Report of the Independent Expert on the proposed transfer of the Czech, Hungarian and Slovakian branches of QBE Insurance (Europe) Limited to Colonnade Insurance S.A.

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1. PURPOSE AND SCOPE

Purpose of the Report

1.1 It is proposed that the Czech, Hungarian and Slovakian branch businesses of QBE Insurance (Europe) Limited ("QIEL"), a UK-based company, be transferred to Colonnade Insurance S.A. ("CISA"), a company based in Luxembourg, 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 "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 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 QIEL and CISA have nominated me to act as Independent Expert to provide the Report in respect of the Scheme, and the PRA has approved my appointment (see paragraph 1.10 below).

1.4 This Report describes the proposed transfers and discusses their possible effects on the policyholders of QIEL and CISA (in respect of all business of QIEL and CISA), including effects on security and levels of service. As such, the Report fulfils the requirements of the FSMA.

1.5 A list of terms defined in the Report is shown in Appendix A. Otherwise I use the same defined terms as are in the Scheme. Unless otherwise specified, references in the Report to the insurance business/policyholders of QIEL and CISA are in respect of all general insurance and reinsurance business/policyholders of QIEL and CISA.

The Proposed Scheme

1.6 On 16 December 2014, QIEL and Fairfax Financial Holdings Limited ("Fairfax") entered into a Framework Agreement relating to the sale of QIEL's Hungarian, Slovakian and Czech businesses (the "Transferring Business") to Fairfax or a nominee thereof. Under the terms of the Framework Agreement, the parties agreed, inter alia, that: the Transferring Business would be 100% reinsured by Polskie Towarzystwo Reasekuracji ("Polish Re"), a subsidiary of Fairfax; Fairfax's nominee (subsequently determined to be CISA) would administer the Transferring Business; and that the parties would work to transfer the Transferring Business by means of an insurance business transfer scheme under Part VII of FSMA from QIEL to Fairfax's nominee (subsequently determined to be CISA).

1.7 The Transferring Business is the entire business of the Czech, Hungarian and Slovakian branches of QIEL. The Transferring Business comprises a mixture of domestic and multinational insurance business for Motor, Property & Engineering, Liability, Accident & Health, Bond and Marine classes. I refer to the policyholders of the Transferring Business as the "Transferring Policyholders".

1.8 The Effective Date of the Scheme is expected to be 31 July 2017. The Scheme is intended to have the effect that all the liabilities under the policies comprising the Transferring Business will pass under the Scheme to CISA.

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

The Independent Expert

1.10 I, Gary Wells, have been appointed by QIEL and CISA as the Independent Expert to consider the Scheme under Section 109 of FSMA. My appointment has been approved by the PRA; this was confirmed in a letter dated 1 December 2015.

1.11 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.

1.12 To the best of my knowledge I do not have, and have never had, any policies issued by any part of the QBE Group, of which QIEL is a subsidiary, or the Fairfax Group, of which CISA is a subsidiary. I am not a shareholder of either the QBE or Fairfax Groups. I have undertaken no work for CISA or for QIEL (save for a very small amount of work for the latter in relation to an abandoned Part VII transfer of the Bulgarian and Romanian branches of QIEL to a Bulgarian insurance group).

1.13 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 Fairfax and QBE Groups on assignments globally. Milliman Inc.'s worldwide annual revenue in respect of the Fairfax Group and the QBE Group have not, however, exceeded 0.1% of the firm's total fee income over each of the last 5 years in respect of each group.

1.14 I do not believe that my involvement in the insurance business transfer mentioned in paragraph 1.12 above, or the involvement of other Milliman Inc. consultants with the Fairfax and QBE Groups affects my ability to act independently in my assessment of the Scheme

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

1.16 I understand that QIEL and CISA will share the costs of my work as Independent Expert, although QIEL will undertake payment of those fees.

The Scope of my Report

1.17 My terms of reference have been reviewed by the PRA and an extract is set out in Appendix C.

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

1.19 The Report describes the Scheme and the likely effects on policyholders of QIEL and CISA, including effects on security and levels of service.

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

1.21 My work has required an assessment of the liabilities of QIEL and CISA for the purposes of describing the effect of the Scheme. My review of the liabilities was based on the actuarial reserve assessments conducted by the respective internal actuaries of QIEL and CISA (and on occasion external actuaries). 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 and external actuaries of QIEL and CISA or to produce independent estimates of the liabilities.

1.22 In addition to the liabilities, I have assessed the appropriateness in nature and amount of any assets to be transferred under the Scheme (including the outwards reinsurance contracts), and the capital position of QIEL and CISA pre- and post-Scheme. Again, I have not attempted to review in detail the calculations of the capital position performed by QIEL or CISA or to produce independently my own estimates.

1.23 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.

1.24 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 QIEL and/or CISA. I confirm that I have complied with this duty.

1.25 I am aware 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.

1.26 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.

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

1.28 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. It is intended that the Supplementary Report will be published on the websites dedicated to the Scheme at least one week before the date of the final Court hearing.

The Structure of my Report

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

- In Section 2, I provide some background to the regulatory environment in which the companies involved in the Scheme operate;
- In Sections 3 and 4, I provide some background to QIEL, and CISA, i.e. the companies involved in the Scheme;
- Section 5 summarises the key provisions of the Scheme;
- Section 6 describes the matters I need to consider as Independent Expert;
- In Section 7, I consider the likely impact of the Scheme on the Transferring Policyholders;
- In Section 8, I consider the likely impact of the Scheme on the policyholders of QIEL who would remain within QIEL after the transfer has taken place;
- In Section 9, I consider the likely impact of the Scheme on the current policyholders of CISA;
- In Section 10, I cover more general issues relating to the Scheme and the management of QIEL and CISA;
- My conclusions are summarised in Section 11.

Reliances and Limitations

1.30 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 QIEL and CISA. 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, and have no reason to believe that there may be, 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.

1.31 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.

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

1.33 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 of QIEL and/or CISA, 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 websites dedicated to the Scheme.

1.34 No summary of the Report may be made without my express consent. I will provide a summary of the Report for inclusion in a document that will be made available to policyholders of QIEL and CISA under the Scheme (the "Summary").

1.35 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.

1.36 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.

1.37 This review does not comprise an audit of the financial resources and liabilities of QIEL or CISA.

1.38 The Report should not be construed as investment advice.

1.39 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.

1.40 In considering the background to QIEL and CISA, the companies involved in the Scheme, and in considering the likely impact of the Scheme, I have made extensive use of financial information for QIEL as at 31 December 2015 as that is the most recent date at which audited financial information is available. I have also taken into account financial information made available to me in respect of CISA as at 31 December 2015 as well as unaudited financial projections made by CISA of its expected financial performance over the period 2016-8. At the date of the Report, I am not aware of any material changes in circumstances of QIEL since 31 December 2015, or those of CISA since 31 December 2015 (noting that CISA only commenced underwriting insurance business subsequent to 31 December 2015), 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.

1.41 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.

1.42 The Report should not be used or relied upon for any purpose other than as the expression of my opinion on the impact of the Scheme in accordance with Section 109 of FSMA. I hereby expressly disclaim any liability to any party who relies or purports to rely on the Report for any other purpose whatsoever.

Professional and Regulatory Guidance

1.43 I am required to comply with relevant professional standards and guidance issued by the Financial Reporting Council and the Institute and Faculty of Actuaries, including *Transformations Technical Actuarial Standard* (as published in December 2010), *Insurance Technical Actuarial Standard* (as published in October 2010), *Technical Actuarial Standard D: data* (as published in November 2009), *Technical Actuarial Standard M: modelling* (as published in April 2010) and *Technical Actuarial Standard R: reporting actuarial information* (as published in November 2009). I have complied with such standards, subject to the principles of proportionality and materiality.

1.44 The Report has been prepared in accordance with the PRA's Statement of Policy on its approach to insurance business transfers (the "PRA Statement of Policy") and with Chapter 18 of the supervision manual ("SUP 18") contained in the FCA Handbook.

2. REGULATORY BACKGROUND

Introduction

2.1 The Scheme proposes the transfer of business from the Czech, Hungarian and Slovakian branches of QIEL, a UK-domiciled company, to the respective branches of CISA, a company domiciled in Luxembourg. In this Section I describe the general insurance markets of each of these countries and the regulatory environments therein.

2.2 The UK, Luxembourg, the Czech Republic, Hungary and the Slovak Republic are all located within the European Union ("EU") and are therefore all subject to the recently introduced EU-wide solvency regime known as Solvency II. I include in this section a description of the key features of Solvency II and how its application to the Transferring Business will change as a result of the Scheme.

2.3 I also comment here on consumer protections schemes in these countries and how access to them will be altered by the Scheme. Finally, I comment on the respective winding-up arrangements for companies in the UK and in Luxembourg.

Overview of Insurance Markets and Regulators

UNITED KINGDOM

2.4 The United Kingdom is the largest insurance market in Europe with gross written premium income in 2014 totalling approximately €240bn[1]. Non-life insurance premiums accounted for about €66bn (or 27%) of the total figure. As of 2014, there were 1,282 insurance companies in the UK.

2.5 UK insurers, as well as other financial services organisations, are regulated by both the PRA and the FCA using a system of dual regulation. Between them, the PRA and the FCA have approximately 3,500 employees and an annual budget of over £600 million. The PRA and the FCA are statutory bodies set up under the Financial Services Act 2012 ("FinSA").

2.6 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.

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

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

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

2.9 The PRA is responsible for overseeing the amount and quality of solvency capital held by firms. As of 1 January 2016 UK firms must hold capital in accordance with the Solvency II regime, which is described below.

[1] All figures in this section relating to written insurance premiums and numbers of insurance companies are taken from Insurance Europe's website

2.10 The FCA is concerned with achieving fair outcomes for consumers and seeks to ensure that firms adhere to its conduct principles. Its operational objectives 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.

2.11 For the purposes of the Report where I refer to the "Regulator" this should be taken to refer to the PRA and/or the FCA (or their predecessor body, the Financial Services Authority, “FSA”) as appropriate.

LUXEMBOURG

2.12 Luxembourg is a small country with a population of around 0.6 million (less than 1% of the UK’s). 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 in Luxembourg.

2.13 Luxembourg’s insurance and reinsurance regulator is the Commissariat aux Assurances (“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.

2.14 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 orderly expansion of the activities of the Luxembourg insurance sector.

CZECH REPUBLIC

2.15 In 2014 total gross insurance premiums written in the Czech Republic amounted to €5.3bn. Around €2.9bn (or 55%) of these premiums related to non-life insurance business. As of 2014, there were 53 insurance companies in the Czech Republic.

2.16 The insurance industry in the Czech Republic is regulated by the Czech National Bank (“CNB”). The CNB’s responsibilities include monetary policy, financial stability as well as supervision and regulation of the financial industry (encompassing the banking sector, capital markets, and pension schemes as well as the insurance industry).

HUNGARY

2.17 In 2014 total gross insurance premiums written in Hungary amounted to €2.7bn. Around €1.2bn (or 45%) of these premiums related to non-life insurance business. As of 2014, there were 32 insurance companies in Hungary.

2.18 The insurance industry in the Hungary is regulated by the Magyar Nemzeti Bank (Hungarian National Bank, or “MNB”). The MNB’s responsibilities include monetary policy, financial stability as well as supervision and regulation of the financial industry, including the insurance industry.

SLOVAK REBUPLIC

2.19 In 2014 total gross insurance premiums written in the Slovak Republic amounted to €2.2bn. Around €1.0bn (or 44%) of these premiums related to non-life insurance business. As of 2014, there were 21 insurance companies in the Slovak Republic.

2.20 The insurance industry in Slovakia is regulated by the Národná banka Slovenska (National Bank of Slovakia). Its responsibilities include monetary policy, financial stability as well as supervision and regulation of the financial industry, including the insurance industry.

Solvency II

2.21 The regulatory solvency reporting requirements for most EU insurers and reinsurers underwent a major change with effect from 1 January 2016, as they now need to meet the requirements of a new solvency regime developed by the European Commission. The formal date for full implementation of these new rules was 1 January 2016.

2.22 This new regime is referred to as Solvency II and aims to introduce solvency requirements that reflect better than the previous solvency regimes the risks that insurers and reinsurers actually face and to introduce consistency across the EU. EU insurance companies will be required to adhere to a set of new, risk-based capital requirements, some of the results of which will be shared with the public.

2.23 Solvency II is a principles-based regime based on three 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.

2.24 A key change under Solvency II compared to Solvency I (the European solvency regime that was in effect up to 31 December 2015) is that both the assets and liabilities are valued on a market consistent basis (whereas under Solvency I only the assets were assessed at a market value, subject to admissibility rules). Therefore under Solvency II, the calculation of Technical Provisions in respect of claims incurred and losses arising from unexpired exposures (together typically the largest item on the liability side of an insurer's balance sheet), and hence the balance sheet itself, normally change substantially when compared to the previous Solvency I regime and current requirements for IFRS/GAAP.

2.25 I set out in Appendix E 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.

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

- the premium provision – the expected present value ("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;
- the claims provision – the expected present value ("best estimate") 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 discounted "best estimate". Under Solvency II, the risk margin is calculated using a cost-of-capital approach (presently employing a 6% cost of capital parameter as provided by EIOPA[2]).

2.27 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:

[2] EIOPA is the acronym for the European Insurance and Occupational Pensions Authority established in consequence of the reforms to the structure of supervision of the financial sector in the European Union.

- 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 plain terms, 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.

2.28 The Minimum Capital Requirement under Solvency II (“MCR_2”), which will be lower than the SCR, defines the point of intensive regulatory intervention. The MCR_2 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). The MCR_2 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 insurers writing liability, credit or suretyship classes).

2.29 Article 30 of the Solvency II Directive states that “[t]he 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 the Transferring Business (i.e. the business written by QIEL through its branches in the Czech Republic, Hungary and Slovakia) is currently therefore the responsibility of the UK regulator (i.e. the PRA). If the Scheme is sanctioned the Luxembourg regulator (the CAA) will assume responsibility for the financial regulation of the Transferring Business.

Consumer Protection Schemes

2.30 In the UK the Financial Services Compensation Scheme (“FSCS”), a statutory “fund of last resort”, compensates customers in the event of the insolvency (or other defined default) of a financial services firm authorised by the PRA or FCA. Insurance protection exists for private policyholders and small businesses (those with an annual turnover of less than £1,000,000) 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 wind-up under compulsory insurance (such as motor third party liability cover) and 90% of the claim incurred before the wind-up for non-compulsory insurance (such as home insurance, or the non-compulsory parts of motor insurance), without any maximum. The FSCS is funded by levies on firms authorised by the Regulator.

2.31 As policyholders of a branch of a UK insurer, relevant Transferring Policyholders would be eligible to seek compensation from the FSCS in the event of QIEL’s insolvency. If the Scheme is sanctioned, however, they would no longer be policyholders of a UK insurance company and would therefore lose any right to compensation under the FSCS. No similar compensation schemes exist in Luxembourg or in any of the host countries of the branches. I discuss the implications on policyholder security of the loss of FSCS protection in Section 7 below.

2.32 In the UK, a further consumer protection scheme, the Financial Ombudsman Service (“FOS”), provides private individuals (and micro enterprises[3]) 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, however, it is necessary for the insurance policy concerned to be, or have been, administered from within the UK and/or issued from within the UK.

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

2.33 The Transferring Policyholders 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.

2.34 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.

Winding-up Regulations

2.35 If QIEL were to become insolvent currently, the extent to which its policyholders, including those of the Transferring Business, would get their claims paid would be dependent upon winding-up regulations in the UK. If the transfer is sanctioned, the Transferring Policyholders will become policyholders of CISA, a Luxembourg-based company, and therefore in the event of the insolvency of CISA the extent to which the Transferring Policyholders would have their claims paid would depend upon the winding-up regulations in Luxembourg. I have therefore considered the differences between the winding-up regulations in the UK and Luxembourg in order to assess whether these differences may have any material effect on the Transferring Policyholders.

2.36 Under English law, the winding-up of an insurance undertaking is governed by the Insurers (Reorganisation and Winding Up) Regulations 2004. Under these regulations direct insurance creditors have precedence over any claim on the insurance undertaking with the exception of certain preferential claims (e.g. claims by employees, rights in rem etc.) with respect to the whole of the insurance undertaking's assets. 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.

2.37 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.

2.38 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.

2.39 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.

2.40 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.

2.41 I discuss further the implications of the differences in winding-up regulations between the UK and Luxembourg in Section 7.

Conduct Regulation

2.42 The Transferring Business 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 Czech, Hungarian and Slovak branches of QIEL will transfer to respective branches of CISA, the host country regulator in relation to conduct of business will not change as a result of the Scheme.

3. BACKGROUND ON QIEL

INTRODUCTION

3.1 QIEL is an insurance company, registered as a private limited company in England and Wales (registered number 1761561) under the Companies Act 2006. QIEL's immediate parent company is QBE Holdings (EO) Limited, which is itself a wholly owned subsidiary of QBE European Operations plc ("QEO"). QEO is registered as a public limited company in England and Wales (registered number 2641728) under the Companies Act 2006. QBE Insurance Group Limited, which is incorporated in Australia, is the ultimate holding company of QIEL.

3.2 QIEL is authorised by the PRA to write general insurance and reinsurance business, and regulated by the FCA and the PRA. The active business of QIEL (measured by gross written premiums during 2015) is written largely in Europe (circa 78%) but also on a world-wide basis (circa 14%) with the remaining 8% in Asia, the Middle East, Australasia, North America, the Caribbean, Central/South America and Africa.

