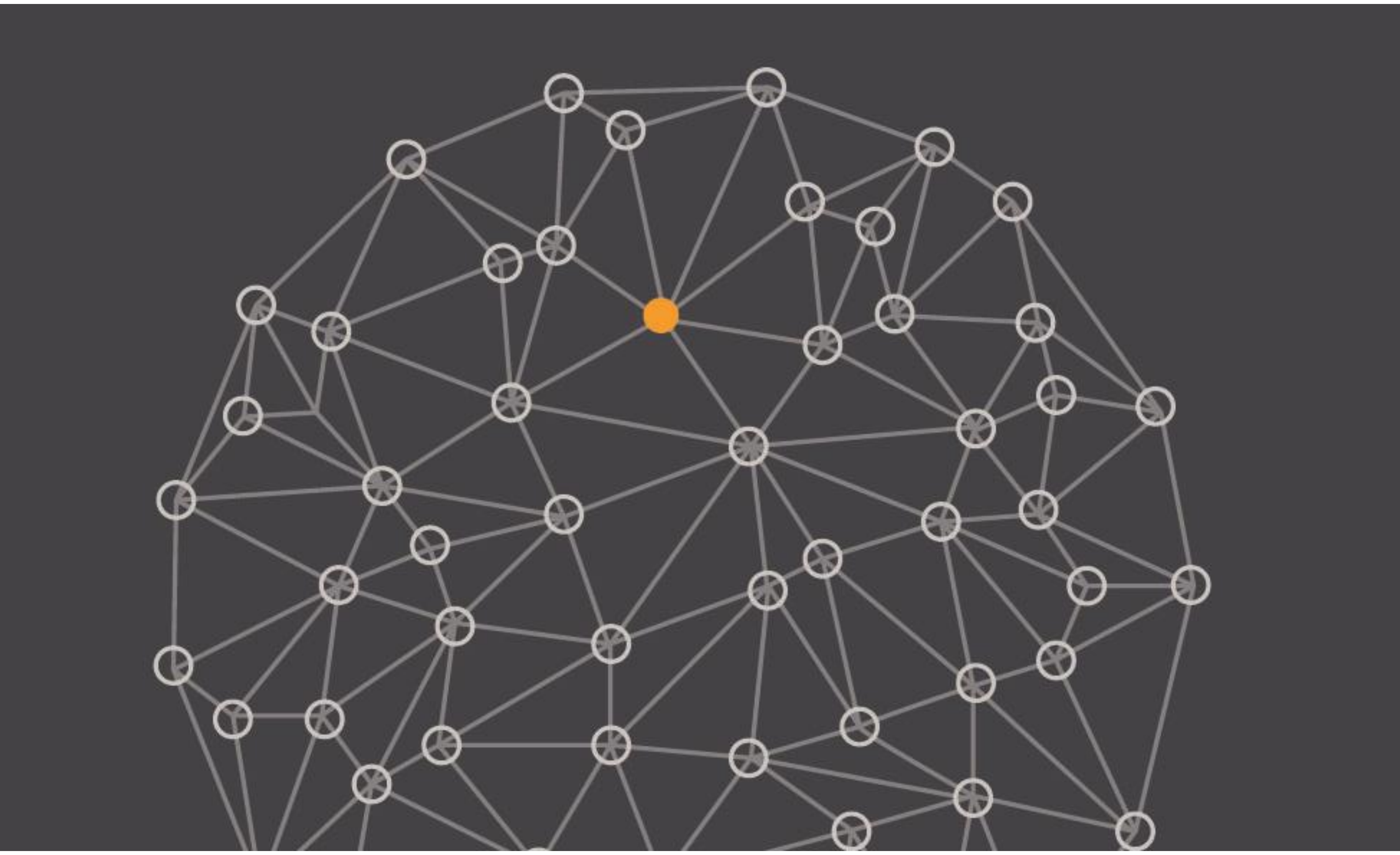
MILLIMAN CLIENT REPORT

Report of the Independent Expert to the High Court of Justice in England & Wales on the proposed transfer of business from QBE UK Limited, from The World Marine & General Insurance PLC and from R&Q Eta Company Limited to Inceptum Insurance Company Limited

18 July 2022

Derek Newton, FIA



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1. Purpose and Scope

PURPOSE OF THIS REPORT

1.1 It is proposed that certain business of QBE UK Limited (“**QUK**”), The World Marine & General Insurance PLC (“**WMG**”) and R&Q Eta Company Limited (“**Eta**”) (collectively the "**Transferors**") be transferred to Inceptum Insurance Company Limited (“**Inceptum**” or the "**Transferee**") by an insurance business transfer scheme ("**the Scheme**"), as defined in Section 105 of the Financial Services and Markets Act 2000 ("**FSMA**"). In this report (the "**Report**"), I refer to any such business transfer scheme as a "**Part VII Transfer**".

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 (“**FSMA Report**"). The FSMA Report must be prepared by an independent person (the “**Independent Expert**") who has the skills necessary to make the report and who is nominated or approved by the Prudential Regulation Authority ("**PRA**"), the PRA having consulted with the Financial Conduct Authority ("**FCA**"). The FSMA Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.

1.3 I refer to QUK, WMG, Eta and Inceptum collectively as "**the Parties**". The Parties have nominated me to act as Independent Expert to provide the FSMA Report in respect of the Scheme, and the PRA, in consultation with the FCA, has approved my appointment (see paragraph 1.11, below).

1.4 This Report describes the proposed transfer and discusses its possible effects on the policyholders of the Parties, including its effects on the security of policyholder benefits and levels of service. As such, this Report fulfils the requirements of the FSMA Report.

1.5 Each of the Parties is domiciled and authorised in the UK, and regulated by both the PRA and the FCA.

1.6 QUK is an indirect subsidiary of QBE Insurance Group Limited (“**QIGL**”). WMG, Eta and Inceptum are subsidiaries of Randall & Quilter Investment Holdings Limited (“**RQIH**”). In this Report, I refer to QIGL and its direct and indirect subsidiaries collectively as “**the QBE Group**” and to RQIH and its direct and indirect subsidiaries collectively as “**the R&Q Group**”.

1.7 A list of terms defined in this Report is shown in Appendix A. Otherwise, I use the same defined terms (which are capitalised in this Report) as are in the document that sets out the terms of the Scheme (the "**Scheme Document**").

THE SCHEME

1.8 Under the Scheme, it is intended that the business to be transferred to Inceptum (the “**Transferring Business**") comprises portfolios of legacy insurance policies written (or assumed) by each of the Transferors, and the supporting assets and associated liabilities.

1.9 The Effective Date of the Scheme is expected to be 2 December 2022.

1.10 The business involved in the Scheme, the arrangements for the Scheme and the effect of the Scheme are discussed in more detail in Sections 4 to 10 of this Report.

THE INDEPENDENT EXPERT

1.11 I, Derek Newton, have been appointed by the Parties as the Independent Expert to consider the Scheme under Section 109 of FSMA. My appointment has been approved by the PRA in consultation with the FCA; this was confirmed in a letter dated 29 November 2021.

