report and presentation referred to in paragraph 6.6 above detail the methodology, assumptions and the Technical Provisions under Solvency II ("TPs") so developed for SJNKE's business as at 31 December 2017. Please refer to Appendix G for more details on TPs.

6.26 The external actuaries have calculated TPs based on SJNKE's UK GAAP held reserves as at 31 December 2017 (as discussed above) as their starting point, by making a series of adjustments to those GAAP held reserves. (I note that the external actuaries have not reviewed the aforementioned GAAP reserves for reasonableness.)

6.27 I have placed no reliance upon the report and presentation prepared by the external actuaries referred to in paragraph 6.6 above. Where I have used them, I have performed sufficient work of my own to confirm that it is appropriate for me to use the information for the purposes of forming my opinion on the Scheme.

6.28 I have read both the report and presentation produced by the external actuaries and considered the approach to estimating the TPs (including the risk margin component) as at 31 December 2017, the key issues and the results presented. In general, a series of adjustments have been made to the GAAP held reserves to calculate TPs as follows:

- Removal of SJNKE management margin (see paragraph 6.8 above) and ULAE (see paragraph 6.21 above);
- Conversion of the UPR to a Solvency II "best estimate" basis – see Appendix H;
- Credit for future premiums on incepted business (i.e. recognition of profits expected to arise on such business);
- Inclusion of Bound But Not Incepted ("BBNI") business – see Appendix H;
- Allowance for a share of the cost of internal and external XL contracts not yet renewed;
- Allowance for ENIDs – see Appendix H;
- Reinsurance bad debt reserve – see Appendix H;
- Allowance for discounting – see Appendix H;
- Solvency II expenses – see Appendix H; and
- Risk margin – see paragraph 6.35 below (and Appendix H).

6.29 I also note that SJNKE's Chief Actuary and SJNKE's Finance Function, acting in the capacity of Actuarial Function ("AF") for SJNKE, have carried out thorough reviews of the reports and presentations (prepared by the external actuaries referred to in paragraph 6.6 above) and have discussed various aspects of the work undertaken with the external actuaries in order for the AF to be satisfied as to the approach, assumptions and results presented.

6.30 I would typically expect to see the adjustments (outlined in paragraph 6.28 above) to be employed in modifying GAAP claims reserves and UPR to produce TPs (under Solvency II). I note, however, that there is uncertainty as to the appropriate level of adjustments to make in order to estimate TPs, and that SJNKE could have made equally reasonable alternate adjustments, which would lead to different results.

6.31 The impact of the adjustments (outlined above) and supporting assumptions (a number of which were provided by SJNKE), generated gross and net (of reinsurance) TPs (as at 31 December 2017) of circa £126 million and £50 million respectively, which compare with gross and net (of reinsurance) GAAP reserves (claims reserves and UPR) of £154.3 million and £29.4 million respectively.

6.32 On a gross (of reinsurance) basis: the claims provision (pre risk margin) component of the TPs is circa £12 million less than the GAAP claims reserves, primarily because of the removal of the management margin and ULAE provision from the TP calculation; and the premium provision (pre risk margin) component of the TPs is circa £18 million less than the UPR, primarily because of the inclusion of expected profits on future premiums and legally obliged business in the TPs calculation.

6.33 On a net (of reinsurance) basis: the claims provision (pre risk margin) component of the TPs is broadly equal to the GAAP claims reserves primarily because the removal of the management margin and ULAE provision is offset by the inclusion of additional (Solvency II) expenses and loadings for reinsurance bad debts and ENID in the TPs calculation; and the premium provision (pre risk margin) component of the TPs is circa £20 million greater than the UPR, primarily because of additional (Solvency II) expenses and expected losses on future net premiums in the TPs calculation.

6.34 In order to get the full level of the TPs (as set out in paragraph 6.30 above), a risk margin needs to be added to both the gross and net claim and premium provisions (pre risk margin) as outlined in paragraphs 6.32 and 6.33 above respectively. The general basis of calculation of the risk margin under Solvency II is set out in Appendix A.

6.35 As explained in paragraph 6.28 above, I have considered the approach to estimating the risk margin component of the TPs (as at 31 December 2017), the key issues and the results presented. In broad terms the calculation of the risk margin (based on the SCR as at 31 December 2017 as calculated according to the SF under Solvency II) follows the general basis as set out in Appendix A. More specifically, future SCRs of the business have been developed assuming that business goes into run-off, as follows:

- the opening run-off SCR is calculated from the main SCR calculation referred to above, subject to certain simplifying assumptions, e.g. there is no market risk;
- run-off SCRs of the business for all future years are estimated by assuming that that future run-off SCRs are proportional to a function of the run-off of the TPs;
- the discounted cost-of-capital is estimated using a cost-of-capital rate of 6% applied to future run-off SCRs, discounted using the EIOPA discount rates to give a risk margin of circa £2 million (as at 31 December 2017).

6.36 I would typically expect to see an approach as set out above to be employed in estimating the risk margin component of the TPs (under Solvency II).

Conclusion

6.37 ***Based on my review as described above, I have concluded that the approach and key assumptions underlying the calculation of Technical Provisions (under Solvency II) as at 31 December 2017 are reasonable, and that SJNKE's Technical Provisions (under Solvency II) appear reasonable at present.***

RESERVE STRENGTH OF EWIL (PRE AND POST SCHEME)

6.38 I have been provided with the following reserving reports for EWIL:

- An internal Actuarial Function report – "Technical Provisions as of 31 December 2016", dated 29 June 2017;

- An internal memo – "Description and review of the loss estimation process used for Hurricanes Harvey, Irma, & Maria and the California Fires", dated 5 February 2018;
- An Audit Committee Reserve Discussion document for EWIL at 4Q 2017, dated 7 March 2018; and
- A 2017 Q4 Solvency II Technical Provisions Presentation, dated 7 March 2018.

6.39 The internal Actuarial Function report referred to in paragraph 6.38 above details the methodology, assumptions and results for the technical provisions on both GAAP and Solvency II bases for EWIL's business as at 31 December 2016. I also note that the SIH Chief Actuary UK has confirmed to me that the aforesaid reserving methodology remains applicable to the reserves established by EWIL as at 31 December 2017 as described in the Audit Committee Reserve Discussion document referred to in paragraph 6.38 above.

6.40 The EWIL actuaries have estimated ultimate claims amounts on an actuarial central estimate[20] basis. As at 31 December 2017, their actuarial central estimate of outstanding claims gross and net of reinsurance (including intra-group reinsurance) was £347.1 million and £128.8 million respectively. In booking gross and net reserves for outstanding claims liabilities in its management accounts as at 31 December 2017, EWIL held reserves equal to the actuarial central estimates. In addition, as at 31 December 2017, EWIL held a UPR gross of reinsurance of £167.4 million (with Deferred Acquisition Costs[21] on the UPR of £33.0 million).

6.41 As at 31 December 2017, the most significant classes within the net actuarial central estimate of outstanding claims were Reinsurance Other (43%), Property (11%), Professional (15%), Energy (14%), UK Motor XL (14%) and Aviation (3%).

6.42 I have reviewed the work carried out by those responsible for estimating reserves for EWIL, as set out in the aforementioned reports, in order to satisfy myself that it is reasonable for me to rely on their work.

6.42.1 I have noted that the general methodology used by the actuaries within EWIL, which was as follows:

- The main methods used for the projection of central-estimate reserves include paid and reported loss development methods; the paid and reported B/F method; the initial expected loss method; and judgment (e.g. for catastrophe losses and some specified large losses, qualitative information and recommendations were provided from the EWIL claims department and the business units). All the methods employed make use of both paid and incurred data. Other reserving methods are considered as required (e.g. frequency-severity techniques for longer tail lines, where information about frequency is known much earlier than for severity). The selected ultimate losses were either based on one particular method or a weighting between several;
- Two main types of parameters were used in the reserving process: IELRs and development patterns – both paid and reported. IELRs were selected from one of a combination of corporate plan loss ratios, pricing loss ratios, historic loss ratios (adjusted for rate changes, inflation and exposure trends), and industry and peer group experience. Development patterns were selected from one or a combination of specific loss development, development patterns from other SIH platforms, account specific information, and insurance industry information;

[20] An actuarial central estimate ("ACE") is one which should as best as possible intend to be neither conservative nor optimistic. In particular:

- It represents an expected value over the range of reasonably possible outcomes;
- The range of reasonably possible outcomes does not include all conceivable outcomes. For example, it does not include conceivable extreme events where the contribution of such events to an expected value is not reliably estimable;
- It is not the result of a probability distribution or a statistical analysis.

[21] Deferred Acquisition Costs ("DAC") describes the practice of deferring the cost of acquiring a new customer over the duration of the insurance, and held as an asset on the insurer's GAAP balance sheet.

- Reserving segments are split (as appropriate) between attritional, large and catastrophe losses. Large loss and catastrophe events are further split out and reviewed on an individual basis, where possible, examining potential loss exposure on a contract by contract basis. In particular, for year-end 2017, the catastrophe estimation process used for Hurricanes Harvey, Irma, and Maria, as well as for the Californian Fires, involved a detailed analysis, which utilised the by-contract expertise of the line underwriters and claims people, and included multiple iterations of management review that in turn included approval by the loss reserve committee; and
- Gross of reinsurance projections were initially undertaken, and then netted down for reinsurance. For pro-rata business, ceded IBNR was set equal to the ratio of the gross IBNR to gross earned premium for the subject business. For working layer XL contracts, IBNR was typically set based upon the ratio of gross IBNR to gross earned premium for the subject business, while for catastrophe oriented covers, if the actuary deemed that a catastrophe has likely not occurred, then no IBNR was selected.

6.42.2 I have noted that those responsible for the reserve estimates include suitably qualified actuaries within EWIL, and I have also noted that their results and conclusions have been reviewed by the Audit Committee for recommendation to the EWIL Board. As a result I have not attempted to review in detail the calculations performed by the EWIL actuaries.

6.42.3 The EWIL reserving documents have been in sufficient detail for me to understand the process by which reserves were set, the approach followed by EWIL's actuaries, the key areas of reserve uncertainty and the apparent strength of the reserves based on these reviews. This has enabled me to consider the appropriateness of the methodologies and major assumptions used. I have concluded that the methodologies, major assumptions and results as at 31 December 2017 appear reasonable.

6.42.4 As a result I have concluded that it is reasonable for me to rely on the reserving work of the EWIL actuaries.

6.43 As noted in paragraph 6.41 above, the claim reserves established by EWIL as at 31 December 2017 have been set equal to the actuarial central estimate. I therefore consider EWIL's booked reserves (on a GAAP basis) to be on a basis higher than a 50% confidence level (as the claim distribution is expected to be positively skewed). I note that, as EWIL does not generally discount its reserves (on a GAAP basis), this gives rise to an off balance sheet asset (or margin) equivalent to the time value of money inherent in the undiscounted part of the reserves. Such a margin increases the security of the policyholders.

6.44 The EWIL actuaries have analysed the business across 7 major classes within which detailed assessments of gross and net of reinsurance claims reserves have been made. The major classes used were: Aviation, Energy, Property, Professional & Casualty, Reinsurance CAT, Reinsurance Motor, and Reinsurance non-CAT. In addition, they have performed a separate detailed analysis for the catastrophe estimation process used for Hurricanes Harvey, Irma, and Maria, as well as for the Californian Fires.

6.45 As at 31 December 2017, EWIL's Audit Committee Reserve Discussion document identifies the main sources of reserve uncertainty to be:

- Third quarter (and post) catastrophe events – Hurricanes Harvey, Irma and Maria, and the Californian wildfires. There is uncertainty as to the ultimate settlement value of these claims. However, this uncertainty is significantly mitigated by EWIL's ceded reinsurance programme;
- UK Motor – the impact of the change in the discount rate, from 2.5% to negative 0.75%, to be applied on settlement to certain lump sum bodily injury claims announced, on 27 February 2017, by the Lord Chancellor could materially increase losses to the excess layers of SIIE's inwards Motor XL account;
- The softening in insurance rates, terms, & conditions starting in 2014 adds an additional element of uncertainty to the selection of ultimate loss ratios;
- Uncertainties relating to new classes of business where it is more difficult to project than classes with which the business is familiar, while noting that such risks are somewhat mitigated due to significant purchases of reinsurance;

- Uncertainties associated with short-tailed lines of business where for accident year 2017, attritional loss activity has been higher than expected;
- Uncertainties associated with long-tailed lines of business where there is inevitably doubt around the ultimate claims outcomes, e.g. the book contains a significant amount of professional liability business, where ultimate results are highly sensitive to adverse trends, such as a worsening legal climate regarding security class actions and litigation impacting financial institutions. This exposure is somewhat mitigated due to EWIL's ceded reinsurance programme; and
- The process for the selection of IELRs.

6.46 I would typically expect to see the above uncertainties in claims reserving for business of this nature.

6.47 The implicit margin within EWIL's booked reserves (i.e. the general non-allowance for the time value of money in the reserves), gives me some assurance that the total reserves held provide a reasonable allowance given the uncertainty around the final cost of these liabilities, the main sources of which I have noted above.

6.48 I note that the aggregate actual versus expected claims emergence/development as at 31 December 2017 for Accident Years 2016 & prior has been unfavourable (i.e. actual claim amounts were greater than expected amounts), while observing that the experience varied by class, with some classes (e.g. Energy) enjoying favourable claims emergence/development albeit outweighed by other classes (such as Professional Liability, Property and Reinsurance non-catastrophe) suffering unfavourable claims emergence/development. In my experience, deviations of this nature in either direction are a typical feature of London Market business (as written by EWIL).

6.49 Based on my review (as set out above) I am satisfied that the methodology and assumptions of the EWIL reserving process (including the catastrophe estimation process used for Hurricanes Harvey, Irma, and Maria, as well as for the Californian Fires) are reasonable, while noting the uncertainty associated with the exposures arising from the types of business written by EWIL.

Transfer of Reserves

6.50 I am informed by SIH that the reserves moving from EWIL to SIIE in respect of the Transferring EWIL EEA (excluding UK) Business will do so (on the Effective Date) at the same balance sheet value, i.e. no credit is to be taken for any reserve strengthening or releases as a result of the Scheme. Furthermore, as SJNKE, EWIL and SIIE all follow SIH's reserving policy (see paragraph 6.63 below) I do not anticipate any associated change in reserve strength in respect of the Transferring EWIL EEA (excluding UK) Business as a result of the Scheme

Conclusion

6.51 ***Based on my review as described above, I have concluded that the methodologies and major assumptions underlying the reserve analyses as performed by the EWIL actuaries as at 31 December 2017 are reasonable, that their central estimate of unpaid claim amounts also appear reasonable and that the reserves booked by EWIL as at 31 December 2017 include some implicit margins (for the time value of money).***

6.52 ***Therefore I conclude that EWIL's reserves appear reasonable at present, while noting the increased uncertainty associated with the types of business written by EWIL. Furthermore, I have no reason to think that the reserve strength of EWIL will be impacted as a result of the Scheme.***

Solvency II Technical Provisions

6.53 The internal Actuarial Function report referred to in paragraph 6.38 above, details the methodology, assumptions and the TPs under Solvency II so developed for EWIL's business as at 31 December 2016. I am informed by the SIH Chief Actuary UK that the aforesaid Solvency II TP methodology remains largely applicable to the TPs established by EWIL as at 31 December 2017, although I note that several enhancements were made to the TP model during 2017 (as explained to me in discussions with relevant EWIL actuaries, and as outlined in an extract, the technical provisions section, of the draft December 2017 SFCR for EWIL also provided to me). In particular, the aforesaid updated TP model included: (1) better reinsurance correspondence, i.e. expected recoveries (and associated reinsurance costs) for existing gross contracts, but not for unincepted contracts, are more appropriately accounted for in the TP model; and (2) the risk margin is more appropriately estimated by slowing down the run-off of the capital to better reflect the greater risk of variability in tail payments (see paragraph 6.60 below). Please refer to Appendix G for more details on TPs.

6.54 The EWIL actuaries have calculated TPs based on EWIL's UK GAAP held reserves as at 31 December 2017 (as discussed above) as their starting point, and made a series of adjustments to those GAAP held reserves.

6.55 I have reviewed the work carried out by the EWIL actuaries in estimating the TPs for EWIL, as set out in the aforementioned Actuarial Function report and extract from the draft December 2017 SFCR, in order to satisfy myself that it is reasonable for me to rely on their work.

6.55.1 I have noted the general approach used by the EWIL actuaries as outlined in paragraph 6.54 above;

6.55.2 I have noted that the EWIL actuaries responsible for the (GAAP reserves and) TP calculations include suitably qualified actuaries, and that the results are subject to review by the Head of Reserving Actuary of EWIL, the CFO of EWIL, and the Endurance Group Chief Reserving Actuary;

6.55.3 The Actuarial Function report has been prepared in sufficient detail for me to understand the process by which the TPs were calculated and the approach followed by the EWIL actuaries. This report, along with the aforementioned extract of the December 2017 SFCR, has enabled me to consider the appropriateness of the approach and the assumptions used. I have concluded that the methodologies, key assumptions and results as at 31 December 2017 appear reasonable.

6.55.4 As a result I have concluded that it is reasonable for me to rely on the TPs calculated by the EWIL actuaries.

6.56 The EWIL actuaries have made a number of adjustments to the GAAP held reserves to calculate TPs as follows:

- Removal of EWIL management margin (if any);
- Conversion of the UPR to a Solvency II "best estimate" basis – see Appendix H;
- Credit for future premiums on incepted business (i.e. recognition of profits expected to arise on such business);
- BBNI business – see Appendix H;
- Allowance for share of the cost of internal and external XL contracts not yet renewed;
- ENIDs – see Appendix H;
- Reinsurance bad debt reserve – see Appendix H;
- Allowance for discounting – see Appendix H;
- Solvency II expenses (i.e. charge a portion of future calendar year expenses, consistent with the business plan, to existing and legally obliged business) – see also Appendix H; and
- Risk margin – see Appendix H.

6.57 The impact of the adjustments made by the EWIL actuaries produced estimated gross of reinsurance TPs of £366.1 million as at 31 December 2017, which compares with gross (of reinsurance) GAAP reserves (claims reserves and UPR net of DAC) of £481.5 million as at 31 December 2017.

6.58 On a net (of reinsurance) basis, the TPs (pre risk margin) are £81.2 million less than the GAAP reserves primarily because of the removal of DAC, expected profits on the UPR and bound but not incepted business, and future premiums in the TPs calculation.

6.59 In order to get the full level of the net TPs a risk margin needs to be added to both the net claim and premium provisions (pre risk margin) as outlined in paragraph 6.58 above. The general basis of calculation of the risk margin under Solvency II is set out in Appendix A.

6.60 The EWIL actuaries have calculated the risk margin (based on the SCR as at 31 December 2017 as calculated according to the SF under Solvency II) broadly as follows:

- estimated future SCRs of the business, assuming that business goes into run-off (and given certain defined assumptions, most notably that EWIL minimises market risk);

- calculated the opening run-off SCR from the main SCR calculation referred to above, with the following assumptions: (1) there was no market risk; (2) there was no Type 1 counterparty default risk relating to cash at bank; and (3) only 50% of the premium expected to be earned in the next 12 months will be earned;
- estimated run-off SCRs of the business for all future years by assuming that the SCR is proportional to the square root of the run-off of the TPs;
- the discounted cost-of-capital was then taken at 6% of the future run-off SCRs, discounted using the EIOPA discount rates to give an estimated risk margin as at 31 December 2017 of £33.8 million (included as part of both the gross and net TPs).

6.61 I would typically expect to see the above adjustments as employed by the EWIL actuaries in modifying GAAP claims reserves and UPR to produce TPs (under Solvency II).

Conclusion

6.62 ***Based on my review as described above, I have concluded that the approach and key assumptions underlying the calculation of Technical Provisions (under Solvency II) as performed by the EWIL actuaries as at 31 December 2017 are reasonable, and that EWIL's Technical Provisions (under Solvency II) appear reasonable at present***.

RESERVE STRENGTH OF SIIE (PRE AND POST SCHEME)

6.63 SIIE will (as do SJNKE and EWIL presently) follow SIH's reserving policy, i.e. employ the following key principles to ensure there is appropriate process and governance to produce loss reserve estimates and to mitigate reserving risk:

- Maintain a prudent and comprehensive reserving process and procedures led by the reserving function including actuarial peer review, Management and Board oversight through the Loss Reserve and Audit Committees;
- Provide accurate, timely and transparent detail on claims emergence, actuarial analyses of key issues and highlighting key reserving uncertainties to Senior Management and the Board to enable them to discharge their responsibilities with regards to reserve setting for SIIE;
- Assure that, in total, booked reserves will be at least as high as the actuarial central estimate (as described in paragraph 6.40 above);
- Ensure a consistent reserving approach over time and across all lines of business;
- As deemed appropriate, obtain information or the opinion of external actuarial firms with relevant experience to supplement SIIE's process for determining an appropriate level of loss reserves together with associated uncertainty;
- Maintain and contribute to the design of systems and processes that accurately capture relevant reserving data (both gross and ceded) premium, paid, and case reserves in sufficient granularity to enable the application of generally accepted reserving techniques and to meet regulatory requirements;
- Ensure that reserving techniques applied are appropriate to the nature of claim and claim emergence for a particular line of business;
- Ensure that reserving data reported internally and in financial statements is appropriate, accurate, complete, and produced in a timely manner. Where appropriate key controls are reviewed with Internal Audit and signed-off as appropriate;
- To review large loss events on an individual basis, where possible, examining potential loss exposure on a contract by contract basis;
- To maintain regular communication between reserving, underwriting and claims personnel to ensure an up-to-date understanding of changes in underwriting conditions including terms and conditions, mix of business, material claims movements and emerging claims trends;

- To consider and highlight uncertainties specific to SIIE's business, which can arise from several factors including but not limited to the following: reliance placed on industry benchmarks rather than SIIE's own loss experience, additional reporting delays arising for pan-EEA products, and legal, social and judicial inflation;
- For medium and longer tail lines of business, maintain initial expectations of loss estimates until SIIE's own experience is sufficiently developed, unless actual claims experience shows deterioration from original estimates or the rating environment significantly varies from SIIE's initial expectation;
- Maintain an adequate staffing level of actuarial and analytical resources, with sufficient experience and knowledge to perform a robust review of reserves; and
- Document the reserving process to appropriate technical standards.