3.3 QIEL's issued and fully paid share capital as at 31 December 2015 was made up of 625,905,272 ordinary shares of £1 each.

BUSINESS WRITTEN

3.4 The main elements of the business written by QIEL are as follows (percentages in brackets are the proportions of total gross premiums written in 2015 which totalled £1,380 million[4]):

- Motor Third Party Liability (20%);
- Fire and other damage to Property (18%);
- Third Party (ex-Motor) Liability (32%);
- Marine, Aviation and Transport (5%);
- Other direct insurance (11%); and
- Inwards Treaty Reinsurance (14%).

TRANSFERRING BUSINESS

3.5 The Transferring Business comprises the Czech, Hungarian and Slovakian branch businesses of QIEL. The key features of the business written by each of these branches are summarised below[5].

Czech Branch

- Years underwritten: 2007 – 2016
- Gross ultimate premiums written in total since inception amount to around £43m
- The lines of business written are product protection (which includes GAP and auto extended warranty business) (which accounts for 13% of premiums written), property (46%) and liability (which includes general liability business, typically covering small companies and retail businesses) (27%)
- The number of policies to be transferred under the Scheme is estimated to be around 5,200
- Outstanding case reserves as at 31 May 2016 totalled approximately £3.1m gross of reinsurance

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4 Based on Annual Report as at 31 December 2015.

5 It is noted that the figures quoted in this paragraph have been converted to pounds sterling using the year-end 2015 exchange rates of £1=€1.36=CKZ36.7=HUF428.9.

- Policyholder jurisdictions – Czech Republic, Slovakia, Hungary, Poland, Romania, Italy
- Policyholders are estimated to be 97% retail (individuals or small enterprises with annual turnover of less than £1 million) and 3% corporate.

Hungarian Branch

- Years underwritten: 2005 – 2016
- Gross ultimate premiums written in total since inception amount to around £124m
- Classes of business underwritten include travel, household, property and general liability
- The number of policies to be transferred under the Scheme is estimated to be around 59,600 (and as of 1 January 2017, this number included around 45,000 individual short-term travel policies)
- Outstanding case reserves as at 31 May 2016 totalled £2.6m gross of reinsurance
- Policyholder jurisdictions – Czech Republic, Slovakia, Hungary, Romania, Germany and Austria
- Policyholders are estimated to be 99% retail (individuals or small enterprises with annual turnover of less than £1 million) and 1% corporate.

Slovakian Branch

- Years underwritten: 2007 – 2016
- Gross ultimate premiums written in total since inception amount to around £115m
- The most material lines of business written are property (which accounts for 30% of premiums written), general liability (18%) and product protection (26%)
- The number of policies to be transferred under the Scheme is estimated to be around 59,000
- Outstanding case reserves as at 31 May 2016 totalled £5.3m gross of reinsurance
- Policyholder jurisdictions – Czech Republic, Slovakia, Hungary, Poland, Bulgaria, Pakistan, Romania, Croatia, the UK, and Italy
- Policyholders are estimated to be 99% retail (individuals or small enterprises with annual turnover of less than £1 million) and 1% corporate

3.6 QIEL held contracts of employment with those staff employed in the Czech, Hungarian and Slovakian branches of QIEL. The company's employees in the branches are covered by statutory pension arrangements. The branches also operate defined contribution pension plans for their employees. The staff formerly employed by the Czech, Hungarian and Slovakian branches of QIEL have already transferred to CISA. These staff continue to manage the Transferring Business (on behalf of QIEL), as well as the on-going business now written by CISA.

KEY FINANCIAL INFORMATION

3.7 As at 31 December 2015, as per QIEL's annual report and accounts (on a UK GAAP basis), the gross outstanding claim reserves within QIEL were £2,917 million (£2,876 million as at 31 December 2014). In addition, as at 31 December 2015, QIEL held a gross provision for unearned premiums of £739 million (£766 million as at 31 December 2014). The reinsurers' share of claims outstanding and unearned premiums was £1,038 million as at 31 December 2015 (£1,066 million as at 31 December 2014).

3.8 QIEL management considers that the UK GAAP booked, best estimate level of reserves remains reasonable and within a range of best estimates for QIEL.

3.9 As at 31 December 2015, the Czech, Hungarian and Slovakian branches of QIEL booked an overall gross (of reinsurance) outstanding claim reserve (including IBNR) of £18.6 million and an overall gross (of reinsurance) provision for unearned premiums of £16.7 million[6]. In total therefore, the overall gross (of reinsurance) outstanding claim reserve and provision for unearned premiums of the Czech, Hungarian and Slovakian branches represented around 1% of QIEL's overall gross (of reinsurance) outstanding claim reserve and provision for unearned premiums.

3.10 As at 31 December 2015, the total assets and liabilities of QIEL, on a UK GAAP basis, amounted to £5,726 million and £4,335 million respectively, giving net assets of £1,391 million[7] (£1,404 million as at 31 December 2014). The net assets represent the capital of the company. As at 31 December 2015, QIEL was in compliance with the (now superseded) EU (Solvency I) and PRA (ICAS) capital requirements.

3.11 As at 23 June 2016, QIEL is rated 'A+' (positive outlook) by Standard & Poor's and A (stable outlook) by A M Best.

REINSURANCE

3.12 QEO/QIEL operates a number of reinsurance programmes, including whole account quota share, facultative and treaty reinsurance and participates in QBE Group's global reinsurance programme.

3.13 QIEL has a number of external reinsurers providing the reinsurance protections described above. For the financial year ended 31 December 2015, circa 41% of the ceded claims provisions was with fellow QBE Group undertakings, and of the remainder over 95% is with external reinsurers with an S&P credit rating of 'A-' or better.

ASSETS

3.14 As at 31 December 2015, QIEL held investment assets valued at approximately £3.3 billion. Just under £3 billion was held in bonds, £0.2 billion in collective investments and the remainder a mixture of equities, deposits and derivatives. Of the £3 billion of bonds, £2.3 billion was in respect of corporate bonds, £0.4 billion government bonds and £0.3 billion collateralised securities.

RISKS

3.15 QIEL's principal risks and uncertainties are co-ordinated and managed together with the principal risks of other entities within the QEO Group (the directors of QIEL being comfortable that the QEO Group's approach meets the risk management needs of QIEL).

3.16 For the purposes of managing its risk, QEO classifies risk into the following categories: insurance, credit, market, liquidity, operational, group and strategic.

3.17 QIEL manages insurance risk (i.e. inappropriate pricing methodologies leading to inadequate premiums; deterioration of reserves; exposure to catastrophes; insufficient reinsurance arrangements; and the risk of increased expenses) through its underwriting strategy, adequate reinsurance arrangements and proactive claims handling as follows:

- Analysis of historical pricing and claims experience;
- Setting tolerance levels for risk concentrations;
- Monitoring and reviewing underwriting performance;
- Conducting both internal and external actuarial reviews of the company's claims provisions, independent of the company's underwriting teams.

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6 For the purpose of preparing its accounts as at 31 December 2015, QIEL used exchange rates of £1=€1.36=CKZ36.7=HUF428.9. It is noted that the pound has weakened by around 15-20% against these currencies since 31 December 2015 and therefore QIEL's claims reserves as at 31 December 2015, in respect of the Transferring Business, would have be approximately 15-20% greater using more recent exchange rates.

7 Annual Report as at 31 December 2015

3.18 Market risk arises from QIEL's investment portfolios, and largely comprises changes in interest rates. A decrease in the value of the assets backing the insurance contracts could adversely affect the financial position of QIEL to the extent that a movement (in particular, a fall) in asset values is not matched by a corresponding movement in liability values. QIEL manages market risk by: actively managing investment assets; maintaining a diversified portfolio; and hedging residual net asset exposures.

3.19 Pension risk (including longevity risk) is considered as part of market risk, and is the risk to which QEO is exposed in relation to its final salary pension scheme(s). The funding position of the QEO pension scheme(s) is sensitive to the assumptions made from time to time (including inflation, interest rate, investment return and mortality) to determine its long-term liabilities relative to the corresponding market value of the pension fund's assets. In particular, the financial position of the QEO pension funds maybe highly sensitive to changes in bond yields and will also be impacted by changes in equity markets.

3.20 The primary sources of credit risk within QIEL are investment and treasury activities and reinsurance counterparty risk. Within the investment and treasury activities, regular reviews of exposure limits for approved counterparties are undertaken. For reinsurance cover, the company maximises the amount of reinsurance it can place with highly rated and regarded counterparties, while limiting concentrating exposures.

3.21 Liquidity risk is the risk of QIEL being unable to meet its cash outflows without recourse to planned contingent funding. Liquidity is managed such that QIEL maintains minimum levels of liquid, short-term marketable securities; stress testing liquidity relative to major catastrophe events; and matching assets and liabilities by major currency positions.

3.22 Operational risks are the risks to which QIEL is exposed during its day-to-day operations, mainly arising from possible failures of control and external events. QIEL manages operational risk by actively monitoring key processes; conducting scenario reviews to identify and quantify potential exposures for mitigation; and maintaining effective segregation of duties, access controls, authorisation and reconciliation procedures.

3.23 QIEL is exposed to group risk, i.e. the current or prospective risk to earnings and capital arising from adverse perception of the image of QIEL (and/or the wider QBE Group) on the part of customers, shareholders, investors or regulators. QIEL manages the risk by carefully managing the relationship with the QBE Group; having independent directors on the QEO main regulated boards; and having contractual arrangements in place for material services provided by other QBE Group divisions and companies.

3.24 QIEL is exposed to strategic risk, i.e. the current or prospective risk to earnings and capital arising from adverse business decisions, improper implementation of decisions or lack of responsiveness to industry changes. This risk is managed by considering strategic options in the light of the impact on earnings volatility and capital requirements; and monitoring capital levels on an ongoing basis with reference to rating agency and regulatory capital requirements.

CAPITAL POLICY AND RISK APPETITE

3.25 Risk appetite is expressed as the level of risk that the board and management of QEO/QIEL are willing to take to achieve the organisation's strategic objectives. It is managed:

- through board-approved risk appetite statements and risk tolerances;
- through the capital adequacy objectives contained in the business plan, including risk-adjusted returns on capital and through detailed risk limits;
- within the delegation of authority from the QBE Group CEO to the QEO CEO and onward to the management team; and
- within QEO policies relating to key risk areas.

3.26 QEO and QIEL received approval from the PRA in December 2015 to use the group's internal (economic capital) model for assessing regulatory capital requirements under Solvency II.

4. BACKGROUND ON CISA

Introduction

4.1 CISA is a Luxembourg domiciled insurance company that was granted a non-life insurance licence by Luxembourg's Minister of Finance on 24 July 2015. CISA was previously registered as a reinsurance company known as Stonebridge Re S.A. (its licence having being granted on 13 March 2014). As Stonebridge Re S.A., the company wrote one reinsurance and one retrocession contract which I am informed were novated prior to its reinsurance licence being withdrawn and it being relicensed as a non-life insurance company and renamed CISA.

4.2 CISA is now authorised to write all classes of business other than class 10 (motor vehicle liability).

4.3 CISA has established branches in the Czech Republic, Hungary, and Slovakia into which it is intended that the Transferring Business will be transferred and through which CISA has commenced underwriting renewals of the ongoing business acquired from QIEL.

4.4 CISA commenced writing business in Hungary on 1 February 2016, in the Czech Republic on 1 April 2016 and in Slovakia on 2 May 2016. CISA's business plan (pre the acquisition of the AIG Business as outlined in paragraph 4.6 below) was to write a similar volume and mix of business in each of its branches to that written under QBE's ownership (with a focus on organic growth). CISA estimates that annual gross written premiums across the 3 branches in respect of this business will reach €48m by 2018. The Transferring Business is described in Section 3.

4.5 I note that while QIEL has ceased underwriting all business in the Czech Republic and Hungary, it continues to underwrite business under a Delegated Underwriting Authority Agreement in Slovakia. QIEL will continue to write this business up until the Effective Date when the existing business will transfer under the Scheme and CISA will commence underwriting such new business directly. I am informed that this arrangement allows for the renewal of existing business on QIEL paper, the majority of which is tacit renewal business that was originally sold under distribution circumstances that made this business difficult for QIEL / CISA to cancel / renew following the migration of the business on 2 May 2016.

4.6 In October 2016 it was announced that Fairfax had entered into an agreement with American International Group, Inc. ("AIG") to acquire the renewal rights of AIG's portfolio of local business written by its Central and Eastern European ("CEE") operations in Bulgaria, Czech Republic, Hungary, Poland, Romania, and Slovakia (the "AIG Business"). It is intended that this business will be written by CISA, which will also assume AIG's CEE operating assets and employees. CISA is expected to commence underwriting this business in the second quarter of 2017. Under the agreement, CISA will carry out the claims handling and administration of the CEE business written by AIG historically, although it will do so on behalf of AIG, which will retain the liabilities related to this business.

4.7 CISA's business plans in respect of the AIG Business anticipate underwriting around €100m of gross premium in 2017, increasing to about €150m in 2019. Of these premium amounts, around 70% is expected to be in respect of personal accident business, property lines, casualty lines, financial lines, and specialty lines; and the remaining circa 30% is expected to be in respect of fronting business which CISA will cede 100% to AIG.

4.8 The acquisition of the renewal rights of the AIG Business is subject to European Commission ("EC") regulatory (merger) approval. I am informed by CISA that a draft merger notification form was sent to the EC's case team on 9 January 2017 and that the necessary approval is expected to be obtained by end-February 2017. Additionally, I am informed by CISA that the company made an application to the CAA (the company's home state regulator in Luxembourg) on 7 December 2016 notifying the CAA that CISA wishes to passport out of Luxembourg by way of: (1) the establishment of a new branch in each of Bulgaria, Poland and Romania; and (2) the extension of an existing branch's passporting activities in each of the Czech Republic, Hungary and Slovakia.

4.9 I will comment in my Supplementary Report on whether or not regulatory (merger) approval has been obtained by CISA from the EC, and whether CISA's application to the CAA for the creation of the three new branches (in Bulgaria, Poland and Romania) and the expansion of the company's licences in the Czech Republic, Hungary and Slovakia has indeed been successful.

Fairfax

4.10 CISA's immediate parent company is Fairfax Holdings Luxembourg Sarl, but it is ultimately owned by Fairfax, a major Canadian holding company which, through its subsidiaries, is engaged in property and casualty insurance and reinsurance and investment management. Its common shares are listed on the Toronto Stock Exchange.

4.11 Through its subsidiaries, Fairfax writes a wide variety of property and casualty insurance and reinsurance business in a number of territories, including Canada, the US, Europe and Asia.

4.12 On or around 4 May 2015, Standard & Poor's affirmed its BBB- long-term counterparty credit rating on Fairfax and its A- long-term counterparty credit and financial strength ratings on its core insurance affiliates.

4.13 During the 12 month period to 31 December 2015, Fairfax generated net earnings of $0.6 billion from the group's underwriting and investment activities.

4.14 As at 31 December 2015, Fairfax had total assets of $41.5 billion, and total liabilities of $29.5 billion. The excess assets were therefore $12.0 billion (including $1.7 billion attributable to non-controlling interests). Fairfax thus had a strong financial position as at 31 December 2015, including strong liquidity with cash and marketable securities at the holding company of over $1 billion.

Reinsurance

4.15 In accordance with the Framework Agreement, QIEL entered into a Loss Portfolio Transfer Reinsurance Agreement (the "LPTA") with Polish Re under which the net liabilities of QIEL's Czech, Hungarian and Slovakian branches (i.e. the liabilities of the Transferring Business) were 100% reinsured by Polish Re, a Poland-domiciled reinsurance company, also ultimately owned by Fairfax.

4.16 The premium paid by QIEL to Polish Re for the LPTA was paid into "designated accounts" (one for each of the branches), from which, subject to certain conditions, funds can be withdrawn by Polish Re for the payment of claims. It should be noted that the amounts in the designated accounts are stated to be the property of Polish Re, and Polish Re has some freedom to withdraw funds from these accounts for investment purposes. However, in the event that the LPTA is terminated, the amounts in the designated accounts would become the property of QIEL and Polish Re must ensure that the amounts in the accounts are equal to the reserves relating to the business at the time of termination. The LPTA provides for a number of circumstances in which QIEL may terminate the LPTA (including breach of contract, insolvency, or if it is directed to do so by the regulator), but no circumstances under which Polish Re may terminate the LPTA. Furthermore, the LPTA does not terminate solely as a result of the Scheme not being sanctioned (as outlined in paragraph 10.31 below).

4.17 Under its original terms, the LPTA, would terminate upon the Scheme being sanctioned. However, QIEL and Polish Re subsequently amended the LPTA such that it will no longer terminate if the Scheme is sanctioned and the benefit of the LPTA can therefore transfer to CISA under the Scheme.

4.18 Polish Re benefits from a guarantee, dated 7 September 2010, provided to it by Fairfax, under which it guarantees the performance of all the reinsurance business written by Polish Re. Under the terms of this agreement, governed under the laws of the Province of Ontario, Fairfax undertakes to pay valid claims in the event of the insolvency of Polish Re. The agreement remains in-force unless terminated by Fairfax on 12 months' prior written notice to Polish Re, and shall thereupon be of no further force or effect in respect of any policies issued or renewed on or after the date of termination. However, the guarantee in respect of any policies issued or renewed prior to the date of termination is a continuing guarantee and extends to all sums payable by Polish Re under such policies

4.19 Fairfax has provided me with an overview of its 2016 reinsurance programme for its central and eastern European business – i.e. principally covering the branch business of CISA. CISA has in place a range of quota share and excess of loss reinsurance contracts that cover the different lines of business. Reinsurance is placed with several different reinsurers, each of which has a Standard and Poor's and/or AM Best credit rating of at least A-. Fairfax first instituted a similar programme for 2015, which initially protected Polish Re's exposure in respect of business written by QIEL through its Czech, Hungarian and Slovakian branches, post 1 January 2015.