1.12 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 ("**IFoA**"), 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 1988. My experience of general insurance includes (reserved) roles such as Signing Actuary to Lloyd's syndicates and to Irish non-life insurance companies, as well as acting as the Independent Expert in eight insurance business transfer schemes that were sanctioned in 2014, 2015, 2016, 2017, 2019, 2020 (two) and 2021 respectively. I have included my Curriculum Vitae in Appendix C in which I explicitly note the insurance business transfer schemes for which I have acted as the Independent Expert, as well as those for which I have provided peer review support to the Independent Expert.

1.13 I do not have, and, to the best of my knowledge, never have had, any direct or indirect interest in any of the parties involved in the proposed Scheme. I have never had any insurance policies with the Parties or with any entity related to the Parties, and I am not a shareholder or member of any entity related to the Parties. I have been involved in the following projects that relate to one or more of the parties:

- I was the Independent Expert in respect of the Part VII Transfer of general insurance business relating to the Ridgwell, Fox & Partners pool from QBE Insurance (Europe) Limited (which is now QUK) and from Moorgate Insurance Company Limited to Bothnia International Insurance Company Limited, a transfer that was sanctioned in 2017.
- In 2018, on behalf of RQIH, I led a review of a portfolio of motor insurance business that had been written in Israel but which was now in run-off (RQIH was considering providing reinsurance cover in respect of this portfolio).

Otherwise, I have not previously acted in an advisory role to either of the Parties or to any entity related to the Parties.

1.14 Milliman is a global firm and some of its many offices have, from time to time, been engaged by members of the QBE Group or of the R&Q Group to provide consultancy services. Over the period 2017-2021 inclusive, work performed on behalf of the QBE Group has accounted for 0.010% of Milliman's total client charges over the period, peaking in 2018 at 0.020% of Milliman's client charges for that year. Over the same period, work performed on behalf of the R&Q Group has accounted for 0.005% of Milliman's total client charges over the period, peaking in 2020 at 0.011% of Milliman's client charges for that year. Milliman has performed no work within at least the last five years for any of WMG, Eta and Inceptum, including prior to their acquisition by the R&Q Group and including under previous names.

1.15 I believe that, for all practical purposes, I am independent for the purposes of assessing the proposed Scheme.

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

1.17 Inceptum will meet the cost of my work as Independent Expert. No costs of the Scheme will be borne directly by any of the policyholders of the Parties.

THE SCOPE OF MY REPORT

1.18 My terms of reference have been reviewed by the PRA and by the FCA and are set out in Appendix D.

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

1.20 The Report describes the Scheme and their likely effects on policyholders of QUK, WMG, Eta and Inceptum, including effects on the security of policyholders' benefits and levels of service.

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

1.22 My work has required an assessment of the liabilities of QUK, WMG, Eta and Inceptum for the purposes of describing the effect of the Scheme. My review of the liabilities was based on the actuarial reserve assessments conducted by in-house actuaries employed by QUK, on behalf of QUK, and by in-house actuaries employed by the R&Q Group, on behalf of Eta, WMG and Inceptum. 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 various actuaries on behalf of QUK, Eta, WMG and Inceptum or to produce independent estimates of the liabilities.

1.23 In addition to the liabilities, I have assessed the appropriateness in nature and amount of any assets to be transferred under the Scheme, and the capital position of QUK, WMG, Eta and Inceptum both pre- and post-Scheme. Again, I have not attempted to review in detail the calculations of the capital position performed by QUK and R&Q Group employees, respectively on behalf of QUK and the three R&Q Group companies, and I have not attempted to produce independently my own estimates.

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

1.25 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 QUK and / or to Inceptum. I confirm that I have complied with this duty.

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

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

1.28 Shortly before the date of the Court hearing at which an order sanctioning the Scheme will be sought, I will prepare a supplemental report ("**Supplemental Report**") that will cover any relevant matters that might have arisen since the date of this Report.

Materiality

1.29 After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 5.13 below), 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 that, 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.

1.30 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.

1.31 When assessing the financial security of policyholders, I have looked at the solvency position of the Parties, both pre- and post-Scheme, relative to regulatory solvency requirements, and also at the nature of the assets that constitute each company's capital and surplus. 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 level of financial security projected to be in place 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 relative to the normal constraints under which the company's capital position was managed before the transfer.

THE STRUCTURE OF MY REPORT

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

- Section 2: I provide an executive summary of this Report (I have also provided a separate summary of this Report, as described in paragraph 1.38, below).
- Section 3: I provide some background information regarding the environment in which the Parties operate.
- Section 4: I provide some background information regarding each of the Parties.
- Section 5: I summarise the key provisions of the Scheme.

- Section 6: I consider the likely impact of the Scheme on the holders of policies included within the Transferring Business (“**Transferring Policyholders**”).
- Section 7: I consider the likely impact of the Scheme on the policyholders who would remain within QUK after the transfer has taken place (“**QUK Non-Transferring Policyholders**”).
- Section 8: I consider the likely impact of the Scheme on the policyholders who would remain within Eta after the transfer has taken place (“**Eta Non-Transferring Policyholders**”) and on the policyholders who would remain within WMG after the transfer has taken place (“**WMG Non-Transferring Policyholders**”).
- Section 9: I consider the likely impact of the Scheme on the current policyholders of Inceptum.
- Section 10: I cover more general issues relating to the Scheme and the management of the Parties.

1.33 I summarise my conclusions in Section 11.

RELIANCES AND LIMITATIONS

1.34 In carrying out my review and producing this 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 the Parties. Reliance has been placed upon, but not limited to, the information detailed in Appendix B. My opinions depend on the substantial accuracy of this data, information and the underlying calculations. I am unaware of any issue that might cause me to doubt the accuracy of the data and other information provided to me. All information that I have requested in relation to my review has been provided. I have been assisted in my review of the information and my analyses by colleagues of mine at Milliman but I have not relied on their work or their advice.

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

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

1.37 Neither this Report, nor any extract from it, may be published without me having provided my specific written consent, save that

- copies of this Report may be made available for inspection by policyholders who might be affected by the Scheme, and
- copies may be provided to any person requesting the same in accordance with legal requirements.
- I explain in paragraph 5.45, below, that QUK and the R&Q Group intend to set up a specific page on their respective websites dedicated to the Scheme. I consent to this Report being made available on the QUK and R&Q Group website pages dedicated to the Scheme.

1.38 No summary of this Report may be made without my express consent. I will provide a summary of this Report (the "**Report Summary**") for inclusion in a document that will be made available to the affected policyholders of QUK and of Inceptum, to the lawyers and brokers dealing with or representing individual claimants in relation to the Transferring Business, and to anyone who has been identified as having an interest in the policies being transferred or who has notified QUK or Inceptum of their interest (further details are provided in paragraphs 5.39-5.43, below). That document will be sent to the FCA and PRA, will accompany the Scheme application to the Court, and will be available on the QUK and R&Q Group website pages dedicated to the Scheme.