6.64 The actuarial central estimate will typically not, and is not intended to, equal the reserve amounts booked by SIIE, but it is intended to provide guidance to the reserving committee and senior management of SIIE in their determination of booked reserves for each quarter. Setting SIIE's technical provisions for the purposes of financial accounting and solvency is a matter reserved to the Board of SIIE (as per the Board's terms of reference). The Audit Committee also has a standing agenda item each quarter to review the reserving report for SIIE.

6.65 Under Solvency II, the members of the SIIE reserving team will have a primary responsibility for the calculation of the technical provisions and are key contributors to business planning and effective risk management within the context of the Actuarial Function.

6.66 In respect of the estimation of the technical provisions these responsibilities include the following:

- Coordinate the calculation of the technical provisions;
- Ensure the appropriateness of the methods, assumptions, and underlying models used as well as the assumptions made in the calculation of the technical provisions;
- Assess the sufficiency and quality of data used in the calculation of technical provisions;
- Compare best estimates against experience. In particular undertaking an analysis of actual versus expected experience as well as other appropriate validation; and
- Ensure that information provided to the Board includes escalation of relevant information provided to regulators, a discussion of key issues, uncertainties, and market conditions.

6.67 An Actuarial Function report will be provided annually to SIIE's management and the Board to outline the scope and work undertaken by the Actuarial Function, the results of the work and to highlight any limitations of the work and how these can be remedied.

6.68 As part of checking the reserving process and to ensure quality control, SIIE will undertake the following:

- Reserving data will be reconciled to SIIE's accounts and regulatory returns;
- Procedures will be put in place to ensure there is exception reporting identifying potential variances or control failures in recording and producing reserve data and that these are investigated and reported as necessary;
- Reserving data will be continually assessed to ensure accuracy, completeness and appropriateness; and
- Internal audit will regularly review the appropriateness of key systems, control framework, and processes related to reserving data.

6.69 As SIIE will follow the SIH's reserving policy as described above, I would expect SIIE to be reasonably reserved before and after the Effective Date, and the uncertainty surrounding the reserves to be fairly typical for an entity writing primarily commercial lines business in EEA states.

Transfer of Reserves

6.70 I am informed by SIH that the reserves moving to SIIE from SJNKE in respect of the Transferring SJNKE EEA (excluding UK) Business will do so (on the Effective Date) at the same balance sheet value, i.e. no credit is to be taken for any reserve strengthening or releases as a result of the Scheme. Likewise, the reserves moving to SIIE from EWIL in respect of the Transferring EWIL EEA (excluding UK) Business will do so (on the Effective Date) at the same balance sheet value, i.e. no credit is to be taken for any reserve strengthening or releases as a result of the Scheme. Furthermore, as SJNKE, EWIL and SIIE all follow SIH's reserving policy (see paragraph 6.63 above) I do not anticipate any associated change in reserve strength in respect of either e Transferring SJNKE EEA (excluding UK) Business or the Transferring EWIL EEA (excluding UK) Business as a result of the Scheme.

Conclusion

6.71 ***Based on my review of reserving policy described as described above, I have concluded that the methodologies and major assumptions underlying the reserve analyses to be performed by SIIE appear reasonable. I am therefore satisfied that the reserves to be established and held by SIIE (with effect from 1 September 2018 or thereabouts) would likewise be reasonable, and that the reserve strength of SIIE will not be materially affected by the Scheme.***

EXCESS ASSETS OF SJNKE

6.72 As noted in paragraph 3.27 above, with effect from 1 January 2016 almost all EU insurers, including SJNKE and EWIL, have been required to satisfy the Solvency II regime.

6.73 I have been provided with the following capital-related reports for SJNKE:

- A SFCR – "Solvency and Financial Condition Report Year Ended 31 December 2017", approved by the SJNKE Board on 30 April 2018;
- An internal ORSA report – "2017 ORSA Report", approved by the SJNKE Board on 27 September 2017;
- SIH (internally) prepared financial projection documents (and supporting spreadsheets) for SJNKE, EWIL and SIIE over the period 2018 – 2022 – "Forecast GAAP and SII Balance Sheets" and "SCR Assessments", dated 18 February 2018;
- An external actuarial report – "Calculation of the SCR and MCR under Solvency II as at 31 December 2017", dated 4 April 2018; and
- An external actuarial presentation – "Results of *[external actuaries]* calculation of the SCR / MCR under Solvency II for SJNKE – Updated Results as at 31 December 2017", dated 4 April 2018.

6.74 I have reviewed the internally prepared 2017 ORSA report in order to satisfy myself that it is reasonable for me to rely on the estimates of the SCR and of the EOF contained therein. This included reviewing the development of the technical provisions and hence the estimation of available own funds, the process by which capital estimates have been made, the approach taken to their calculation, the key assumptions employed, and the resulting capital amounts based on this review. I note that the forward looking capital estimates (2018 – 2022) based on information available as at 30 June 2017, have been produced by a team of suitably qualified actuaries (and other individuals) within SJNKE, and that that team had also replicated the SCR as at 31 December 2016 (the starting capital position for the 2017 ORSA process) as calculated by the firm of external actuaries (commissioned by SJNKE). I further note that the capital estimates have been reviewed and agreed by SJNKE's senior management prior to and during the 2017 ORSA process.

6.75 The external actuarial report and presentation referred to in paragraph 6.73 above detail the methodology, assumptions and the SCR / MCR (under Solvency II) so developed for SJNKE's business as at 31 December 2017.

6.76 The external actuaries have calculated the SCR / MCR (under Solvency II) as at 31 December 2017 using the SF and the results are in turn based (to a large degree) on the results of the TPs calculation as at 31 December 2017 (see paragraph 6.31 above).

6.77 I have placed no reliance upon the report and presentation prepared by the external actuaries referred to in paragraph 6.73 above. Where I have used them, I have performed sufficient work of my own to confirm that it is appropriate for me to use the information for the purposes of forming my opinion on the Scheme.

Solvency Capital Requirement

6.78 SJNKE is using, and intends to continue using, the SF to calculate SJNKE's SCR under Solvency II.

6.79 I note that SJNKE has undertaken work (as part of its 2017 ORSA) to assess whether SJNKE's risk profile deviates from the assumptions underlying the SCR when calculated in accordance with the SF, which included consideration of the following elements:

- A comparison of the ranking of risks between SJNKE's risk register and the SF calculation;
- The overall structure of the SF;
- The risks that are covered by the SF, and how these compare with the risk profile of SJNKE;
- The correlations incorporated in the SF to combine risks;
- The simplifications adopted by SJNKE when calculating the SF; and
- The assumptions underlying each of the risks that are covered by the SF, and whether SJNKE's risk profile deviates from the assumptions used for these risks. For this part of the work the external actuaries:
    - considered each of the modules/sub-modules of the SF in turn; and
    - consideration as to whether or not it is likely to be appropriate or necessary for SJNKE to apply to use Undertaking Specific Parameters ("USPs") in respect of premium and reserve risk.

6.80 Based on the work undertaken by SJNKE as described above, SJNKE's senior management remains of the view that calculating the SCR using the SF (without USPs) is an appropriate and proportionate approach to estimating the Solvency II capital requirements for the SJNKE business (and the basis for setting SJNKE's own economic capital requirements), i.e. the SF provides an appropriate quantification of a one-year 99.5% VaR for SJNKE, covering all material quantifiable risks to which SJNKE is exposed and covering existing business, as well as the new business expected to be written over the following 12 months.

6.81 Further, I have described above how SJNKE has determined SJNKE's TPs, and concluded (as per paragraph 6.37 above) that SJNKE's TPs appear reasonable at present. This is an important item, since the level of the TPs is a key determinant in assessing the amount of EOF that are available to meet the regulatory capital requirement, i.e. the SCR, as illustrated in Appendix G.

6.82 I have read both the report and presentation produced by the external actuaries and considered the approach to estimating the SCR / MCR (under Solvency II) as at 31 December 2017, the key issues and the results presented. In general, the SF methodology (as prescribed under Solvency II) used for calculating SJNKE's SCR and MCR looks at each risk individually and applies a prescribed factor or scenario based approach for each individual risk. In order to create the inputs required for the SF calculation it is necessary to make a number of assumptions and adjustments to the data provided.

6.83 I would typically expect to see an approach as set out in paragraph 6.82 above to be employed in estimating the SCR / MCR (under Solvency II). I further note that a team of suitably qualified actuaries (and other individuals) within SJNKE have performed their own SCR calculation as at 31 December 2017 in order to cross-check the external actuaries results for quality assurance purposes.

6.84 I have reviewed the assumptions and data adjustments used in the SF calculation as performed by the SJNKE team (referred to in paragraph 6.83 above), and consider them to be appropriate for the nature of the business and to the data available. I have also questioned the aforesaid SJNKE team to confirm my understanding and received satisfactory answers to my questions.

6.85 As a result of my review outlined above, I believe it is reasonable for me to rely on the work of SJNKE, and therefore I have not attempted to review in detail the calculations performed by (or for) SJNKE in order to calculate its SCR.

6.86 I note that SJNKE's portfolio includes some long-tailed claims (e.g. those associated with employers' liability business such as hearing loss) and that SJNKE largely mitigates this risk via its comprehensive outwards reinsurance programme (see paragraphs 4.21 to 4.28 above). While the risks relating to such claims may emerge over a number of years, in each year I would expect them to only be a small part of the overall risk profile of SJNKE (particularly at a net of reinsurance level). In my view, this is a normal feature of insurance companies writing mainstream lines of business that include liability classes.

6.87 The key components of SJNKE's SF SCR calculation are the charges for (non-life and health) underwriting risk, and counterparty default risk that together make up over 85% of the pre-diversified SCR. Based on my qualitative review above, and given the heavy reliance of SJNKE on reinsurance (to mitigate in large part underwriting risk) I consider the risk composition of the SCR to be reasonable, and that the SF SCR is unlikely to underestimate the financial resource requirements of SJNKE. Therefore, I am satisfied that the SF SCR provides a suitable economic capital reference point for SJNKE.

Conclusion

6.88 ***As at 31 December 2017, SJNKE had EOF of £143.6 million and an estimated SCR of £28.9 million, thereby generating a Capital Cover Ratio of 497%, i.e. SJNKE would be considered a very well-capitalised company (based on my capital coverage criteria as per paragraph 6.5 above)***.

Own Risk Solvency Assessment

6.89 As noted in paragraph 6.73 above, I have been provided with a report entitled "*2017 ORSA Report*" approved by the SJNKE Board on 27 September 2017, which includes a forward looking assessment of SJNKE's SCR and EOF over the period 2018 – 2022. The SCRs have been produced on a 99.5% VaR over a one-year time horizon both with and without the BHIIL indemnity risk charge (see paragraph 4.40 above).

6.90 I have read the 2017 ORSA Report, and noted that SJNKE has conducted various stress and scenario tests within its ORSA to examine the robustness of its capital base. The stress and scenario testing covers a wide range of risks to which SJNKE is exposed, including:

- claims frequency increasing by 1%, 2% and 3% per annum;
- claims severity increasing by 1%, 2% and 3% per annum;
- volumes of new business reducing by 25%, 50% and 75%; and
- a reverse stress test (i.e. SJNKI becomes unable to honour a call under the SJNKE NWA).

6.91 The stress and scenario testing undertaken by SJNKE demonstrates that in all scenarios (other than the reverse stress test designed to be a constructive failure scenario) it would have sufficient capital to meet its SCR. I consider the range of stresses and scenarios that SJNKE has examined to be reasonable, and that they are suitable for testing insurance and credit risks to ultimate (for the reasons outlined the Solvency Capital Requirement sub-section above, and as concluded in paragraph 6.87 above).

Financial Projections 2018 – 2022

6.92 As noted in paragraph 6.73 above, I have been provided with financial projection documents (and supporting spreadsheets) prepared by SIH for SJNKE, EWIL and SIIE over the period 2018 – 2022 – "Forecast GAAP and SII Balance Sheets" and "SCR Assessments", dated 18 February 2018 (the "Financial Projections 2018 – 2022"), which provide forward looking assessments of SJNKE's SCR and EOF over the period 2018 – 2022 (and update those contained in the ORSA discussed above).

6.93 I have reviewed these documents (and supporting spreadsheets) in order to satisfy myself that it is reasonable for me to rely on the estimates of the SCR and of the EOF contained therein. This included reviewing the development of the technical provisions and hence the estimation of EOF, the process by which capital estimates have been made, the approach taken to their calculation, the key assumptions employed, and the resulting capital amounts based on this review. I note that the capital estimates have been produced by suitably qualified actuaries (and other individuals) within SIH, and have been reviewed and agreed by the UK Chief Risk Officer.

6.94 SIH has made projections of the SCR and Solvency II (and GAAP) balance sheet(s) as at year-ends 2018 to 2022, on the basis that the Scheme is implemented as at 31 December 2018 and that SJNKE ceases underwriting new/renewed UK and non-EEA business from 1 September 2018 (or thereabouts). I note that SIH has also made projections on the basis that the Scheme is not implemented, which I discuss in Section 9.

6.95 On the basis that the Scheme is implemented, and that capital management actions are taken to target capital of 180% of the SF SCR, a projected intra-group capital distribution of circa £95 million ($130 million) is forecast to be made by end-2018, and SJNKE is projected to be a well-capitalised company as at 31 December 2018 (i.e. immediately prior to the Scheme being implemented). As per paragraph 5.4 above, the Scheme will be carried out in conjunction with a cross-border merger of SJNKE into SIIE, and, as a consequence of the cross-border merger, SJNKE will be dissolved without going into liquidation.

Conclusion

6.96 ***I have explained above why I consider that the SJNKE calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of SJNKE, all of whom are expected to transfer under the proposed Scheme, currently benefit from the financial strength provided by a well-capitalised company, and are expected to continue to do so up to the Effective Date (allowing for an intra-group capital distribution of circa £95 million to be made by end-2018).***

EXCESS ASSETS OF EWIL

6.97 I have been provided with the following capital-related reports for EWIL:

- An internally prepared SFCR – “Solvency and Financial Condition Report for the Year Ended 31 December 2017”, approved by the EWIL Board on 04 May 2018;
- An internal ORSA report – “Own Risk and Solvency Assessment 2018 – 2022, approved by the EWIL Board on 26 March 2018”;
- SIH (internally) prepared financial projection documents (and supporting spreadsheets) for SJNKE, EWIL and SIIE over the period 2018 – 2022 – “Forecast GAAP and SII Balance Sheets” and “SCR Assessments”, dated 18 February 2018; and
- An internal SF document – “Endurance Worldwide Insurance Limited Year End 2017 Standard Formula Appropriateness Assessment” dated 17 May 2018.

6.98 I have reviewed these reports and documents in order to satisfy myself that it is reasonable for me to rely on the estimates of the SCR and of the EOF contained therein. This included reviewing the development of the technical provisions and hence the estimation of available own funds, the process by which capital estimates have been made, the approach taken to their calculation, the key assumptions employed, and the resulting capital amounts based on this review. I note that the capital estimates have been produced by suitably qualified actuaries (and other individuals) within EWIL and have been reviewed and approved by the Board of EWIL.

Solvency Capital Requirement

6.99 EWIL is using, and intends to continue using, the SF to calculate its SCR under Solvency II. It is therefore important for me to consider whether there is a risk that the SF underestimates an appropriate level of financial resources required by EWIL.

6.100 Firstly, I note that the SIH London Capital Function (the “SLCF”) has undertaken an independent review (as detailed in the internal SF document referred to in paragraph 6.97 above) to assess whether the SCR calculated by EWIL using the SF (as at 31 December 2017) is appropriate as a measure of the capital requirement for EWIL based on an assessment of the structure and assumptions underpinning the SF relative to the EWIL risk profile. Based on the work undertaken by the SLCF I note that the following conclusions emerged:

- The level of regulatory capital – the SCR as calculated by the SF was deemed appropriate as a measure for the capital requirements of EWIL, while falling towards the more conservative end of a range of reasonable capital assessment estimates;

- All material risk drivers are captured – although the SF calculation does not capture all risks, the key risk areas to which EWIL is exposed are captured. Other risks drivers (e.g. group, reputational and liquidity risks) are monitored through other means within the wider EWIL Risk Management function;

- Any assumptions made are appropriate – deviations from the assumptions underlying the SF were deemed either conservative or not significant for material sources of risk;

- Any simplifications are appropriate and justified – simplifications are understood and are appropriate given the nature and complexity of the EWIL risk profile. In particular, the exclusion of catastrophe risk to reflect the stop loss cover was considered to be valid given the difficulty in allowing for stop loss cover within the SF and an assessment of the impact of the simplification; and

- The capital calculation is sufficiently sensitive – the SF responds to changes in the EWIL risk profile in a manner consistent with EWIL's expectations. In particular, sensitivity testing of the key correlation assumptions (a) across SF modules and (b) between lines of business yielded diversification benefits that were in line with EWIL's expectations.

6.101 I also note that, while EWIL does not have a PRA approved internal model, it does use the Sompo International Group Economic Capital Model ("ECM") to provide insight and context in relation to the appropriateness of the SF SCR. The results of the ECM applied to the EWIL portfolio (risk profile) give a lower capital requirement than the SF (in line with what EWIL would typically expect, as the SF generates higher risk charges than the ECM due to the more bespoke nature of the modelling in the ECM, albeit that the ECM makes allowance for liabilities to their ultimate position). As such, EWIL believes this to be a strong indicator that the use of the SF is not inappropriate (given that it overstates what EWIL believes to be the necessary capital for policyholder protection at the required level).

6.102 Based on the work undertaken by a team of suitably qualified actuaries (and other individuals) within the SLCF, as described in paragraphs 6.100 and 6.101 above, the SCR calculated using the SF was judged by EWIL to be an appropriate measure of its capital requirement based on the aforementioned assessment of the structure and assumptions underpinning the formula relative to the EWIL risk profile (i.e. the SF provides an appropriate quantification of a one-year 99.5% VaR for EWIL, covering all material quantifiable risks to which EWIL is exposed and covering existing business, as well as the new business expected to be written over the following 12 months).

6.103 Further, I have described above how EWIL has determined its TPs, and concluded (as per paragraph 6.62 above) that EWIL's TPs appear reasonable at present. This is an important item, since the level of the TPs is a key determinant in assessing the amount of EOF that are available to meet the regulatory capital requirement, i.e. the SCR, as illustrated in Appendix G.

6.104 For my review of the SCR as determined by EWIL, I have first read the report produced by the SLCF (i.e. the internal SF document referred to in paragraph 6.97 above) and have considered the approach used by EWIL in estimating the SCR (under Solvency II) as at 31 December 2017, as well as the key issues and the results presented. In general, the SF methodology (as prescribed under Solvency II) used for calculating EWIL's SCR (and MCR) looks at each risk individually and applies a prescribed factor or scenario based approach for each individual risk. I would typically expect to see such an approach employed by (the finance team of) EWIL in estimating the SCR (under Solvency II).

6.105 More generally, I note that EWIL is a company that continues to write new business. As a result, a large element of the risks it faces relate to factors that are sufficiently well represented when considered over a one-year time horizon. In my experience, this is a normal time frame for such calculations for 'live' underwriting entities. Further, the classes of business written and the investment assets of EWIL appear to me to be relatively standard in nature and reasonably represented in the data used by EIOPA to calibrate the relevant parts of the SF SCR.

6.106 I have then reviewed the assumptions and data adjustments used in the SF calculation as performed by (the finance team of) EWIL, and consider them to be appropriate for the nature of the business and to the data available. Further, I have questioned the aforesaid EWIL finance team to confirm my understanding and received satisfactory answers to my questions.

6.107 I have also discussed, at a high level, the use of the ECM with relevant qualified actuaries (and other individuals) of EWIL in order to understand how the model produces estimates of the capital required for EWIL at the 1 in 200 year level (on a to-ultimate basis). Based on my high level discussions, I am satisfied that the modelling approach, assumptions employed and the resulting capital estimate(s) from the ECM are informative for the purposes of comparison with capital estimate(s) determined using the SF. On this basis, the results are what I would normally expect to see, i.e. the SF generates higher capital estimate(s) than those determined using the ECM, because modelling via an ECM typically provides a closer fit to the risk profile of an insurance company (while also making allowance for liabilities to their ultimate position) than the SF, which is based on the risks within an 'average' insurance company.

6.108 As a result of my review (and high level discussions related to capital estimates using the ECM), I believe it is reasonable for me to rely on the work of (the finance team of) EWIL in relation to the calculation of the SF SCR, and therefore I have not attempted to review in detail the calculations performed by EWIL in this respect.

6.109 The key components of EWIL's SF SCR calculation as at 31 December 2017 (as a proportion of the pre-diversified SCR) are the charges for market risk (50%), non-life (and health) insurance risk (31%), counterparty risk (13%) and operational risk (6%). This apparently atypical composition of risk charges arises because EWIL holds a large part of its capital in USD, which is not EWIL's functional currency (GBP), which in turn generates a large currency risk charge under the SF (circa 45% of the pre-diversified SCR). Notwithstanding the relatively high market/currency risk charge component (which arises because of a functional currency "mis-match" that EWIL plans to address during 2019) and noting the level at which EWIL purchases outwards reinsurance (see paragraph 4.86 above), I consider the risk composition of the SCR to be reasonable.

6.110 I note that EWIL faces some long-tailed claims (i.e. those arising from lines of business such as general liability, where the risks relating to such claims may emerge over a number of years), and that EWIL largely mitigates the risk arising from such claims via its comprehensive outwards reinsurance programme (see paragraph 4.86 above).