Guarantees

4.20 CISA benefits from a guarantee provided to it by Fairfax, under which it guarantees the performance of all the (re)insurance business written by CISA. Under the terms of this agreement, governed under the laws of the Province of Ontario, Fairfax undertakes to pay valid claims in the event of the insolvency of CISA. The agreement remains in-force until and automatically terminates on 31 December 2017 (unless renewed or extended by Fairfax) and shall thereupon be of no further force or effect in respect of any policies issued or renewed on or after the date of termination. However, the guarantee in respect of any policies issued or renewed prior to the date of termination is a continuing guarantee and extends to all sums payable by CISA under such policies.

4.21 Fairfax has also provided a commitment (dated 3 December 2015) to the CAA that it would capitalise CISA's immediate parent Fairfax Holdings Luxembourg Sarl to a minimum of 200% of CISA's SCR from 1 January 2016. This commitment is documented in a letter from Fairfax to the CAA (dated 3 December 2015) which replaces an earlier (and identical) guarantee to the previous direct shareholder, Stonebridge Holdings Sarl, issued on 24 July 2015, and documented in a letter from Fairfax to the CAA (dated 24 July 2015) as part of the CISA business plan/authorisation submission to the CAA. I am informed that in the event that CISA were to require additional capital at some future date to meets its solvency obligations on a stand-alone basis, the requisite funding would be made available by Fairfax Holdings Luxembourg Sarl (by way of a capital contribution, subscription for shares in CISA or another appropriate mechanism). It is noted that all of the directors of Fairfax Holdings Luxembourg Sarl are also directors of CISA.

Claims Administration

4.22 As of 1 February 2016, the staff working for QIEL's Hungarian branch migrated to the Hungarian branch of CISA. The staff of QIEL's Czech branch migrated to the Czech branch of CISA on 1 April 2016 and the staff of the Slovakian branch migrated to the Slovakian branch of CISA on 2 May 2016. These staff continue to manage the Transferring Business (on behalf of QIEL), as well as the on-going renewal business written by CISA, under the oversight of a recently recruited chief operating officer.

4.23 There will therefore be no change in the personnel administering the Transferring Business if the Scheme is sanctioned. Existing IT systems will also continue to be used.

Capital

4.24 As at 31 December 2015, CISA's balance sheet recorded capital and reserves amounting to €21.9m. This consisted of €9.5m of subscribed capital (of which €7m was unpaid), a share premium account of €13.9m, a legal reserve of €0.95m and a retained loss of €2.4m.

4.25 In September 2016 a capital injection of €2m was made by CISA's immediate parent.

4.26 In order to maintain solvency levels in the company whilst writing the AIG Business, I am informed by Fairfax management that a schedule of further planned capital injections into CISA has been established. On 15 December 2016 an additional €12m was paid into CISA, and this will be followed by further planned capital injections of €43m in 2017 before the Effective Date, and a further €3m in 2018.

4.27 The Board of CISA has concluded that the company's capital risk appetite is to maintain at any given time a minimum SCR coverage ratio (i.e. the ratio of Own Funds to the corresponding SCR) of 120%.

Investment Policy

4.28 The investments of CISA are managed by Hamblin Watsa Investment Counsel Ltd, a wholly owned subsidiary of Fairfax.

4.29 Investments are made with the following objectives: to invest for the long term always providing sufficient liquidity for the payment of claims and other obligations; to adhere to relevant legislation and regulatory guidelines; and to ensure the preservation of invested capital for policyholder protection.

4.30 Permitted investment categories are cash and cash equivalents (short term notes and treasury bills), fixed income (at least 95% BBB rated or higher), real estate and mortgages and derivatives (for hedging purposes).

4.31 As at 31 December 2015 the investments actually held by CISA consisted predominantly of cash (circa €14.5m). CISA is also parent to TIG (Bermuda) Ltd. and its balance sheet includes an asset of €1.1 million in relation to its ownership of this entity. TIG (Bermuda) Ltd. is an insurance company authorised in Bermuda but has not written any new or renewing insurance business for at least the last 7 years. Its net assets comprise a cash / investment portfolio of approximately $1 million (with nil liabilities).

Risks

4.32 CISA identifies the main risks facing its business as being reserving, underwriting, credit, market, liquidity and operational. Its approach to managing each of these risks is as follows.

RESERVING RISK

4.33 This is the risk of unpaid loss reserves proving to be inadequate. CISA has appointed a chief actuary, who is based in Luxembourg, to assess reserving levels, working in close cooperation with underwriting and claims staff within each of the branches. Oversight and reserve setting and compliance with the reserving policy (as established by the board of CISA) are the responsibility of the reserving committee which meets at least quarterly. Fairfax's group actuarial team in Toronto will also review final reserve selections.

UNDERWRITING RISK

4.34 Underwriting risk includes both the risk of inappropriate underwriting and inadequate pricing. CISA is following the underwriting approach taken by the branches historically, led by experienced teams of managers and underwriters. Underwriting is subject to a number of protocols (underwriting authorities, guidelines, rate monitoring and peer review) and is supported by pricing models. Underwriting is overseen by the underwriting committee, which monitors and reports on performance against plan. Control structures are in place to mitigate the risk of accumulations of loss from catastrophic events and is further protected by the reinsurance programme introduced by Fairfax from 1 January 2015.

CREDIT RISK

4.35 The primary credit risk is the risk of default from a reinsurer or investment counterparty. Reinsurers are assessed according to criteria adopted across the Fairfax group with selection based on rating and amount of exposure to any one reinsurer.

MARKET RISK

4.36 CISA's investment management and foreign exchange committee oversees monitoring of investment performance and compliance with investment guidelines, reporting to the board quarterly. CISA underwrites contracts denominated in Czech koruna, Hungarian forints and euros. Currency risk exposure is to be reduced by matching technical provisions with assets in the corresponding currencies.

LIQUIDITY RISK

4.37 Oversight of liquidity risk is also the responsibility of the investment management and foreign exchange committee. CISA monitors cash and investments to ensure liquidity requirements are addressed.

OPERATIONAL RISK

4.38 Managing day-to-day operational risk is the responsibility of the local branch managers. This includes responsibility for managing claims risks through policies and procedures including defining authority levels, protocols for management oversight, an automated system to support and report on major claims activity and a formal review process for major claims. CISA’s investment managers are responsible for establishing processes and controls to ensure an effective risk management framework with regard to investments. Operational risks through exposures to key counterparties like banks are managed by the management of CISA whereas risks arising from relationships with brokers and other local counterparties are the responsibility of local branch managers.

5. THE PROPOSED SCHEME

Motivation for the Scheme

5.1 As detailed in Section 1 above, on 16 December 2014 Fairfax entered into an agreement with QIEL to acquire its insurance operations in the Czech Republic, Hungary and Slovakia. The renewal rights of the business have been transferred to CISA and the staff of QIEL's Czech, Hungarian and Slovakian branches have transferred to newly established branches of CISA. These staff continue to manage the run-off of the business written by QIEL (which is now 100% reinsured into Polish Re, another company in the Fairfax group) as well as underwrite new business on behalf of CISA. The Scheme is therefore the final part of the acquisition process, and if implemented will allow QIEL to completely exit the Czech, Hungarian and Slovakian markets.

Outline

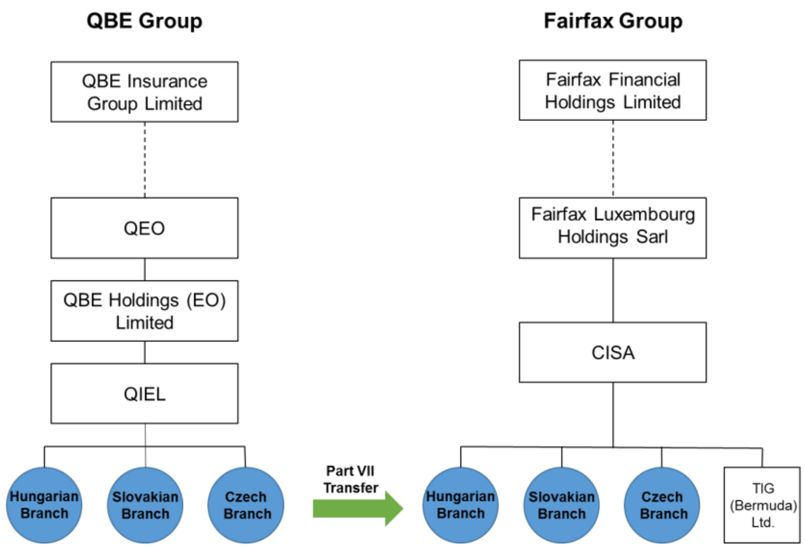
5.2 In accordance with the terms of the Framework Agreement, the Scheme provides for the transfer of the rights and obligations under all policies of the Transferring Business together with policy data and third party contracts (including outwards reinsurance contracts) and any assets, rights and information relating to the policies of the Transferring Business.

5.3 No consideration will be paid in respect of the Scheme.

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

5.5 Figure 5.1 below illustrates the effect of the Scheme in moving the Transferring Business from branches in QIEL, a QBE group company, to branches of CISA, a company in the Fairfax group.

Figure 5.1
Simplified Corporate Structure and Effect of the Scheme



5.6 In the unlikely event of there being any policies that cannot be transferred to CISA under the Scheme on the Effective Date, these "Excluded Policies" will be excluded from the Scheme until they can be transferred. It is not currently expected that there will be any Excluded Policies. In accordance with the terms of the LPTA, if any policies are not transferred under the Scheme, Polish Re will continue to reinsure them for no further consideration.

5.7 Provided that there are no Excluded Policies, it is QBE's intention that the Czech, Hungarian and Slovakian branches of QIEL will be de-authorised following the Scheme.

Effect of the Scheme on the Balance Sheets of CISA and QIEL

5.8 Table 5.1 below illustrates how the Scheme is expected to impact the GAAP-basis balance sheet of CISA, based on projections for CISA and the Transferring Business on the assumption that the Scheme is effected during the second quarter of 2017. It should be noted that whilst CISA is now underwriting almost all the business formerly written by QIEL's branches in the Czech Republic, Hungary and Slovakia, QIEL's Slovakian branch continues to underwrite a delegated authority arrangement and will continue to do so up until the Scheme is sanctioned (as outlined in paragraph 4.5 above). Like the rest of the Transferring Business, this business is ceded to Polish Re. However, any business written in 2017 will be retroceded from Polish Re to CISA. The element of the Transferring Business underwritten by QIEL in 2017 will therefore already be included within CISA's balance sheet as at the time of the transfer and this is reflected in the figures shown in Table 5.1 below. An adjustment is included such that the "post-Scheme" position is as if the 2017 Slovakian delegated authority business had originally been written in CISA (i.e. the LPTA and retrocession of this business cancel each other out).

Table 5.1
Projected Balance Sheets for CISA and the Transferring Business at the beginning of the second quarter of 2017

EUR '000s	CISA Pre-Scheme	Transferring Business		Adjustment	CISA Post-Scheme
		2016 and Prior	2017		
Assets					
Investment in TIG (Bermuda) Ltd	1,109				1,109
Investments and cash deposits	73,272	(115)			73,157
Premium and other receivables	2,024	155			2,179
Deferred acquistion costs	3,002	4,600			7,603
Reinsurer's share of UPR	659	16,370	4,353	(4,353)	17,030
Reinsurer's share of claims reserves	66	16,224	480	(480)	16,290
Total Assets	**80,133**	**37,235**	**4,833**	**(4,833)**	**117,368**
Liabilities					
Shareholder's equity*	63,150				63,150
Trade and other payables	2,595	40			2,635
Unearned premium reserve	10,983	16,370	4,353	(4,353)	27,353
Ceded deferred acquisition costs	0	4,600			4,600
Gross claims reserves	3,406	16,224	480	(480)	19,630
Total Liabilities	**80,133**	**37,235**	**4,833**	**(4,833)**	**117,368**

*Shareholder's funds excludes €7m of unpaid capital which is available for meeting capital requirements under Solvency II

5.9 As can be seen from Table 5.1 above, prior to the implementation of the Scheme, CISA is expected to have gross technical provisions of around €14.4m (€3.4m in claims reserves and €10.9m in unearned premium reserves). These provisions relate to business written from early 2016 by the Czech, Hungarian and Slovakian branch businesses CISA acquired from QIEL. The Transferring Business is expected to comprise gross technical provisions of around €32.6m (€16.2m in claims reserves and €16.4m[8] in unearned premium reserves). As the Transferring Business is 100% reinsured (and will continue to be if the Scheme is implemented), the transfer will not increase the reserves of CISA on a net of reinsurance basis.

5.10 In the case of QIEL, as at 31 December 2015, the Transferring Business represented approximately 1% of the gross (of reinsurance) Technical Provisions, and the net impact on the QIEL balance sheet is zero as the Transferring Business is currently 100% reinsured. The Scheme would therefore not have a material impact on QIEL's balance sheet.

[8] The relatively large UPR in relation to the Transferring Business is a function of a significant contribution from the Product Protection class (principally GAP business) which covers multi-year periods. In particular, the UPR balance of over €16m relates to business written in 2016 and prior years as follows: €13.2m relates to Product Protection business (SK: €8.8m; CZ: €3.8m; HU: €0.7m); €1.4m relates to business written under the Delegated Underwriting Authority Agreement in Slovakia in 2016 (excluding Product Protection business); and €1.6m relates to cover for leased agricultural machinery written in Hungary.

Policyholders Affected

5.11 I have considered the effects of the Scheme on three main groups of policyholders, namely:

- those policyholders of QIEL whose policies are to be transferred to CISA;
- the current policyholders of QIEL who have policies that are not being transferred; and
- the current policyholders of CISA.

5.12 I do not consider that the policyholders of any other insurance companies are affected by the Scheme.

Administration

5.13 The administration (including claims handling) of the Transferring Business is currently undertaken by the CISA branches by staff that have transferred to CISA in accordance with the Framework Agreement. These staff will continue to administer the business in the same way if the Scheme is sanctioned. The Scheme will therefore not have any effect on the policy administration arrangements for the Transferring Business.

Approach to Communication with Policyholders

5.14 The approach that QIEL and CISA intend to take in communicating information about the proposed transfer of business to the affected policyholders and other parties is set out in Section 10.

5.15 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 QIEL, and if the Scheme is sanctioned, CISA to continue to meet its obligations under transferring and non-transferring policies; and
- Meet legal and regulatory requirements.

5.16 I comment on this proposed approach to communications with policyholders in Section 10.

6. GENERAL CONSIDERATIONS OF THE INDEPENDENT EXPERT

Introduction

6.1 I have compiled my report in accordance with the PRA's Statement of Policy and SUP 18 of the FCA Handbook.

6.2 The PRA's Statement of Policy and SUP 18 require me to consider the terms of the Scheme generally and how the different groups of policyholders are likely to be affected by the Scheme. In particular I am required to give my views on:

- The effect of the Scheme on the security of the policyholders' contractual rights, 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

6.3 After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 5.11 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.

6.4 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.

6.5 When assessing the financial security of policyholders, I have looked at the solvency position of the companies involved in the Scheme, on both pre- and post-transfer bases, relative to regulatory solvency requirements. It should be noted that a company may have capital considerably in excess of its regulatory requirements, but that the directors of a company could legitimately reduce that level of capital (for example through the payment of dividends) and still leave the company appropriately capitalised. In circumstances where the Scheme has adversely affected the financial security of a group of policyholders, in order to determine whether that impact is material, I have considered whether the degree of financial security afforded after the transfer would have been acceptable and permissible before the transfer had taken place. I would determine that any adverse impact to a particular group of policyholders is material if the level of financial security afforded to them after the transfer would not have been acceptable under the normal constraints under which the company's capital position was managed before the transfer.

Security of Policyholder Benefits

6.6 As noted above, I need to consider the security of policyholder benefits, i.e. the likelihood that policyholders will receive their benefits when due.

6.7 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.

6.8 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.

6.9 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).

Levels of Service provided to Policyholders

6.10 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.

6.11 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

6.12 SUP 18.2.36 and the PRA's Statement of Policy require me, as the 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' contractual rights.

6.13 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' contractual rights.

Development of the Scheme

6.14 In the following sections I comment on the Scheme as it will be presented to the Court. During the development of the proposed terms of the transfer I have commented on drafts of the Scheme.

7. THE IMPACT OF THE SCHEME ON THE TRANSFERRING POLICYHOLDERS

Introduction

7.1 Under the Scheme, the current business of the Czech, Hungarian and Slovakian branches of QIEL will be transferred from QIEL to CISA.

7.2 The main issues affecting the transferring policyholders of QIEL as a result of the Scheme arise from relative differences in:

- The financial strength of CISA after the transfer compared with that of QIEL currently. Financial strength is derived from:
    - the strength of the reserves held;
    - excess assets or capital; and
    - specific financial support arrangements;
- The risk exposures in CISA compared with those in QIEL;
- The policy servicing levels provided by CISA after the transfer compared with those currently enjoyed by the policyholders of QIEL.