1.39 This 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. Milliman and/or I will accept no liability for any application of this Report to a purpose for which it was not intended or for the results of any misunderstanding by any user of any aspect of this Report. In particular, no liability will be accepted by Milliman or me under the terms of the Contracts (Rights of Third Parties) Act 1999.

1.40 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 this Report. No warranty is given by Milliman or me that the assumptions, results and conclusions on which this Report is based will be reflected in actual future experience.

1.41 This review does not comprise an audit of the financial resources and liabilities of QUK, Eta, WMG or Inceptum.

1.42 The Report should not be construed as investment advice.

1.43 Nothing in this Report should be regarded as providing a legal opinion on the effectiveness of the Scheme.

1.44 In considering the background to the Parties, and in considering the likely impact of the Scheme, I have made extensive use of the most recent audited financial information that is available. I have also taken into account updated financial information that has been made available to me, although I note that this updated information has not been audited and that, in general, it has not been publicly disclosed. I have asked the managements of the Parties for information regarding any developments between the dates of their respective most recent audited financial statements and the date of this Report that would have affected the Parties, in particular any development that might have affected the security of their policyholders and the standards of service provided to them, both now and in future. I have referred in this Report to the developments that they have reported to me. The managements of the Parties have confirmed to me that there have been no other such developments. I have also searched using on-line resources for information regarding any such developments. At the date of this Report, I am not aware of any material changes in circumstances since the dates of the Parties’ respective most recent audited financial statements other than those referred to in this Report. The Report also takes no account of any information that I have not received, or of any inaccuracies in the information provided to me. I will review any further financial statements of the Parties, whether audited or unaudited, as and when they become available, and will comment on this information in my Supplemental Report.

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

PROFESSIONAL AND REGULATORY GUIDANCE

1.46 I am required to comply with relevant professional standards and guidance maintained by the Financial Reporting Council and by the IFoA, including *TAS 100: Principles for Technical Actuarial Work* and *TAS 200: Insurance*. I have complied with such standards, subject to the principles of proportionality and materiality.

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

1.48 This Report has been prepared under the terms of the guidance set out in the Statement of Policy entitled *Insurance business transfers* ("**the Policy Statement**"), issued by the PRA in January 2022 (see Appendix F), and in Section 18 of the FCA Supervision Manual ("**SUP18**") contained in the Handbook of Rules and Guidance to cover scheme reports on the transfer of insurance business. I have also followed the guidance contained within the FCA's February 2022 paper on Part VII Transfers (“**FG22/1**”).

2. Executive Summary

CONCLUSION

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

- the Scheme will not materially adversely affect the security of the benefits of:
    - the policyholders of QUK whose policies will be transferred under the Scheme ("**QUK Transferring Policyholders**");
    - the QUK Non-Transferring Policyholders;
    - the Eta policyholders;
    - the WMG policyholders; and
    - the existing Inceptum policyholders;

  and
- the Scheme will not have any impact on service standards experienced by:
    - the QUK Transferring Policyholders;
    - the QUK Non-Transferring Policyholders;
    - the Eta policyholders;
    - the WMG policyholders; and
    - the existing Inceptum policyholders..

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

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

THE SCHEME

2.4 The Transferring Business consists primarily of legacy liabilities (mostly UK Employers' Liability ("**EL**") and UK Public Liability ("**PL**") policies), underwritten or assumed by QUK prior to 1 January 2008, and the supporting assets (the "**QUK Transferring Business**"). It also comprises all remaining business written or assumed by Eta and WMG, which have been in run-off since 2012 and 2001 respectively, again with the supporting assets. Under the Scheme, the Transferring Business will be transferred to Inceptum.

2.5 The QUK Transferring Business comprises approximately 2.4 million transferring policies (the "**QUK Transferring Policies**") that in turn cover approximately 0.8 million individual policyholders (the "**QUK Transferring Policyholders**"). The QUK Transferring Business was written up to the end of 2007. There are approximately 1,500 claims within the QUK Transferring Business that remain open, covering approximately 700 policyholders. As at 31 December 2021, QUK carried GAAP reserves in respect of the QUK Transferring Business totalling £58.0 million, gross of reinsurance (nil, net of reinsurance). These reserves equate to 2.6% of QUK's total GAAP reserves, gross of reinsurance, as at 30 September 2021 (nil, net of reinsurance).

2.6 The business that the Scheme is intended to transfer from Eta to Inceptum (the "**Eta Transferring Business**") comprises 427 transferring policies (the "**Eta Transferring Policies**") that in turn cover 326 individual policyholders (the "**Eta Transferring Policyholders**"). The Eta Transferring Business was written between 2004 and 2012. There are no claims within the Eta Transferring Business that remain open. As at 31 December 2021, Eta carried nil GAAP reserves (both gross and net of reinsurance) in respect of the Eta Transferring Business.

2.7 The business that the Scheme is intended to transfer from WMG to Inceptum (the "**WMG Transferring Business**") comprises approximately 16,085 transferring policies (the "**WMG Transferring Policies**") that in turn cover approximately 3,901 individual policyholders (the "**WMG Transferring Policyholders**"). The WMG Transferring Business was written up to the end of 2001. There are ten claims within the WMG Transferring Business that remain open. As at 31 December 2021, WMG carried GAAP reserves in respect of the WMG Transferring Business totalling £986k, gross of reinsurance (£95k, net of reinsurance). These reserves equate to 100% of WMG's total GAAP reserves, both gross and net of reinsurance, as at 31 December 2021.

2.8 Since its establishment in 1998 until its closure to new business in 2009, Inceptum wrote 3,142,571 personal and commercial UK motor policies over the period 1998-2009, since when it has been in run-off. As at 31 December 2021, 19 claims remained open. As at 31 December 2021, Inceptum carried GAAP reserves totalling £88.4 million, gross of reinsurance (£4.4 million, net of reinsurance). If the Scheme is sanctioned, the Transferring Business would, in total, represent approximately 67% by value of Inceptum's existing business based on the GAAP accounts as at 31 December 2021.

Motivation for the Scheme

2.9 As described in paragraph 4.54, below, QUK has already transferred to the R&Q Group the economic liability for the QUK Transferring Business. One purpose of the proposed Scheme is to align the legal liability for the QUK Transferring Business with the economic liability for the QUK Transferring Business. This will also provide finality to QUK.

2.10 The inclusion within the Scheme of the business of Eta and WMG enables the R&Q Group to advance its strategic plan of streamlining and amalgamating acquired business in order to achieve capital and governance efficiencies. The Scheme will combine the businesses of Eta and WMG with that of Inceptum, enabling the R&Q Group to wind-up Eta and WMG post-Scheme.

Policyholders Affected

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

- the Transferring Policyholders, specifically
    - The QUK Transferring Policyholders;
    - The Eta Transferring Policyholders; and
    - The WMG Transferring Policyholders;
- the QUK Non-Transferring; and
- the current policyholders of Inceptum.