6.111 While the risks relating to long-tailed claims may emerge over a number of years, in each year I would expect them to only be a small part of the overall risk profile of EWIL (particularly at a net of reinsurance level). Furthermore, for the reasons outlined in paragraphs 6.101 and 6.107 above, I believe that using more focused insurance (and credit) risk measure(s) over a longer time horizon is unlikely to provide more suitable quantitative measures than the SF (because, in my view, the SCR calculated using the SF applied to the EWIL risk profile produces a sufficiently prudent capital measure).

6.112 The counterparties for EWIL's outwards reinsurance programme are third-party reinsurers that are required to have a Standard & Poor's rating of A- or better (in order to participate on the programme) and intra-group reinsurers within the Sompo Group that enjoy a Standard & Poor's rating of A+. Based on rating agency analysis, the likelihood of a default by EWIL's third-party reinsurers and/or intra-group reinsurers is estimated to be of the order of a 1-in-1,000 year level of risk (or a 0.1% likelihood), which is well beyond the level of risk at which insurance companies are required to be capitalised under Solvency II (i.e. a 1-in-200 year level of risk). I am therefore satisfied that EWIL's outwards reinsurance programme is structured to provide its policyholders with protection beyond the one-year time horizon of the SF SCR.

6.113 Based on my review of the calculation of the EWIL SF SCR, it is my view that the SF SCR is unlikely to underestimate the financial resource requirements of EWIL (even though the SF considers liabilities over a one-year time horizon). Therefore, I am satisfied that the SF SCR provides a suitable economic capital reference point for EWIL.

Conclusion

6.114 ***As at 31 December 2017, EWIL had EOF of £359.3 million and an estimated SCR of £132.7 million, thereby generating a Capital Cover Ratio of 271%, i.e. EWIL would be considered a very well-capitalised company (based on my capital coverage criteria as per paragraph 6.5 above) and will continue to be so whether or not the Scheme is sanctioned***.

Own Risk Solvency Assessment

6.115 As noted in paragraph 6.97 above, I have been provided with a report entitled "*Own Risk and Solvency Assessment 2018 – 2022*", approved by the EWIL Board on 26 March 2018, which includes a forward looking assessment of EWIL's SCR and EOF over the period 2018 – 2022. The SCRs have been produced on a 99.5% VaR over a one-year time horizon with allowance for the planned change in functional currency (see paragraph 6.101 above).

6.116 I have read the 2018 ORSA Report, and noted that EWIL has examined various stress scenarios within its ORSA to examine the robustness of its capital base. The stress scenarios cover a wide range of risks to which EWIL is exposed, including:

- a series of five large natural catastrophe losses resulting in an industry loss of circa $105 billion, including a Californian earthquake, New Zealand earthquake, Chilean earthquake, North East America windstorm and Massachusetts windstorm;
- a major Florida hurricane makes landfall in September 2018 followed by a major Gulf windstorm in October 2018, generating aggregate industry losses of $290 billion;
- a cessation of intra-group reinsurance protections;
- an unanticipated increase in inflation from 1.8% to 4.0%; and
- a reverse stress test, i.e. a run of unprecedented market losses, leading to a string of other events, including failure of the intra-group reinsurance and group capital support.

6.117 The stress testing undertaken by EWIL demonstrates that in all scenarios (other than the reverse stress test designed to be a constructive failure scenario) EWIL would have sufficient capital to meet its SCR. I consider the range of stress scenarios that EWIL has examined to be reasonable and suitable for testing insurance and credit risks to ultimate (for the reasons outlined in the Solvency Capital Requirement sub-section above, and as concluded in paragraph 6.113 above).

Financial Projections 2018 – 2022

6.118 As noted in paragraph 6.97 above, I have been provided with financial projection documents (and supporting spreadsheets) prepared by SIH for SJNKE, EWIL and SIIE over the period 2018 – 2022 – "Forecast GAAP and SII Balance Sheets" and "SCR Assessments", dated 18 February 2018 (the "Financial Projections 2018 – 2022"), which provide forward looking assessments of EWIL's SCR and EOF over the period 2018 – 2022 (and update those contained in the ORSA discussed above).

6.119 I have reviewed these documents (and supporting spreadsheets) in order to satisfy myself that it is reasonable for me to rely on the estimates of the SCR and of the EOF contained therein. This included reviewing the development of the technical provisions and hence the estimation of EOF, the process by which capital estimates have been made, the approach taken to their calculation, the key assumptions employed, and the resulting capital amounts based on this review. I note that the capital estimates have been produced by suitably qualified actuaries (and other individuals) within SIH, and have been reviewed and agreed by the UK Chief Risk Officer of SIH.

6.120 SIH has made projections of the SCR and Solvency II (and GAAP) balance sheet(s) as at year-ends 2018 to 2022, on the basis that the Scheme is implemented as at 31 December 2018 (for illustrative purposes) and that EWIL commences underwriting new/renewed UK and non-EEA business from 1 September 2018 (or thereabouts) that would have been written by SJNKE (i.e. at the same time that SJNKE largely stops writing all new/renewed business) and stops underwriting EEA (excluding UK) business with effect from 1 September 2018 (or thereabouts). I note that SIH has also made projections on the basis that the Scheme is not implemented.

6.121 EWIL's projected balance sheets and SCR calculations are based on the assumptions in EWIL's business plans over the period 2018 – 2022. SIH has provided me with details of separate business plans for SJNKE (both EEA (excluding UK) business and UK and non-EEA business), EWIL (both EEA (excluding UK) business and UK and non-EEA business) and SIIE (EEA (excluding UK) business). Its plan for the EWIL business shows EWIL continuing to write the same lines of UK and non-EEA business as currently written *plus* (with effect from 1 September 2018, or thereabouts) the UK and non-EEA business formerly written by SJNKE *less* (with effect from 1 September 2018, or thereabouts) the new/renewed EEA (excluding UK) business that EWIL would have written. The plans show gross written premiums for the EWIL business to be £390 million in 2018, growing to circa £435 million in 2019), and then growing annually at an average rate of around 8% over the period to year-end 2022. The mix of business over the projection period is forecast to be reasonably stable with Speciality, Energy & Marine, Professional Liability, Property, and Reinsurance representing on average 12%, 22%, 23%, 14% and 29% respectively of gross written premiums in the period (2018 – 2022). EWIL's projected loss ratios are generally fairly constant over the projection period, informed, as appropriate, by the historic experience for this business of EWIL (and SJNKE).

6.122 EWIL's business plans have continuity with the relevant past experience of EWIL (and SJNKE), while also reflecting SIH's future strategy for UK and non-EEA business (e.g. a stable mix of business, as illustrated in paragraph 6.121 above). For these reasons, I do not believe that EWIL's plans are unreasonable. It should be understood, however, that EWIL's business plans are based on forecasts that may or may not materialise. For example, business volumes will not exactly match those forecast and claims experience will likely deviate from expectations. The financial performance of EWIL will therefore vary, perhaps materially, from that anticipated in its business plans.

6.123 As noted above, SIH has made a projection of EWIL's own funds and SCR over the period 2018 – 2022 under two scenarios: (1) that the Scheme is implemented; and (2) that the Scheme does not go ahead (which I consider in Section 9). Under the first scenario, i.e. the Scheme is implemented (which, for illustration purposes, is assumed to be with effect from 31 December 2018), EWIL's projected Solvency II SCRs (calculated assuming that no capital top-ups or distributions are made from EWIL, with all profits/losses retained over the forecast time horizon) are estimated to be around £170 million as at 31 December 2018, dropping to around £130 million at year-end 2019 and then rising steadily to around £185 million at year-end 2022. The projected decrease in the SCR between 2018 and 2019 arises from the anticipated change in functional currency from GBP to USD (reflecting the fact that the majority of the asset holdings of EWIL are USD denominated) which materially improves the projected Capital Cover Ratios and forecast surplus capital (i.e. the excess of EOF above the SCR) for EWIL.

6.124 As at 31 December 2019 (i.e. the end-date in the year of the anticipated change in functional currency from GBP to USD) the risk charge proportions of EWIL's (pre-diversified) SCR are estimated to be: 38% for non-life (and health) underwriting risk; 18% for counterparty risk; 9% for operational risk; and 35% for market risk. It is projected that these risk charge proportions in relation to EWIL's (pre-diversified) SCRs will be broadly maintained for year-ends 2020 – 2022.

6.125 The composition and size of EWIL's SCRs throughout the projection period are in line with what I would typically expect to see in regulatory capital calculated using the SF for the type of business written by EWIL. In particular, the relatively large market risk charge arises as a result of a combination of interest rate, spread and currency risks on the EWIL investment portfolio. I note that, were the functional currency change (from GBP to USD) not to take place as anticipated (e.g. because of operational constraints), the projected SCRs between 2019 and 2022 would increase significantly, primarily as a result of currency risk increasing substantially under the SF (i.e. a significant foreign exchange rate risk arises in relation to the EWIL balance sheet expressed in GBP, because the majority of the asset holdings of EWIL are USD denominated).

6.126 Under scenario (1), as per paragraph 6.123 above, i.e. the Scheme is implemented, EWIL is forecast to be a very well-capitalised company throughout the projection period (2018 – 2022). I note that were the functional currency change (from GBP to USD) not to take place as anticipated, EWIL is forecast to be a well-capitalised (on the boundary of a very well-capitalised) company throughout the projection period (2018 – 2022).

Conclusion

6.127 ***I have explained above why I consider that the EWIL calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of EWIL, including those expected to transfer under the proposed Scheme, currently benefit from the financial strength provided by a very well-capitalised company*, *and are expected to continue to do so in the near term thereafter (in line with SIH's financial projections for EWIL over the 5-year period 2018 – 2022)***.

EXCESS ASSETS OF SIIE

6.128 As per paragraph 6.97 above, I have been provided with the Financial Projections 2018 – 2022, and I have reviewed these documents in order to satisfy myself that it is reasonable for me to rely on the estimates of the SCR and of the EOF contained therein, as I describe below.

Solvency Capital Requirement

6.129 Following the authorisation of SIIE by the CAA (on 29 March 2018), SIIE will use the SF to calculate its SCR under Solvency II. It is therefore important for me to consider whether there is a risk that the SF underestimates an appropriate level of financial resources required by SIIE.

6.130 SIIE is a company scheduled to commence underwriting new/renewed business from 1 September 2018, or thereabouts. As a result, a large proportion of the risks it faces relate to factors that are sufficiently well represented when considered over a one-year time horizon. In my experience, this is a normal time frame for such calculations for 'live' underwriting entities.

6.131 The types of business forecast to be written by SIIE (i.e. a mixture of EEA commercial lines, essentially Property, Energy & Marine, Professional Liability and Speciality, and relatively small volumes of inwards reinsurance of EEA risks) and the projected investment assets of SIIE appear to me to be relatively standard in nature and well represented in the data used by EIOPA to calibrate the relevant parts of the SF SCR.

6.132 I note that SIIE faces some long-tailed claims (e.g. those arising from liability business), and that SIIE largely mitigates the risk arising from such claims via its outwards reinsurance programme (see paragraph 4.154 above). While the risks relating to such claims may emerge over a number of years, in each year I would expect them to only be a small part of the overall risk profile of SIIE (particularly at a net of reinsurance level). In my view, this is a normal feature of insurance companies writing the classes of business identified in paragraph 6.131 above.

6.133 I also note that SIIE will have a heavy reliance on reinsurance insomuch that it will only retain, on average, 10% of the risks that it writes. The counterparties for SIIE's outwards reinsurance programme are third-party reinsurers that are required to have a credit rating of A- or better (in order to participate on the programme) and intra-group reinsurers within the Sompo Group that enjoy a Standard & Poor's rating of A+. Based on rating agency analysis, the likelihood of a default by SIIE's third-party reinsurers and/or intra-group reinsurers is estimated to be of the order of a 1-in-1,000 year level of risk (or a 0.1% likelihood) which is well beyond the level of risk at which insurance companies are required to be capitalised under Solvency II (i.e. a 1-in-200 year level of risk). I am therefore satisfied that SIIE's outwards reinsurance programme is structured to provide its policyholders with protection beyond the one-year time horizon of the SF SCR.

6.134 My qualitative review of the nature of risks forecast to be written by SIIE (as set out above) and the level at which SIIE is projected to purchase outwards reinsurance (as outlined in paragraph 4.154 above) have led me to conclude that the SF SCR is unlikely to underestimate the financial resource requirements of SIIE. I am therefore satisfied that the SF SCR provides a suitable economic capital reference point for SIIE.

Financial Projections 2018 – 2022

6.135 SIH has made projections of the SCR and Solvency II (and GAAP) balance sheet(s) as at year-ends 2018 to 2022, on the basis that the Scheme is implemented as at 31 December 2018 (for illustrative purposes) and that SIIE also commences underwriting new/renewed business from 1 September 2018, or thereabouts (at the same time that SJNKE largely stops writing new/renewed business).

6.136 SIIE's projected balance sheets and SCR calculations are based on the assumptions in SIIE's business plans over the period 2018 – 2022. SIH has provided me with details of separate business plans for SJNKE (both EEA (excluding UK) business and UK and non-EEA business), EWIL (both EEA (excluding UK) business and UK and non-EEA business) and SIIE (EEA (excluding UK) business). Its plan for the SIIE business shows it continuing to write mainly the same lines of EEA (excluding UK) business as those formerly written by EWIL and/or SJNKE. The plans show gross written premiums for SIIE business to be €30 million in 2018, growing substantially to circa €120 million in 2019 (being SIIE's first full year of operation), and then growing annually at around 6% over the period to year-end 2022. The mix of business over the projection period is forecast to be reasonably stable with Speciality, Energy & Marine, Professional Liability, Property, and Reinsurance representing circa 16%, 23%, 36%, 23% and 1% respectively of gross written premiums in each year (2018 – 2022). SIIE's projected loss ratios are generally fairly constant over the projection period, informed, as appropriate, by the relevant parts of the historic experience of SJNKE and EWIL.

6.137 SIIE's business plans have continuity with the relevant past experience of SJNKE and EWIL, while also reflecting SIH's future strategy for EEA (excluding UK) business (e.g. a stable mix of business, as illustrated in paragraph 6.136 above). For these reasons, I do not believe that SIIE's plans are unreasonable. It should be understood, however, that SIIE's business plans are based on forecasts that may or may not materialise. For example, business volumes will not exactly match those forecast and claims experience will likely deviate from expectations, perhaps materially. The financial performance of SIIE will therefore vary, perhaps materially, from that anticipated in its business plans.

6.138 As noted above, SIH has made a projection of SIIE's own funds and SCR over the period 2018 – 2022 under two scenarios: (1) that the Scheme is implemented; and (2) that the Scheme does not go ahead (which I consider in Section 9). Under the first scenario, i.e. the Scheme is implemented (which, for illustration purposes, is assumed will be with effect from 31 December 2018), SIIE's projected Solvency II SCRs (calculated allowing for additional capital of €85.5 million as per paragraph 5.32 above) are estimated to be around €5 million as at 31 December 2018 (assumed to be immediately prior to the Scheme being implemented and includes a relatively modest amount of business having been written in SIIE), and circa €30 million at each year-end 2019 – 2022. The initial steep increase in the SCR between 2018 and 2019 arises from the business transfers under the Scheme into SIIE (including the surplus assets of SJNKE) and also the first full year of SIIE writing business. As mentioned earlier, the level of SCR remains broadly level thereafter as the rate of increase in business written settles into a modest growth pattern of around 6% per annum (see paragraph 6.136 above).

6.139 As at 31 December 2019 (i.e. the end-date of SIIE's first full year of operation) the risk charge proportions of SIIE's (pre-diversified) SCR are estimated to be: 22% for non-life (and health) underwriting risk; 47% for counterparty risk; 19% for operational risk; and 12% for market risk. The projected growth in gross earned premium during 2019 (from circa €7 million to €114 million) drives a temporary large risk charge for operational risk as at 31 December 2019. As at 31 December 2020, the risk charge proportions of SIIE's (pre-diversified) SCR are estimated to be: 22% for non-life (and health) underwriting risk; 55% for counterparty risk; 11% for operational risk; and 12% for market risk. It is projected that these risk charge proportions in relation to SIIE's (pre-diversified) SCRs will be broadly maintained for year-ends 2021 and 2022.

6.140 The composition and size of SIIE's SCRs throughout the projection period are in line with what I would typically expect to see in regulatory capital calculated using the SF for the type of business written by SIIE. In particular, the relatively large counterparty risk charge as a result of the reinsurer default charge associated with the circa 90% outwards reinsurance of the SIIE business.

6.141 I am informed by SIH that €85.5 million was injected into SIIE on 31 May 2018 (via monies cascading down from SJNKI) as per paragraph 5.32 above (i.e. ahead of the Court hearing for directions scheduled for first half of September 2018) to provide extra capital for SIIE (in addition to the surplus assets of circa €42 million to be transferred from SJNKE to SIIE under the Scheme on the Effective Date, as illustrated in Table 5.3 above). On the basis of SIIE having received €85.5 million on 31 May 2018 (and the surplus assets, other than £4 million of retained assets that are to transfer under the CBM, to be transferred from SJNKE to SIIE under the Scheme) SIIE is projected to be very well-capitalised throughout the projection period (2018 – 2022).

6.142 The future results for SIIE are sensitive to the assumed premium volumes/growth (as is the SCR). I have therefore tested the impact of higher and lower premium volumes/growth, which in isolation give rise to higher and lower forecast profits and/or increased losses over the 5-year period 2018 – 2022 respectively.

6.142.1 The sensitivity test on lower premium volumes/growth assumes premiums will be 10% lower than the level assumed in the SIIE business plan for each year 2018 – 2022. Under this sensitivity test, allowing for the €85.5 million capital injection as per paragraph 5.32 above (and the surplus assets, less £4 million of retained assets that are to transfer under the CBM, to be transferred from SJNKE to SIIE under the Scheme) SIIE continues to have a Capital Cover Ratio such that it remains a very well-capitalised for each year 2018 – 2022 inclusive.

6.142.2 The sensitivity test on higher premium volumes/growth assumes premiums will be 10% higher than the level assumed in the SIIE business plan for each year 2018 – 2022. Under this sensitivity test, allowing for the €85.5 million capital injection as per paragraph 5.32 above (and the surplus assets, less £4 million of retained assets that are to transfer under the CBM, to be transferred from SJNKE to SIIE under the Scheme) SIIE continues to have a Capital Cover Ratio such that it remains a very well-capitalised for each year 2018 – 2022 inclusive.

6.143 In summary, the premium growth/volume sensitivity tests above illustrate that the projected capital position of SIIE is robust and SIIE remains a very well-capitalised company over the 5-year period 2018 – 2022 inclusive.

6.144 I have also considered the impact on SIIE of adopting alternative plausible assumptions. In this respect, I have investigated the impact of stressing a combination of key assumptions to understand the effect on the Capital Cover Ratios I have used to compare security before and after the Scheme. In particular, I have considered two stress tests: (1) a combination of a +10% premium increase (as per sub-paragraph 6.142.2 above), +10% loss ratio increase (e.g. a 50% loss ratio in the SIIE business plan would become 55% in this scenario) and +5% expense ratio increase (e.g. a 20% expense ratio in the SIIE business plan would become 21% in this scenario); and (2) a combination of a 10% premium decrease (as per sub-paragraph 6.142.1 above), +10% loss ratios, and +5% expense ratios. Again allowing for the €85.5 million capital injection on 31 May 2018, and the surplus assets (other than £4 million of retained assets that are to transfer under the CBM) to be transferred from SJNKE to SIIE under the Scheme (see paragraph 6.141 above), scenario test (1) shows that SIIE continues to have a Capital Cover Ratio greater than 200% (albeit on a declining trend) for each year 2018 – 2022 inclusive. Likewise, allowing for the €85.5 million capital injection on 31 May 2018, and the surplus assets (other than £4 million of retained assets that are to transfer under the CBM) to be transferred from SJNKE to SIIE under the Scheme (see paragraph 6.141 above), scenario test (2) shows that SIIE continues to have a Capital Cover Ratio greater than 200% for each year 2018 – 2022 inclusive.

6.145 As described above, neither of the two stress tests is expected to cause SIIE to become insolvent, i.e. own funds (available capital) remain strongly positive over the 2018 – 2022 projection period, and are not expected to trigger regulatory intervention. These stress tests illustrate that, even in the absence of management actions, the projected capital position of SIIE is robust over the 5-year period 2018 – 2022. In practice, I would expect the management of SIIE to take appropriate actions to steer SIIE onto a lower expense and more profitable path if premiums, loss ratios and/or expense ratios are substantially different (higher) than those used in the SIIE business plan. Based on my findings in relation to the stress tests above, I consider the likelihood of SIIE's own funds being exhausted to be remote over the projection period (2018 – 2022).

6.146 In summary, the projected own funds of SIIE on the Effective Date (and through to 2022) are estimated to be substantially greater than SIIE's corresponding regulatory capital requirements (i.e. its SCRs). Further, as outlined in paragraph 6.145 above, the projected capital position of SIIE is forecast to be robust over the 5-year period 2018 – 2022. I am therefore of the view that the projected own funds of SIIE on the Effective Date (and through to 2022) are satisfactory for the risks transferring to SIIE under the Scheme.

6.147 I also note that, as detailed in paragraph 4.166 above, ESIL has guaranteed the financial performance of SIIE's insurance business. The excess assets[22] of ESIL (circa £5 billion as at 31 December 2017) are substantial and, while they cannot be assumed to provide absolute security, provide very significant financial resources to support the SIIE NWA. The policyholders of SIIE therefore benefit from the additional security afforded by the SIIE NWA, over and above the capital resources held within SIIE itself.

[22] Excess assets are taken to be Shareholder's Equity as per ESIL's consolidated balance sheet as at 31 December 2017.