7.3 In this Section 7 I address each of the issues.

The Change in Financial Strength due to the Scheme

RESERVE STRENGTH OF QIEL (PRE AND POST SCHEME)

7.4 I have been provided with a report outlining the most recent full actuarial analysis undertaken by QIEL's actuaries, based on data as at 30 September 2015. I have also been provided with a subsequent report which outlines the additional work done to update the 30 September 2015 actuarial reserve estimates to 31 December 2015, and which forms the basis of the reserves booked by QIEL as at 31 December 2015. I have further been provided with a copy of the previous full actuarial report based on data as at 31 October 2014.

7.5 The report as at 30 September 2015 details the methodology, assumptions and IBNR selections, as well as claims and business developments since the previous review for each of the lines of business written by each of QIEL's business divisions. The 31 December 2015 analysis bridges the gap between 30 September 2015 and 31 December 2015 and updates the 30 September 2015 actuarial reserve estimates for, inter alia, payments made between the end of September and the end of December, foreign exchange movements and actual versus expected claims movements (split between catastrophe, large and attritional claim movements). Whilst the actuarial estimates presented in the 30 September 2015 analysis are on an ultimate, underwriting year basis only, the 31 December 2015 report provides reserve estimates on an earned basis, suitable for inclusion in QIEL's accounts. The actuarial central estimate of outstanding claims as at 31 December 2015 were £2,841m gross of reinsurance and £1,974m net of reinsurance. The outstanding claims liabilities booked in the accounts as at 31 December 2015 (which include a margin over and above the central estimate) were £2,918m gross of reinsurance and £2,027m net of reinsurance.

7.6 I have reviewed the work carried out by the QIEL actuaries in estimating reserves for QIEL in order to satisfy myself that it is reasonable for me to rely on their work. This included reviewing the report and assessing the appropriateness of the methodologies and major assumptions used. I note that these reserve estimates have been produced by suitably qualified actuaries (and other individuals) within QIEL; and have been reviewed and agreed by senior members of the QIEL Actuarial Team.

7.7 Accordingly, I believe it is reasonable to rely on the work of the QIEL actuaries, and as such I have not attempted to review in detail the calculations performed by the QIEL actuaries. Instead I have reviewed the process by which reserves are set, the approach followed by QIEL's actuaries, the key areas of reserve uncertainty and the apparent strength of the reserves based on this review.

7.8 The internal actuaries have used generally accepted actuarial methods to estimate reserve requirements. From my review of the various documents supporting the reserve calculations I am satisfied that the methodologies, major assumptions and results as at 30 September 2015, and updated to 31 December 2015, appear reasonable.

7.9 The QIEL actuaries have estimated ultimate claims amounts on a central estimate basis, i.e. not deliberately biased upwards or downwards, and do not include any margins. The reserves established by QIEL as at 31 December 2015 do however incorporate a margin over and above the actuarial central estimate. I therefore consider QIEL's booked reserves to be on a basis higher than a 50% confidence level (as the claim distribution is expected to be positively skewed[9]). I note that, as QIEL does not generally discount its reserves, 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.

7.10 The QIEL actuaries have analysed the business by 18 subdivisions which represent high level groupings of product types. Liability is the largest subdivision representing about 29% of the net reserves estimated as at 30 September 2015. Property (18%), Financial and Specialty Markets (16%) and Motor (15%) are the next most significant subdivisions.

7.11 QIEL's actuarial report identifies the key areas of reserve uncertainty to be:

- uncertainties relating to long term disease claims, in particular those relating to noise induced hearing loss ("NIHL") and mesothelioma exposures;
- exposure of the unearned business to future catastrophe events and large losses;
- unreported but incurred large losses, and the future development of known large losses;
- its exposure to a growing number of Periodic Payment Orders ("PPOs") claims (annuity-like settlements that can be awarded by the Courts in respect of injury claims); and
- the external environment, including regulatory changes.

7.12 More generally, QIEL has identified the following main areas of uncertainty inherent within its projections:-

- the appropriateness of development tail factors;
- general levels of new claims notifications; and
- new future, and as yet unknown and unquantifiable, large market loss events that could impact the business.

7.13 While the settlement of QIEL's claim liabilities are subject to the key uncertainties (identified above) the reserves established as at 31 December 2015 incorporate a margin over and above the actuarial central estimate (as outlined in paragraph 7.9 above), and this has given me some comfort that the total reserves held provide a reasonable allowance given the uncertainty around the final cost of these liabilities. I also note that QIEL does not generally reflect the time value of money in its (UK GAAP) gross and net reserves, which provides a potential safety margin in the reserves that increases the security of the policyholders.

7.14 The results of the 30 September 2015 actuarial review showed that overall experience was favourable compared to the previous review as at 31 October 2014. Only the Financial and Specialty Markets subdivision showed deterioration over the period. This was driven in particular by reserve increases on the solicitors' professional indemnity class following adverse claims experience.

9 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.

7.15 I note that the previous review as at 31 October 2014 showed a deterioration in the profitability of the business compared to the previous review as at 30 November 2013. This related to two main areas: UK storm losses that impacted the unearned element of the 2013 underwriting year and reserve strengthening related to the Legacy and Business Management division, in particular relating to noise induced hearing loss and other long term disease claims. As noted above, long term disease claims have been identified by QIEL as one of its key uncertainties. This uncertainty relates to the changing legal and claims environment as well as the long latency period prior to these claims being reported, in particular for mesothelioma claims for which latency periods of 40 years are common. There had been a spike in mesothelioma claims the previous review, a trend QIEL projected to continue, leading to reserve strengthening. A spike in NIHL claims has been seen across the industry in recent years. QIEL project each disease type separately using a frequency-severity method on a reporting-year basis, as is market practice for these types of claims.

7.16 There was little change in the overall expected ultimate cost of disease claims between the review as at 30 September 2015 and the prior review as at 31 October 2014. An increase in the average claim cost assumption led to reserves for mesothelioma claims being strengthened. However, this has been offset by releases on the other disease types, in particular hearing loss owing to fewer claims being reported than expected in the period. The total unpaid claims reserve estimated by the actuaries in their review as at 30 September 2015 for long tail disease claims was £100m.

7.17 I note that in June 2016, i.e. subsequent to the production of the actuarial analyses that I have reviewed, QIEL entered into a retrospective quota share reinsurance agreement relating to its 2007 and prior Employers' Liability and Public Liability exposures. This provides ground-up cover up to 155% of reserves with a further layer with a different reinsurer providing unlimited cover above that. Following completion of this deal, QIEL has effectively mitigated the reserve risk relating to these liabilities, although it retains counterparty risk relating to its reinsurers under the reinsurance.

7.18 As noted in paragraph 3.9 above, the Transferring Business, which forms part of the Central and Eastern Europe ("CEE") division, represented only about 1% of the technical provisions of QIEL as at 31 December 2015. They will however form a large part of the reserves of CISA if the Scheme is sanctioned and I have therefore performed an assessment of the adequacy of the provisions established by QIEL of the Transferring Business.

7.19 QIEL provided me with paid and incurred claims triangles for each of the major lines of business making up each of the three branches of the Transferring Business. The data also contained the actuarial estimates of ultimate premiums and claims. The effective date of the data was 31 October 2015 (i.e. one month later than the data used in the actuarial reviews). The ultimate values provided were, once accounting for exchange rate changes, consistent with the ultimates forming part of the 30 September 2015 actuarial review.

7.20 I note that the spreadsheets provided indicated that the Product Protection line of business accounts for a large fraction of the IBNR estimates across the three branches. However, the triangle data was not populated for this class. I am informed by QIEL that, for IT reasons, the Product Protection data for the CEE division is not booked on QIEL's underwriting system and therefore it is not possible to construct triangles for this class. A separate system exists however which is maintained by the underwriters for the business. The underwriters also project the ultimate value of claims for this business and record these values on their system. The QIEL actuaries use the underwriters' estimates, subject to discussions with them about the business and carrying out comparisons of the underwriters estimates for the UK Product Protection business (for which triangle data does exist) to estimates made by the actuaries themselves. I was informed that the business generally experiences stable development and that the underwriters' projections for the UK business were typically close to those of the actuaries.

7.21 In order to test the reserve of the Product Protection class I requested extracts of data from the underwriting system for the past three years in order to assess whether developments had been stable and whether the underwriters' reserve estimates had held up. Having analysed the data over the period provided, it appears that the underwriters set reserves cautiously initially and gradually release reserves when the emerging experience allows. I also assessed the IBNR reserves for the other claim types written by the branches of the Transferring Business. I have concluded that the gross reserves estimated by the QIEL actuaries as at 31 October 2015 for the Transferring Business are reasonable.

7.22 As noted previously, as the liabilities of the Transferring Business have been 100% reinsured, the net reserves for the Transferring Business were nil. If the Scheme is implemented there would therefore be very little change to the reserves or reserve strength of QIEL.

Conclusion

7.23 ***Based on my review as described above as at 31 December 2015, the reserves of QIEL appear reasonable at present. Furthermore, there is no reason to think that the reserve strength of QIEL will be impacted by the Scheme.***

RESERVE STRENGH OF CISA (PRE AND POST SCHEME)

7.24 As at 31 December 2015 CISA had no insurance liabilities and therefore held no technical provisions.

7.25 CISA commenced underwriting through its Hungarian branch on 1 February 2016, and underwriting commenced in its Czech and Slovakian branches in the second quarter of 2016. At the Effective Date of the Scheme, CISA will therefore carry some claim reserves for this business, although as shown in Table 5.1 above, such claim reserves are expected to be relatively small compared to the gross claim reserves of the Transferring Business.

7.26 CISA has informed me that it does not believe that it has a materially different view of the value of the liabilities of the Transferring Business than QIEL, i.e. the reserving basis will not change in a material manner as a result of the Scheme. In particular, the same actuary is responsible for developing the reserve estimates for the CISA business and those for the Transferring Business. (Further, I am informed that the inwards reserves of Polish Re, an affiliate company of CISA within the Fairfax group, in respect of the Transferring Business which it has reinsured are also based on the figures advised by QIEL.)

7.27 I have been provided with copies of the spreadsheets used in the calculation of the claims reserves for CISA as at 31 December 2016, which themselves contain details of the assumptions employed. I have reviewed the spreadsheets to assess the approach followed, the assumptions used and the calculations performed by the internal actuaries. In addition, I have performed a high-level reserve review of two of the main classes (see paragraph 7.29 below) to provide me with further comfort that the reserve estimates produced by the internal actuaries (and other individuals) within CISA are reasonable.

7.28 The internal CISA actuaries have used generally accepted actuarial methods (in particular the Chain Ladder and Bornhuetter Ferguson methods, as described in Appendix A) to estimate reserve requirements as at 31 December 2016 for the business written by CISA during 2016. The reserve estimates so developed are designed to be on a best estimate basis, i.e. not deliberately biased upwards or downwards, and do not include any margins. I interpret this measure to be on a basis higher than a 50% confidence level (as the claim distribution is expected to be positively skewed).

7.29 I have undertaken a high-level reserve review (as at 31 December 2016) of two of the main classes (namely, Travel and Commercial Property) and am satisfied that the claim reserve assessments are in the range of reasonable claim reserve estimates.

7.30 From my review of the spreadsheets supporting the reserve calculations for the business written by CISA during 2016 (as described above) I am satisfied that the methodologies, major assumptions and results as at 31 December 2016 appear reasonable.

Conclusion

7.31 ***I have no reason to believe that the security of the Transferring Policyholders will be materially adversely affected by the Scheme as a result of the reserve strength of CISA.***

EXCESS ASSETS

7.32 For the purposes of my comparative analysis of the excess assets/capital levels of QIEL and CISA pre and post the proposed Scheme, I have considered the extent to which each company holds capital in excess of its regulatory solvency level, in which case the actual capital that the company under consideration holds (the “Available Capital”) will be greater than the “Required Capital” calculated. I refer to the ratio of Available Capital to Required Capital as the “Capital Cover Ratio”. For the purposes of the terms I use in this Report, a company with sufficient capital (relative to the regulatory capital requirement under consideration) will have a Capital Cover Ratio just greater than 100%. I describe a company as well-capitalised if it has a Capital Cover Ratio greater than 150% (or thereabouts) and very well-capitalised if it has a Capital Cover Ratio in excess of 200% (or thereabouts).

7.33 If the Capital Cover Ratio increases after the Scheme for a group of policyholders, then there is an increase in security for those policyholders. If the Capital Cover Ratio reduces then there is a reduction in security and I need to consider whether the reduction is likely to be material to those policyholders.

7.34 QIEL and CISA are both currently required to satisfy capital requirements imposed by the EU-wide Solvency II regime. In December 2015 the PRA approved QEO to use its internal model for the purposes of calculating its SCR. QEO uses its internal model to calculate the SCR for QEO along with its subsidiaries QIEL and QBE Re. I have therefore considered the results of the internal model-calculated SCR when assessing the solvency position of QIEL. I have also considered the results of QIEL's SCR as calculated by means of the standard formula. This allows for a more direct comparison in capital strength with CISA which does not have an internal model and uses the standard formula to calculate its SCR for regulatory purposes.

EXCESS ASSETS OF QIEL

7.35 As at 31 December 2015 the policyholders of QIEL enjoyed the security of capital resources (i.e. assets available to meet regulatory capital requirements under the now superseded Solvency I regime) as measured in QIEL's 2015 PRA return of £988 million compared with a statutory minimum capital requirement (MCR_1) of £246 million. The Capital Cover Ratio for the MCR was therefore about 400% and the free assets equal to £742 million (i.e. capital resources less MCR_1). QIEL could therefore be considered to be very well-capitalised as at 31 December 2015 (on a Solvency I basis).

7.36 From 1 January 2016 QIEL, like other EU insurers, is required to satisfy its SCR under the newly-introduced Solvency II regime. As stated above, QEO has been approved to use an internal model to calculate its SCR. I have been provided with QEO's "2015 SCR Report" dated May 2015, which I understand describes the version of the model that was used as the basis for QEO's internal model approval application to the PRA. The report sets out in detail the results of the internal model calculations for QEO, QIEL and QBE Re. The 2015 SCR Report covers the SCR for 2015 and is based on the financial position as at 31 December 2014.

7.37 QEO uses its internal model to calculate its SCR on two bases: one year and to-ultimate. The one year basis considers the variability expected to emerge during the current year in relation to existing business and business to be written in the current year. The to-ultimate basis considers the ultimate variability for the business to be written in the current year, as well as the variability in the current reserves to ultimate. In both cases the SCR is calculated to a one in 200 year confidence level. Whilst the one year basis only considers risk emergence over the forthcoming year, it only benefits from one year's investment income and also includes a risk margin that must be established at the end of the year. The ultimate basis considers the emergence of all risk over the run-off of the business (risks are assumed to have fully emerged after 10 years), but incorporates 10 years of investment income on assets and no risk margin is deemed to be required at the end of the 10 year period. For all entities considered (including QIEL), the one year SCR is greater than the ultimate, indicating that a large portion of the risk is expected to emerge over the first year.

7.38 Insurance risk is the most significant component of QIEL's SCR. QIEL has modelled insurance risk in three components: earned reserve risk, unearned reserve risk and underwriting risk. Earned reserve risk is the risk around the earned reserves at the valuation date, whereas unearned reserve risk is the risk relating to business that had been written as at the valuation date but which was not yet earned. Underwriting risk relates to the risk associated with the business to be written in the coming year – the risk is considered as relating to three claim types: attritional, large and catastrophe.

7.39 Other material risk classes are reinsurer credit risk (the risk of reinsurers not meeting their obligations); operational risk (which QEO has categorised into 7 sub-risks including internal and external fraud, improper business practice and business and transaction risks); and market risk (the risks around asset returns relative to the returns assumed in the discounting of reserves).

7.40 I have reviewed the work carried out by the QIEL actuaries (and other individuals) in estimating capital requirements for QIEL in order to satisfy myself that it is reasonable for me to rely on their work. This included reviewing the process by which capital estimates have been made, the approach followed by QIEL's modelling team, 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 QIEL; and have been reviewed and agreed by senior members of the QIEL modelling team.

7.41 Accordingly, I believe it is reasonable to rely on the work of the QIEL modelling team, and as such I have not attempted to review in detail the calculations performed by the QIEL actuaries (and other individuals). Based on my review, I consider the methodology and modelling techniques used by QIEL to be in line with industry practice and generally appropriate.

7.42 Based on the 1 year SCR and own funds reported in its May 2015 SCR report, which formed the basis of QEO's successful internal model approval application and was based on data as at 31 December 2014, QIEL could be considered more than sufficiently capitalised. The SCR report compares the 1 year internal model SCR with the SCR calculated using the standard formula. Despite differences in methodology, the standard formula SCR is overall close to the internal model 1 year SCR, although slightly less. Relative to the standard formula SCR, QIEL could also be considered more than sufficiently capitalised as at 31 December 2014.

7.43 QIEL has subsequently implemented some changes to its internal model including parameter updates and changes to tail dependences as reported in a subsequent SCR report as at November 2015. These changes have led to a reduction in the SCR. QIEL has provided me with a copies of its Day 1 Quantitative Reporting Templates ("QRTs", which are regulatory reporting templates under the new Solvency II regime). These show that, as at 31 December 2015, QIEL could still be considered a more than sufficiently capitalised company based on its Capital Cover Ratio relative to its internal model SCR. Whilst the reported SCR was less than that reported in its SCR report as of May 2015, its eligible own funds were also reduced, which I understand relates to increased technical provisions due to amended reinsurance contract boundaries on the bound but not incepted business. I have further been provided with QIEL's QRTs as at 30 June 2016. These continue to show that QIEL was more than sufficiently capitalised relative to its SCR.