2.12 I have not considered the effects of the Scheme upon, per se, current policyholders of either Eta or WMG whose policies will not be transferred under the Scheme, as it is intended that there will be none. However, it is possible that not all of the Transferring Policies will be transferred to Inceptum by the Scheme. I refer in this Report to any such policies as "**Excluded Policies**" and have also considered the impact of the Scheme on holders of Excluded Policies. I discuss Excluded Policies further in paragraphs 5.15-5.16, below.

Administration

2.13 As described in paragraph 4.54, below, the QUK Transferring Business is currently wholly administered by R&Q Central Services Limited ("**RQCS**"), which is the UK services division of the R&Q Group. Eta, WMG and Inceptum currently outsource all administrative functions, including claims handling and policy servicing, to RQCS[1]. It is intended that RQCS will continue to provide, post-Scheme, all claims handling and policy servicing in respect of the Transferring Business and the existing Inceptum, i.e. there should be no change in the servicing of policies.

THE IMPACT OF THE SCHEME UPON THE TRANSFERRING POLICYHOLDERS

2.14 I am satisfied that the proposed Scheme does not affect in a materially adverse way either the security or the policy servicing levels of the Transferring Policyholders. I have reached this conclusion by considering:

- the reserves of the Parties as at 31 December 2021 (and subsequently where available);
- the excess assets of the Parties as at 31 December 2021 (and subsequently where available);

[1] *A small part of the business of WMG is administered by Resolute Management Services Ltd ("**RMSL**"), as explained in paragraph 4.104, below. Post-Scheme, RMSL will continue to administer that business.*

- the risk exposures in the Parties and the impact that the Scheme might have on those; and
- the standards of policy servicing in each of the Parties.

2.15 I concluded that:

- the reserves of QUK, Eta, WMG and Inceptum appeared reasonable as at 31 December 2021;
- there is no reason to think that the reserve strength of QUK or Inceptum will be impacted by the Scheme (it is expected that no business will remain post-Scheme within either Eta or WMG and so no reserving will be required post-Scheme for either Eta or WMG);
- as at 31 December 2021, QUK is a well-capitalised company, Eta is a more than sufficiently capitalised company, WMG is a very well-capitalised company and Inceptum is a well-capitalised company (I have defined these terms in paragraph 6.3, below);
- the Transferring Policyholders will not be materially adversely affected due to relative differences in the financial strength of Inceptum post-Scheme to those of QUK, Eta or WMG pre-Scheme;
- 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; and
- the proposed Scheme is unlikely to have any impact on the standards of policy servicing experienced by the Transferring Policyholders compared to their current position.

THE IMPACT OF THE SCHEME UPON THOSE POLICYHOLDERS REMAINING WITHIN QUK

2.16 I am satisfied that the security of the contractual rights and the standards of policy servicing currently enjoyed by the QUK Non-Transferring Policyholders, and by any holders of QUK policies that become Excluded Policies, will not be adversely affected by the Scheme.

2.17 In reaching this conclusion I have noted that:

- post-Scheme, the insurance liabilities of QUK will essentially be unchanged (the QUK Transferring Business having been 100% reinsured by a third party since 2016); and
- there are no planned changes to the policy service standards within QUK post-Scheme.

THE IMPACT OF THE SCHEME UPON THOSE POLICYHOLDERS REMAINING WITHIN EITHER ETA OR WMG

2.18 The only policyholders who will remain within either Eta or WMG will be those (if any) whose policies become Excluded Policies. I am satisfied that the security of the contractual rights and the standards of policy servicing currently enjoyed by the policyholders (if any) who will remain within either Eta or WMG will not be adversely affected by the Scheme.

2.19 In reaching this conclusion I have noted that:

- post-Scheme, while they retain the various permissions from the PRA (which will not be withdrawn while insurance liabilities remain), both Eta and WMG will maintain solvency capital that is at least equal in value to the Minimum Capital Requirement ("**MCR**"). As such, the security of any remaining insurance liabilities would be very well protected; and
- there are no planned changes to the policy service standards within either Eta or WMG post-Scheme.

THE IMPACT OF THE SCHEME UPON THE EXISTING POLICYHOLDERS OF INCEPTUM

2.20 I have concluded that the Scheme would not have a materially adverse impact on the existing policyholders of Inceptum.

2.21 In reaching this conclusion I have noted that:

- Inceptum's estimates of solvency, assuming the successful completion of the Scheme, suggest that Inceptum will be a well-capitalised company as at 31 December 2022 (the first year-end after the Scheme's Effective Date), consistent with its position as at 31 December 2021;
- although the proposed Scheme will lead to a change to the risk exposures of the existing Inceptum policyholders, this will not have a materially adverse impact on the security of their benefits; and
- there are no planned changes to the policy service standards within Inceptum post-Scheme.

THE IMPACT OF THE SCHEME IN RESPECT OF OTHER MATTERS

2.22 I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts relate to the Transferring Business. Of the Transferring Business, only the WMG Transferring Business benefits from outwards reinsurance. There is no outwards reinsurance in respect of the other parts of the Transferring Business. I am satisfied that the Scheme will not have a materially adverse effect on the reinsurers of the WMG Transferring Business. The administration of the WMG Transferring Business, including the management and handling of claims, will continue to be performed post-Scheme by the same people, using the same processes, as it had been pre-Scheme, so the magnitude and timing of recoveries claimed against reinsurance contracts relating to the WMG Transferred Business will be unaffected by the Scheme.

2.23 I have been informed that the Scheme is not expected to have any material tax implications that would affect any of the Parties or any of the groups of policyholders identified in paragraph 2.11, above.

2.24 I have been provided with an estimate of the external costs of the Scheme. I consider that the costs of the Scheme will not be such as to jeopardise the security of any of the groups of policyholders.

APPROACH TO COMMUNICATION WITH POLICYHOLDERS

2.25 The Parties' approach to communicating the Scheme to affected policyholders and their brokers is outlined in paragraphs 5.37-5.46, below.

2.26 I consider the approach being taken in relation to the affected policyholders to be reasonable.

2.27 The Parties will apply to the Court for a waiver of the notification requirements in respect of

- the QUK Non-Transferring Policyholders;
- those QUK Transferring Policyholders who neither have an open claim under a QUK Transferring Policy nor have notified an industrial disease claim since 1 January 2017;
- the Eta Transferring Policyholders;
- those WMG Transferring Policyholders who do not have an open claim under a WMG Transferring Policy
- those Inceptum policyholders who do not have an open claim under an Inceptum policy.

2.28 In addition to direct, written correspondence with specific policyholders, their brokers and their solicitors, the reinsurers of the WMG Transferring Business, and certain other interested parties (as identified in paragraph 5.39, below), the Parties also plan indirect notification via advertisements in appropriate publications, including two UK national newspapers in the UK, specialist industry publications and the websites of relevant industry bodies.