Conclusion

6.148 ***Based on my review of the excess assets of SIIE as described above, I believe that SIIE is a very well-capitalised company and is expected to continue to be so in the near term thereafter (in line with SIH's financial projections over the 5-year period 2018 – 2022).***

RELATIVE FINANCIAL STRENGTH OF TRANSFERRING POLICYHOLDERS PRE AND POST SCHEME

6.149 I have concluded above, based on my review of excess assets held relative to Solvency II capital requirements, that:

- SJNKE is a very well-capitalised company (moving to a well-capitalised company during 2018 if an intra-group capital distribution, projected to be circa £95 million ($130 million), is made as assumed in the Financial Projections 2018 – 2022) and forecast to continue to be a well-capitalised company up until the Effective Date of the Scheme;
- EWIL is a very well-capitalised company, and expected to be a very well-capitalised company on the Effective Date following the implementation of the Scheme, and this is forecast to continue to be the case in the short term (2019 – 2022) thereafter (assuming the anticipated change in functional currency from GBP to USD in 2019). If the anticipated change in functional currency from GBP to USD does not take place, EWIL is forecast to be a well-capitalised company, on the boundary of very well-capitalised, in the short term (2019 – 2022) thereafter;
- SIIE is expected to be a very well-capitalised company on the Effective Date following the implementation of the Scheme, and it is projected to continue to be the case in the near term (2019 – 2022) thereafter. Indeed, the Capital Cover Ratio for SIIE (allowing for the €85.5 million capital injection on 31 May 2018 and the surplus assets of SJNKE, other than £4 million of retained assets that are to transfer under the CBM, to be transferred to SIIE under the Scheme) is estimated to be on average around one third greater than that of EWIL over the period 2019 – 2022 (assuming the change in functional currency is implemented).

6.150 The Transferring EWIL EEA (excluding UK) Policyholders and the Transferring SJNKE EEA (excluding UK) Policyholders will therefore be transferring to a company (i.e. SIIE) with a stronger Capital Cover Ratio than their existing insurer.

6.151 I note that the Transferring SJNKE EEA (excluding UK) Policyholders will be moving from a medium-sized company (with capital support from SJNKI, via the SJNKE NWA) to a similar sized company in SIIE, albeit one that has only just been established. Nonetheless, SIIE (like SJNKE) is part of the Sompo Group, and ESIL has guaranteed the performance of SIIE's insurance business under the SIIE NWA (which provides more additional security than that afforded SJNKE under the under the SJNKE NWA).

6.152 While the Transferring EWIL EEA (excluding UK) Policyholders will be moving from a large company (with capital support presently from the Bond, to be replaced by the EWIL NWA, provided by its immediate parent ESIL) to a medium-sized company that has only just been established, it should be borne in mind that SIIE (like EWIL) is part of the Sompo Group, and ESIL has guaranteed the performance of SIIE's insurance business under the SIIE NWA (which provides greater additional security to that afforded EWIL under the Bond, and essentially the same level of additional security to be provided under the EWIL NWA).

6.153 The Transferring SJNKE UK and non-EEA Policyholders will be moving from a medium-sized company (SJNKE) to a large company (EWIL) both of whom are part of the Sompo Group. Further, EWIL enjoys capital support from the Bond, to be replaced by the EWIL NWA, provided by its immediate parent ESIL (itself supported by the ESIL NWA provided by SJNKI to ESIL as per paragraph 4.115 above), while SJNKE enjoys capital support from SJNKI, via the SJNKE NWA (which provides a broadly similar level of additional security to that afforded EWIL under the Bond or the EWIL NWA).

6.154 As indicated in paragraph 5.36 above, the Transferring EWIL EEA (excluding UK) Policyholders and the Transferring SJNKE EEA (excluding UK) Policyholders will ultimately lose access to the FSCS if SIIE fails to get its UK branch authorised by the PRA. However, as the likelihood of the insolvency of SIIE appears remote and the security of the Transferring EWIL EEA (excluding UK) Policyholders and the Transferring SJNKE EEA (excluding UK) Policyholders will be further supported by the SIIE NWA, I do not consider that this loss of access to the FSCS will materially adversely affect the security afforded to the Transferring EWIL EEA (excluding UK) Policyholders and the Transferring SJNKE EEA (excluding UK) Policyholders.

6.155 I note that there are differences in the winding-up provisions between the UK and Luxembourg as set out in Section 3 above. As most of the policies of the Transferring EWIL EEA (excluding UK) Business and the Transferring SJNKE EEA (excluding UK) Business are direct insurance contracts, most Transferring EWIL EEA (excluding UK) Policyholders and Transferring SJNKE EEA (excluding UK) Policyholders will have preferential access to any remaining funds in the relevant companies in the event of the insolvency of SJNKE or EWIL pre-Scheme and SIIE post-Scheme, albeit, as noted in Section 3, the extent to which claims would be paid is a function of the assets available and their size relative to the reserves. Nevertheless, as the insolvency of either SJNKE, EWIL or SIIE appears remote, I do not believe that differences in winding-up provisions between the UK and Luxembourg will materially adversely affect the Transferring EWIL EEA (excluding UK) Policyholders and the Transferring SJNKE EEA (excluding UK) Policyholders.

6.156 As stated in paragraph 4.9 above, certain SJNKE policyholders pre-Scheme currently enjoy an additional layer of security through an ILU guarantee. I have been informed by the legal advisors to SJNKE (in relation to the Scheme) that the guarantee will continue to operate in the same way after the Scheme, i.e. the guarantee will continue to provide the same additional security to the same policyholders. In consequence, I do not consider the SJNKE policyholders with the benefit of the ILU guarantee to be materially adversely affected by the proposed Scheme as they will continue to benefit from the ILU guarantee.

Conclusion

6.157 ***I am therefore satisfied that the policyholders of the Transferring SJNKE EEA (excluding UK) Business will not be materially adversely affected due to relative differences in the financial strength of SIIE post Scheme to those of SJNKE pre-Scheme. I am therefore also satisfied that the Transferring EWIL EEA (excluding UK) Policyholders will not be materially adversely affected due to relative differences in the financial strength of SIIE post-Scheme to those of EWIL pre-Scheme.***

CHANGES IN RISK EXPOSURES

6.158 If the Scheme is sanctioned, the Transferring EWIL EEA (excluding UK) Policyholders and the Transferring SJNKE EEA (excluding UK) Policyholders will no longer be subject to the risk exposures of EWIL and SJNKE (as appropriate). They will, however, become exposed to those existing within SIIE, albeit that, as at the expected Effective Date of the Scheme, only a limited amount of business will have been written by SIIE, and it will be of a similar nature and mix to the Transferring EWIL EEA (excluding UK) Business and Transferring SJNKE EEA (excluding UK) Business.

6.159 Further, if the Scheme is sanctioned, the Transferring SJNKE UK and non-EEA Policyholders will no longer be subject to the risk exposures of SJNKE. They will however, become exposed to those existing within EWIL.

6.160 SJNKE is a medium sized and diverse insurance company, writing business predominantly in the EEA, but also in the UK and further afield. The liabilities of SJNKE include short-tailed lines of business and uncertain long-tailed lines of business, including exposure to disease claims arising from UK Employers' Liability business.

6.161 EWIL, on the other hand, is a large and diverse insurance company, writing business predominantly in the UK, but also elsewhere in Europe and further afield. The liabilities of EWIL include short-tailed lines of business, with exposure to large losses from catastrophe events, and uncertain long-tailed lines of business.

6.162 The Transferring EWIL EEA (excluding UK) Policyholders will lose the benefit afforded by being part of a large and diverse insurance company. On the other hand, they will no longer be exposed to EWIL's other risk exposures. The Transferring EWIL EEA (excluding UK) Policyholders will, however, become exposed to SIIE if the Scheme is sanctioned, and will therefore be part of a less geographically diversified portfolio (insomuch that there will no longer be significant UK exposures). Further, it is my view, for the reasons outlined in paragraph 6.134 above, that the Transferring EWIL EEA (excluding UK) Policyholders will not experience a diminution of security over time as a result of SIIE maintaining own funds (available capital) at least as great as the SF SCR calculated using the SIIE risk profile (i.e. the SF SCR represents an appropriate level of the financial resources anticipated to be required by SIIE).

6.163 The Transferring SJNKE EEA (excluding UK) Policyholders will lose the benefit afforded by being part of a medium-sized and diverse insurance company. On the other hand, they will no longer be exposed to SJNKE's other risk exposures, e.g. uncertain UK liability-type claims. The Transferring SJNKE EEA (excluding UK) Policyholders will, however, become exposed to SIIE if the Scheme is sanctioned, and will therefore be part of a less geographically diversified portfolio (insomuch that there will no longer be significant UK exposures). Further, it is my view, for the reasons outlined in paragraph 6.134 above, that the Transferring SJNKE EEA (excluding UK) Policyholders will not experience a diminution of security over time as a result of SIIE using the SF applied to the expected SIIE risk profile to calculate its SCR (i.e. it represents an appropriate level of the financial resources anticipated to be required by SIIE).

6.164 The Transferring SJNKE UK and non-EEA Policyholders will lose the benefit afforded by being part of a medium-sized and diverse insurance company. On the other hand, they will no longer be exposed to SJNKE's EEA (excluding UK) risk exposures. The Transferring SJNKE UK and non-EEA Policyholders will, however, become exposed to EWIL if the Scheme is sanctioned, although EWIL benefits from being a larger and more diversified entity, albeit with less geographical diversification (insomuch that there will no longer be any EEA exposures). Further, it is my view, for the reasons outlined in paragraph 6.113 above, that the Transferring SJNKE UK and non-EEA Policyholders will not experience a diminution of security over time as a result of EWIL maintaining own funds (available capital) at least as great as the SF SCR calculated using the EWIL risk profile (i.e. the SF SCR represents an appropriate level of the financial resources anticipated to be required by EWIL).

6.165 Based on my analysis of changes in risk exposures as outlined above, the Scheme creates both potential positives and negatives for the Transferring EWIL EEA (excluding UK) Policyholders, the Transferring SJNKE EEA (excluding UK) Policyholders, and the Transferring SJNKE UK and non-EEA Policyholders. Nonetheless, given the financial strength of SIIE, as discussed above, I do not consider that the Transferring EWIL EEA (excluding UK) Policyholders or the Transferring SJNKE EEA (excluding UK) Policyholders will be materially adversely affected by the changes in risk exposures. Likewise, given the financial strength of EWIL, as discussed above, I do not consider that the Transferring SJNKE UK and non-EEA Policyholders will be materially adversely affected by the changes in risk exposures.

Conclusion

6.166 ***I am satisfied that, although the proposed Scheme will lead to a change to the risk exposures of the business transferring under the Scheme, this will not have a materially adverse impact on the security of policyholder benefits.***

POLICY SERVICING

6.167 The administration (including policy servicing and claims handling) of the Transferring SJNKE EEA (excluding UK) Business is currently undertaken by the SJNKE branches (and/or in the SJNKE London office). These SJNKE branch staff will continue to administer this business in the same way whether the Scheme is sanctioned or not, since they will have transferred from SJNKE to SIIE on or before the Effective Date. The administration (including policy servicing and claims handling) of the Transferring SJNKE UK and non-EEA Business is currently undertaken in the SJNKE London office. These SJNKE London staff will continue to administer this business in the same way whether the Scheme is sanctioned or not, since they have transferred from SJNKE to EBSL, and EBSL will continue to administer this business. The administration (including policy servicing and claims handling) of the Transferring EWIL EEA (excluding UK) Business is currently out-sourced to EBSL, who will continue to administer this business in the same way whether the Scheme is sanctioned or not, since SIIE will also out-source the administration to EBSL. Therefore, the Scheme should not have any effect on the policy administration arrangements (including policy servicing and claims handling) for the Transferring EWIL EEA (excluding UK) Business, the Transferring SJNKE EEA (excluding UK) Business, and the Transferring SJNKE UK and non-EEA Business, while noting the impact of Brexit and the requirements of ELTO as set-out in paragraphs 6.169 and 6.170 respectively.

6.168 The core systems of SIH globally are *Guidewire* and *Polaris* for policy administration and *SAP GL* for accounting. SIIE will use these systems with effect from 1 September 2018 (or thereabouts), and the current systems of SJNKE (*AeGIS* for policy administration and *Sompo GL* for accounting) will co-exist alongside these core systems following the implementation of the Scheme. Likewise, EWIL, which already operates the aforementioned core systems of SIH (*Guidewire, Polaris* and *SAP GL*), will also use the current systems of SJNKE (*AeGIS* and *Sompo GL*) following the implementation of the Scheme. In this manner, both EWIL and SIIE will operate systems post-Scheme that maintain continuity with the systems employed pre-Scheme. Post-Scheme, I am informed by SIH that it plans an orderly transfer of SJNKE's current policy administration and accounting system functions onto SIH's core global systems, and that it expects this to be completed in the first few years following the implementation of the Scheme. Therefore, the Scheme should not have any material adverse impact on the systems supporting the policy administration and accounting arrangements for the Transferring EWIL EEA (excluding UK) Business, the Transferring SJNKE EEA (excluding UK) Business, and the Transferring SJNKE UK and non-EEA Business.

6.169 As described in paragraph 6.183 below, SIIE is to establish a regulated (third country) UK branch (subject to the approval of the PRA/FCA) prior to the end of the Brexit Transition Period in order that those Transferring SJNKE EEA (excluding UK) Policies and those Transferring EWIL EEA (excluding UK) Policies that involve exposures across both the UK and the rest of the EU (and possibly the EEA) can be administered and meet relevant regulatory requirements (in the UK and the rest of the EEA). I am therefore satisfied that the administration (including policy servicing and claims handling) of the Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business that involves exposures across both the UK and the rest of the EU (and possibly the EEA) would not be materially adversely affected as a result of the Scheme and Brexit.

6.170 The Transferring SJNKE UK and non-EEA Business includes Employers' Liability business, and as such SJNKE is subject to FCA reporting requirements (including the annual submission to the FCA of a Directors Certificate stating compliance with the Employers' Liability rules) as well as the requirements of ELTO, both as outlined in paragraph 5.43 above. On the Effective Date, these reporting requirements will pass to EWIL, which again as outlined in paragraph 5.43 above, are scheduled to be operational within EWIL on or before the Effective Date under the auspices of the EWIL compliance team (which contain the same members as the SJNKE compliance team). Accordingly, I am satisfied that the requirements of the FCA and ELTO in relation to the Employers' Liability business of the Transferring SJNKE UK and non-EEA Business will not be materially adversely affected by the implementation of the Scheme.

6.171 I therefore have no reason to believe that there will be any materially adverse change to policy servicing, including claims handling, resulting from the Scheme.

Conclusion

6.172 ***I believe that the proposed Scheme is unlikely to have a materially adverse impact on the standards of policy servicing and claims handling experienced by the Transferring SJNKE UK and non-EEA Policyholders, the Transferring SJNKE EEA (excluding UK) Policyholders or the EWIL Transferring EWIL EEA (excluding UK) Policyholders compared to their current position.***

DISPUTE RESOLUTION

6.173 In order to assess whether any loss of access to the FOS will materially adversely affect transferring EEA (excluding UK) policyholders, I asked SIH to provide me with statistics concerning the number of Transferring EWIL EEA (excluding UK) Policyholders and Transferring SJNKE EEA (excluding UK) Policyholders that are private policyholders, or "small businesses" or "micro enterprises"; the number of complaints raised historically both in general and with the FOS by policyholders of EWIL and policyholders of SJNKE; and the number of claims and complaints made by policyholders situated in SJNKE branches.

6.174 The statistics provided to me for SJNKE show that the number of complaints received each year is a small number, i.e. 5 in 2016 of which none were eligible to go to the FOS (due to their size, i.e. the policyholders/complainants were not private policyholders, or "small businesses" or "micro enterprises"); 7 in 2017 (of which one was raised in the French branch) and none were eligible to go to the FOS (due to their size); and (at the time of writing this Report) 5 complaints in 2018 of which none were eligible to go to the FOS (due to their size). I note that (at the time of writing this Report) of the complaints made in 2016, 2017 and 2018 all have been resolved with letters issued to the clients (save for one complaint in 2018 that is still being processed).

6.175 The statistics provided to me for EWIL also show that the number of complaints received each year is a small number, i.e. none in 2016; 5 in 2017; and (at the time of writing this Report) 2 complaints in 2018 of which one is eligible to go to the FOS. I note that (at the time of writing this Report) of the complaints made in 2016, 2017 and 2018 all have been resolved with letters issued to the clients (while noting that the complainant in 2018 that is eligible to go to the FOS has not referred the matter to the FOS, though they still remain in time to do so).

6.176 Having considered the situation, I have concluded that any loss of access to the FOS as a result of the Scheme will not materially adversely affect the policyholders of the Transferring SJNKE EEA (excluding UK) Business or the Transferring EWIL EEA (excluding UK) Business for the following reasons:-

- At the time of writing this Report, SJNKE has circa 3,560 policyholders that are eligible to bring a complaint to the FOS (of which circa 3,500 policyholders relate to Nippon Express[23] business) and of these FOS eligible policyholders only 39 would transfer to SIIE under the Scheme. This is primarily because the relevant "Nippon Express" policies (circa 3,500 by number) provide short-term coverage (circa 40 days plus inland shipment) and are not expected to be live policies at the Effective Date (noting that SJNKE will largely stop writing new/renewed business with effect from 1 September 2018 or thereabouts). Thus, any claims arising from this business would be expected to be notified and settled within a short timeframe (i.e. a matter of weeks). It therefore follows that the number of Transferring SJNKE EEA (excluding UK) Policyholders eligible to bring a complaint to the FOS from the Effective Date is expected to be small. Additionally, there are a number of Transferring SJNKE UK and non-EEA Policyholders who are eligible to bring a complaint to the FOS who will transfer to EWIL under the Scheme and (as per paragraph 5.37 above) will be unaffected in relation to their access to the FOS as a result of the Scheme.
- Further, at the time of writing this Report, EWIL has circa 950 policyholders that are eligible to bring a complaint to the FOS; however, only 10 are Transferring EWIL EEA (excluding UK) Policyholders that would transfer to SIIE under the Scheme. Again, it follows that the number of Transferring EWIL EEA (excluding UK) Policyholders eligible to bring a complaint to the FOS from the Effective Date is expected to be small. I also note that the other circa 940 EWIL policyholders that are eligible to bring a complaint to the FOS will remain with EWIL, and will therefore be unaffected in relation to their access to the FOS as a result of the Scheme.
- Very few complaints in general have been referred to SJNKE or EWIL historically.
- At the time of writing this Report, no complaints have ever been brought to the FOS from any policyholder of SJNKE or EWIL.
- Any access to dispute resolution schemes that Transferring SJNKE EEA (excluding UK) Policyholders and Transferring EWIL EEA (excluding UK) Policyholders may have in their home country will not be affected by the Scheme.
- FOS compulsory jurisdiction covers complaints about the activities of a firm in the UK. This includes the UK branch activities of a pass-porting EEA insurer, so there should be no change as a result of the Scheme. Activities carried on in an EEA establishment outside the UK are not covered by FOS before or after the Scheme. Activities carried on by an establishment in the UK (whether through a head office or branch of a firm) are covered by FOS both before and after the Scheme. In the event that there were an intention to shift activities that may become the subject of a complaint from the UK to outside the UK, policyholders may be able to bring complaints to the Médiateur en Assurances, as described in paragraph 3.21 above.

[23] From 2014, SJNKE started underwriting under a Marine Open Cover Agreement with Nippon Express, which enables Nippon Express to sell insurance coverage to their customers as part of their freight forwarding activities which consist of both Commercial and Retail business. The Retail business tends to be for Japanese secondees working within Europe (who would be classed as private policyholders) and provides cover against loss or damage to Personal Effects during transit (the policy duration being circa 40 days plus inland shipment). I note that, at the time of writing this Report, there were around 3,500 SJNKE policyholders with Nippon Express policies that would be classified as private policyholders, but that no complaints have been received by SJNKE in relation to this business during the past 3 years.

Conclusion

6.177 ***Based on my review of the potential loss of access to the FOS as a result of the Scheme as described above, I believe that the Scheme will not materially adversely affect the Transferring SJNKE EEA (excluding UK) Policyholders and Transferring EWIL EEA (excluding UK) Policyholders. I further believe that the proposed Scheme will have no impact in this respect on the Transferring SJNKE UK and non-EEA Policyholders.***

BREXIT

6.178 As noted in paragraph 3.38 above, the process by which the UK exits the EU has begun and, unless otherwise agreed by the UK and all of the remaining EU Member States, will have concluded on or before 29 March 2019.

6.179 The terms of Brexit are subject to negotiation and it is unlikely that those terms will be known publicly until shortly before the exit. Therefore, it is difficult to anticipate the effects of Brexit without resorting to speculation. However, in the context of the Scheme there are some themes that should be considered. In particular, I need to consider whether Brexit will reinforce or mitigate the effects of the Scheme on the Transferring EWIL EEA (excluding UK) Policyholders, the Transferring SJNKE EEA (excluding UK) Policyholders, and the Transferring SJNKE UK and non-EEA Policyholders. I note that the Transferring EWIL EEA (excluding UK) Business and the Transferring SJNKE EEA (excluding UK) Business will be transferred from companies that it is expected will, from 29 March 2019, no longer reside within the EU (and which might also then reside outside the EEA) to SIIE that is and will remain within the EU. I also note that the policy servicing is to be provided to SIIE via branches (in Belgium, France, Germany, Italy, Spain and the UK) and/or by related companies, of which it is expected that one (EBSL) will, from 29 March 2019, no longer reside within the EU (and possibly the EEA).

6.180 Post Brexit, EWIL (and SJNKE assuming that it then still exists) would continue to be regulated by the PRA and FCA, and SIIE would continue to be regulated by the CAA.

6.181 The Non-Transferring EWIL Business will continue to be administered according to UK regulations post-Scheme, as will the Transferring SJNKE UK and non-EEA Business that will form part of EWIL post-Scheme. I therefore believe that Brexit will have no material adverse impact on the ability of EWIL to service the Non-Transferring EWIL Business and/or the Transferring SJNKE UK and non-EEA Business.