7.44 I have additionally been provided with QEO's Annual ORSA Report dated November 2015. The ORSA includes a forward looking assessment of QIEL's SCR and own funds over the period 2015-2017, albeit that the starting point for this analysis does not reflect the most up-to-date position as per the Day 1 QRTs. The ORSA shows that the QIEL's 1 year SCR is projected to decrease slightly in 2016 and 2017 and the own funds increase as the underlying business plans assume the business becomes more profitable. Based on these projections I would expect QIEL to remain more than sufficiently capitalised in the short term.

Conclusion

7.45 ***Overall, based on my review as described above concerning the excess assets of QIEL, I believe the policyholders of QIEL, including those who will transfer under the proposed Scheme, currently benefit from the strength provided by a more than sufficiently capitalised company.***

EXCESS ASSETS OF CISA

7.46 As at 31 December 2015 CISA had available assets of €13.8m relative to a Solvency I minimum capital requirement of the statutory minimum amount of €3.7m. Whilst this indicates that CISA was very well-capitalised (on the superseded Solvency I basis) as at that date, this was prior to CISA underwriting any insurance business.

7.47 CISA has undertaken business plan projections over the period 2017 to 2019 showing the projected business volumes to be written by its newly acquired Czech, Hungarian and Slovakian branches, as well as the impact of the Scheme and the impact of commencing underwriting the AIG Business in 2017. Like QIEL, CISA must now hold capital to meet its SCR under the Solvency II regime. CISA has used the standard formula approach to estimate its SCR as at 31 December 2016 based on projected business volumes for the new business it writes in 2017. It has also made projections of the SCR and Solvency II balance sheet as at year ends 2017 to 2019, on the basis that the Scheme is sanctioned during 2017 and that it also commences underwriting the AIG Business in the second quarter of 2017. Given the types of business written (i.e. a typical mixture of property and liability lines) I do not have reason to believe that the use of the standard formula to calculate the SCR is inappropriate for CISA.

7.48 CISA's projected balance sheets and SCR calculations are based on the assumptions in its business plans over the period 2017-19. CISA has provided me with details of separate business plans for both the business acquired from QIEL and the AIG Business, as well as consolidated plans. Its plan for the QIEL business shows it continuing to write mainly the same lines of business as those formerly written by QIEL, although it is intending to focus growth on particular lines of business. The plans show gross written premiums for the former QIEL business to be €41.7m in 2017, growing annually at between 10% - 15% over the period to end-2019. A number of lines of business are projected to grow significantly in the Czech branch, in particular certain liability lines and commercial property. I am informed by CISA that this growth will be driven by a number of factors including greater management of brokers and more proactive underwriting, increased market demand in some lines and improved CISA brand awareness. Growth is also forecast in Hungary, in particular, a new line of liability business with a recently hired team of underwriters. CISA also believe it can significantly increase the Hungarian household line through increased brand awareness and new distribution channels. CISA's projected loss ratios are generally fairly constant over the projection period, informed by historic experience, although where lines are new or expanded they are based on underwriters' expectations.

7.49 CISA's plans for the AIG Business are based on the actual performance of the business during 2015 under AIG's ownership (see paragraph 4.7 above). CISA's plans, which are predicated on renewing a proportion of existing business, plus an element of new business, therefore anticipate that it will take a few years before it is able to write a similar volume of business to AIG. The business plans assume losses based on loss ratios that are constant during the projection period and are informed by AIG's experience.

7.50 CISA's business plans have continuity with past experience, and where lines are expected to grow or cost savings are expected to be made, CISA management have been able to explain to me the rationale for their assumptions. For these reasons, I do not believe that CISA's plans are unreasonable. It should be understood, however, that CISA'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 CISA will therefore vary from that anticipated in its business plans.

7.51 As noted above, CISA has made a projection of its own funds and SCR over the period 2017-19 under two business plan scenarios: (1) for the business acquired from QIEL, including the Transferring Business, but excluding the AIG Business (the "QIEL Business"); and (2) on a consolidated basis, i.e. the QIEL Business and the AIG Business. CISA's projected Solvency II balance sheet and SCRs are summarised in Appendix F. The initial position as at 31 December 2016 is prior to the Scheme being sanctioned and includes only a modest amount of business having been written in CISA. As at that date, the main component of CISA's SCR is non-life underwriting risk, in particular premium risk, in expectation of the significantly increased premiums to be written in 2017, excluding and including the AIG Business as appropriate. There is also a catastrophe risk charge relating primarily to flood and earthquake exposures. The catastrophe risk calculation accounts for various layers of reinsurance being in place, covering losses up to €50m with an attachment point of €2m. Whilst CISA plans to increase the capacity of its reinsurance covers in light of the additional business it will be writing, it intends to keep retentions at similar levels, so the catastrophe risk charge is similar throughout the projection period.

7.52 The other components of CISA's SCR as at 31 December 2016 are market risk, which is predominantly interest rate risk relating to the mismatch in the expected timings of asset and liability cash flows; counterparty risk, which relates to the cash held; health underwriting risk, which is in respect of medical expense and income protection business; and operational risk.

7.53 These components of CISA's SCR increase throughout the projection period as more business is written. There is an initial steep increase in SCR between 2016 and 2017 under both scenarios as the Transferring Business transfers into CISA and a further steep increase under scenario (2) as it starts to write the AIG Business. The counterparty risk charge increases particularly significantly in 2017 as a result of the reinsurer default charge associated with the outwards reinsurance of the Transferring Business. The rate of increase of the SCR does slow, however, under both scenarios as the rate of increase in business written slows.

7.54 Based on CISA's projection of own funds for the company, it is expected to be: well-capitalised throughout the projection period under business plan scenario (1), i.e. just the QIEL Business; and more than sufficiently capitalised throughout the projection period, on the boundary of well capitalised under business plan scenario (2), i.e. the QIEL Business and the AIG Business. In order to maintain this level of capitalisation, Fairfax has established a schedule of capital injections into CISA, as noted in paragraph 4.26 above. This schedule includes a capital injection of €12m paid on 15 December 2016 for business plan scenarios (1) and (2), followed by €43m in 2017 for scenario (2) only, and €3m in 2018 again for scenario (2) only. These capital injections are (projected to be) required as follows:

- for business plan scenario (1), a single capital injection of €12m (paid on 15 December 2016) to offset the increases in SCR over the period associated with CISA's business plan (excluding the AIG Business) as well as the cumulative retained losses through to end-2016 resulting primarily from the initial expenses incurred in relation to the company's start-up costs. A modest loss is forecast for 2017, while 2018 and 2019 are projected to be profitable as the operating expenses increase proportionately less than earned premium; and

- for business plan scenario (2), capital injections in 2016, 2017 and 2018 (as outlined above) to offset the large increases in SCR over the period, as well as the losses which are expected to be made in 2017, associated mainly with the acquisition of the AIG Business. In overview, CISA's projected income statement under business plan scenario (2) shows: forecast gross written premium ("GWP") in 2017 of €155m, but with only €52m actually assumed to be earned in 2017 (net of reinsurance) since this is a partial year of writing that reduces earned premiums relative to those for a full year; projected GWP in 2018 of €193m, with net earned premiums for 2018 at €110m, i.e. projected to be much greater than net earned premiums for 2017; claim and commission ratios are equivalent in 2017 and 2018, while operating expenses in 2017 and 2018 remain fairly similar at circa €34m; there are also some initial IT implementation expenses as well as other initial costs that fall in 2017, and some operating expenses are assumed to be incurred in proportion to written premium rather than earned premium. Against this background, the significant operating costs set against the relatively small amount of earned premium in 2017 gives rise to a projected loss, while 2018 is projected to turn profitable as there is much more premium earned and the operating expenses, while increased compared to 2017 reflecting a full year's worth of business written, increase proportionately less than earned premium.

7.55 I am informed by Fairfax that the additional €43m of capital scheduled for 2017 will be paid into CISA prior to the sanction hearing for the Scheme. I will report, therefore, in my Supplementary Report on whether or not this additional capital has indeed been injected. My conclusions herein are based on these additional capital amounts as per paragraph 7.54 above (including, for the avoidance of doubt, the capital injection of €43m to be paid into CISA prior to the sanction hearing for the Scheme) being provided.

7.56 CISA has also accounted for €7m of unpaid share capital in its eligible own funds. Under Solvency II rules, unpaid share capital is considered "ancillary own funds" and is eligible (subject to certain limits) given the approval of the regulator. The CAA has given its approval to CISA for its use of the €7m of unpaid share capital as ancillary own funds. Further as set-out in paragraph 4.21 above, Fairfax has also provided a commitment to the CAA that it will capitalise CISA's immediate parent, Fairfax Holdings Luxembourg Sarl, to at least 200% of CISA's SCR. This would therefore ensure that Fairfax Holdings Luxembourg Sarl has sufficient resources to pay up the unpaid share capital if called upon by CISA to do so. Furthermore, I am informed by Fairfax management that in the event that CISA was to require additional capital at some future date to meet its solvency obligations on a stand-alone basis, the requisite funding will be made available by Fairfax Holdings Luxembourg Sarl (by way of a capital contribution, subscription for shares in CISA or another appropriate mechanism). Such a procedure was used in September 2016 and December 2016 when additional share capital of €2m and €12m was provided to CISA as noted in paragraphs 4.25 and 4.26 above respectively. It is also noted that all of the directors of Fairfax Holdings Luxembourg Sarl are also directors of CISA.

7.57 The future results for CISA 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 3-year period 2017 – 2019 respectively. The sensitivity test on lower premium volumes/growth on a consolidated basis (i.e. the AIG Business plus the QIEL Business) assumed the GWP for the AIG Business to be two thirds of the level assumed in the consolidated CISA business plan (for each year); and that for the QIEL business (which is expected to be more readily projectable due to past knowledge and dealings) to be 20% lower than the level assumed in the consolidated CISA business plan for 2017 followed by growth of 5% per annum (rather than the higher growth rates assumed in the consolidated CISA business plan). Under this sensitivity test, assuming the capital injections are made as planned, CISA continues to have an SCR coverage ratio greater than 100% (and indeed greater than 120% as per the company's capital risk appetite) for each year 2017, 2018 and 2019, and it is only in 2019 that the SCR coverage ratio would be expected to be somewhat lower than that forecast under the consolidated CISA business plan.

7.58 The sensitivity test on higher premium volumes/growth on a consolidated basis assumed the GWP for the AIG Business to be four thirds of the level assumed in the consolidated CISA business plan (for each year); and that for the QIEL business (expected to be more readily projectable due to past knowledge and dealings) to be 20% higher than the level assumed in the consolidated CISA business plan for 2017 followed by growth in line with the consolidated CISA business plan). Under this sensitivity test, assuming the capital injections are made as planned, CISA continues to have an SCR coverage ratio greater than 100% (and indeed greater than 120% as per the company's capital risk appetite) for each year 2017, 2018 and 2019, and by 2019 the SCR coverage ratio is projected to be in excess of that forecast under the consolidated CISA business plan.

7.59 I have likewise tested the impact of higher and lower premium volumes/growth over the 3-year period 2017 – 2019, but assuming only the QIEL Business is written by CISA going forward (i.e. for whatever reason the AIG Business is not entered in to by CISA). Further, for these sensitivity tests, no further capital injections were assumed to be made in to CISA in either 2017 or 2018.

7.60 For the lower premium volumes/growth basis I have assumed the GWP for the QIEL Business to be 20% lower than the level assumed in the CISA business plan (excluding the AIG Business) for 2017 followed by growth of 5% per annum (rather than the higher growth rates assumed in the CISA business plan, excluding the AIG Business). Under this sensitivity test, CISA continues to have an SCR coverage ratio comfortably greater than 120% (as per the company's capital risk appetite) for each year 2017, 2018 and 2019, albeit on a declining trajectory.

7.61 For the higher premium volumes/growth basis I have assumed the GWP for the QIEL Business to be 20% higher than the level assumed in the CISA business plan (excluding the AIG Business) for 2017 followed by growth as assumed in the CISA business plan, excluding the AIG Business). Under this sensitivity test, CISA again continues to have an SCR coverage ratio comfortably greater than 120% (as per the company's capital risk appetite) for each year 2017, 2018 and 2019, and broadly in line with those projected under the CISA business plan (excluding the AIG Business).

7.62 All the premium growth/volumes sensitivity tests above illustrate that, even in the absence of management actions, the projected capital position of CISA is reasonably robust over the 3-year period 2017 – 2019. In practice, I would expect the management of CISA to take appropriate actions to steer CISA onto a lower expense and profitable path should premium growth/volumes be substantially different (lower) than those used in the CISA business plan (with and without the AIG Business).

7.63 I have also tested the robustness of CISA's projected capital position. In the first case, I have considered the impact of a range of severe stress tests on CISA's solvency, all of which represent stresses that fall outside the normal course of business, on a consolidated business basis (i.e. including both the AIG Business and the QIEL Business). I have considered the effects of reserve inadequacy, reinsurance failure and a fall in investment values as detailed below. I have considered the impact of these stresses occurring at each of 31 December 2017, 31 December 2018 and 31 December 2019. While these stresses do not represent an exhaustive list of adverse events that could impact CISA, they include risks I consider most material and relevant to my analysis. The severe stress tests considered are as follows (the results are shown in detail in Appendix F):

- 50% increase in gross technical provisions – in this scenario the gross technical provisions of CISA are considered to be deficient and require increasing by 50%. In doing this I have assumed that the reinsurance recoveries would likewise increase by 50%. I believe this is reasonable as the Polish Re reinsurance of the Transferring Business would increase proportionately, and most of the outwards reinsurance on the AIG Business is proportional. As the technical provisions of CISA are expected to be relatively small as at 31 December 2016 the effect of this scenario is less significant than at the later time periods but, nevertheless, the own funds would be expected to reduce by about 20%. The effect of this scenario increases as time progresses as the Transferring Business (which is 100% reinsured) runs off, and the other portfolios (which are not reinsured to the same extent) become prominent. The position at 31 December 2017 is a reduction in own funds of about 40%, increasing to around 50% as at 31 December 2018 and 31 December 2019. It follows, therefore, that under this stress scenario the SCR coverage ratio would drop below both the company's 120% risk appetite level and below 100% for all years (2017 – 2019). Furthermore, this stress scenario would have an impact on the SCR, i.e. the SCR would increase (due to the increase in technical provisions), although as the premium volumes are a more significant driver of the premium and reserve risk, I estimate that the SCR would increase by less than 10% in this scenario. Accounting for the increase in SCR, I have estimated the additional capital required to bring CISA back to a 120% Capital Cover Ratio, and across all years (2017 – 2019) the amount is significantly less than the amount of capital Fairfax has committed to hold in CISA's immediate parent and so a capital injection should be a feasible mitigant in this scenario.

- Failure of reinsurance from Polish Re protecting the Transferring Business – the Transferring Business will be 100% reinsured and majority of this reinsurance will be held with Polish Re (see paragraph 4.15 above). I have considered the impact of the failure of this reinsurance. The effect of this scenario would be most keenly felt if it occurred soon after the Effective Date of the Scheme. Based on CISA's projected balance sheet as at 31 December 2017, writing off the reinsurance asset with Polish Re would reduce own funds significantly, by about 25%. The effect would be less significant if Polish Re failed later on, when the Transferring Business is further into run-off and the reinsurance asset less significant. Based on the projected balance sheets, own funds would reduce by about 12% if failure occurred as at 31 December 2018 and 8% as at 31 December 2019. It follows, therefore, that under this stress scenario the SCR coverage ratio would drop below the company's 120% risk appetite level in 2017 (while at the same time remaining above 100%), but stay above the company's 120% risk appetite level in both 2018 and 2019. Furthermore, while this stress scenario would have an impact on the SCR, the effect on the SCR would be limited (i.e. an increase in reserve risk, as net Technical provisions increase as a result of the Polish Re asset being written-off, which itself diminishes as the Transferring Business moves further into run-off). I therefore estimate that in this scenario the SCR would increase by less than 3% in 2017 while being broadly unaffected in 2018 and 2019. Accounting for the small increase in SCR, I have estimated that the additional capital required to bring CISA back to a 120% Capital Cover Ratio for 2017 (the Capital Cover Ratio is projected to be greater than 120% in 2018 and 2019) is again significantly less than the amount of capital Fairfax has committed to hold in CISA's immediate parent and so a capital injection should be a feasible mitigant in this scenario.

- 25% reduction in the value of bonds – CISA's business plan shows investments to be held mainly in government bonds. It also has its holding in TIG (Bermuda) Ltd., which for the purposes of the business plan, is valued at €1.1m throughout the projection period. It is also assumed that CISA will hold a significant amount of cash. As at 31 December 2017 it is assumed that cash will represent 16% of investable assets and government bonds 81% (with the investment in TIG Bermuda 3%). Cash is assumed to become slightly more significant over time representing 22% as at 31 December 2019 and bonds 77%. The risks associated with these investments is therefore expected to be low. In particular, the SCR projections assume medium term bonds, predominantly German, although some are assumed to be issued by governments in Eastern Europe, including those of the Czech Republic, Hungary and Slovakia. A reduction in value of these bonds could be associated with a downgrading of the credit worthiness of the issuing government, or with an increase in inflation expectations. For the purposes of the stress I have assumed a 25% reduction in the value of the bonds. The effect of this would be a reduction in own funds of about 33% across the projection period 2017 – 2019. It follows, therefore, that under this stress scenario the SCR coverage ratio would drop below both the company's 120% risk appetite level for all years (2017 – 2019) but only below 100% in 2018. I estimate that this stress scenario would have a limited impact on the SCR itself because the investments are all held in government bonds which are assumed to be risk free in the standard formula methodology, I have therefore estimated the additional capital required to bring CISA back to a 120% Capital Cover Ratio across all years (2017 – 2019) assuming that the SCR would be broadly unchanged under this scenario. Once again the amount is significantly less than the amount of capital Fairfax has committed to hold in CISA's immediate parent and so a capital injection should be a feasible mitigant in this scenario.