2.29 The letters, notices and advertisements will refer all queries to a postal address or a telephone number or an email address, all of which are intended to respond promptly to any such queries. Both this Report and the Supplemental Report will be published on the R&Q Group and QUK websites, on pages dedicated to the Scheme.

3. Background regarding the regulatory environments

OVERVIEW OF UK INSURANCE REGULATION

Background

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

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

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

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

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

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

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

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

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

Taxation

3.7 In the UK, proprietary general insurance companies are taxed on profits achieved at the main rate of corporation tax (currently 19% for the financial year ending 31 March 2023). Mutual general insurance companies are taxed only on their investment income and, to the extent that they conduct some business not on a mutual basis, on the proceeds of that non-mutualised business.

Financial Services Compensation Scheme

3.8 As well as through the PRA and FCA regulations, consumer protection is also provided by the Financial Services Compensation Scheme ("**FSCS**"). This is a statutory "fund of last resort", which compensates customers in the event of the insolvency (or other defined default) of a financial services firm authorised by the PRA or FCA, subject to certain eligibility rules. Insurance protection exists for private policyholders and small businesses[2] that hold eligible policies in the situation when an insurer is unable to meet fully its liabilities. For general insurance business, the FSCS will pay 100% of any claim incurred before the default:

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

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

and 90% of any claim incurred before the default for other eligible types of insurance (such as home insurance).

3.9 These limits have been effective since 3 July 2015; prior to that date, for general insurance business, only claims in respect of compulsory insurance were eligible for 100% payment by the FSCS in the event of the default of an authorised firm.

3.10 No protection is available for Goods in Transit, Marine, Aviation and Credit Insurance. Contracts of reinsurance are also not protected. The FSCS is funded by annual levies on all firms regulated by the PRA and by the FCA, with separate tariffs for each of five broad classes of activity (deposits, life and pensions, general insurance, investments and home finance).

Financial Ombudsman Service

3.11 The Financial Ombudsman Service ("**FOS**") provides eligible complainants with a free, independent service for resolving disputes with financial companies. An eligible complainant must be a person that is one of the following:

- a consumer (essentially, a private individual);
- a micro-enterprise[3];
- a charity that has an annual income of less than £6.5 million at the time that the complaint is made;
- a trustee of a trust that has a net asset value of less than £5 million at the time that the complaint is made;
- in relation to consumer buy-to-let ("**CBTL**") business, a CBTL consumer;
- a small business[4] at the time the complainant refers the complaint to the respondent;
- a guarantor.

3.12 For a complaint regarding an insurance policy to be dealt with by the FOS, it is not necessary for the complainant to live or be based in the UK, but it is necessary for the insurance policy concerned to be, or have been, administered from within the UK.

FCA Conduct Principles

3.13 Within its document "*Fair treatment of customers*", the FCA sets out six consumer outcomes that firms (and the UK branches of insurers not domiciled in the UK) should strive to achieve to ensure fair treatment of customers. These remain core to what the FCA expects of firms. These are as follows:

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

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

[3] An entity is considered to be a micro-enterprise if it has an annual turnover of less than €2 million and fewer than ten employees.

[4] According to FOS eligibility rules, a small business is a business that is not a micro-enterprise but which has an annual turnover of less than £6.5 million and either has a balance sheet total of less than £5 million or employs fewer than 50 people.

3.15 The FCA has supplemented its *Fair Treatment of Customers* document with guidance, published in January 2018, entitled *The Responsibilities of Providers and Distributors for the Fair Treatment of Customers* ("**RPPD**"). This provides the FCA's view on what the combination of Principles for Businesses and detailed rules require respectively of providers and distributors in certain circumstances to treat customers fairly. The RPPD looks particularly to the following four of the FCA's eleven Principles:

- Principle 2: A firm must conduct its business with due skill, care and diligence;
- Principle 3: A firm must take reasonable care to organise and control its affairs responsibly and effectively, with adequate risk management systems;
- Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly; and
- Principle 7: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way that is clear, fair and not misleading..

3.16 The FCA has published proposals for a new "Consumer Duty" that are intended to set higher expectations for the standard of care that UK insurers and intermediaries must provide to customers, and to deliver a significant shift in culture and behaviour by consistently focusing on customer outcomes. The consultation period for the proposed rule changes closed on 15 February 2022 and new rules are expected to be published by 31 July 2022.

3.17 Central to the Consumer Duty is a "Consumer Principle" that firms must act to deliver good outcomes to retail clients. The Consumer Principle is supported by the "Four Outcomes," which are a suite of rules and guidance setting more detailed expectations for firm conduct in four areas that represent key elements of the firm-consumer relationship:

- the governance of products and services;
- price and value;
- consumer understanding; and
- consumer support.

3.18 The key behaviours required by the Consumer Duty are set out by "Cross-cutting Rules," and make clear that the Consumer Principle requires firms to:

- act in good faith;
- take all reasonable steps to avoid foreseeable harm to consumers; and
- take all reasonable steps to enable consumers to pursue their financial objectives.

3.19 The Consumer Duty is underpinned by the concept of reasonableness. This is an objective test and means the rules and this guidance must be interpreted in line with the standard that could reasonably be expected.

3.20 The proposals contain much detail but the FCA has helpfully summarised its expectations that, under the Consumer Duty, firms should:

- put consumers at the heart of their business
- provide products and services that are fit for purpose, that they know provide fair value, that help consumers achieve their financial objectives and which do not cause them harm
- communicate and engage with consumers so that they can make effective, timely and properly informed decisions about financial products and services and take responsibility for their actions and decisions
- not seek to exploit customers' behavioural biases, lack of knowledge or characteristics of vulnerability
- support their customers in realising the benefits of the products and services they buy and acting in their interests without unreasonable barriers
- consistently consider the needs of their customers, and how they behave, at every stage of the product/service lifecycle
- continuously learn from their growing focus and awareness of real customer outcomes
- embed a culture of acting to deliver good outcomes in each of their business functions and related policies, from high-level strategic planning to individual customer interactions
- monitor and regularly review the outcomes that their customers are experiencing in practice and take action to address any risks to good customer outcomes, and

- ensure that their management and executive body takes full responsibility for the outcomes their customers are experiencing, in line with their accountability under the Senior Managers and Certification Regime.

The Insurance Distribution Directive

3.21 The Insurance Distribution Directive ("**IDD**") has applied in the UK (and in all EU Member States) with effect from 1 October 2018. The key requirements of the IDD are:

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

The Insurers (Reorganisation and Winding-Up) Regulations 2004

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

SOLVENCY CAPITAL FRAMEWORK (SOLVENCY II)

3.23 With effect from 1 January 2016, the regulatory solvency and reporting framework for (re)insurers regulated within the EU, which is commonly referred to as Solvency II, introduced, consistently across the EU, solvency requirements that reflect the risks that individual (re)insurers actually face.

3.24 The UK left the EU with effect from 31 January 2020. Effectively, the UK continues to apply Solvency II, having transcribed an identical regime into UK regulations. I therefore refer in this Report to the UK's regulatory regime as Solvency II.