6.182 As discussed above in paragraph 4.175, although EBSL considers and adjusts claims on behalf of SIIE, its role is advisory. SIIE management ultimately decides whether liability should be accepted, claims should be settled and the appropriate level of reserves to maintain. Therefore, EBSL provides no services that are subject to regulation. SIIE intends that, if the Scheme is sanctioned by the Court, the management of, and decision-making relating to, claims will continue to take place at its head office in Luxembourg and, notwithstanding any future departure of the UK from the EU, the administration of the Transferring SJNKE EEA (excluding UK) Business (non-branch) and the Transferring EWIL EEA (excluding UK) Business to continue to be sub-contracted to EBSL post Scheme. I therefore believe that Brexit will have no material adverse impact on the servicing of the Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business, noting the operation of the UK branch (of SIIE) as described in paragraph 6.183 below.

6.183 As the Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business presently contains some policies that involve exposures across both the UK and the rest of the EU (and possibly the EEA), SIIE plans to establish a regulated (third country) UK branch (subject to the approval of the PRA/FCA) as outlined in paragraph 4.130 above. The UK branch (of SIIE) will be able to service the UK component of such policies, including claims adjustment, claims settlement, and set the appropriate level of reserves to maintain (in each case subject to SIIE's internal guidelines). I am therefore satisfied that, subject to the approval of the SIIE's UK (third country) branch by the PRA/FCA ahead of Brexit, the policy servicing of any existing contract within or that relates to the Transferring SJNKE EEA (excluding UK) Business or the Transferring EWIL EEA (excluding UK) Business that involves exposures across both the UK and the rest of the EU (and possibly the EEA) would not be materially adversely affected by Brexit. I further note that, if (for whatever reason) approval of the SIIE's UK (third country) branch by the PRA/FCA is not forthcoming on or before Brexit, the Scheme is planned to continue (as described further in paragraph 9.38 below).

Effect on Balance Sheets

6.184 Immediately following the referendum, the value of Sterling on the currency exchange market dropped sharply, but has subsequently stabilised against the Euro and appreciated against the USD. This was largely balanced by rises in the UK equity markets, which have now reached or are near to record highs.

6.185 It is unclear what will happen to Sterling and to UK asset values over the period of the Brexit negotiation and following Brexit itself. However, it is likely that there will be instability, especially as rumours and speculation emerge regarding the progress of those negotiations. Any such instability would affect the balance sheets of companies with assets and/or liabilities in multiple currencies including Sterling, although the impact could be mitigated by the matching of assets and liabilities by currency. I note that SIIE's assets and liabilities will be predominantly in Euros and so its balance sheet should be largely immunised against the effects of currency exchange rate movements. For EWIL, fluctuations in non-Sterling denominated currencies, in which EWIL presently operates, are managed by EWIL periodically buying and selling non-Sterling denominated currencies or investment securities in an attempt to match non-Sterling assets and liabilities. Therefore, while Brexit may lead to general economic uncertainty I do not have reason to believe that SIIE would be impacted to any greater extent by such uncertainty than EWIL (and SJNKE assuming that it then still exists).

Conclusion

6.186 ***I do not believe that Brexit will materially alter the expected effects (if any) of the proposed Scheme on the security of the benefits or the standards of policy servicing experienced by the Transferring SJNKE UK and non-EEA Policyholders, the Transferring SJNKE EEA (excluding UK) Policyholders, or the Transferring EWIL EEA (excluding UK) Policyholders.***

CONCLUSION FOR THE POLICYHOLDERS OF SJNKE AND EWIL TRANSFERRING UNDER THE SCHEME

6.187 ***I am satisfied that the proposed Scheme does not affect in a materially adverse way either the security or the policy servicing levels of the Transferring SJNKE UK and non-EEA Policyholders, the Transferring SJNKE EEA (excluding UK) Policyholders, or the Transferring EWIL EEA (excluding UK) Policyholders.***

7. THE IMPACT OF THE SCHEME ON THE POLICYHOLDERS WHO WILL NOT TRANSFER UNDER THE SCHEME

7.1 In this Section of the Report I consider the impact of the Scheme on those policyholders whose policies will not be transferred to SIIE or EWIL, but which will remain within EWIL (and SJNKE) after the Effective Date.

7.1.1 Within EWIL this will be a large proportion of the policyholders.

7.1.2 Within SJNKE it is intended that all policies will be transferred to SIIE or EWIL and that none will remain within SJNKE. However, as noted above in paragraph 5.45 above, it might not be possible legally to transfer all policies within the Transferring SJNKE EEA (excluding UK) Business and the Transferring SJNKE UK and non-EEA Business, and any policies that cannot be transferred would be deemed Excluded Policies. When discussing the impact of the Scheme on the policyholders of SJNKE who will not transfer under the Scheme, I am referring only to SJNKE policyholders who hold Excluded Policies (the “SJNKE Excluded Policyholders”).

EWIL

7.2 The net effect of transferring the Transferring SJNKE UK and non-EEA Business into EWIL and transferring the Transferring EWIL EEA (excluding UK) Business out of EWIL is projected to represent a very small part of EWIL’s portfolio at the Effective Date (i.e. less than 0.5% of the projected gross UPR and Claims reserves as at 31 December 2018). The proposed Scheme will therefore result in a small decrease to the liabilities of EWIL and with a *de minimis* net effect on the capital (and regulatory capital position) of EWIL.

7.3 In my opinion the financial effect of the proposed Scheme on the security of the Non-Transferring EWIL Policyholders will be *de minimis* and their security levels are effectively unchanged on both the pre-Scheme position and the post-Scheme position.

7.4 I also note that for the Non-Transferring EWIL Policyholders, the additional security they enjoy under the Surety Bond provided by ESIL to EWIL is to be replaced by the EWIL NWA provided (on better terms) by ESIL (see paragraph 4.111 above) and to be implemented prior to the Effective Date.

7.5 In the unlikely event of EWIL becoming insolvent prior to the Effective Date, the direct Non-Transferring EWIL Policyholders would have priority over any reinsurance Non-Transferring EWIL Policyholders in accessing the remaining assets.

7.6 Were EWIL to become insolvent after the Effective Date, the direct Non-Transferring EWIL Policyholders and the direct Transferring SJNKE UK and non-EEA Policyholders would have priority over any reinsurance Non-Transferring EWIL Policyholders and the reinsurance Transferring SJNKE UK and non-EEA Policyholders in accessing the remaining assets. Nonetheless, I have concluded above that, post-Scheme, the Non-Transferring EWIL Policyholders (and the Transferring SJNKE UK and non-EEA Policyholders) will be in either a very well-capitalised company (if the anticipated change in functional currency from GBP to USD is implemented in 2019) or a well-capitalised company, on the boundary of very well-capitalised (if the anticipated change in functional currency from GBP to USD is not implemented). This means that I consider the risk of insolvency of EWIL post-Scheme to be low. I am therefore satisfied that the potential change in the wind-up priorities of the Non-Transferring EWIL Policyholders that would be caused by the Scheme will have no material impact on the security of benefits of the Non-Transferring EWIL Policyholders.

7.7 The policy servicing of the non-transferring business of EWIL will be unchanged by the proposed Scheme.

7.8 As noted in paragraph 5.45 above, it is possible that, after the Effective Date, there might remain in EWIL some policies of the Transferring EWIL EEA (excluding UK) Business that could not be transferred under the Scheme. The gross liability for these will remain with EWIL, but they will be 100% reinsured by SIIE. In this situation the security of the holders of such excluded policies (the “EWIL Excluded Policies”) would be similar to that had the EWIL Excluded Policies transferred under the Scheme. There would also be no changes to the policy servicing or administration of the EWIL Excluded Policies (in the period prior to their eventual transfer).

Conclusion for the policyholders of EWIL not transferring under the Scheme

7.9 ***I am satisfied that the non-transferring policyholders of EWIL would not be adversely affected by the Scheme***.

SJNKE

7.10 The Transferring SJNKE EEA (excluding UK) Business and the Transferring SJNKE UK and non-EEA Business comprises the whole of SJNKE's portfolio. Therefore, it is expected that there will be no SJNKE policyholders who do not transfer under the Scheme. However, as noted above in paragraph 5.45, it is possible that, after the Effective Date, there might remain in SJNKE some policies that could not be transferred under the Scheme (i.e. "SJNKE Excluded Policies"). The gross liability for these will remain with SJNKE, but they will be 100% reinsured by SIIE in respect of such policies emanating from the Transferring SJNKE EEA (excluding UK) Business, or 100% reinsured by EWIL in respect of such policies emanating from the Transferring SJNKE UK and non-EEA Business in each case following the transfers under the Scheme. In this situation, the security of the holders of the SJNKE Excluded Policies would essentially be identical to that had the SJNKE Excluded Policies transferred under the Scheme. There would also be no changes to the policy servicing or administration of the SJNKE Excluded Policies (in the period prior to their eventual transfer).

7.11 Were there to remain policies within SJNKE, SJNKE would need to maintain capital equal to at least the absolute floor of the MCR under Solvency II at the Effective Date (assumed to be pre-Brexit). Even if all of SJNKE's portfolio became SJNKE Excluded Policies, the SJNKE Excluded Policies would continue to enjoy a very high level of security through the EOFs within SIIE or EWIL (as the case may be).

7.12 While Brexit might affect the holders of SJNKE Excluded Policies (should there be any), I do not believe that it would exacerbate, to any material degree, the impact on them of the Scheme.

Conclusion for the policyholders of EWIL not transferring under the scheme

7.13 ***I am satisfied that any policyholders of SJNKE whose policies become SJNKE Excluded Policies would not be adversely affected by the Scheme.***

8. THE IMPACT OF THE SCHEME ON THE CURRENT SIIE POLICYHOLDERS

8.1 Under the Scheme, the existing policyholders of SIIE will remain in SIIE in the same position as prior to the Effective Date of the Scheme. The main effect of the Scheme on these SIIE policyholders arises from the transfer into SIIE of all the EEA (excluding UK) business currently in SJNKE and EWIL.

8.2 SIIE is scheduled to commence underwriting business only with effect from 1 September 2018 (or thereabouts) and as at the Effective Date of the Scheme will have only a limited portfolio of existing insurance business.

8.3 The Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business will be large compared to SIIE's existing portfolio on both a gross (and net) of reinsurance basis. Therefore, SIIE's SCR will increase substantially as a result of the Scheme. However, as SIIE received additional capital of €85.5 million on 31 May 2018 (see paragraph 5.32 above), and is projected to be a very well-capitalised company over the projection period (2018 – 2022), I do not believe that the financial security of the existing SIIE policyholders will be materially adversely affected as a result of the Scheme.

8.4 I also note that the current SIIE policyholders will enjoy the additional security under the SIIE NWA provided by ESIL (see paragraph 4.164 above) both pre- and post-Scheme.

8.5 The risk exposures within SIIE will broaden as a result of the Scheme, but I note that the Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business is of the same type that is expected to be underwritten by SIIE going forward.

8.6 There will be no change to the administration or policy servicing of the existing SIIE policyholders as a result of the Scheme.

Conclusion for the SIIE Policyholders

8.7 ***For the reasons discussed above, I am satisfied that the Scheme will not have a materially adverse effect on the security or service levels of the existing SIIE policyholders***.

9. OTHER CONSIDERATIONS

ASSETS OF SJNKE, EWIL AND SIIE

9.1 In assessing the impact of the Scheme, I have considered the nature of the assets within each of SJNKE, EWIL and SIIE before and after the Scheme occurs (as illustrated in Tables 5.1, 5.2 and 5.3 above). The assets of each of SJNKE, EWIL and SIIE available to meet policyholder obligations can be classified into three broad categories:

9.1.1 Investments and Cash – Financial investments held by SJNKE, EWIL and SIIE are held in bonds and cash. The investment policies pursued by SJNKE, EWIL and SIIE (as described in Section 4) are conservative in nature, with investments made in a broad mix of short to medium-term government bonds and corporate bonds (the latter predominantly comprising bonds issued by corporations which are considered highly secure by public rating agencies);

9.1.2 Reinsurance assets (made up of ceded reserves for unearned premiums and outstanding claims, and reinsurance recoveries on paid claims) – Subject to the specific terms of the relevant reinsurance contracts, reinsurance assets have the capacity to absorb losses arising from the underlying reinsured insurance liabilities thereby reducing financial risk. I note that SJNKE, EWIL and SIIE all have a material reliance on reinsurance. However, the nature and level of utilisation of such arrangements is in line with my expectations given the reinsurance strategies of each of SJNKE, EWIL and SIIE (as described in Section 4). Further, I note that the Court has the power to order (and the Scheme provides for) the transfer of the relevant outwards reinsurance contracts of SJNKE and EWIL, as set out in paragraph 9.3 below; and

9.1.3 Premium and Other Debtors – sundry assets arising in the normal course of business such as accounts due from intermediaries, policyholders and suppliers, and intercompany balances due from other members of the Sompo Group largely arising as a consequence of recharges of expenses between group companies. These balances are in line with my expectations for a business of this nature.

9.2 I do not identify any matter arising from the balance sheet assets held by SJNKE, EWIL and SIIE that would cause me to perform specific further analysis. I note that no change in the overall asset composition of SJNKE, EWIL and SIIE (available to meet policyholder obligations) will arise as a direct result of the Scheme.

9.3 The Court has the power to order (and the Scheme provides for) the transfer: to SIIE, of SJNKE's and EWIL's relevant outwards reinsurance contracts in respect of the Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business; and to EWIL, of SJNKE's relevant outwards reinsurance contracts in respect of the Transferring SJNKE UK and non-EEA Business. On the basis that SJNKE's and EWIL's relevant outwards reinsurance contracts (modified as described in paragraphs 9.13 to 9.17 below) are transferred as part of the Scheme, the net (of reinsurance) positions of SIIE and EWIL will not be materially adversely impacted as a result of the Scheme.

9.4 As outlined in sub-paragraph 9.1.1 above, SJNKE, EWIL and SIIE have sufficiently liquid assets to meet liabilities as they fall due, both before and after the Scheme. As a result, I do not anticipate that the Scheme will create any material adverse impact with respect to liquidity for the Transferring SJNKE EEA (excluding UK) Policyholders, the Transferring EWIL EEA (excluding UK) Policyholders; the Transferring SJNKE UK and non-EEA Policyholders, the Non-Transferring EWIL Policyholders or the current SIIE Policyholders.

OPERATIONAL PLANS AND CHANGES IN ASSETS AND LIABILITIES UP TO THE EFFECTIVE DATE

9.5 The balance sheets I have reviewed for SJNKE and EWIL show amounts as at 31 December 2017. I have chosen this date because it is the latest date for which audited financial information is available.

9.6 I expect that the current activities of SJNKE, EWIL and SIIE (from 1 September 2018, or thereabouts) to have continued, and will continue, between 31 December 2017 and the Effective Date (and, as appropriate, after the Effective Date). SJNKE and EWIL have continued, and will continue, as will SIIE (from 1 September 2018, or thereabouts) to write new business, settle claims and reassess reserves in the light of experience. I do not consider that any material additional risk to any group of affected policyholders will emerge as a result of the continuation of normal business.

9.7 Further to considering the continuation of normal business, I have discussed with SIH the possibility of management actions, other than the proposed Scheme, as considered in this Report, that could affect the financial position of SJNKE, EWIL and/or SIIE (such as significant changes in new business strategy or operational plans). I have been informed that: EWIL has no planned activities that would have a material effect on the security of EWIL's policyholders; SIIE has no planned activities that would have a material effect on the security of SIIE's policyholders; and SJNKE has no planned activities that would have a material effect on the security of SJNKE's policyholders.

9.8 I believe that it is unlikely that any events occurring between 31 December 2017 and the Effective Date would affect any conclusion that I have reached based on my review as at 31 December 2017 (and subsequent updates to projections).

9.9 A short time before the final Court hearing, I will consider the extent to which actual changes in assets and liabilities have been in line with expectations (relative to the position as at 31 December 2017, and subsequent updates to projections) and hence whether there have been any changes (including those associated with current economic conditions) that would affect my overall opinion, and, if necessary, I will report on these separately.

MIS-SELLING LIABILITIES

9.10 In her judgement regarding the recent case of PA(GI) Limited v (1) GICL 2013 Limited (2) Cigna Insurance Services (Europe) Limited (2015), Mrs Justice Andrews DBE said that *"..an intention to make provision for the transfer of mis-selling liabilities would quantify as an unusual feature which might have a material financial impact on the scheme, and which one would therefore expect to be expressly disclosed in the context of an application for a transfer under a Part VII scheme*." …

9.11 Neither SJNKE nor EWIL is aware of any actual or potential mis-selling liabilities within its predominantly commercial business. I note that commercial (re)insurance business which tends to involve larger corporate policyholders is by its nature unlikely to give rise to any mis-selling liabilities in relation to the Transferring SJNKE EEA (excluding UK) Business, the Transferring SJNKE UK and non-EEA Business and/or the Transferring EWIL EEA (excluding UK) Business. In any event, it is intended that the Scheme will transfer any such liabilities, should they arise in relation to the Transferring SJNKE EEA (excluding UK) Business and/or the Transferring EWIL EEA (excluding UK) Business, from SJNKE and EWIL to SIIE. Likewise, the Scheme will transfer any such liabilities, should they arise in relation to the Transferring SJNKE UK and non-EEA Business, from SJNKE to EWIL. Any mis-selling liability that arises within SJNKE or EWIL that is not related to the Transferring SJNKE EEA (excluding UK) Business and/or the Transferring EWIL EEA (excluding UK) Business would not be transferred from SJNKE or EWIL to SIIE as part of the Scheme. Likewise, any mis-selling liability that arises within SJNKE that is not related to the Transferring SJNKE UK and non-EEA Business would not be transferred from SJNKE to EWIL as part of the Scheme. I have not considered it necessary to comment further on this matter in the Report.

THE LIKELY EFFECTS OF THE SCHEME UPON REINSURERS OF SJNKE AND EWIL

9.12 In accordance with the PRA Statement of Policy and SUP18, I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts cover those parts of the business to be transferred by the Scheme from SJNKE and EWIL to SIIE, and those parts of the business to be transferred by the Scheme from SJNKE to EWIL.

9.13 SIH intends to modify the outwards reinsurance contracts that currently provide reinsurance protection to the business written by SJNKE. This means that SIH will reach agreement with each reinsurer that the reinsurance that they each provide will continue to apply (as relevant) to all of the Transferring SJNKE EEA (excluding UK) Business that transfers to SIIE, and to all of the Transferring SJNKE UK and non-EEA Business that transfers to EWIL. Therefore, after the modification of reinsurance is completed there would be no material change to the reinsurance protecting the business written by SJNKE, because:

- For SJNKE non-Japanese corporate business, SIH will add SIIE and EWIL along with SJNKE as named insureds on any intra-group treaties, and relevant treaties with external reinsurers;
- For SJNKE Japanese relationship business, SIH will add SIIE and EWIL along with SJNKE as named insureds on the intra-group treaties with SJNKI, and will add SIIE and EWIL along with SJNKE as named insureds on treaties with external reinsurers;

- The risk profiles of the transferring reinsurance contracts will not be changed as a result of the Scheme. Further, SIH will continue to separate the Japanese relationship business and the non-Japanese corporate business in SIIE and in EWIL after the transfers and cede them into each reinsurance scheme accordingly;
- While any aggregate limitation or attachment point shall continue to be applicable to each transferring reinsurance contract as a whole, I am informed that SIH, which already has in place and runs an operational protocol on the application of aggregate limits and/or attachment points in relation to all the companies of the SIH group, will continue to apply such protocols on and after the Effective Date; and
- Likewise, while any excess or deductible shall continue to be applicable to each transferring reinsurance contract as a whole, I am informed that SIH, which already has in place and runs an operational protocol on the application of excess levels and/or deductibles in relation to all the companies of the SIH group, will continue to apply such protocols on and after the Effective Date.

9.14 I am informed that SIH has already reached an internal agreement in principle to proceed with modifications with those reinsurers of SJNKE that are part of the Sompo Group. There is a small number of reinsurers of SJNKE external to the Sompo Group, and SIH is currently carrying out a project to identify such reinsurance contracts and to reach an agreement with the reinsurers that have provided those contracts by 1 November 2018.

9.15 SIH also intends to modify certain of the outwards reinsurance contracts that currently provide reinsurance protection to the business written by EWIL. This means that SIH will reach agreement with each reinsurer that the reinsurance that they each provide will continue to apply to all of the Transferring EWIL EEA (excluding UK) Business that transfers to SIIE. Therefore, after the modification of reinsurance is completed there would be no material change to the reinsurance protecting the business written by EWIL, because:

- SIH will add SIIE along with EWIL as a named insured on any intra-group treaties, and relevant treaties with external reinsurers;
- The risk profiles of the transferring reinsurance contracts will not be changed as a result of the Scheme;
- While any aggregate limitation or attachment point shall continue to be applicable to each transferring reinsurance contract as a whole, I am informed that SIH, which already has in place and runs an operational protocol as the application of aggregate limits and/or attachment points in relation to all the companies of the SIH group, will continue to apply such protocols on and after the Effective Date; and
- Likewise, while any excess or deductible shall continue to be applicable to each transferring reinsurance contract as a whole, I am informed that SIH, which already has in place and runs an operational protocol as the application of excess levels and/or deductibles in relation to all the companies of the SIH group, will continue to apply such protocols on and after the Effective Date.

9.16 I am informed that SIH has already reached an internal agreement in principle to proceed with modifications with those reinsurers of EWIL that are part of the Sompo Group. There are a number of reinsurers of EWIL external to the Sompo Group, and SIH is currently carrying out a project to identify such reinsurance contracts of EWIL and to reach an agreement with the providers of those reinsurance contracts by 1 November 2018.

9.17 I understand that all necessary modifications of both internal and external reinsurance treaties of SJNKE and EWIL are expected to be completed by 1 November 2018 (i.e. prior to the Effective Date). My conclusion in this Report is based on the assumption that the transferring reinsurance will be modified as described above prior to the Effective Date.