7.64 Secondly, I have considered the impact of the same range of severe stress tests on CISA's solvency, but assuming only the QIEL Business is written by CISA going forward (i.e. for whatever reason the AIG Business is not entered in to by CISA). Further, for these stress tests, no further capital injections were assumed to be made in to CISA in either 2017 or 2018.

7.65 The results of the second set of stress tests are similar to those described in paragraph 7.63 above for the CISA business on a consolidated basis (noting that the failure of Polish Re is relatively more adverse, since the Transferring Business, which is wholly reinsured by Polish Re, forms a more significant element of the company's overall portfolio in this scenario). Again, for each stress test, I have estimated the additional capital required to bring CISA back to a 120% capital cover, and across all years (2017 – 2019) the amount is significantly less than the amount of capital Fairfax has committed to hold in CISA's immediate parent and so a capital injection should be feasible mitigant in each stress scenario.

7.66 As described above, each stress, when considered in isolation, is not expected to cause CISA to become insolvent, i.e. own funds (available capital) remain positive over the 2017 – 2019 projection period, albeit they may be projected to be lower than the associated SCR. If any of these stress scenarios were to occur in combination, within a short period of time, CISA's solvency would be more likely to be compromised, although such scenarios are more remote. Based on my findings in relation to the stress tests above, I consider the likelihood of CISA's own funds being exhausted to be remote and beyond the 1-in-200 event likelihood. Furthermore, in each stress scenario (as outlined in paragraph 7.63 above) I have estimated the additional capital required to bring CISA back to a 120% capital cover ratio, and across all years (2017 – 2019) the amount is significantly less than the amount of capital Fairfax has committed to hold in CISA's immediate parent and so a capital injection should be feasible. I believe this to be the most likely mitigant to bring the SCR coverage ratio above 100%, and indeed 120% in line with the company's capital risk appetite.

7.67 I note that, according to its audited financial statements as at 31 December 2015, Polish Re had total assets of PLN 891m. Its technical provisions totalled PLN683m gross of outwards reinsurance, with reinsurers' share of these being and PLN 67m. It had shareholder's equity of PLN 260m. I have also been provided with details of Polish Re's SCR and own funds as at 31 December 2015, as reported in its opening Solvency II regulatory returns. This indicates that Polish Re was more than sufficiently capitalised as at 31 December 2015. I also note (as per paragraph 4.18 above) that Fairfax has provided Polish Re with a guarantee on the performance of all reinsurance agreements entered into by Polish Re (which I am satisfied is in place and enforceable by Polish Re as described in paragraphs 10.28 to 10.30 inclusive). Therefore, in the short term at least, given Polish Re's own capital strength and the guarantee provided by Fairfax, the likelihood of all CISA's reinsurance asset failing would appear to be a very remote scenario.

7.68 I also note that, as detailed in paragraph 4.20 above, Fairfax has guaranteed the financial performance of CISA's insurance business. The excess assets of Fairfax, as detailed in Section 4 above, are substantial and, while they cannot be assumed to provide absolute security, provide very significant financial resources to support the guarantee. The policyholders of CISA therefore benefit from the additional security afforded by this guarantee, over and above the capital resources held within CISA itself.

Conclusion

7.69 ***Based on my review of the excess assets of CISA as described above, and on the assumption that the additional capital amounts are paid into CISA according to the schedule set out by Fairfax management (including, for the avoidance of doubt, the capital injection of €43m to be paid into CISA prior to the sanction hearing for the Scheme), at the Effective Date of the Scheme, CISA is expected to be a more than sufficiently capitalised company (on the boundary of well capitalised) and is expected to continue to be so in the short term thereafter (as per CISA's financial projections).***

Relative Financial Strength of Transferring Policyholders pre- and post-Scheme

7.70 I have concluded above, based on my review of excess assets held relative to Solvency II capital requirements, that QIEL is a more than sufficiently capitalised company and that this is likely to continue to be the case up until the Effective Date of the Scheme. I also concluded that CISA is expected to be a more than sufficiently capitalised company, on the boundary of well capitalised, on the Effective Date following the implementation of the Scheme, and it is likely to continue to be the case in the short term thereafter.

7.71 The Transferring Policyholders will therefore be transferring to a company with a comparable Capital Cover Ratio to their existing insurer.

7.72 Whilst the Transferring Policyholders will be moving from a large company to a small company that has only just been established, it should be borne in mind that CISA is part of a very large group, and its ultimate parent, Fairfax, has guaranteed the performance of CISA's insurance business. The security of the Transferring Policyholders is therefore strengthened by this guarantee, in addition to the security afforded by the capital held within CISA.

7.73 The Transferring Business is currently 100% reinsured and will continue to be if the Scheme is sanctioned (albeit that an element of the Slovakian business to be written in 2017 will be retroceded back into CISA, as noted in paragraph 5.9 above). Most of the reinsurance asset protecting the Transferring Business is held with Polish Re. If Polish Re were no longer able to meets its obligations under the reinsurance currently, the liabilities would fall back on QIEL. As the gross liabilities of the Transferring Business represent only 1% of QIEL's total gross technical provisions, this is unlikely to materially affect the security of the policyholders of QIEL. If Polish Re were unable to meet its obligations after the Scheme were implemented this could impact the solvency position of CISA given the significance of the Polish Re reinsurance asset on CISA's balance sheet, at least in the short term. However, as discussed in paragraph 7.64 above, given the financial strength of Polish Re and the guarantee in place with Fairfax, this scenario would appear to be remote.

7.74 As stated in paragraph 2.31 above, the Transferring Policyholders will lose access to the FSCS if the Scheme is sanctioned. The impact of which is minimal because as identified in paragraph 7.72 above, the existence of the guarantee provided by Fairfax on the performance of CISA's insurance business (which I am satisfied is in place and enforceable by CISA as described in paragraphs 10.28 to 10.30 inclusive) means that the winding-up scenario is remote. As the likelihood of the insolvency of CISA appears remote and the security of the Transferring Policyholders will be further strengthened by the Fairfax guarantee, I do not consider that this loss of access to the FSCS will materially adversely affect the security afforded to the Transferring Policyholders.

7.75 I note that there are differences in the winding-up provisions between the UK and Luxembourg as set out in Section 2 above. As most of the policies of the Transferring Business are direct insurance contracts, most Transferring Policyholders will have preferential access to any remaining funds in the company in the event of the insolvency of QIEL pre-Scheme and CISA post-Scheme, albeit, as noted in Section 2, the extent to which claims would be paid is a function of the assets available and their size relative to the Technical Provisions. Nevertheless, as the insolvency of either QIEL or CISA appears remote I do not believe that differences in winding-up provisions between the UK and Luxembourg will materially adversely affect the Transferring Policyholders.

7.76 ***I am therefore satisfied that the Transferring Policyholders will not be materially adversely affected due to relative differences in the financial strength of CISA post-Scheme to those of QIEL pre-Scheme.***

Changes in Risk Exposures

7.77 If the Scheme is sanctioned, the Transferring Policyholders will no longer be subject to the risk exposures of QIEL. They will however become exposed to those existing within CISA, albeit that, as at the expected Effective Date of the Scheme, only a limited amount of business will have been written by CISA, and will be of a similar nature to the Transferring Business.

7.78 QIEL is a large and diverse insurance company, writing business predominantly in the UK, but also elsewhere in Europe and further afield. The liabilities of QIEL include a large and uncertain legacy portfolio, which includes risks related to asbestos and other long-tail disease exposures, albeit that these are now 100% reinsured.

7.79 The Transferring 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 QIEL's other risk exposures. The Transferring Policyholders will however become exposed to Fairfax group risk if the Scheme is sanctioned, although to some extent they already have some exposure to the Fairfax group through the LPTA.

7.80 Based on my analysis of changes in risk exposures as outlined above, the Scheme creates both potential positives and negatives for the Transferring Policyholders. Nonetheless, given the financial strength of CISA, as discussed above, I do not consider that the Transferring Policyholders will be materially adversely affected by the changes in risk exposures.

Conclusion

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

Policy Servicing

7.82 The administration (including claims handling) of the Transferring Business is currently undertaken by the CISA branches by staff that have transferred from QIEL to CISA in accordance with the Framework Agreement. These staff will continue to administer the business in the same way whether the Scheme is sanctioned or not. The Scheme should therefore not have any effect on the policy administration arrangements for the Transferring Business. I note that the acquisition of the AIG Business is not expected to have any immediate effect on the operations of the ongoing CISA business as it has been agreed with AIG that the AIG Business will be self-sufficient at the time of transition. This will include ensuring that functions performed by AIG centrally can be carried out locally.

7.83 As described in paragraph 2.32 above, eligible policyholders of a UK company may be able to bring complaints to the FOS. Also, as noted in paragraph 2.32 above, to be within the scope of the FOS a policyholder need not be resident in the UK, but their policy must have been administered from within the UK. In the case of the Transferring Business, whilst these policies were written in and are administered from the local branches, I understand that in certain circumstances claims are referred back to QIEL staff in London for consideration, direction or determination. This was the case prior to QIEL entering into the LPTA and remains the case now. I have therefore sought legal advice as to whether the referral of policies back to QIEL in the UK would bring any of these affected policies with the scope of the FOS.

7.84 The legal advice received (which was addressed both to me and to parties to the Scheme and upon which I am entitled to rely) suggests that policyholders that have brought a claim or complaint which has been referred to QIEL claims staff based in the UK for consideration, direction or determination may be able bring a complaint to the FOS. It follows therefore that any such policyholders may lose access to the FOS if the Scheme is sanctioned.

7.85 In order to assess whether this loss of access to the FOS will materially adversely affect policyholders, I asked QIEL/CISA to provide me with statistics concerning the number of complaints raised historically with the FOS by policyholders of QIEL's Czech, Hungarian and Slovakian branches, and with statistics on the number of claims and complaints made by these policyholders that had been referred to QIEL in the UK.

7.86 I am informed by QIEL no complaints have ever been referred to the FOS by policyholders of QIEL's Czech, Hungarian and Slovakian branches. I am also informed that very few complaints (only 3 across the three branches since 2013) have been referred directly by these policyholders to QIEL in the UK. In these cases QIEL in the UK undertook a high level review (where possible due to language difficulties) and referred them back to the local branches for follow-up. QIEL also informed me that there are no formal procedures in place for branch staff to escalate complaints to QIEL UK staff, and that whilst branch staff might refer a complaint to the UK for high level advice on process/approach, the actual handling of branch complaints always takes place locally. Of the complaints that had been made locally to the branches in the last 3 years, three complaints from the Slovakian branch were noted as having been referred to the regulator in Slovakia, no such referrals were noted in Hungary or the Czech Republic.

7.87 The statistics provided to me show that the number of claims referred to QIEL in the UK is a very small proportion of the total number of claims handled. In 2014 (prior to the Framework Agreement and the LPTA being effected) 17 out 15,172 claims (or 0.1%) were referred to QIEL in the UK. In 2015 (after the Framework Agreement and the LPTA were effected) 28 out of 13,721 claims (or 0.2%) were referred to the UK.

7.88 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 Business for the following reasons:-

- No complaints have ever been brought to the FOS historically from any policyholder of the Czech, Hungarian or Slovakian branches of QIEL.
- Very few complaints have been referred to QIEL in the UK historically and complaints handling is undertaken locally. Therefore, any access to the FOS by virtue of complaints being handled in the UK appears extremely limited.
- The proportion and absolute number of Transferring Policyholders that might have access to the FOS by virtue of their claims having been referred to QIEL in UK for consideration, direction or determination is extremely small.
- The Framework Agreement, which specifies the circumstances under which claims are currently referred to QIEL in the UK could be changed and therefore no rights of access to the FOS for any of the Transferring Policyholders can be guaranteed to continue.
- Any access to dispute resolution schemes Transferring Policyholders may have in their home country will not be affected by the Scheme.
- Although any access to the FOS will be lost as a result of the Scheme, to the extent that claims or complaints are referred to CISA's head office in Luxembourg after the Scheme, Transferring Policyholders may be able to bring complaints to the Médiateur en Assurances, as described in paragraph 2.34 above (I am informed by CISA that local claims handling authorities are in place and where claims exceed these limits they are referred to CISA's chief operating officer and its reserving committee).

Conclusion

7.89 ***I believe that the proposed Scheme is unlikely to have a materially adverse impact on the standards of policy servicing experienced by the Transferring Policyholders compared to their current position.***

Conclusion for the Policyholders of QIEL transferring under the Scheme

7.90 ***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 Policyholders under the proposed Scheme.***

8. THE IMPACT OF THE SCHEME ON THE POLICYHOLDERS OF QIEL WHO WILL REMAIN IN PLACE AFTER THE TRANSFER

8.1 As the Transferring Business is currently a very small part of QIEL's portfolio, and is already 100% reinsured, the non-transferring policyholders will be, to all intents and purposes, unaffected by the Scheme.

8.2 I have been provided with figures showing the effect of the implementation of the Scheme on QIEL's 1 year SCR. Given the size of the Transferring Business relative to the rest of QIEL's business, and the fact that the business is fully reinsured, the impact is negligible. The only component of the SCR that is impacted is reinsurance credit risk, which will reduce slightly as a result of the Scheme. The effect of the Scheme on the SCR overall is expected to be a reduction of only 0.2%, with no impact on own funds.

8.3 Currently, if Polish Re were to fail, the gross liabilities of the Transferring Business would fall back on QIEL. Given the size of the Transferring Business, this is unlikely to affect materially the other policyholders of QIEL. If the Scheme were sanctioned this risk would be removed, and therefore the non-transferring policyholders would benefit from the Scheme in this way. Similarly, were QIEL to be wound-up (a possibility which also appears to be remote based on QIEL's current excess assets, as described in Section 7 above), the non-transferring policyholders of QIEL would be marginally better off had the Scheme been sanctioned as there would be fewer policies with which to share the remaining assets of QIEL.

8.4 As noted in paragraph 5.6 above, it is possible that, after the Effective Date, there might remain in QIEL some policies of the Transferring Business that could not be transferred under the Scheme. The gross liability for these will remain with QIEL but, the terms of the LPTA provides for them to continue to be 100% reinsured by Polish Re. In this respect the situation of the holders of Excluded Policies would be identical to that prior to the Effective Date. There would also be no changes to the policy servicing or administration of the Excluded Policies.

Conclusion for the policyholders QIEL not transferring under the Scheme

8.5 ***I am satisfied that the non-transferring policyholders of QIEL will not be adversely affected by the Scheme.***

9. THE IMPACT OF THE SCHEME ON THE CURRENT CISA POLICYHOLDERS

9.1 Under the Scheme, the existing policyholders of CISA will remain in CISA in the same position as prior to the Effective Date of the Scheme. The main effect of the Scheme on these CISA policyholders arises from the transfer into CISA of all the business currently in the Czech, Hungarian and Slovakian branches of QIEL.

9.2 CISA only commenced underwriting business in 2016 and as at the Effective Date of the Scheme will have only a limited portfolio of existing insurance business, which may include an element of the AIG Business if CISA has commenced underwriting that business at that stage.

9.3 The Transferring Business will be relatively large compared to the existing portfolio on a gross of reinsurance basis, but will be 100% reinsured. Therefore, whilst CISA's SCR will increase as a result of the Scheme, this will be predominantly related to counterparty risk, which, in isolation, is a relatively small part of the overall SCR. I therefore do not believe that the financial security of the existing CISA policyholders will be materially affected as a result of the Scheme.

9.4 The risk exposures within CISA will broaden as a result of the Scheme, but the Transferring Business is of the same type that is expected to be underwritten by CISA going forward.

9.5 It should be borne in mind that the Scheme is essentially having the effect of unifying the business written by the Czech, Hungarian and Slovakian branches of QIEL historically with that written by the same businesses from 2016, but on behalf of CISA.

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

Conclusion for the CISA Policyholders

9.7 ***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 CISA policyholders.***

10. OTHER CONSIDERATIONS

The Likely Effects of the Scheme upon Reinsurers of QIEL

10.1 In accordance with the PRA Statement of Policy and SUP 18, I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts are to be transferred by the Scheme from QIEL to CISA.

10.2 All reinsurance contracts benefiting the Transferring Business will transfer under the Scheme. As at 31 December 2015, non-LPTA reinsurers' share of outstanding claims and IBNR claims in QIEL's books for the Transferring Business amounted to approximately £4.5m. Of this amount, around £2.6m was in respect of reinsurance placed internally with other parts of the QBE group. It is anticipated that this reinsurance will transfer under the Scheme (see paragraph 10.22 below).

10.3 As described in paragraph 10.3 above, the non-LPTA reinsurance arrangements will transfer under the Scheme and will continue to protect the Transferring Business. The amount of the liabilities of each external reinsurer of QIEL or CISA will not change as a result of the Scheme. I do not consider the existing reinsurers to be materially impacted by the Scheme.

10.4 I have considered whether the Scheme is likely to lead to any changes in the rights of set-off for creditors or debtors of QIEL or CISA. '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 CISA and the Transferring Business have external reinsurance and inwards reinsurance policyholders, there is the possibility of changes in the right of set-off on the insolvency of CISA post-Scheme. The chances of insolvency of CISA 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 QIEL whose contracts of reinsurance are to be transferred by the Scheme

10.5 ***For the reasons discussed above, I am satisfied that the Scheme will not have a materially adverse effect on the reinsurers of QIEL whose contracts of reinsurance are to be transferred by the Scheme.***

The Approach to Communication with Policyholders

10.6 Regulations made under the FSMA require a communication regarding the proposed transfer to be sent to every policyholder of the parties to the Scheme. 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 SUP 18.2.46G, 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. The companies intend to comply with this guidance.