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

- Under Pillar I, quantitative requirements define a market consistent framework for valuing the company's assets and liabilities, and determining the Solvency Capital Requirement ("**SCR**") and the Minimum Capital Requirement ("**MCR**").
- 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 internal audit and actuarial functions. Insurers must regularly complete an Own Risk and Solvency Assessment ("**ORSA**").
- Under Pillar III, there are explicit requirements governing disclosures to supervisors and policyholders.

3.26 Under Solvency II, both the assets and liabilities of insurers are valued on a market consistent basis. Therefore, under Solvency II, the 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) are often substantially different from those calculated under the current requirements for IFRS/GAAP.

3.27 I set out in Appendix G simplified details for the balance sheet, and the calculation of technical provisions (in respect of claims incurred and losses arising from unexpired exposures), for an insurer under Solvency II. In this Report I denote technical provisions under Solvency II as "**TPs**".

3.28 TPs as relating to general insurance business are:

- The premium provision: the expected present value (with no allowance for optimism or prudence) of all future cash-flows (claim payments, expenses and future premiums due) relating to future exposures arising from policies for which the insurer is obligated as at the valuation date;

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

3.29 TPs in respect of claims required under Solvency II differ from the GAAP/IFRS reserves in several ways, including the following:

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

I have set out the differences and their balance sheet implications in Appendix H.

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

- Using an internal model approved by the local supervisor: an internal model calculation of the SCR is based upon an assessment of the risks specific to an insurer, and is calibrated so as to correspond to a confidence level of 99.5% over a one-year trading period that net assets remain positive (i.e. the insurer remains solvent); or
- Using the standard formula specified in detail in the Solvency II legislation (the "**Standard Formula**"): the Standard Formula is designed to be applicable to all insurers and is not therefore tailored to the circumstances of an individual insurer. In summary, the basic SCR consists of five 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 five main modules, which in turn are aggregated using a further correlation matrix to determine the basic SCR. A further module is used to calculate operational risk, which is added to the basic SCR to produce the (Standard Formula) SCR.

3.31 The MCR defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over a one-year time horizon (compared to 99.5% for the SCR). The MCR is calculated as a linear function of the TPs 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 €3.7 million for (re)insurers writing liability, credit or suretyship classes).

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

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

BREXIT

3.33 As mentioned above in paragraph 3.24, the UK formally withdrew from membership of the EU on 31 January 2020, and the formal transition period concluded on 31 December 2020. The EU and UK have signed a Trade and Cooperation Agreement, which reaffirmed the commitment of both the UK and the EU to ensure financial stability, market integrity and the protection of investors and consumers of financial services. It further noted agreement for enhanced regulatory cooperation between the UK and the EU and the integrity of the respective, autonomous equivalence financial services frameworks. This suggests that it is unlikely that the UK Government will, in the foreseeable future, seek to cancel or materially alter its existing solvency regime for insurers such that it deviates materially from the Solvency II regime that applies throughout the EU. However, I note that:

- consultation exercises have recently been conducted in both the UK and EU that are expected to result in some adjustments to the respective regulatory regimes; and
- despite the UK's solvency regime (currently) being identical to how it was pre-Brexit and to the Solvency II regime currently in-force across the EU, the EU has declined to declare the UK's solvency regime to be equivalent to its Solvency II regime.

3.34 While I note the possibility of future changes to the UK's solvency regime, I would be surprised were any such changes to affect materially the matters that I have considered in this Report and hence my conclusions, Therefore, I have not considered further this possibility in this Report.

4. Background regarding the entities concerned in the Scheme

4.1 In this section of the Report, I set out some background information and key metrics relating to the entities that are involved in the Scheme.

- In paragraphs 4.3-4.57, below, I discuss QUK.
- In paragraphs 4.58-4.99, below, I discuss Eta.
- In paragraphs 4.100-4.133, below, I discuss WMG.
- In paragraphs 4.134-4.170, below, I discuss Inceptum.
- For each entity, I cover the following:
  - general information about the entity, including the types of business it writes or has written;
  - key financial information relating to entity;
  - outwards reinsurance arrangements (if any) that protect the entity;
  - the entity's governance structure;
  - the entity's risk management strategy;
  - the key risks faced by the entity how those risks are being managed;
  - the entity's capital policy;
  - the entity's conduct risk policy and its procedures for handling complaints
  - the entity's current plans.
- For QUK, WMG and Eta, I also discuss the business that they are intending to transfer to Inceptum via the Scheme.

4.2 Readers should understand that I intend the content of this section of the Report to be factual. I reserve my opinions on these (and other) facts to Sections 6-11 of this Report.

QUK

Background

4.3 QUK is an insurance company, registered as a private limited company in England and Wales (registered number 01761561) under the Companies Act 2006. QUK is a wholly owned subsidiary of QBE Holdings (EO) Ltd ("**QEO**"). QEO is registered as a public limited company in England and Wales (registered number 2641728) under the Companies Act 2006. QIGL, which is incorporated in Australia, is the ultimate holding company of QUK.

4.4 Prior to 31 December 2018, QUK was known as

- Legibus 373 Limited (from the date of its incorporation, 14 October 1983, until 11 April 1984)
- Delta International Reinsurance Company Limited (from 11 April 1984 until 3 February 1987)
- Imperial Chemicals Reinsurance Limited (from 3 February 1987 until 14 October 1988)
- QBE Reinsurance (London) Limited (from 14 October 1988 until 4 March 1992)
- QBE International Insurance Limited (from 4 March 1992 until 30 September 2005)
- QBE Insurance (Europe) Limited (from 30 September 2005 until 31 December 2018).

4.5 QUK is authorised by the PRA to write general insurance and reinsurance business, and is regulated by the FCA and the PRA. The active business of QUK (measured by gross written premiums during 2020) is written primarily in the UK (over 95%), with the remainder written by QUK's United Arab Emirates branch. This covers mostly UK risks (67%) and "worldwide" risks (22%) but also risks located specifically in Asia, Middle East and Australasia (5%) and North America (4%), with small amounts located elsewhere.

4.6 Since 1 January 2019, the business formerly written by QUK in EEA member states has been written by QBE Europe SA/NV ("**QBE Europe**"), another wholly owned subsidiary of QEO, and the EEA business already written by QUK was transferred to QBE Europe via two Part VII Transfers, the second of which was with effect from 1 November 2020. QUK no longer holds any EEA regulatory permissions or underwrites EEA business, and the remaining dormant branches located in the EEA are in an advanced state of closure.

4.7 I refer in this Report to QEO and its subsidiaries as the "**QEO Group**".

4.8 QUK's issued and fully paid share capital as at 31 December 2020 comprised 625,905,272 ordinary shares of £1 each[6].

4.9 The main elements of the business written by QUK are as follows (percentages in brackets are the proportions of total gross premiums written in 2020 which totalled £998.2 million[7]):

- Motor Third Party Liability (30%);
- Fire and other damage to Property (19%);
- Third Party (ex-Motor) Liability (26%);
- Marine, Aviation and Transport (3%);
- Other direct insurance (5%); and
- Inwards Treaty Reinsurance (17%).