9.18 I have considered whether the Scheme is likely to lead to any changes in the rights of set-off for creditors or debtors of SJNKE, EWIL or SIIE. '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. Since the existing business of SIIE, the Transferring SJNKE EEA (excluding UK) Business and the Transferring EWIL EEA (excluding UK) Business have external reinsurance and inwards reinsurance policyholders, there is the possibility of changes in the right of set-off on the insolvency of SIIE post-Scheme. The chances of insolvency of SIIE are, however, remote (particularly in the short-term). Likewise, since the existing business of EWIL and the Transferring SJNKE UK and non-EEA Business have external reinsurance and inwards reinsurance policyholders, there is the possibility of changes in the right of set-off on the insolvency of EWIL post-Scheme. The chances of insolvency of EWIL are, however, remote (particularly in the short-term). As such I do not believe the right of set-off affects my conclusions on the impact of the Scheme on reinsurers.

Conclusion for the reinsurers of EWIL and SJNKE whose contracts of reinsurance are to be transferred by the Scheme

9.19 ***For the reasons discussed above, I am satisfied that the Scheme will not have a materially adverse effect on the reinsurers of EWIL or SJNKE whose contracts of reinsurance are to be transferred to SIIE or EWIL by the Scheme (subject to the necessary modifications of both internal and external reinsurance treaties of SJNKE and EWIL being completed prior to the Effective Date)***.

THE APPROACH TO COMMUNICATION WITH POLICYHOLDERS

9.20 Regulations made under the FSMA require a communication regarding the proposed Scheme to be sent to every policyholder of the Companies. However, consideration may be given to the practicality and costs of sending notices against the likely benefits for policyholders of receiving such communications. In order to comply with both paragraph 2.53 of the Policy Statement and paragraph 2.46G of SUP18, the Companies would be expected to notify the policyholders, or interested persons, at least six weeks before the date of the Court hearing at which the application to sanction the Scheme will be heard.

9.21 I set out my understanding of the Companies’ proposed approach to communicating the Scheme to affected policyholders below.

9.22 EWIL and SJNKE intend to publish a notice stating that the application has been made in a form approved by PRA in:

- The London, Edinburgh and Belfast Gazettes;
- The Times; and
- The Financial Times.

9.23 For other countries, EWIL and SJNKE do not consider it appropriate to publish a notice in any EEA State other than Germany and the Netherlands, given the expense of advertising (which SJNKE/EWIL estimates would be approximately £5,000 per EEA state) and given the number of policyholders in any one state (other than in Germany and the Netherlands) do not exceed 300.

9.24 Rather than sending a copy of the notice to policyholders, it is intended that a more detailed statement (the “Policyholder Statement”) be sent to policyholders of SIIE, SJNKE and EWIL. The Policyholder Statement is to have enclosed with it a short document containing the terms of the Scheme, and the IE Summary.

9.25 Subject to an exception referred to in paragraph 9.26 below, the Policyholder Statement and IE Summary will be sent to each person who holds a policy issued by SIIE, SJNKE or EWIL under which:

(a) the period of insurance cover is ongoing;

(b) a claim has been made and is outstanding; or

(c) a sum, payment or benefit is contingently due, payable or to be provided (other than those referred to in (a) or (b) above)

in each case where the name and address of that policyholder appear in the computerised records of SIIE, SJNKE or EWIL.

9.26 Some of SJNKE's business is very mature, dating from 1989. Since it is often possible for a policyholder to bring a claim many years after the year of cover, it is therefore not possible to compile an exhaustive list of all the persons holding an SJNKE policy other than those referred to in sub-paragraphs 9.25 (a) and (b) above, under which a sum, payment or benefit is contingently due, payable or to be provided. Thus, in order to ensure that a reasonable proportion of such policyholders are mailed, SJNKE is proposing to include in the mailing those persons who have held a SJNKE policy written in the last fifteen years. Given the period within which a claim will typically be made on a SJNKE policy (only around 2% of outstanding claims relate to policies which incepted before 1 January 2003) SJNKE believes that notifying those holders of SJNKE policies which were entered into or renewed on or after 1 January 2003 will result in the Policyholder Statement being sent in respect of over 95% of the SJNKE policies falling within paragraph 9.25(c) above. SJNKE therefore proposes to limit its notification in relation to paragraph 9.25(c) above to SJNKE policies which were entered into or renewed on or after 1 January 2003. SJNKE believes that by notifying those SJNKE policyholders in addition to those referred to in paragraph 9.25(a) and (b) it will include the vast majority of policyholders who would ever bring a claim against SJNKE.

9.27 Many of the policies written by EWIL and SJNKE were effected through brokers. It is therefore proposed that EWIL and SJNKE will send copies of the Policyholder Statement to the brokers through which such policies were effected, or through whom correspondence in relation to the relevant policyholders is carried out, and whose names and addresses appear in EWIL's or SJNKE's computerised records. EWIL and SJNKE cannot be sure of having contact details for all brokers through whom policies were effected and EWIL and SJNKE do not have a contractual right to enforce a broker's co-operation. This mailing to brokers is not intended to be a substitute for the policyholder mailing referred to in paragraph 9.25 above and is not to be carried out because (as is sometimes the case) only brokers have the contact details of policyholders who have effected policies through brokers. Rather, the purpose of EWIL and SJNKE taking this step is as a further measure to bring the proposed Scheme to the attention of policyholders and relevant brokers through whom policies have been effected.

9.28 In relation to the broker mailings I am informed by SIH (via its legal advisors in relation to the Scheme) that:

- EWIL and SJNKE will follow up these brokers with an e-mail to check safe receipt and whether they have any questions;
- EWIL and SJNKE will not have control over this process as they cannot force brokers to distribute the pack, nor determine how they will do so;
- Should any person or persons affected by the Scheme object to the Scheme, the mailed materials will state to whom any such objections should be sent – therefore, there is no reason why brokers themselves should receive or handle any objections to the Scheme;
- Neither EWIL nor SJNKE will be relying on a third party to notify their policyholders. Instead they will notify policyholders themselves and will <u>additionally</u> notify brokers in order to raise awareness of the Scheme in the market more generally.

9.29 EWIL and SJNKE will also send a detailed letter to each reinsurer of a transferring SJNKE/EWIL outwards reinsurance contract informing them of the intention to transfer such contracts. Further, in relation to the reinsurer mailings I am informed by SIH (via their legal advisors in relation to the Scheme) that EWIL and SJNKE will follow up these reinsurers with an e-mail to check safe receipt and whether they have any questions; and that the mailed materials state where any objections can be sent to.

9.30 It is anticipated that each of the following groups of policyholders will be substantially affected by the proposed Scheme:

(a) EEA (excluding UK) policyholders of SJNKE, because they will be moving to SIIE;

(b) EEA (excluding UK) policyholders of EWIL, because they will be moving to SIIE;

(c) SIIE policyholders, because a substantial cohort of additional policies will be transferring to SIIE from EWIL and SJNKE;

(d) UK and non-EEA policyholders of SJNKE, because they will be moving to EWIL; and

(e) The existing policyholders of EWIL, because a substantial cohort of additional policies will be transferring to EWIL from SJNKE.

9.31 It is therefore not proposed that any request be made for dispensation from notifying any of these groups as a whole.

9.32 It will ultimately be for the Court to decide what notifications are required. This will be decided at a court hearing after this Report is finalised and will be subject to any amendments required by the Court. It is possible, therefore, that the actual approach to policyholder notification may differ in some respects from that proposed and outlined above.

9.33 I also note here that my comments in this sub-section ("The Approach to Communication with Policyholders") are based on my general industry experience and on my understanding of the policyholders affected (as described in paragraph 2.10 above), rather than on specific expertise in the area of policyholder communication.

9.34 When thinking through the proposed approach to notifications, I have considered a number of factors, including whether the policyholders in SJNKE, EWIL or SIIE are likely to be interested in being informed of the proposed Scheme. In this context, I believe that the approach to policyholder notifications needs to consider the likelihood of a policyholder having a claim, whether the policyholder's policy is transferring and the impact of the Scheme on security. I have therefore weighed these issues up against the risk of policyholder notifications causing confusion or annoyance in relation to an issue that policyholders may consider to be insignificant, and against the practicability of notifying policyholders, as follows:

9.34.1 Ultimate policyholder security falls to companies in the Sompo Group both before and after the implementation of the Scheme. As a result, I consider that the risk of adverse consequences for policyholders or third-party claimants who do not receive notification is low;

9.34.2 For the Scheme, all policyholders expected to be substantially affected are essentially being notified (as described in paragraphs 9.30 and 9.31 above);

9.34.3 For those SJNKE policyholders identified in sub-paragraph 9.25(c) above, because of the difficulty in contacting all such policyholders, the notification is to be limited to policies issued on or after 1 January 2003 representing over 95% of policies. Taking into account both the high proportion of affected policyholders being notified and my comments in sub-paragraph 9.34.1 above, I consider the proposed arrangements to be reasonable;

9.34.4 As many of the policies written by EWIL and SJNKE were effected through brokers, the aforesaid companies are also to send copies of the Policyholder Statement to those brokers whose names and addresses appear on EWIL's or SJNKE's computerised records. I note that this mailing to brokers is not a substitute for the policyholder notifications referred to in sub-paragraph 9.34.2 above, but is a further measure intended to bring the Scheme to the attention of policyholders and relevant brokers;

9.34.5 SIH (via its legal advisors in relation to the Scheme) has shown me the wording in the Policyholder Statement. to be sent to policyholders of SIIE, SJNKE and EWIL (which is to have enclosed with it a short document containing the terms of the Scheme, and the IE Summary). I believe that this document will make the aforesaid policyholders aware of the Scheme and its impact on their position;

9.34.6 SIH proposes to publicise the Scheme in the publications listed in paragraph 9.22 above, and to publish notices for the Scheme in Germany and the Netherlands. No notices are to be published in any other EEA state because the numbers of policyholders in any one of these other states do not exceed 300. Given the small number of policyholders outside the UK, Germany and the Netherlands, I consider that the publicity arrangements for the Scheme are reasonable and will help reduce the risk of there being policyholders affected who will not be aware of the Scheme;

9.34.7 For the Scheme, EWIL and SJNKE are to send a detailed letter to each reinsurer of the transferring EWIL/SJNKE outwards reinsurance contract informing them of the intention to transfer such contracts. I consider that such an approach is appropriate.

9.35 ***Based on my considerations (as outlined above), I believe the proposed approach to communication with policyholders and reinsurers (as the case may be) including the dispensations sought to be both proportionate and reasonable. In making this statement I reiterate that it is for the Court to approve the notification arrangements.***

WHAT WOULD HAPPEN WERE THE SCHEME NOT TO PROCEED?

9.36 If the Scheme were not to proceed then:

9.36.1 The SJNKE transferring business would remain with SJNKE. Other than SJNKE largely ceasing to accept new and/or renewing business with effect from 1 September 2018 (or thereabouts) there would in effect be no change from the current situation, although the parties to the Scheme would revisit the contractual arrangements that are in place in relation to the SJNKE transferring business to ensure they remain appropriate, in particular post-Brexit. This situation would not provide the regulatory split between EEA (excluding UK) and UK and non-EEA risks that SJNKE seeks in respect of this business, and there is a risk that post-Brexit, were it to continue to service its EEA (excluding UK) policies in line with its contractual obligations, SJNKE would be breaching regulatory rules .

9.36.2 The EWIL transferring business would remain with EWIL. Other than writing new UK and non-EEA business from 1 September 2018 (or thereabouts) that would largely have been written by SJNKE, and accepting UK and non-EEA business that would largely have renewed with SJNKE from 1 September 2018 (or thereabouts) there would in effect be no change from the current situation, although the parties to the Scheme would revisit the contractual arrangements that are in place in relation to the EWIL transferring business to ensure they remain appropriate, in particular post-Brexit. This situation would not provide the regulatory split between EEA (excluding UK) and UK and non-EEA risks that EWIL seeks in respect of this business, and there is a risk that post-Brexit, were it to continue to service its EEA (excluding UK) policies in line with its contractual obligations, EWIL would be breaching regulatory rules .

9.36.3 SIIE would continue to operate as it currently does and would remain a vehicle for writing EEA (excluding UK) business within the Sompo Group, including the new and renewing EEA (excluding UK) business of EWIL and SJNKE from 1 September 2018 (or thereabouts). This mode of operation would not change as a result of Brexit.

9.37 As indicated in paragraph 9.36 above, in the absence of the proposed Scheme there is a risk that SJNKE and EWIL will not be able to service policies (including the settlement of claims) in line with regulatory rules as a result of Brexit. In particular, were the Scheme not to proceed then, following Brexit, SIH has estimated that, at the date of the Report, there will be: 1,512 Transferring SJNKE EEA (excluding UK) Policies that SJNKE might no longer be authorised to service; and 1,173 Transferring EWIL EEA (excluding UK) Policies (made up of 1,050 policies with case reserves and an additional 123 policies from the in-force portfolio that are not duplicates) that EWIL might no longer be authorised to service.

9.38 I note that SIIE plans to establish a UK (third country) branch, ahead of the end of the Brexit Transition Period and subject to approval by the PRA/FCA, in order that policies which involve exposures across both the UK and the rest of the EU (and possibly the EEA) can be serviced if needed in the UK. If, for whatever reason, approval of a UK (third country) branch is not forthcoming from the PRA/FCA prior to the end of the Brexit Transition Period, any UK risk component will be administered by SIIE's offices outside the UK (as there is no UK legal requirement for UK risks to be serviced in the UK) in accordance with SIIE’s administration standards that apply to all of its business across the EEA. Thus, I am informed by SIH that the Scheme is planned to proceed whether approval (or otherwise) of a UK (third country) branch by the PRA/FCA is forthcoming on or before the end of the Brexit Transition Period.

POLICYHOLDERS LOCATED OUTSIDE THE EEA

9.39 I understand an insurance business transfer scheme as defined in Section 105 of FSMA would be effective as a result of the Court Order sanctioning the business transfers for all policies governed by the law of an EEA Member State. However, there is no obligation on the courts of non-EEA states to recognise automatically the ability of the Court to transfer a policy governed by non-EEA state laws. Thus it may be possible for one or more transferring policyholders with non-EEA policies to challenge the validity of the transfer subsequent to its Effective Date.

9.40 The Transferring SJNKE UK and non-EEA Business includes policies that (re)insure policyholders who are located outside the EEA (circa 240 at the time of writing this Report). Such policies are typically governed by the law of the location of the policyholder, for example the law of a US state, under which it may not be clear how a transfer pursuant to Part VII of FSMA is to be treated. I have therefore considered whether from the point of view of non-EEA policyholders, the Scheme is likely to make it any more difficult to bring a claim against EWIL than it would be to do so against SJNKE should the Scheme not go ahead. I believe that this would only be an issue if EWIL were to assert that the Scheme was not effective in such jurisdiction. As this would conflict with the terms of the Court's Order (approving the Scheme, which will provide that EWIL will accept the liabilities arising out of the Transferring SJNKE UK and non-EEA Business whatever the governing law of the policies), it is not considered to be a realistic scenario. In any event, if a court in a particular jurisdiction did not recognise the Scheme and so made an order that SJNKE pay a claim, SJNKE would pay the claimants concerned, but nonetheless could recover the amount of the claim under the indemnity that EWIL has provided to SJNKE in the Scheme, i.e. there would be no adverse impact on those policyholders.

9.41 The Order also provides that any proceedings commenced after the Effective Date in relation to the Transferring SJNKE UK and non-EEA Business will be commenced against EWIL, and that any orders or awards obtained in relation to the Transferring SJNKE UK and non-EEA Business against SJNKE will be enforceable against EWIL. As a result, if a policyholder outside the EEA were to take proceedings or obtain judgment against SJNKE, EWIL would be regarded under the terms of the Order as the defendant in those proceedings and would be obliged to meet any judgment or award obtained.

PENSION SCHEME OBLIGATIONS

9.42 Staff members of SJNKE in the UK were transferred to EBSL on 1 April 2018, while those in the branch offices are to be transferred to SIIE on or before the Effective Date, and in each case will continue to provide services to SJNKE (after the staff transfers have taken place) through the Sompo Group Services Agreement. Further, the staff transfers are subject to the Transfer of Undertaking (Protection of Employment) Regulations (“TUPE”).

9.43 SJNKE has a legacy Defined Benefit pension scheme with around 11 active members, 34 deferred members and 25 retirees. I am informed by SIH that the active members are to be removed from the Defined Benefit pension scheme as part of the TUPE staff transfer, and will join the Defined Contribution pension scheme of EBSL. Likewise the other UK employees of SJNKE are to join the Defined Contribution pension scheme of EBSL as part of the TUPE transfer. The employees of SJNKE located in the branch offices (to be transferred to SIIE during 2018) will join the Sompo International pension plan.

9.44 External consultants have been retained by SIH as advisors in relation to the restructuring of the SJNKE Defined Benefit pension scheme and (at the time of writing this Report) are working on administrative matters to prepare for the disposal of the SJNKE Defined Benefit pension scheme to a third party, expected to take place in the second half of 2018 prior to the Effective Date (of the Scheme). At which point there will be no pension liabilities/obligations remaining within SJNKE.

9.45 I am informed by SIH that Sompo Holdings will bear all the related costs, including any solvency deficit, on the disposal of the SJNKE Defined Benefit pension scheme, and thus there will be no direct impact on SJNKE’s financial condition as a result of the aforesaid disposal.

9.46 There are no pension liabilities in EWIL or SIIE. The majority of staff are employed by EBSL (servicing the business of EWIL and SIIE) and employee pension benefits are provided by EBSL, while the employee pension benefits for the branch staff of SIIE (including those SJNKE staff transferred to SIIE) are provided through the Sompo International pension plan.

9.47 The pension arrangements described above are either in place or will be so prior to the Effective Date (of the Scheme), and will not change after the Scheme. Given that there will be no pension liabilities in SJNKE, EWIL or SIIE at the Effective Date, I do not believe that these pension arrangements affect my conclusion on the Scheme.

COSTS AND TAX EFFECTS OF THE SCHEME

9.48 The external costs of the Scheme (estimated to be about £900,000, based on the Scheme and planned communication with policyholders as outlined above) will be split equally between EWIL and SJNKE. While these costs are not insubstantial, they are one-off in nature and not material in the context of the available capital of SJNKE and EWIL as at 31 December 2017 (and forecast over the period 2018 – 2022).

9.49 I am informed by SIH that the Scheme is not expected to have tax implications that would have a material effect on any of the Companies or any of the groups of policyholders identified in paragraph 2.10 above. I have not identified any reasons for a material tax liability to be incurred and, on that basis, I have no reason to disagree with the conclusion reached by SIH that there are no material tax implications as a result of the Scheme.

9.50 I do not believe that the cost or tax effects of the Scheme will have a materially adverse impact on the policyholders affected by the Scheme (as identified in paragraph 2.10 above).

10. CONCLUSIONS

10.1 In summary, in my opinion, provided the proposed Scheme operates as intended, and I have no grounds for believing that it will not do so:

- The security of benefits to policyholders of SJNKE, EWIL and SIIE will not be materially adversely affected by the implementation of the Scheme on the Effective Date; and
- The Scheme will not materially adversely impact on service standards experienced by the policyholders of SJNKE, EWIL and SIIE.

10.2 In reaching this opinion I have applied the following principles:

- I have considered which parties might be affected by the Scheme and in what way. I have documented my findings.
- I have not performed my own modelling, rather I have relied on the results of models developed and operated within SJNKE, EWIL and SIIE. I have reviewed documentation describing the models, describing and justifying the assumptions underlying those models, and explaining the derivation of the data underlying the models and assumptions, in particular explaining how its accuracy, completeness and relevance has been verified.
- To the best of my knowledge there are no beneficiaries for whom the impact of the Scheme has not been considered.
- I have considered how the Scheme might lead to any changes in the material risks to the benefits of the different interested parties.
- I have considered the impact on the actuarial information provided to me of SJNKE, EWIL and SIIE having adopted alternative plausible assumptions.

Gary Wells / 16 August 2018

Fellow of the Institute and Faculty of Actuaries

APPENDIX A DEFINITIONS

2018 EWIL ORSA Report	The ORSA Report prepared in respect of EWIL and approved by the EWIL Board on 26 March 2018.
2017 SJNKE ORSA Report	The ORSA Report prepared in respect of SJNKE and approved by the SJNKE Board on 27 September 2017.
Actuarial Central Estimate ("ACE")	An ACE represents an expected value over the range of reasonably possible claims outcomes. As the range of reasonably possible outcomes does not include all possible outcomes, e.g. it does not include conceivable extreme events where the contribution of such events to an expected value is not reliably estimable, it is not the result of a probability distribution or a statistical analysis.
Actuarial Function ("AF")	The AF is a key function under Article 48 of the Solvency II Framework Directive, having responsibilities for Technical Provisions, Underwriting, Reinsurance and Risk Management.
AeGIS	The name of the software platform used by SJNKE for policy administration purposes.
APH	Asbestos, pollution and health hazard.
APS	Actuarial Profession Standard, as issued by the Institute and Faculty of Actuaries.
BBNI	Bound but not incepted, i.e. policies that have been written but have not yet incepted at the valuation date.
Best estimate	This term is used in this Report in reference to outstanding claim reserves and is intended to represent the arithmetic mean of the perceived distribution of all possible claims outcomes. A best estimate reserve will therefore normally be designed to include no margins for caution or optimism.
B/F Method	Bornhuetter-Ferguson method, a means of projecting claims data to its ultimate value. It is effectively a mixture of the chain ladder method and the initial expected loss approach, the results being a weighting of the results of these two other methods, the weighting being increasingly towards the results of the chain ladder method the greater the time since the date of the underlying claim, or of the underwriting year (depending on the underlying data).
BHIIL	Berkshire Hathaway International Insurance Limited, a UK regulated insurer.
The Bond	The Surety Bond purchased by EWIL from ESIL, dated 19 March 2003.
Brexit	"Brexit" is an abbreviation of "British Exit" which refers to the impending exit of the UK from the EU, following the referendum on continuing membership held in the UK in June 2016. The UK government began the formal process for negotiating the terms of the UK's exit in March 2017 by triggering Article 50 of the Lisbon Treaty. The negotiation process is likely to take at least two years, and at the time of drafting this Report, the terms of Brexit were unknown.
Brexit Transition Period	The transition period is for 21 months after Brexit (i.e. to 31 December 2020) within which the UK will leave the EU but remain within the single market and customs union.
CAA	Commissariat aux Assurances (the "CAA") is the Luxembourg regulator for financial services, established pursuant to the insurance sector legislation enacted on 6 December 1991.