10.7 I set out my understanding of the companies' proposed approach to communicating the Scheme to affected policyholders below.

10.8 For existing (non-transferring) policyholders of QIEL no direct communication will be undertaken. I am informed that the rationale for seeking a waiver of the requirement to notify these policyholders is as follows:

- the policies held by the Transferring Policyholders have already been reinsured to Polish Re and therefore the exposure of the non-transferring policyholders of QIEL to the Transferring Policyholders is limited;
- as the non-transferring policyholders of QIEL are not transferring to another insurer, the purpose of the notification would be in effect simply to notify them that their policies are not transferring and that they need take no action; and
- the cost of notifying the non-transferring policyholders would be significant (estimated to be approximately £700,000).

10.9 QIEL sold travel insurance policies to both businesses (where the travel policy was a group policy, typically for a one year period, covering all staff for travel risks) and to individuals. The individual travel policies (of which there were approximately 45,000 as of 1 January 2017) were sold via Hungarian travel agents. I am informed by QIEL that the practice is for short term travel cover to be sold prior (usually within one to two months) to the cover period beginning and can be granted for a two day to three week duration. I understand that the last such policy was sold on 31 January 2016, and the final short term travel period of cover expired on 28 March 2016, and in the event of a claim arising in respect of a short term travel policy, notification of a loss (including all supporting information) must be presented within one year following the event that precipitated the claim. Therefore the final date QIEL can be notified (in full) of a loss is 28 March 2017, i.e. prior to the Effective Date. Thus, all short term travel policies will have expired prior to the planned implementation of the Scheme. It has been decided not to individually notify all the individual travel policyholders (other than those individual travel policyholders who have brought a claim which remains open), although group travel policyholders will be notified. I am informed that the rationale for this is that:

- QIEL does not have any address details for any such individual Hungarian travel policyholders;
- all such policies have expired and it is considered highly unlikely, based on past claims experience, that any claims are outstanding; and
- in the unlikely event a claim was made, it would be notified in any event to CISA.

10.10 QIEL therefore intends to seek a waiver from the Court of its requirement to notify its Hungarian travel policyholders. Likewise, for similar reasons, a waiver is to also be sought from the requirement to notify the individual Hungarian travel insurance policyholders of CISA (other than those individual Hungarian travel policyholders who present a new claim between the date of filing the CISA witness statement and the Effective Date, or those individual Hungarian travel policyholders who have an open claim as at the date of filing the CISA witness statement). For the avoidance of doubt, the Slovakian and Czech branches of QIEL and CISA do not (and did not) write travel insurance policies.

10.11 The Transferring Policyholders and the existing policyholders of CISA (excluding, in both cases, the individual Hungarian travel policyholders, other than those individual Hungarian travel policyholders who have brought a claim which remains open, or those individual Hungarian travel policyholders of CISA who present a new claim between the date of filing the CISA witness statement and the Effective Date), will be sent a Communication Pack, which will include a covering letter containing the prescribed information stating that the Scheme application has been made to the Court; a statement setting out the terms of the proposed Part VII Transfer and containing a summary of this Report; and a question and answer booklet relating to the Part VII Transfer. It is intended that a Communication Pack will be sent to each policyholder at the address held in the operational computer records of QIEL or CISA for that policyholder. I am informed that addresses are held for policyholders (other than the individual Hungarian travel policyholders). QIEL and CISA also intend to notify all brokers who have placed business comprising the Transferring Business with QIEL and/or placed business with CISA in the Czech Republic, Hungary and/or Slovakia. I am informed that 370 brokers in Slovakia, 220 in Hungary and 30 in the Czech Republic will be notified.

10.12 For the avoidance of doubt, the business written by the CISA Slovakian branch under the Delegated Underwriting Authority Agreement (as outlined in paragraph 4.5 above) is solely in relation to existing QIEL Slovakian policyholders (and therefore known to QIEL) that are due for renewal (up to the Effective Date), and will therefore be sent a Communication Pack (as described in paragraph 10.11 above).

10.13 QIEL will operate a dedicated section of its website on which a summary of the Scheme, a summary of this Report and a full copy of this Report will be posted from the date that the posting of individual notices to transferring policyholders commences until 6 months after the proposed Scheme is sanctioned.

10.14 The notification process will also be supported by general publicity and advertising. A notice stating that the Scheme application has been made will be published in:

- the London, Edinburgh and Belfast Gazettes;
- two national newspapers in each of the UK, the Czech Republic, Hungary and Slovakia; and
- the international edition of the Financial Times.

10.15 I am informed that a waiver will be sought from publishing a notice of the Scheme in newspapers in any other EEA states, for the following reasons:-

- the Transferring Policies were marketed exclusively in the Czech Republic, Hungary and Slovakia;
- there are no more than 15 policyholders in any other EEA state and the costs of publishing a notice in national newspapers in all EEA is deemed to be disproportionately high, particular as contact details are available for each of these policyholders and they will each be sent a Communication Pack individually; and
- it is intended to publish a notice in the international edition of the Financial Times (that being available in other EEA states).

10.16 Regulations made under the FSMA also require all reinsurers of the Transferring Business to be notified of a proposed transfer. QIEL does not intend to seek any waiver from the requirements regarding the notification of reinsurers (other than that typically sought to cover the situation where a reinsurer is inadvertently not notified).

10.17 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.

10.18 When thinking through the proposed approach to notifications, I have considered a number of factors, including whether the policyholders in either QIEL or CISA 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. These issues need to be weighed-up against the risk of policyholder notifications causing confusion or annoyance in relation to an issue that policyholders may consider to be insignificant. The practicability of notifying policyholders also needs to be taken into account.

10.19 ***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 waivers sought to be both proportionate and reasonable.***

Assets and Liabilities of CISA and the Transferring Business

10.20 As noted above, other than the reinsurance assets, no assets will transfer to CISA under the Scheme. Based on the gross reserve held by QIEL as at 31 December 2015 approximately 75% of the reinsurance asset is held with Polish Re, 15% with other parts of the QBE Group and 10% with other reinsurers.

10.21 Some of the reinsurance placed with other parts of the QBE Group is held with Equator Re. I am informed by QIEL that it commuted the intra group 2008 - 2010 Equator Re Casualty Treaty Excess of Loss Programme in December 2015 as a result of the aggregate policy limits being exhausted on an incurred basis. I am further informed that three policies of the Transferring Business have open claims where the future payment of the current local outstanding reported losses could have potentially been recoverable under the Equator Re reinsurance. In compensation for the potential loss of this reinsurance asset, the parties are discussing the transfer of an appropriate allocation of commutation proceeds to CISA upon the sanctioning of the Scheme. I will comment on the amount agreed to be transferred in my Supplementary Report.

10.22 It is intended that all other reinsurance contracts will transfer under the Scheme. In order to determine whether there would be any legal impediment for transferring the outwards reinsurance contracts under the Scheme, QIEL has reviewed the laws governing the transferring outwards reinsurance contracts. Facultative reinsurance is placed locally by the local branches. The local branches have reviewed these contracts and all were found to be written under either local law or English law. Treaty reinsurance is placed centrally by QIEL's London-based reinsurance department, which has confirmed that all treaty reinsurance covering the Transferring Business is written under English law. As all transferring reinsurance was written under the laws of an EEA state, it is thought that all reinsurance will transfer successfully under the Scheme.

10.23 ***In my view the type and nature of the assets associated with the Transferring Business does not generate any material additional risk to the security of the policyholders of CISA, including the Transferring Policyholders.***

Operational Plans and Changes in Assets and Liabilities up to the Effective Date

10.24 I expect that the current activities of QIEL and CISA will continue up to the Effective Date (and, as appropriate, after the Effective Date). QIEL and CISA will continue to write new business, and the companies will continue to 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.

10.25 Further to considering the continuation of normal business, I have discussed with QIEL and CISA the possibility of management actions, other than the proposed Scheme, as considered in this Report, that could affect the financial position of QIEL and CISA (such as significant changes in new business strategy or operational plans). I have been informed that QIEL has no planned activities that would have a material effect on the security of QIEL's policyholders; and by CISA that other than the proposed acquisition, subject to regulatory approval, of the renewal rights of the AIG Business, as also considered in this Report, CISA has no planned activities that would have a material effect on the security of CISA's policyholders.

10.26 I believe that it is unlikely that any events occurring between 31 December 2015 and the Effective Date would affect any conclusion that I reach based on my review as at 31 December 2015 (and subsequent updates to projections, in particular those made to assess the impact of the acquisition, subject to regulatory approval, of the renewal rights of the AIG Business as outlined in paragraph 4.6 above).

10.27 A short time before the final Court hearing, I will consider the extent to which the operational plans of QIEL and CISA have altered (relative to the position at the Date of this Report) and seek confirmation from QIEL and CISA that they have no planned activities that would have a material effect on the security of their policyholders. I will comment on this matter in my Supplementary Report. In addition, I will consider the actual changes in assets and liabilities (relative to the position as at 31 December 2015) and hence whether there have been any changes (including those associated with current economic conditions) that would affect my overall opinion, and again comment on this in my Supplementary Report.

Legal Opinion

10.28 Fairfax has obtained an opinion based on the laws of the Province of Ontario and the laws of Canada applicable in Ontario, addressed to CISA and me, from an external firm of lawyers (operating in their Canadian practice) in relation to the enforceability of the guarantees outlined in paragraphs 4.18 and 4.20 above. This opinion confirms that the guarantees each constitute a legal, valid and binding obligation of Fairfax enforceable against it in accordance with its terms. In particular, the conditions that must be met before the guarantees are enforceable require it be shown that CISA or Polish Re (as the case may be) has been declared insolvent and has been placed in liquidation by a court of competent jurisdiction and has failed to pay any contractual loss payable within the time therein agreed, and further provided, that Fairfax shall not be required to make duplicate (re)insurance payments as a result of the guarantees.

10.29 I have reviewed the guarantees outlined in paragraphs 4.18 and 4.20 above, together with the opinion from the external lawyers (retained in relation to the guarantees) as outlined below in this paragraph 10.29, to inform my view. In summary the opinion of the external lawyers (retained in relation to the guarantees) is as follows:

- The guarantees each constitute a legal, valid and binding obligation of Fairfax enforceable against it in accordance with its terms;
- The effectiveness or admissibility in evidence of each of the guarantees is not dependent on:
  - Any registrations, filings, notarisations or similar actions; or
  - Any consents, authorisations, licences or approvals of general application from governmental, judicial or public bodies;

- The obligations of Fairfax under each of the guarantees:
  - Are directly enforceable by the parties to the contracts besides Fairfax, CISA and Polish Re;
  - Are not dependent on or subject to any action by CISA or Polish Re as the case may be; and
  - Would not be affected by any insolvency proceedings brought against CISA or Polish Re in any jurisdiction.

10.30 Based on my review: (1) I am satisfied that the guarantees are in place; and (2) the opinion I have been presented with made sense to me and has not raised any questions or concerns. In the light of this, and the professionalism and integrity of the external lawyers (retained in relation to the guarantees) I have not felt a second independent legal opinion is warranted.

What would happen were the Scheme not to proceed?

10.31 The Framework Agreement has a “long-stop date” of 31 December 2017. If the Scheme is not sanctioned by that date, the obligations within the Framework Agreement to see that the Scheme is implemented will cease. The LPTA would however continue, and so whilst the Transferring Business would remain in QIEL it would continue to be 100% reinsured by Polish Re and would be administered by the Czech, Hungarian and Slovak branches of CISA.

11. CONCLUSIONS

11.1 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 QIEL and CISA will not be materially adversely affected by the implementation of the Scheme on the Effective Date; and
- The Scheme will not have a materially adverse impact on the service standards experienced by the policyholders of either QIEL or CISA.

11.2 In reaching this opinion I have applied the following principles (as set out in the Transformations TAS):

- I have considered which parties might be affected by the Scheme and in what way. I have documented my findings.
- Although I have not performed my own modelling, rather I have relied (as explained in Section 7) on the results of models developed and operated within QIEL and CISA, 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 QIEL and CISA having adopted alternative plausible assumptions, for example in the scenario and sensitivity tests within the SCR calculation.

Gary Wells

Gary Wells / 09 March 2017

Fellow of the Institute and Faculty of Actuaries

APPENDIX A DEFINITIONS

Admissible Assets	Assets valued in accordance with applicable regulations, which can be taken into account for the purposes of demonstrating that a general insurance company meets its solvency requirements.
American International Group, Inc. ("AIG")	A US insurance group, from which Fairfax has agreed to acquire the AIG Business
AIG Business	The portfolio of business written in Bulgaria, Czech Republic, Hungary, Poland, Romania, and Slovakia, in respect of which Fairfax has agreed to acquire the renewal rights from AIG. Fairfax intends to write this business the renewals of this business in CISA from the second quarter of 2017. AIG staff will transfer to CISA, which will also administer the existing business written by AIG on its behalf.
Available Capital	The amount of capital an insurer has available to meet its capital requirements, subject to admissibility rules. In the context of Solvency II, this would be the Own Funds of the insurer.
Bornhuetter Ferguson method	The Bornhuetter Ferguson method is a commonly used actuarial method for estimating claim reserves. It can be thought of as a weighted mixture of the Chain Ladder method (see below) and the expected ultimate losses (less paid losses) the latter being typically based on the underwriter's view. For more recent accident (or underwriting) years more weight is given to the expected ultimate losses (where claim based methods are less reliable); on older years more weight is given to the Chain Ladder method (where claim data provides more information.
Capital Cover Ratio	The ratio of Available Capital to Requirement Capital. This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the company.
CEE	Central and Eastern Europe
Chain Ladder method	The Chain Ladder method is an actuarial method commonly used to estimate claim reserve amounts. The method considers the historical development of reported paid and incurred claims and then extrapolates this historical claim development into the future to estimate future claim development. An important assumption in this method is that it expects the future development of claims to be similar to the historical average. The method involves some actuarial judgement in determining the assumption for the pattern of future claims from the historical data.
Colonnade Insurance S.A. ("CISA")	A Luxembourg company, ultimately owned by Fairfax, which it is proposed will accepted the Transferring Business under the Scheme
Commissariat aux Assurances ("CAA")	Luxembourg's insurance and reinsurance regulator. 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.
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).
European Economic Area ("EEA")	The 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.

Fairfax Financial Holdings Limited ("Fairfax")	Fairfax Financial Holdings Limited, a major Canadian holding company which, through its subsidiaries, is engaged in property and casualty insurance and reinsurance and investment management. The ultimate parent of CISA and Polish Re.
The Financial Conduct Authority (FCA)	The FCA is a regulatory agency that focusses 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.
The Financial Services Act 2012 (FinSA)	FinSA is an Act of the UK Parliament which implemented a regulatory framework for the financial system and financial services in the UK, and came into effect on April 1, 2013.
Financial Ombudsman Service (FOS)	Set up by the UK Parliament, the Financial Ombudsman Service is the UK's official expert in sorting out problems with financial services.
Financial Services Compensation Scheme (FSCS)	The FSCS is the compensation fund of last resort for customers of authorised financial services firms.
Framework Agreement	In the context of this Report, the Framework Agreement is an agreement entered into by QIEL and Fairfax, defining the terms under which QIEL's Hungarian, Slovakian and Czech businesses were sold to Fairfax.
Financial Services and Markets Act 2000 (FSMA)	FSMA, the legislation under which Part VII governs the transfer of (re)insurance business between (re)insurance undertakings.
Generally accepted accounting principles (GAAP)	The standard framework of guidelines for financial accounting used in any given jurisdiction.
IBNR	Incurred But Not Reported refers to the amount an insurer expects to pay in claims from claimants who have had a covered loss but have yet to report it.
International Financial Reporting Standards ("IFRS")	A common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
Loss Portfolio Transfer Agreement ("LPTA")	A reinsurance agreement under which the net liabilities of QIEL's Czech, Hungarian and Slovakian branches (i.e. the liabilities of the Transferring Business) were 100% reinsured by Polish Re.
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.
Own Risk Solvency Assessment ("ORSA")	The 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.
Polskie Towarzystwo Reasekuracji ("Polish Re")	A reinsurance company ultimately owned by Fairfax. Polish Re currently reinsures the Transferring Business under the LPTA.
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 are required to submit this information to the FSA.

Prudential Regulation Authority (PRA)	The PRA is part of the Bank of England and carries out the prudential regulation of financial firms, 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.
Quantitative Reporting Templates (QRTs)	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.
Required Capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (for example the Solvency II SCR).
Reinsurance	An arrangement with another insurer whereby risks are shared (or passed on).
Report	References to “the Report” refer to this report.
Scheme	In the context of this Report, the proposal that the Czech, Hungarian and Slovakian branch businesses of QIEL be transferred to CISA under the provisions of Part VII of FSMA.
Solvency I	The system for establishing minimum capital requirements for EU (re)insurers under relevant EU Directives prior to the introduction of Solvency II on 1 January 2016.
Solvency I Minimum Capital Requirement (“MCR_1”)	Required minimum level of capital under Solvency I rules. MCR_1 comprised the greater of a premium measure, a claims measure, a prior year MCR measure, and a minimum amount, last set at €3.7 million for year-end 2015.
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 II Minimum Capital Requirement (“MCR_2”)	MCR_2 is lower than the SCR, and defines the point of intensive regulatory intervention. The MCR_2 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).
Solvency Capital Requirement (“SCR”)	The SCR under Solvency II is the amount of capital required to ensure continued solvency over a 1 year trading time frame with a likelihood of 99.5%.
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.
Technical Provisions	Liabilities determined for regulatory purposes. 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 E for further details).
Transferring Business	QIEL’s Hungarian, Slovakian and Czech businesses, which are to be transferred to CISA under the Scheme.
Transferring Policyholders	The policyholders of the Transferring Business.
Underwriting Year	The year to which a claim is allocated based on the date the policy was written.