4.10 QUK's financial year runs 1 January - 31 December.

Key financial information

4.11 As at 31 December 2020, on a UK GAAP basis, QUK’s booked reserves for outstanding liabilities, including the provisions for unearned premiums ("**UPR**"), were as set out in Figure 4.1, below.[8]

FIGURE 4.1 QUK’S RESERVES ON A UK GAAP BASIS AS AT 31 DECEMBER 2020 (£MILLION)

	Claims Outstanding	UPR	TOTAL
Gross	2,454	530	2,983
Ceded	-1,029	-72	-1,101
Net	1,425	458	1,882

4.12 QUK management considers that the UK GAAP booked reserves remain reasonable and comply with QUK’s reserving policy. I discuss QUK’s reserves in more detail in paragraphs 6.4-6.20, below.

4.13 As at 31 December 2020, on a UK GAAP basis, the total assets[9] of QUK amounted to £4,356.9 million, and the total liabilities[10] amounted to £3,395.7 million respectively, giving net assets of £961.2 million. The net assets represent the capital of the company under UK GAAP (it should be noted that this is not the same as the own funds available to meet the solvency requirements under Solvency II).

4.14 As at 31 December 2020, on an UK GAAP basis, QUK held investment assets[11] valued at £2,500.0 million. The largest share of this (£2,248.7 million or 90%) comprised listed debt securities and other fixed income securities. Of this amount, nearly 80% was in securities rated A or stronger by Standard & Poor’s. The minimum permitted credit quality per the investment guidelines is BBB-.

4.15 As at 31 December 2020, on a Solvency II basis, QUK’s technical provisions, by line of business, were as set out in Figure 4.2, below.[12]

[6] Based on QUK’s Annual Report as at 31 December 2020, Note 24.
[7] Based on QUK’s Annual Report as at 31 December 2020, Note 4(b).
[8] Based on QUK’s Annual Report as at 31 December 2020, Note 14.
[9] Based on QUK’s Annual Report as at 31 December 2020
[10] Based on QUK’s Annual Report as at 31 December 2020
[11] Based on QUK’s Annual Report as at 31 December 2020.
[12] Based on the QEO Solvency and Financial Condition Report for the year ending 31 December 2019, S.17.01.02 (QUK-specific).

FIGURE 4.2 QUK'S TECHNICAL PROVISIONS ON A SOLVENCY II BASIS AS AT 31 DECEMBER 2020 (£MILLION)

	Premium Provision			Claim Provision			Risk	TOTAL		
	Gross	Ceded	Net	Gross	Ceded	Net	margin	Gross	Ceded	Net
Income protection insurance	0.3	0.0	0.3	4.1	-0.1	4.0	0.0	4.4	-0.1	4.3
Motor vehicle liability insurance	60.8	2.3	63.1	418.8	-71.1	347.7	24.7	504.3	-68.8	410.8
Other motor insurance	16.8	0.8	17.6	32.4	-5.4	27.0	2.7	51.9	-4.6	44.6
Marine, aviation and transport (MAT) insurance	4.7	-0.5	4.2	52.5	-21.6	30.9	1.4	58.6	-22.1	35.1
Fire and other damage to property insurance	68.7	33.2	101.9	458.1	-365.5	92.6	9.3	536.1	-332.3	194.5
General liability insurance	54.0	6.4	60.4	1,067.5	-405.5	662.0	69.1	1,190.6	-399.1	722.4
Credit and suretyship insurance	18.0	3.1	21.1	22.9	-14.6	8.3	2.9	43.8	-11.5	29.4
Legal expenses insurance	0.2	0.0	0.2	11.1	-1.6	9.5	0.6	11.9	-1.6	9.7
Assistance	0.0	0.0	0.0	0.2	0.0	0.2	0.0	0.2	0.0	0.2
Miscellaneous financial loss insurance	0.0	0.0	0.0	4.6	-5.4	-0.8	0.0	4.6	-5.4	-0.8
Non-proportional health reinsurance	0.0	0.0	0.0	1.6	0.0	1.6	0.0	1.6	0.0	1.6
Non-proportional casualty reinsurance	13.3	0.5	13.8	146.0	-14.9	131.1	32.5	191.8	-14.4	144.9
Non-proportional MAT reinsurance	-8.3	28.4	20.1	33.2	-26.5	6.7	1.9	26.8	1.9	26.8
Non-proportional property reinsurance	1.3	-0.1	1.2	14.1	-17.0	-2.9	0.1	15.5	-17.1	-1.7
Life and health similar to life				88.1	-36.5	51.6	6.9	95.0	-36.5	51.6
TOTAL	**229.8**	**74.1**	**303.9**	**2,355.2**	**-985.7**	**1,369.5**	**152.1**	**2,737.1**	**-911.6**	**1,673.4**

4.16 QUK's financial strength is rated as follows (as at 18 February 2022):

- A+ (stable outlook) by Standard & Poor's
- A (stable outlook) by AM Best
- A+ (stable outlook) by Fitch
- A1 (negative outlook) by Moody's.

Reinsurance

4.17 QUK operates a number of reinsurance programmes, including Quota Share ("**QS**"), facultative and treaty reinsurance and participates in QBE Group's global reinsurance programme. As at 31 December 2020, 62.5% of its ceded balances were with the QBE Group's captive reinsurer, Equator Re, and 89.4% of the remaining balance was provided by reinsurers with an S&P credit rating of 'A-' or better.

Governance

4.18 The QUK Board has four non-executive directors, including the Chair of the Company. All non-executive directors are members of the (established jointly with the other regulated members of the QEO Group) Audit Committee, the Risk and Capital Committee ("**RCC**"), the People & Remuneration Committee, the Nomination Committee, and the Investment Committee. The RCC is, in turn, supported by three groups: Compliance Management Group, Conduct Risk Group ("**CRG**") and Risk and Capital Group.

4.19 QUK is also supported by the Executive Management Board (the "**EMB**"), which acts as a Management Committee for QUK (and for a sister company).

Risk management strategy

4.20 The members of the QEO Group manage risk via a centralised risk function. The following functions and processes are consistent across the QEO Group:

- A common risk management framework applied consistently across all legal entities;
- Key risk assessment processes (e.g. business planning, reserving, exposure management, capital modelling), conducted by common functions using a consistent process across all trading entities;
- Key IT systems including Underwriting, Finance, IT, HR and Risk Management operate consistently across all trading entities;
- The three lines of defence model operates consistently across all trading entities. Where identified control failures relate to a specific legal entity, they are escalated to the appropriate legal entity Board as appropriate; and
- A consistent Internal Model[13] operated across the regulated subsidiaries, the outputs from which are reviewed by the same governance forums before being reported to their relevant entity Boards.