Capital Cover Ratio	The ratio of Available Capital to Required Capital. This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the company.
CAR/EAR	Construction/Erection All-Risk ("CAR/EAR") insurance covers contractors against unexpected events that might otherwise compromise the completion of a construction project.
Cross Border Merger CBM	Cross Border Merger, which is a mechanism whereby at least two companies from different EU member states can effect mergers in which all the assets and liabilities of the transferor company (including employees) are automatically transferred to the transferee company and the transferor company ceases to exist without needing to be put into liquidation.
The Companies	The collective term for SJNKE, EWIL and SIIE.
Correlation	Correlation (in the context of the Report) is a number that describes the statistical relationship between two variables (e.g. equity prices and interest rates).
The Court	The High Court of Justice of England and Wales
Direct Policyholder	A policyholder (or a prospective policyholder) who makes arrangements for him/her to enter in to a contract of insurance (directly or through an agent) with an insurance undertaking. I refer to policies issued to Direct Policyholders as Direct Policies.
Duck Creek	The software platform used by EWIL for those classes of business not supported on *Guidewire*.
EBSL	Endurance Business Services Limited.
ECM	Economic Capital Model.
EEA	The European Economic Area ("EEA") was established by the EEA Agreement on 1 January 1994. The EEA unites the 28 EU Member States with Iceland, Liechtenstein, and Norway into an internal market governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely about the EEA in an open and competitive environment, a concept referred to as the four freedoms.
Effective Date	The date on which the Scheme shall become operative (expected to be 1 January 2019).
EIOPA	The European Insurance and Occupational Pensions Authority ("EIOPA") was established in consequence of the reforms to the structure of supervision of the financial sector in the EU, with the goals of: better protecting consumers and rebuilding trust in the financial system; ensuring a high, effective and consistent level of regulation and supervision taking account of the varying interests of all Member States and the different nature of financial institutions; greater harmonisation and coherent application of rules for financial institutions & markets across the EU; strengthening oversight of cross-border groups; and promoting coordinated EU supervisory responses.
ELTO	Employers' Liability Tracing Office, which is an independent, not-for-profit UK company limited by guarantee and funded by a levy, and which aims to help claimants suffering from a disease/injury caused at work to find the insurer of their former employer.
ENID	In estimating the technical provisions under Solvency II, insurers must make allowance for events not in data ("ENID"), i.e. those possible future events or developments that have not been seen in the historic claims experience of the insurer.

EOF	Eligible Own Funds, which is that element of the Own Funds that can count towards meeting the SCR (or MCR).
ERM	Enterprise Risk Management, which is the process of planning, organising, leading, and controlling the activities of an organisation in order to minimise the effects of risk on an organisation's capital and earnings.
ESIL	Endurance Specialty Insurance Ltd, a Class 4 Bermuda insurance company, which is a direct wholly owned subsidiary of SIH, and a member of the Sompo Group.
EU	The European Union.
EWHL	Endurance Worldwide Holdings Limited, which is a wholly owned subsidiary of ESIL and a member of the Sompo Group.
EWIL	Endurance Worldwide Insurance Limited, which is a wholly owned subsidiary of EWHL and a member of the Sompo Group.
Excluded Policy	A contract of insurance or reinsurance (if any) written or assumed by SJNKE or by EWIL under which any liability remains unsatisfied or outstanding as at the Effective Date and which, for any reason, is not transferred by order of the Court pursuant to Part VII of FSMA on the Effective Date. I have referred separately to such a policy as a SJNKE Excluded Policy if it emanates from SJNKE and as an EWIL Excluded Policy if it emanates from EWIL.
FCA	The Financial Conduct Authority (“FCA”) is the UK regulatory agency that focuses on the regulation of conduct by retail and wholesale financial services firms. The FCA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
FoE	Freedom of Establishment, which is a form of EEA passport rights whereby an EEA domiciled firm can set-up and operate as a branch in another EEA state.
FoS	Freedom of Services, which is a form of EEA passport rights whereby an EEA domiciled firm can provide cross-border services or advice in other EEA states (from its home EEA state).
FOS	Set up by the UK Parliament, the Financial Ombudsman Service (“FOS”) is the UK’s official expert in sorting out problems with financial services.
Framework Agreement	An agreement between SJNKE, EWIL and SIIE under which SJNKE and EWIL wish to transfer their EEA (excluding UK) related business to SIIE and SJNKE wishes to transfer its UK and non-EEA related business to EWIL. The parties have agreed to give effect to this proposal on the terms and subject to the conditions contained in the Framework Agreement.
FRC	Financial Reporting Council, the body that oversees the actuarial profession in the UK and which is responsible for the issuance of all professional guidance to UK actuaries.
FSA	The Financial Services Authority (“FSA”) was the UK regulator for financial services until 2012. Its responsibilities were then taken over by and divided between the PRA and the FCA.
FSCS	The Financial Services Compensation Scheme (“FSCS”) is the compensation fund of last resort for customers of UK authorised financial services firms.
FSMA	Financial Services and Markets Act 2000, the legislation under which Part VII governs the transfer of (re)insurance business between (re)insurance undertakings.

FSMA Report	A report on the terms of a transfer under Part VII of FSMA, to be prepared by an independent person. The FSMA Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.
GAAP	Generally accepted accounting principles ("GAAP") form the standard framework of guidelines for financial accounting used in any given jurisdiction.
Genius	A financial software package used by EWIL – policies recorded in both the *Guidewire* and *Duck Creek* systems are entered into *Genius* once bound, as the financial system of record.
Gross	Excluding the effect of reinsurance arrangements, e.g. "gross insurance liabilities" refers to insurance liabilities before taking into account any offsetting of reinsurance assets.
Guidewire	The software platform used by EWIL as its primary policy administration system for insurance business.
Holding company	A holding company is a company established for the sole or main purpose of holding shares in subsidiary companies.
IBNR reserves	These are reserves in respect of claims which relate to claim events that have occurred before the valuation date but which were still to be reported to the insurer as at that date. For the purposes of this Report they also include reserves in respect of any perceived shortfall between the projected ultimate costs and the case estimates for claims already notified.
IDD	The Insurance Distribution Directive (EU) 2016/97 of the European Parliament and of the Council.
The IE Summary	A summary of the Report.
IELR	An Initial Expected Loss Ratio ("IELR") is generally based on a review of previous accident (or underwriting) year ultimate loss ratios and the relevant ultimate loss ratios used in the company's business plan.
IFRS	International Financial Reporting Standards ("IFRS") form a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
ILU	Institute of London Underwriters.
Independent Expert	The Independent Expert prepares the FSMA Report and provides it to the Court in order that it may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question. In the case of the Scheme, I have been appointed as the Independent Expert.
Independent Peer Review	Work Review undertaken by one or more individual(s) who is, or are, not otherwise involved in the work in question and who would have had the appropriate experience and expertise to take responsibility for the work themselves.
Inwards (or Assumed) Reinsurance Policyholder	A policyholder (or a prospective policyholder) who enters in to a contract of reinsurance that is assumed by (or written by) an insurance undertaking (as distinct from outwards reinsurance that is ceded to a reinsurer). I refer to policies issued to Assumed Reinsurance Policyholders as Assumed Reinsurance Policies.

Jurisdiction	The concept that a court or government authority or regulator may exercise control over a person or property because of the location of the property, the activities of a person within a geographic area, or a person's request for assistance from that authority, thereby voluntarily subjecting themselves to jurisdiction.
Law of 2015	The law of 7 December 2015 on the insurance sector, as amended, operating in Luxembourg.
Liability	A claim against the assets, or legal obligations of a person or organisation, arising out of past or current transactions or actions.
LOC	Letter of credit.
LMX	Excess of Loss reinsurance business written in the London Market.
M&B	Sompo Japan Nipponkoa Martin Et Boulart SAS.
MCR	The Solvency II Minimum Capital Requirement ("MCR") is lower than the SCR, and defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over one year (compared to 99.5% for the SCR).
MI	Management information.
Milliman	Milliman LLP
MTPL	Motor third party liability.
Net	Including the effect of reinsurance arrangements, e.g. "net insurance liabilities" refers to insurance liabilities after deducting any offsetting reinsurance assets from the gross insurance liabilities.
NICE	Nippon Insurance Company (Europe) Limited. A UK regulated insurer and wholly-owned subsidiary of SJNKI that ceased to exist on 15 October 2013.
NIHL	Noise induced hearing loss.
NKE	Nipponkoa Insurance Company of Europe Limited. A UK regulated insurer and wholly-owned subsidiary of SJNKI that ceased to exist on 31 July 2015.
Non-Transferring EWIL Policyholders	Policyholders of EWIL that are not to be transferred to SIIE under the Scheme.
NWA	Net Worth Agreement, which, in the context of the Sompo Group, is an agreement by which one Sompo Group company (e.g. SJNKI or ESIL) agrees to cause another Sompo Group company (e.g. SJNKE) to have capital resources (to at least meet applicable regulatory capital requirements) and sufficient cash funds (to pay valid claims and other obligations). I refer to the NWA by which SJNKI agrees to support SJNKE as the "SJNKE NWA", the NWA by which ESIL agrees to support EWIL as the "EWIL NWA" and the NWA by which ESIL agrees to support SIIE as the "SIIE NWA".
Ogden Rate	The colloquial term given to the discount rate applied when calculating lump sum payments in respect of personal injury claims.

Own Funds	In Solvency II terminology, the amount of capital or excess assets of an insurance company. Own funds are divided into basic own funds and ancillary own funds (e.g. unpaid share capital), which require regulatory approval.
ORSA	The Own Risk Solvency Assessment ("ORSA") is a fundamental set of processes under Solvency II constituting a tool for decision-making and strategic analysis. It aims to assess, in a continuous and prospective way, the overall solvency needs related to the specific risk profile of the insurance company.
Parameter	A numerical input which affects the result of a calculation.
POG	Product oversight and governance arrangements (in relation to the IDD).
Polaris	The software platform used by EWIL as its primary policy administration system for reinsurance business.
The Policy Statement	The Statement of Policy issued by the PRA entitled *The Prudential Regulation Authority's approach to insurance business transfers*, issued in April 2015.
Policyholder Obligation	The contractual obligation of an insurer to its policyholders.
Policyholder Statement	A statement be sent to policyholders of SIIE, SJNKE and EWIL (which is to have enclosed with it a short document containing the terms of the Scheme, and the IE Summary).
PRA	The Prudential Regulation Authority ("PRA") is part of the Bank of England and carries out the prudential regulation of financial firms in the UK, including banks, investment banks, building societies and insurance companies. The PRA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
PRA Returns	Accounts, balance sheets, abstracts and statements relating to the business of an insurance company required under PRA rules to be submitted periodically to the PRA. Prior to May 2013, companies were required to submit this information to the FSA.
QS	Quota Share, a form of proportional reinsurance in which the insurer and reinsurer share premiums and losses according to a fixed percentage.
QRTs	Quantitative Reporting Templates, which are reporting templates that must be completed by insurers and submitted to the regulator on a regular basis in accordance with Solvency II. The QRTs cover a wide range of quantitative financial information about the insurer including details of its balance sheet, capital requirements and reserves.
RAO	Part 1 of Schedule 1 of FSMA (Regulated Activities) Order 2001
Required Capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (for example the SCR).
Reinsurance	An arrangement with another insurer whereby risks are shared (or passed on). If reinsurance is termed as being "inwards" then the reinsurer in question has accepted risk from an(other) (re)insurer; if reinsurance is termed as being "outwards" then the (re)insurer in question has passed risk to a(nother) reinsurer.
The Report	References to the "Report" refer to this report as produced by the Independent Expert.

Risk Margin	The risk margin under Solvency II is designed to ensure that the value of TPs is sufficient for another insurer to take-over and meet the insurance obligations. It is calculated by determining the cost of providing an amount of EOF equal to the SCR necessary to support the obligations over their lifetime based currently on a 6% cost-of-capital rate.
Run-off	An insurer that is in run-off is not writing any new (or renewal) business, but will continue to administer and pay claims for existing policies.
The Scheme	In the context of this Report, the proposal that the EEA (excluding UK) related business of SJNKE and of EWIL be transferred to SIIE, and that the UK and non-EEA related business of SJNKE be transferred to EWIL, all under the provisions of Part VII of FSMA.
Scheme Document	This document sets out the terms of the Scheme.
SFCR	Each insurer is expected to publish a Solvency Financial Condition Report ("SFCR") annually which will contain certain qualitative and quantitative information, the quantitative information being in the format of certain prescribed QRTs.
SF	Standard Formula, which is the basis prescribed under Solvency II for the calculation of capital requirements where an internal model has not been approved. The SCR estimated using the SF has been calibrated to meet the general requirements of firms across the EU.
SIIE	SI Insurance (Europe), SA. A Luxembourg regulated insurer and wholly-owned subsidiary of SIH, and a member of the Sompo Group.
SIIE Policyholder	A policyholder of SIIE.
SIH	Sompo International Holdings Ltd, a Bermudian exempted company, which is a direct wholly owned subsidiary of SJNKI, and a member of the Sompo Group.
SJNKE	Sompo Japan Nipponkoa Insurance Company of Europe Limited, a member of the Sompo Group.
SJNKI	Sompo Japan Nipponkoa Insurance Inc. a property and casualty insurance company organised under the laws of Japan, which is a direct wholly owned subsidiary of Sompo Holdings, and a member of the Sompo Group.
SLCF	The SIH London Capital Function.
Solvency II	The system for establishing (among other things) minimum capital requirements for EU (re)insurers under the Solvency II Directive 2009/138/EC.
Solvency Capital Requirement ("SCR")	The SCR under Solvency II is the amount of capital required to ensure continued solvency over a one-year trading time frame with a likelihood of 99.5%.
Sompo Group	A collective term for Sompo Holdings and its direct and indirect subsidiaries.
Sompo Holdings	Sompo Holdings, Inc. a publicly-traded financial services company organised under the laws of Japan.
SUP18	Section 18 of the FCA Supervision Manual.

Supplementary Report	A report I will prepare in advance of the Court hearing to sanction the Scheme covering any relevant matters which might have arisen since the date of the Report.
TAS	Technical Actuarial Standards issued by the Financial Reporting Council.
TCF	The TCF ('treating customer fairly') principle aims to raise standards in the way firms carry on their business by introducing changes that will benefit consumers and increase their confidence in the financial services industry. Specifically, TCF aims to: help customers fully understand the features, benefits, risks and costs of the financial products they buy; and minimise the sale of unsuitable products by encouraging best practice before, during and after a sale.
TPs	Technical Provisions, which are the value of the liabilities as determined for regulatory purposes under Solvency II. In particular, the provisions for the ultimate costs of settling all claims arising from events which have occurred up to the balance sheet date, including provision for claims incurred but not yet reported, less any amounts paid in respect of these claims; plus the provisions for future claims (and premiums) arising on unexpired periods of risk (see Appendix G for further details).
Transferee(s)	The insurer(s) to which business is being transferred – in the case of the Scheme these are SIIE and EWIL.
Transferor(s)	The insurer(s) from which business is being transferred – in the case of the Scheme these are SJNKE and EWIL.
Transferring EWIL EEA (excluding UK) Business	The business of EWIL, which is to be transferred to SIIE under the Scheme. I have referred separately to a policy that is part of such transferring business as a Transferring EWIL EEA (excluding UK) Policy, and the holders of a Transferring EWIL EEA (excluding UK) Policy as Transferring EWIL EEA (excluding UK) Policyholders as described in detail in paragraph 2.10 above.
Transferring SJNKE EEA (excluding UK) Business	The business of SJNKE, which is to be transferred to SIIE under the Scheme. I have referred separately to a policy that is part of such transferring business as a Transferring SJNKE EEA (excluding UK) Policy, and the holders of a Transferring SJNKE EEA (excluding UK) Policy as Transferring SJNKE EEA (excluding UK) Policyholders as described in detail in paragraph 2.10 above.
Transferring SJNKE UK and non-EEA Business	The business of SJNKE, which is to be transferred to EWIL under the Scheme. I have referred separately to a policy that is part of such transferring business as a Transferring SJNKE UK and non-EEA Policy, and the holders of a Transferring SJNKE UK and non-EEA Policy as Transferring SJNKE UK and non-EEA Policyholders as described in detail in paragraph 2.10 above.
TUPE	Transfer of Undertaking (Protection of Employment) Regulations 2006 and as subsequently amended.
ULAE	Unallocated loss adjustment expenses, i.e. claim-related costs that cannot be allocated specifically to individual claims, such as the costs of running a claims team.
UPR	Unearned Premium Reserve, which is the premium corresponding to the time period remaining on an insurance policy at a valuation date. The UPR is typically proportionate to the unexpired portion of the insurance and appears as a liability on an insurer's balance sheet.
Underwriting Year	The year to which a claim is allocated based on the date the policy was written.

USP	Undertaking Specific Parameters used, subject to prior approval from the local regulator, in the SF.
Value at Risk ("VaR")	For example, the SCR under Solvency II is the amount of capital required to ensure continued solvency over a one-year trading time frame with a VaR of 99.5%, i.e. the amount of capital required by an insurer over a one-year period to meet expected losses on 199 years out of 200 years (because of 99.5% probability).
Winding-up	A process that entails liquidating all the assets of a business entity, paying off creditors, distributing any remaining assets to the principals, and then dissolving the business.
Work Review	Process by which a piece of actuarial work is considered by at least one other individual for the purpose of providing assurance as to the quality of the work in question.
XL	Excess of loss ("XL"), which is a form of non-proportional reinsurance in which the reinsurer indemnifies the insurer for losses that exceed an attachment point up to a specified limit.

APPENDIX B LIST OF PREVIOUS TRANSFERS FOR WHICH GARY WELLS HAS ACTED AS THE INDEPENDENT EXPERT

2004: Transfer of the business of the Continental Reinsurance Company (UK) Limited to Continental Management Services Limited

2005: Transfer of the business of the UK branch of the Continental Insurance Company to Continental Management Services Limited

2006: Transfer of the IGI portfolio of CX Reinsurance Company Limited to CNA Insurance Company Limited

2008: Transfer of the Irish branch business of Royal & Sun Alliance Insurance plc to Europa General Insurance Company Limited

2009: Transfer of the business of Arran Insurance Company Limited to Chevanstell Limited

2010: Transfer of the business of Euler Hermes Guarantee plc to Euler Hermes UK plc

2011: Transfer of the business of Euler Hermes UK plc to Euler Hermes Credit Insurance Belgium SA (NV)

2011: Transfers of the business of PA(GI) Ltd to Royal & Sun Alliance Insurance plc and Marine Insurance Company Limited

2011: Rationalisation of 22 UK regulated entities of Royal & Sun Alliance Insurance plc to 5 UK companies via 3 Part VII transfer schemes (effective 1 January 2012)

2013: Transfer of certain business of the Italian branch of Sompo Japan Insurance Company of Europe Limited to Berkshire Hathaway International Insurance Limited.

2013: Transfer of the business of Arbor Property & Casualty Ireland Limited to AIG Europe Limited (portfolio transfer under Irish legislation)

2013: Transfer of the European branch business of Mitsui Sumitomo Insurance Company (Europe) Limited to MSIG Insurance Europe AG.

2013: Transfer of the business of Chevanstell Limited to R&Q Insurance (Malta) Limited

2015: Transfer of the business of Nipponkoa Insurance Company (Europe) Limited to Sompo Japan Nipponkoa Insurance Company of Europe Limited

2015: Transfer of the Italian branch business of the RSA Group to ITAS Mutua

2016: Transfer of the UK branch business of Sompo Japan Nipponkoa Insurance Inc. to Transfercom Limited

2016: Transfer of the business of Cardrow Insurance Limited to Tenecom Limited

2017: Transfer of the 1992 and prior insurance business of Markel International Insurance Company Limited to RiverStone Insurance (UK) Limited.

2017: Transfer of the Czech, Hungarian and Slovakian branches of QBE Insurance (Europe) Limited to Colonnade Insurance S.A.

2017: Transfer of the UK branch of Nisshin Fire & Marine Insurance Co., Ltd. to Rombalds Run-off Limited.

APPENDIX C SCOPE OF THE WORK OF THE INDEPENDENT EXPERT IN RELATION TO THE SCHEME

C.1. The following was included within the letter of engagement that was agreed between the Companies, Milliman and me, and which was shown to the PRA prior to the approval by the PRA and FCA of my appointment as the Independent Expert in respect of the Transfer. As such the following constitutes my terms of reference in respect of this assignment.

"My report(s) will consider the terms of the Scheme generally and the effect which the Scheme will have on the holders of (re)insurance policies of the Companies.