APPENDIX B LIST OF PREVIOUS TRANSFERS FOR WHICH GARY WELLS HAS ACTED AS THE INDEPENDENT EXPERT OR EQUIVALENT

1997: Transfer of the PHI business from Norwich Union Limited to Norwich Union Life & Pensions Limited

1997: Transfer of business from Security Assurance Limited to Norwich Union Life & Pensions Limited

1999: Transfer of the business of London & Edinburgh Life to Norwich Union Life & Pensions Limited

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 business from Arran Insurance Company Limited to Chevanstell Limited

2010: Transfer of business from Euler Hermes Guarantee plc to Euler Hermes UK plc

2011: Transfer of business from Euler Hermes UK plc to Euler Hermes Belgium

2011: Transfers of business from 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 certain European branch business of Mitsui Sumitomo Insurance Company (Europe) Limited to MSIG Insurance Europe AG.

2013: Transfer of the business 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 businesses of the RSA Group to ITAS Mutua.

2016: Transfer of the UK branch business of the Sompo Japan Nipponkoa Insurance Inc. to Transfercom Limited

2016: Transfer of the business of Cardrow Insurance Limited to Tenecom Limited

2016: Transfer of the business of Beech Hill Insurance Limited to Tenecom Limited (portfolio transfer under Irish legislation)

APPENDIX C TERMS OF REFERENCE

The Independent Expert's report is to 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 (i.e. QIEL and CISA).

The Independent Expert's review and report 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; and
- Any other matters drawn to my attention by the Regulators or which are required by the Regulators to be addressed within the Report.

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.

APPENDIX D KEY SOURCES OF DATA

D.1. In writing the Report, I relied upon the accuracy of certain documents provided by QIEL and CISA. These included, but were not limited to the following:

Legal and regulatory documents

- A copy of the Framework Agreement between QIEL and Fairfax dated 16 December 2014
- The application to the CAA for CISA's authorisation, dated 17 July 2015
- Letter to the PRA dated 18 February 2016 setting out the proposed policyholder notification arrangements
- Guarantees made as of 1 January 2016 and 1 January 2017 provided by Fairfax with regard to the performance of liabilities under CISA's insurance policies for the subsequent year
- Letter from Fairfax to the CAA dated 3 December 2015 guaranteeing the capitalisation of Fairfax Holdings Luxembourg Sarl
- Guarantee dated 7 September 2010 provided by Fairfax with regard to the performance of liabilities under Polish Re's insurance policies
- A legal opinion, dated 19 January 2017, addressed to CISA and me, from external lawyers (retained by Fairfax) on the enforceability of the guarantees given to CISA and Polish Re by Fairfax.
- A memo, dated 10 October 2016, addressed to CISA, QIEL and me, from external lawyers (retained by Fairfax) providing advice regarding the application of the Financial Ombudsman Service to the proposed Scheme.
- A letter, dated 25 November 2016, from the CAA to CISA confirming its approval of CISA's use of unpaid share capital of €7m as ancillary own funds under Solvency II.

Financial returns and projections

- PRA Return for QIEL for the year-ended 31 December 2015
- Audited report and accounts for QIEL as at 31 December 2015
- Financial statements for CISA as at 31 December 2015
- Report and accounts and auditor's opinion for Polish Re as at 31 December 2015
- Spreadsheets detailing the projected financial position of CISA over the period 2015-2019, including separate projections for the AIG Business

Solvency / Capital information

- QEO 2015 SCR Report dated 28 May 2015
- QEO Annual ORSA report dated 18 November 2015
- QEO November 2015 ORSA SCR Report dated 26 November 2015
- QIEL Day-1 QRTs as at 31 December 2015
- QIEL QRTs as at 30 June 2016
- A memo dated 16 February 2016 setting out the expect effect of the Scheme on QIEL's SCR
- Spreadsheets detailing the calculation of CISA's projected SCR using the standard formula as at year-ends 2016, 2017, 2018 and 2019

Reserving

- QIEL actuarial report as at 31 October 2014
- Actuarial memo dated 19 March 2015 bridging the reserves between 31 October 2014 and 31 December 2014
- QIEL actuarial report as at 30 September 2015
- Actuarial memo dated 15 March 2016 bridging the reserves between 30 September 2015 and 31 December 2015
- A spreadsheet detailing the held reserves and other accounting information for each of the branches of the Transferring Business as at 31 December 2015
- Spreadsheets detailing the results of QIEL's actuarial projections for each of the branches of the transferring business as at 31 October 2015.
- Spreadsheets showing claim and premium triangles for the each of the branches of the transferring business as at 31 October 2015.

Outwards reinsurance

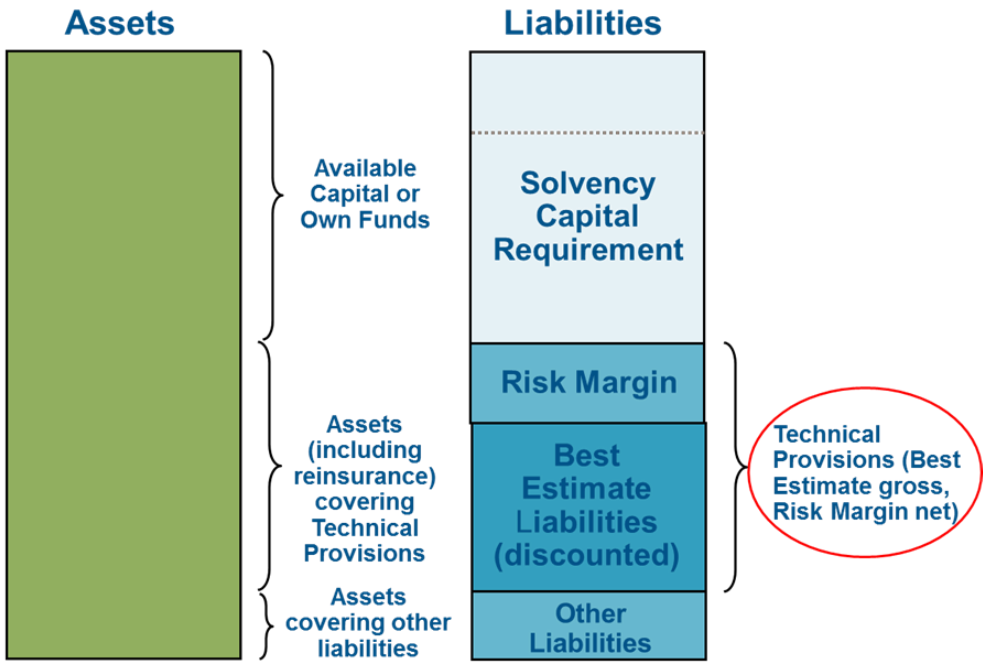
- A copy of the LPTA between QIEL and Polish Re (including the amendments such that the reinsurance agreement will no longer terminate if the Scheme is sanctioned).
- A document summarising QEO's 2016 outwards reinsurance programmes.
- A document summarising Fairfax's Central and Eastern Europe's 2016 outwards reinsurance arrangements.
- A spreadsheet showing the breakdown of QIEL's reinsurance asset by reinsurer as at 31 December 2015.

Information relating to the items listed above was also gathered during discussions with staff of QIEL and CISA.

APPENDIX E SOLVENCY II BALANCE SHEET

E.1. A simplified illustration of a Solvency II balance sheet is shown in Figure E.1 below.

Figure E.1
Solvency II balance sheet



E.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.

E.3. A key consideration for management in making significant decisions will be the excess of assets over Technical Provisions, other liabilities and the Solvency Capital Requirement (SCR). This excess of Own Funds over the SCR will determine whether the entity can expand existing business, move in to 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.

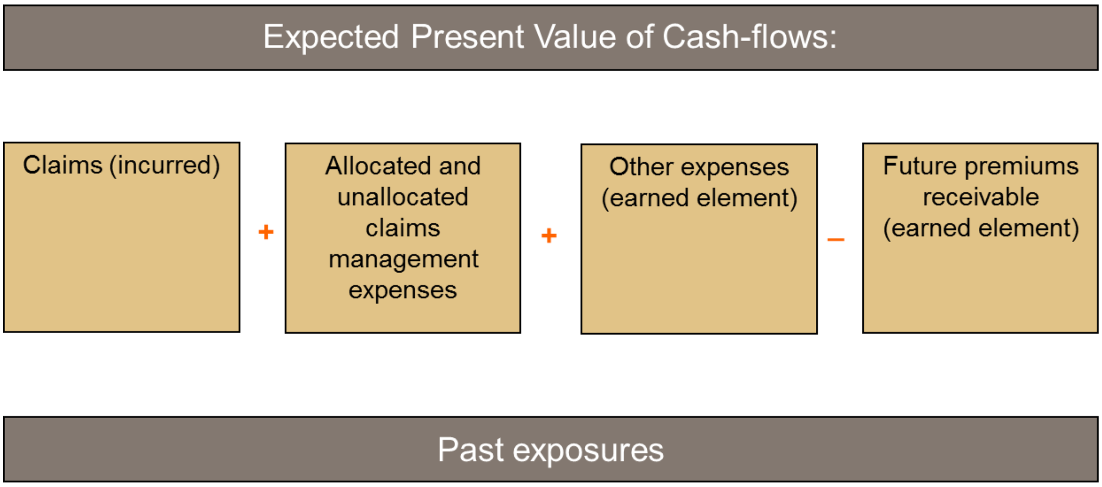
E.4. The Technical Provisions are a direct input to the balance sheet, and are therefore a fundamental input in to the SCR calculation that models the potential movement in the balance sheet over a one year time horizon.

E.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

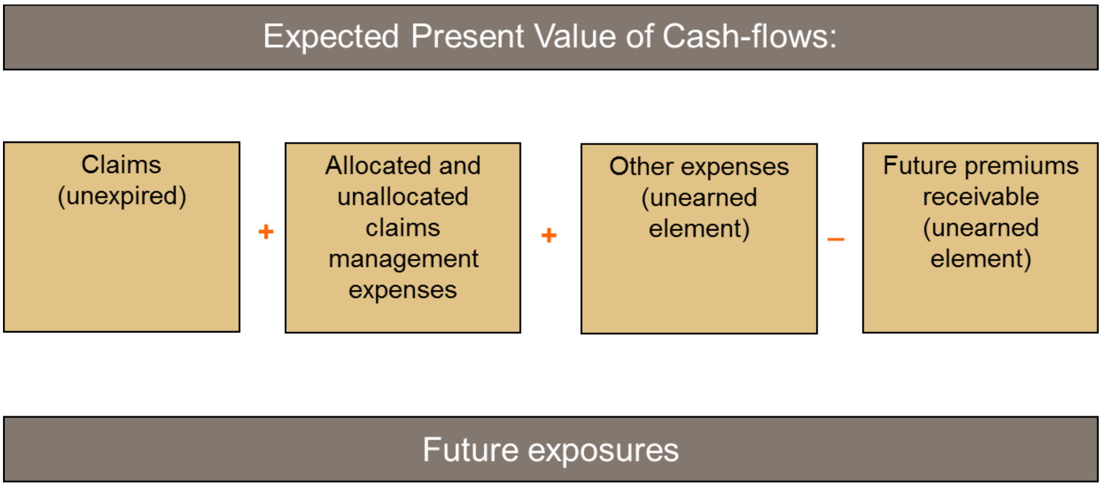
E.6. The claims provision is the expected present value/discounted 'best estimate' of all future cash-flows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date. Figure C.2 below illustrates the components of the claims provision calculation.

Figure E.2
Claim Provision



E.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 E.2
Premium Provision



E.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 F CISA SOLVENCY II PROJECTIONS AND STRESS TESTS

F.1. Table F.1 below shows projected balance sheets, SCRs and resulting Capital Cover Ratios for CISA over the next few years in a number of different scenarios. The first column of figures shows the position as at 31 December 2016, on the basis that the Part VII transfer will not take place and the AIG Business is not written. The next column shows the projected position on the same basis as at 31 December 2017. The next three columns show the projected position as at year-ends 2017-19 on the basis that the Scheme is sanctioned during 2017, but that the AIG Business is not written. The final three columns show the projected position as at year-ends 2017-19 assuming that the Scheme is sanctioned in 2017 and CISA commences writing the AIG Business in the second quarter of 2017.

Table F.1
Projected Solvency II Balance Sheets and SCRs for CISA (€000)

	Pre-Transfer Excluding AIG Business		Post Transfer Excluding AIG Business			Post Transfer Including AIG Business		
	31/12/2016	31/12/2017	31/12/2017	31/12/2018	31/12/2019	31/12/2017	31/12/2018	31/12/2019
Assets								
Bonds & Cash	23,638	39,603	39,603	52,271	65,368	88,132	117,371	134,819
Reinsurance share of technical provisions	216	276	16,973	11,071	8,921	31,358	38,417	41,827
Insurance recoverables	4,772	3,492	3,492	4,013	5,044	19,017	32,911	47,412
Other assets	2,970	0	0	0	0	0	0	0
Total Assets	**31,595**	**43,371**	**60,067**	**67,355**	**79,333**	**138,508**	**188,699**	**224,058**
Liabilities								
Gross technical provisions								
Best Estimate	6,825	17,544	34,642	36,345	41,132	69,076	98,957	116,651
Risk margin	1,818	2,348	2,371	2,958	3,182	3,354	4,256	4,498
(Re)insurance accounts payable	1,903	3,510	3,510	5,788	7,755	20,091	27,802	32,118
Other payables / accruals	2,235	0	0	0	0	0	0	0
Total Liabilities	**12,780**	**23,402**	**40,522**	**45,090**	**52,069**	**92,520**	**131,015**	**153,267**
Excess of Assets over Liabilities	**18,815**	**19,969**	**19,545**	**22,265**	**27,265**	**45,988**	**57,684**	**70,791**
Unpaid Share Capital (Tier 2 Own Funds)	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000
Deduction to restrict Tier 2 & 3 to 50% of SCR	(1,645)	0	0	0	0	0	0	0
Eligible Own Funds to cover SCR (X)	**24,170**	**26,969**	**26,545**	**29,265**	**34,265**	**52,988**	**64,684**	**77,791**
SCR (Y)	**12,868**	**16,294**	**16,682**	**20,193**	**21,981**	**34,576**	**46,059**	**50,776**
Capital Cover Ratio (X / Y)	**188%**	**166%**	**159%**	**145%**	**156%**	**153%**	**140%**	**153%**

F.2. Table F.2 below shows the results of the three balance sheet stress tests detailed in paragraph 7.63 above. The stress tests are carried out on the assumption that the Scheme is sanctioned in 2017 and CISA commences writing the AIG Business in the second quarter of 2017.

Table F.2
Results of Balance Sheet Stress Tests Applied to CISA (€000s)

	Base Scenario No Stress			Stress 1: Increase in TPs			Stress 2: Failure of Polish Re RI			Stress 3: Reduction in Investments		
Year End	2017	2018	2019	2017	2018	2019	2017	2018	2019	2017	2018	2019
Assets												
Bonds & Cash	88,132	117,371	134,819	88,132	117,371	134,819	88,132	117,371	134,819	70,767	94,514	108,998
Reinsurance share of technical provisions	31,358	38,417	41,827	47,037	57,626	62,740	18,968	30,568	35,741	31,358	38,417	41,827
Insurance recoverables	19,017	32,911	47,412	19,017	32,911	47,412	19,017	32,911	47,412	19,017	32,911	47,412
Total Assets	**138,508**	**188,699**	**224,058**	**154,187**	**207,908**	**244,972**	**126,117**	**180,850**	**217,972**	**121,143**	**165,842**	**198,237**
Liabilities												
Gross technical provisions												
Best Estimate	69,076	98,957	116,651	103,614	148,435	174,976	69,076	98,957	116,651	69,076	98,957	116,651
Risk margin	3,354	4,256	4,498	5,030	6,384	6,747	3,354	4,256	4,498	3,354	4,256	4,498
(Re)insurance accounts payable	20,091	27,802	32,118	20,091	27,802	32,118	20,091	27,802	32,118	20,091	27,802	32,118
Total Liabilities	**92,520**	**131,015**	**153,267**	**128,735**	**182,621**	**213,841**	**92,520**	**131,015**	**153,267**	**92,520**	**131,015**	**153,267**
Excess of Assets over Liabilities	**45,988**	**57,684**	**70,791**	**25,452**	**25,286**	**31,131**	**33,597**	**49,835**	**64,706**	**28,623**	**34,827**	**44,971**
Unpaid Share Capital (Tier 2 Own Funds)	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000	7,000
Eligible Own Funds to cover SCR	**52,988**	**64,684**	**77,791**	**32,452**	**32,286**	**38,131**	**40,597**	**56,835**	**71,706**	**35,623**	**41,827**	**51,971**
Change in Own Funds vs Base (€'000)				**-20,536**	**-32,398**	**-39,661**	**-12,391**	**-7,849**	**-6,086**	**-17,365**	**-22,857**	**-25,821**
Change in Own Funds vs Base (%)				**-39%**	**-50%**	**-51%**	**-23%**	**-12%**	**-8%**	**-33%**	**-35%**	**-33%**