My review and report(s) will address generally the way in which the Companies have conducted their (re)insurance business but taking into account the particular circumstances of each of the different groups of policyholders of the Companies involved in the Scheme. It will deal inter alia *with the following aspects:*

- *The likely scope for deteriorations in each of the Companies' claims reserves (i.e. the likelihood and extent to which each of the Companies' reserves may prove inadequate);*
- *The impact of the Scheme on the security/financial strength afforded the different groups of policyholders of the Companies involved in the Scheme;*
- *The corporate governance structures operating in the Companies involved in the Scheme and the impact on the different groups of policyholders in the Companies involved in the Scheme;*
- *The impact of the Scheme on the levels of service provided to the different groups of policyholders of the Companies involved in the Scheme;*
- *The existing and proposed agreements between the Companies and their reinsurers;*
- *Guarantees and/or agreements (if any) between the Companies;*
- *Guarantees and/or agreements (if any) between each of the Companies and their respective parent company;*
- *Transactions (outside the Scheme) that impact upon one or both of the Companies;*
- *The terms and conditions (if any) expected to be imposed by the Scheme to be presented to the Court;*
- *The matters required by applicable provisions of the PRA's Policy Statement PS7/15 and Chapter 18 of the supervision manual in the FCA's Handbook;*
- *A review of the communications made to policyholders;*
- *Any other matters drawn to my attention by the Regulators or which are required by the Regulators to be addressed within the report(s).*

The above list is not intended to be exclusive to any other aspects which may be identified during the completion of the project and which are considered to be relevant.

I shall not be directly involved in the formulation of the proposed transfers although I should expect to give guidance during the evolution of the detailed proposals on those issues which concern me, or which I consider unsatisfactory.

I will meet with the Companies at an early stage to identify key issues.

I will support the Companies in their liaison with and provision of information to the Regulators and share the Part VII Report(s) (and drafts) and any supplemental report with those noted at paragraph 6(b) of the engagement letter.

I will not provide any advice with respect to the merits of the proposed Scheme."

APPENDIX D KEY SOURCES OF DATA

D.1. In writing the Report, I relied upon the accuracy of certain documents provided by SJNKE, EWIL and SIIE. These included, but were not limited to the following:

- Draft Scheme Document
- Draft Framework Agreement (between SJNKE, EWIL and SIIE).
- Draft Witness Statements for the Companies
- Financial projection documents and supporting spreadsheets (dated February/March 2018) as prepared by SIH for SJNKE, EWIL and SIIE over the period 2018 – 2022, showing GAAP and Solvency II balance sheets and corresponding SCRs under central assumptions and alternative plausible assumptions.

SJNKE

- Solvency and Financial Condition Report for the year-ended 31 December 2017 (containing certain QRTs as at 31 December 2017) approved by the Board on 30 April 2018.
- The audited financial statements as at 31 December 2016 and 31 December 2017.
- SJNKE Annual ORSA report, dated September 2017
- Internal Actuarial Reserve Reports at Q3 2017 and Q4 2017
- Actuarial Function Report Q4 2017
- External Solvency II Technical Provisions Report and Presentation Q4 2017, dated 4 April 2018
- External Solvency II SCR / MCR Report and Presentation Q4 2017, dated 4 April 2018
- Actuarial Function Underwriting Opinion, dated 01 September 2017
- Actuarial Function Reinsurance Opinion, dated 31 August 2017
- Materials from Board meeting held on 30 November 2017
- Copy of UK ELTO Manual (and a related certificate to the FCA, dated 25 July 2017)
- Copy of Net Worth Agreement between SJNKI and SJNKE, dated 02 December 2015
- Documents summarising SJNKE’s 2018 outwards reinsurance programmes.

EWIL

- The audited financial statements as at 31 December 2016 and 31 December 2017.
- Solvency and Financial Condition Report for the year-ended 31 December 2017 (containing certain QRTs as at 31 December 2017).
- ORSA – annual report, approved by the EWIL Board on 26 March 2018.
- Actuarial Function Report for year-end 2016, dated 29 June 2017.
- Chief Financial Officer’s Report Q3 2017.
- Audit Committee Q4 2017 Reserve Discussion document, dated 7 March 2018.
- EWIL 2017 Q4 Solvency II Technical Provisions Presentation, dated 7 March 2018.
- Memo describing and reviewing the loss estimation process for Hurricanes Harvey, Irma and Maria, and the Californian Fires, dated 5 February 2018.

- Extract providing Q3 2017 Solvency economic II balance sheet and Technical Provisions
- Risk Management Policy & Procedures document, dated December 2016.
- Documents summarising SJNKE's 2018 outwards reinsurance programmes.
- Copy of Surety Bond document, dated 19 March 2003
- Draft Net Worth Agreement between ESIL and EWIL.

SIIE

- Application File to CAA, dated December 2017.
- Annexes to Application File to CAA, dated December 2017.
- Reserving policy.
- Draft Net Worth Agreement between ESIL and SIIE.

D.2. Information relating to the items listed above was also gathered during discussions and e-mails with staff of SJNKE, EWIL and SIIE.

APPENDIX E COMPLIANCE WITH THE PRA POLICY STATEMENT

The table below indicates how I have complied with the provisions of the PRA Policy Statement ("*The Prudential Regulation Authority's approach to insurance business transfers*", dated April 2015) that pertain to the form of the Report.

PRA Policy Statement Reference	Requirement	Scheme Report paragraph reference
2.30 (1)	Who appointed the Independent Expert and who is bearing the costs of that appointment	Paragraphs 1.13 and 1.19
2.30 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator.	Paragraph 1.13
2.30 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role.	Paragraph 1.14 and Appendix B
2.30 (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.	Paragraphs 1.15 and 1.16
2.30 (5)	The scope of the report.	Paragraphs 1.20 – 1.31
2.30 (6)	The purpose of the scheme.	Paragraphs 2.6 – 2.9 and paragraphs 5.1 – 5.5
2.30 (7)	A summary of the terms of the scheme in so far as they are relevant to the report.	Paragraphs 1.8 – 1.12, paragraph 2.5 and paragraphs 5.6 – 5.33
2.30 (8)	What documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided.	Appendix D
2.30 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgment of others	 Paragraphs 1.33 – 1.46 Paragraphs 1.24, 1.45, 4.168 and 10.2
2.30 (10)	The people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable	Paragraphs 1.33, 1.34 and 1.36
2.30 (11)	His 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	 Paragraphs 2.14 and 2.14.5, and Section 6 Paragraphs 2.16 – 2.18, and Section 7 Paragraphs 2.19 – 2.21, and Section 8

2.30 (12)	His 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	Paragraphs 2.22 – 2.26 and 9.12 – 9.19
2.30 (13)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the scheme	None of which I am aware.
2.30 (14)	For each opinion that the independent expert expresses in the report, an outline of his reasons.	Paragraphs 2.14, 2.17, 2.18, 2.20, 2.21, 6.23, 6.24, 6.37, 6.51, 6.52, 6.62, 6.71, 6.88, 6.96, 6.114, 6.148, 6.157, 6.166, 6.172, 6.177, 6.186, 6.187, 7.9, 7.13, 8.7
2.32 (1)	The summary of the terms of the scheme should include a description of any reinsurance agreements that it is proposed should pass to the transferee under the scheme	Paragraphs 5.8 and 5.9
2.32 (2)	The summary of the terms of the scheme should include a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	Paragraphs 5.22 and 5.31
2.33 (1)	The independent expert's opinion of the likely effects of the scheme on policyholders should include a comparison of the likely effects if it is or is not implemented	Paragraph 9.36
2.33 (2)	The independent expert's opinion of the likely effects of the scheme on policyholders should state whether he considered alternative arrangements and, if so, what	Paragraph 1.21
2.33 (3)	The independent expert's opinion of the likely effects of the scheme on policyholders should, where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders	Paragraph 6.156
2.33 (4)	The independent expert's opinion of the likely effects of the scheme on policyholders should include his 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, expense levels and valuation bases in so far as 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	 Sections 6, 7 and 8 Paragraphs 9.1 – 9.11, 9.39 – 9.41, and 9.42 – 9.47 Not applicable

	(c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations	Paragraphs 9.48 and 9.49
2.35 (1)	For any mutual company involved in the scheme, the report should 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	Not applicable
2.35 (2)	For any mutual company involved in the scheme, the report should state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights	Not applicable
2.35 (3)	For any mutual company involved in the scheme, the report should comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without.	Not applicable
2.36 (1)	For a scheme involving long-term insurance business, the report should describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits	Not applicable
2.36 (2)	For a scheme involving long-term insurance business, the report should, if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;	Not applicable
2.36 (3)	For a scheme involving long-term insurance business, the report should describe the likely effect of the scheme on the approach used to determine: (a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and (b) the levels of any discretionary charges	Not applicable
2.36 (4)	For a scheme involving long-term insurance business, the report should describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm	Not applicable
2.36 (5)	For a scheme involving long-term insurance business, the report should include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders	Not applicable
2.36 (6)	For a scheme involving long-term insurance business, the report should state whether the independent expert is satisfied that for each firm the scheme is	Not applicable

	equitable to all classes and generations of its policyholders	
2.36 (7)	For a scheme involving long-term insurance business, the report should state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented.	Not applicable

APPENDIX F GENERAL CONSIDERATIONS OF THE INDEPENDENT EXPERT

INTRODUCTION

F.1. I have compiled my Report in accordance with the Policy Statement and with SUP18.

F.2. Under FSMA, the concept of TCF must be applied. To help ensure that customers are treated fairly in the future it is necessary to understand how they have been treated in the past. From the policyholders' perspective, the acceptability of the Scheme must be on the basis that it will not have a materially adverse effect on their benefits or fair treatment.

F.3. In order to fulfil my obligations as Independent Expert I have considered the terms of the Scheme generally and how the different groups of policyholders are likely to be affected by the Scheme. In particular, I have considered:

- The likely effects of the Scheme on the security of the policyholders' benefits, including the likelihood and potential effects of the insolvency of the insurer; and
- The likely effects of the Scheme on policyholder servicing levels (e.g. claims handling).

Materiality

F.4. After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 2.10 above), I have drawn conclusions as to whether I believe the Scheme will materially adversely affect that group of policyholders. It should be recognised that the Scheme will affect different policyholders in different ways, and, for any one group of policyholders, there may be some effects of the Scheme that are positive, and others that are adverse. If some effects of the Scheme are adverse, that does not necessarily mean that the Scheme is unreasonable or unfair, as those adverse effects may be insignificant or they may be outweighed by positive effects.

F.5. In order to determine whether any effects of the Scheme on any group of policyholders are materially adverse it has been necessary for me to exercise my professional judgement in the light of the information that I have reviewed. If the potential impact under consideration is very unlikely to happen and does not have a significant impact, or is likely to happen but has a very small impact, on a group of policyholders then it is not considered to have a material effect on that group of policyholders.

F.6. My assessment of materiality will also take into account the nature of the potential impact so that, for example, the materiality threshold for a change that could have a direct impact on the financial security of a group of policyholders is likely to be lower than the materiality threshold for a change that does not have a direct financial impact.

F.7. This is the framework in which I undertake my consideration of materiality in relation to the Scheme.

SECURITY OF POLICYHOLDER BENEFITS

F.8. As noted above, I need to consider the security of policyholder benefits, i.e. the likelihood that policyholders will receive their benefits when due.

F.9. In considering and commenting upon policyholder security I shall consider the financial strength of each entity. Financial strength is provided by the margins for prudence in the assumptions used to calculate the Technical Provisions, by the shareholder capital and by any specific arrangements for the provision of financial support. In considering policyholder security it is also necessary to take into account the potential variability of future experience (including claim frequency and severity). Security is also affected by the nature and volume of future new business.

F.10. The main factors that determine the risks to which a policyholder is exposed are:

- Size of company;
- Amount of capital held, other calls on that capital and capital support currently available to the company;
- Reserve strength;
- Mix of business written; and
- Company strategy – for example, whether it is open or closed to new business.

F.11. I also need to consider the impact on policyholders' security in the event of the default of an insurer (e.g. the role of the FSCS).

TREATING CUSTOMERS FAIRLY

F.12. As Independent Expert I also need to consider the impact of the Scheme on levels of service provided to policyholders, including those resulting from changes in administration, claims handling and expense levels.

F.13. Further, I have considered the proposals in the context of applicable conduct rules/regulation, e.g. the fair resolution of complaints between an insurer and its customers (policyholders).

OTHER CONSIDERATIONS

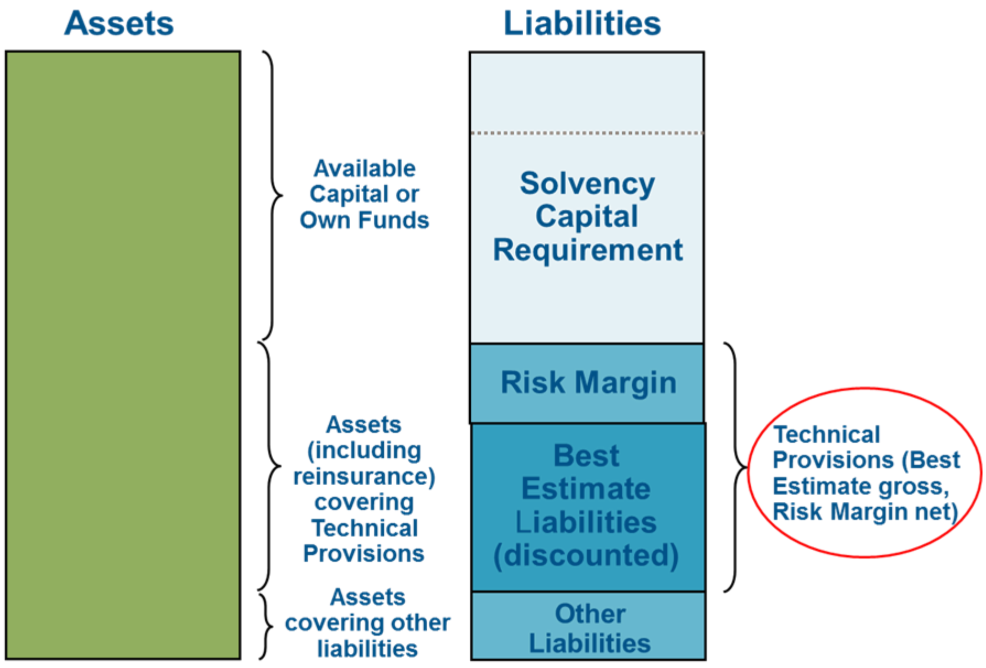
F.14. Paragraph 2.34(4)(b) of the Policy Statement and paragraph 2.36 of SUP18 both require me, as Independent Expert, to consider the likely effects of the Scheme on matters such as investment management, new business, administration, expense levels and valuation bases insofar as they might impact on levels of service to policyholders or on the security of policyholders' benefits.

F.15. I am also required to consider the cost of the Scheme and the tax effects of the Scheme insofar as they might impact on the security of policyholders' benefits.

APPENDIX G SOLVENCY II BALANCE SHEET

G.1. A simplified illustration of a Solvency II balance sheet is shown in Figure G.1below.

Figure G.1
Solvency II balance sheet



G.2. The Solvency II balance sheet is intended to be a tool for management to assess an entity's solvency and hence an important consideration for significant decisions. It is also a tool for regulators to assess the solvency of an insurer.

G.3. A key consideration for management in making significant decisions will be the excess of assets over Technical Provisions, other liabilities and the SCR. This excess of Own Funds over the SCR will determine whether the entity can expand existing business, move into new areas, undertake mergers/acquisitions (with less capital rich entities), etc. or whether they need to consider reducing business volumes, moving out of capital intensive lines of business, purchasing additional reinsurance and so on. The level of Own Funds will also likely impact the credit rating of an entity.

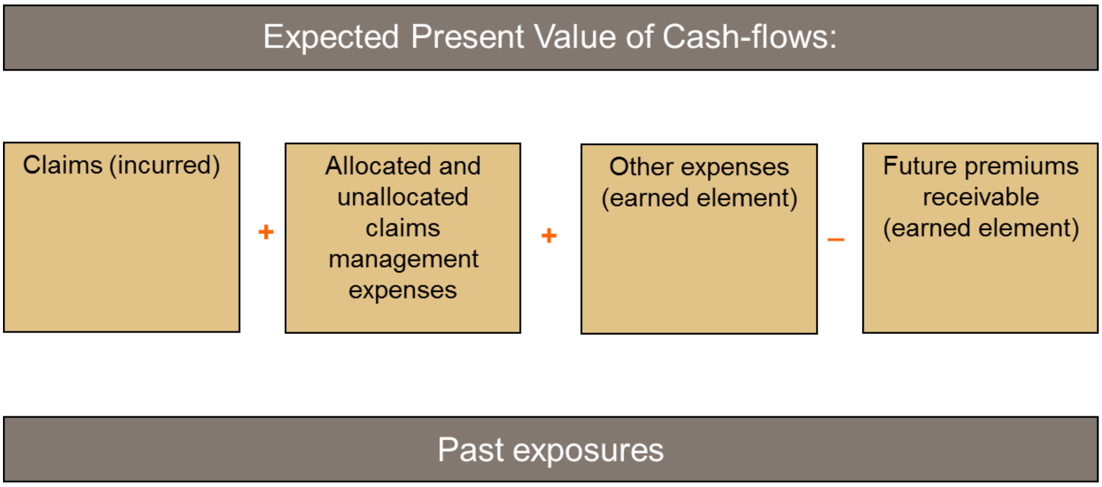
G.4. The Technical Provisions are a direct input to the balance sheet, and are therefore a fundamental input to the SCR calculation that models the potential movement in the balance sheet over a one-year time horizon.

G.5. Solvency II requires the Technical Provisions (as at the valuation date) to be determined using a market consistent valuation of the liabilities relating to insurance contract. In practice, a market consistent liability valuation cannot be calculated by reference to market prices, because such prices are not (for practical purposes) available. Therefore Technical Provisions are presently estimated on a proxy to a market value basis, i.e. a 'best estimate' of the liabilities relating to insurance contracts allowing (i.e. discounting) for the time value of money supplemented by a risk margin. More specifically the Technical Provisions are made up as follows:

Claims provision + Premium provision + Risk margin

G.6. The claims provision is the expected present value/discounted 'best estimate' of all future cash-flows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date. Figure G.2 below illustrates the components of the claims provision calculation.

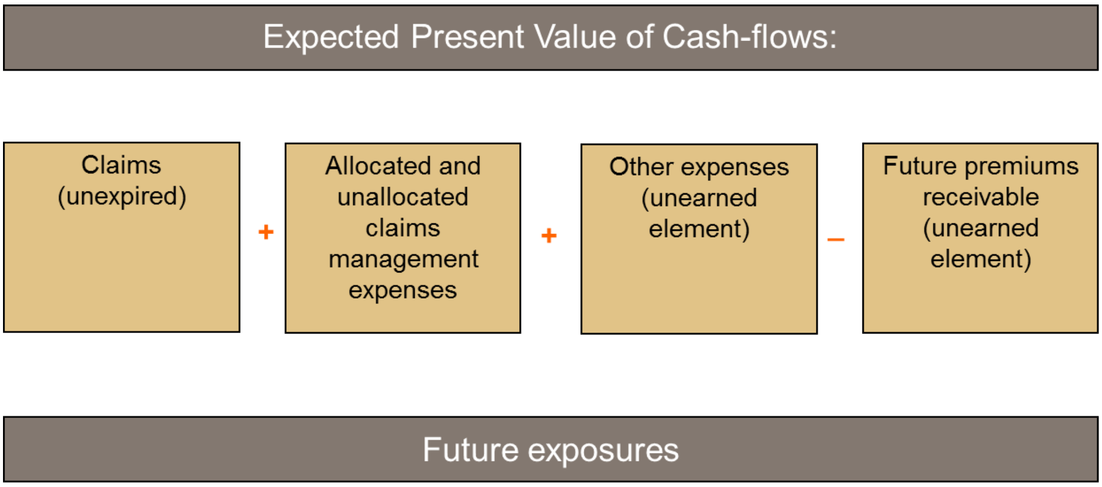
Figure G.2
Claim Provision



G.7. The premium provision is the expected present value/discounted ‘best estimate’ of all future cash-flows (claim payments, expenses and future premiums due) relating to future exposures arising from policies that the insurer is obligated to at the valuation date. Figure C.3 below illustrates the components of the premium provision calculation.

Figure H.2

Premium Provision



G.8. The risk margin (‘RM’) is intended to be the balance that another (re)insurer taking on the liabilities at the valuation date would require over and above the discounted ‘best estimate’. Under Solvency II, the RM is calculated using a cost-of-capital (‘CoC’) approach (presently employing a 6% CoC parameter as provided by EIOPA). More specifically, the calculation is as follows:

$$RM = CoC \times \sum_{t \geq 0} \frac{SCR(t)}{(1 + r_{t+1})^{t+1}}$$

where:

SCR(t) as employed for the RM formula consists of underwriting risk (with respect to existing business); counterparty risk (e.g. reinsurance); operational risk; and market risk (if unavoidable, i.e. not hedge-able); and

r_t is the risk-free discount rate(s) at time t as provided by EIOPA for all major currencies.

APPENDIX H KEY DIFFERENCES BETWEEN UK GAAP AND SOLVENCY II TECHNICAL PROVISIONS

A summary of the key differences between UK GAAP reserves and Solvency II TPs is set out in the table below:

Area of change	UK GAAP Reserves	Solvency II Technical Provisions	Balance sheet impact
Earned business	Claims reserve = point estimate within a reasonable range (“not insufficient’’)	Claims provision = probability weighted average of future cash flows	Reduces liabilities (remove margins)
Unearned business	Unearned premium reserve, net of DAC	Premium provision = probability weighted average of future cash flows	Reduces liability (expected profit)
Risk Margin	n/a	Explicit item, based on cost of capital approach	Increases liabilities
Discounting	Undiscounted	Discounted cash flows	Reduces liabilities
Contract recognition	Policies written	Policies written and legally bound Unincepted policies (‘’BBNI policies’’)	Reduces liabilities (due to expected profit on BBNI policies)
Expenses	Claims handling expense reserve	More explicit treatment of expenses	Increases liabilities
Events Not In Data (‘’ENIDs’’)	Limited allowance for contingent liabilities	New concept allowance for extreme outcomes (which are ‘’not in the data’’ used for reserving)	Increase liabilities
Reinsurance Bad Debt Provision	n/a	Explicit provision required for reinsurer bad debt	Increases liabilities