[13] QEO and QUK received approval from the PRA in December 2015 to use the internal model developed for assessing regulatory capital requirements for QEO and its subsidiaries under Solvency II ("**the QEO Internal Model**").

4.21 The QEO Group has adopted the QBE Group Risk Management Strategy ("**RMS**") to identify and assess the risks the QEO Group faces in delivering on its strategic and business objectives or performance. Given the centralised nature of the QBE Group's risk management framework, the RMS applies equally to all the regulated members of the QEO Group and is approved by the Boards of those Companies. The strategy sets out the high-level governance arrangements and key roles and responsibilities relating to risk management and identifies the key risk processes and reporting mechanisms.

4.22 It is supported by the QEO Group's ERM Framework, by the QEO Group Risk Policies and by a number of more detailed procedures/standards. These procedures and standards cover Risk and Control Self-assessments, incident reporting, issues and actions management, scenario analysis, risk appetites, key risk indicators and risk reporting.

4.23 The QBE Group's Risk Appetite Statement ("**RAS**") sets out the nature and level of risk that the QBE Group is willing to accept to achieve its strategic objectives. The RAS is then cascaded down through the various levels of the QBE Group, including QUK.

Risks

4.24 QUK's principal risks and uncertainties are co-ordinated and managed together with the principal risks of QEO and other subsidiaries of QEO (the directors of QUK being comfortable that the QEO's approach meets the risk management needs of QUK).

4.25 For the purposes of managing its risk, QUK classifies risk into the following categories:

- Insurance risk (which it further subdivides between earned reserves, unearned reserves and underwriting);
- Credit risk;
- Market risk;
- Liquidity risk;
- Operational risk (including compliance risk);
- Group risk; and
- Strategic risk.

Insurance risk

4.26 This is the risk of insurance payments differing from expectations, in magnitude and/or in timing. The underlying risks can include:

- Inaccurate pricing of risk when underwritten;
- Inadequate reinsurance protection;
- Fluctuations in the timing, frequency and severity of claims and claims settlements relative to expectations; and
- Inadequate claims reserves.

4.27 Insurance risk can be considered in several component parts:

- underwriting risk, in respect of future earned business;
- catastrophe risk (both natural and man-made); and
- reserving risk, in respect of earned business.

4.28 QUK manages its insurance risk through

- careful monitoring of its exposures;
- the appropriate pricing and effective underwriting of its business, including monitoring against market premium rates;
- setting and maintaining appropriate tolerance levels for risk concentrations, especially in respect of exposure to catastrophic losses;
- internal and external actuarial reviews of its claims provisions, independent of its underwriting team; and

- effective control of reinsurance purchasing, in line with the risk appetite of the business.

Credit risk

4.29 Credit risk is the risk that a counterparty will be unable to pay amounts in full when due. The primary sources of credit risk within QUK are in respect of broker default on premium payments and (more materially) reinsurance counterparty risk. Regular reviews of exposure limits for approved counterparties are undertaken in order to manage the risks within investment and treasury activities. For reinsurance cover, QUK only buys cover from providers with a credit rating above a certain threshold. It also holds collateral in in the form of letters of credit in respect of certain exposures.

Market risk

4.30 Market risks arise from QUK's investment portfolios where, because of market movements, QUK might be exposed to fluctuations in the value of its assets, the amount of its liabilities, or the income from its assets. A key risk would be a material change in interest rates leading to a decrease in the value of the assets backing the insurance contracts, which, if not balanced by a corresponding movement in liability values, would adversely affect the financial position of QUK. To mitigate this risk, QUK actively manages investment assets, maintains a diversified portfolio and hedges residual net asset exposures.

4.31 QUK measures market risk using the Economic Scenario Generator within the QEO Internal Model.

4.32 QUK is exposed to pension risk through its final salary pension scheme. Apart from longevity risk, the principle components of QUK's pension risk are changes in bond yields in equity markets, leading to a materially different valuation of the pension fund assets, which might be only partially matched by changes in the present value of the future liabilities. The final salary pension scheme is subject to review by independent actuaries every three years and this valuation is updated each balance sheet date for current market rates, valuation and accounting standards.

Liquidity risk

4.33 Liquidity risk is the risk that (without resort to contingency funding arrangements) cash may not be available to pay obligations as they fall due. QUK manages its liquidity such that it maintains minimum levels of liquid, short-term marketable securities. QUK stress tests its liquidity relative to major catastrophe events, and matches assets and liabilities by major currency positions.

Operational risk

4.34 Operational risks are the risk of loss resulting from inadequate or failed internal processes, people and systems, or from external events. QUK seeks to limit exposure to operational risks through ensuring that an effective infrastructure, robust systems and controls and appropriately experienced and qualified individuals are in place throughout the organisation. It manages operational risk in accordance with the QEO Operational Risk Management Framework ("**ORMF**"). The framework comprises a number of elements:

- **Risk Appetite**: the risk appetite statement (discussed above) defines the level of operational risk that QUK is willing to accept and underpins QUK's approach to managing operational risk;
- **Governance**: the Board of Directors of QEO oversees the ORMF, and Board Committees and Executive Management Groups act as operational government forums, reporting (and escalating issues) to QEO Executive Management Board or Committee ("**QEOEM**");
- **Reporting**: the RCC receives quarterly reports on:
    - The risk environment;
    - Adherence to the risk appetite, including explanations of any breaches and updates on all actions taken to manage current and past breaches;
    - Areas for specific focus, as determined by the QEOEM;
    - Emerging risks;
    - Incidents (e.g. material losses, fraud);
    - Status update on all open critical and high-rated issues, highlighting numbers of open and overdue issues;
    - Details of any targeted risk reviews;
- **Operational risk processes**: see below; and

- **The risk culture**: this includes staff training. All QEO Group staff have to complete annually a set of training modules, intended to inculcate the desired risk culture.

Operational risk processes

4.35 QUK uses a Risk and Control Self-Assessment ("**RCSA**") process and scenario analyses in order to identify and assess operational risk exposure. The RCSA provides the ongoing assessment of key risks as well as control design and performance, whereas the scenario analysis considers the potential impacts of extreme events in order to evaluate the robustness of control environments and inform management about potential severe losses.

4.36 QUK then collates and fits curves to the outputs of the RCSA and the scenario analyses for each operational sub-risk category in order to develop an overall distribution of outcomes for the operational loss. This process, termed Total Risk Assessment, is used to set input parameters for risk models (namely the Economic Capital Model);

4.37 The management of operational risk is the responsibility of all QBE employees. Within the risk sub-category structure, every operational risk has an appointed Risk Owner. The Risk Owner is responsible for ensuring the risk (inherent and residual) is managed appropriately and in accordance with the risk appetite;

4.38 QUK uses four key processes to monitor operational risk:

- **Control Assurance**: The first line undertakes regular assessments of the operational controls, testing that they are working as intended (i.e. that they are both properly designed and that they are operating effectively). Weaknesses, issues or opportunities to improve controls are captured by the issues and actions process and tracked through the risk management system. The second line then validate these control assessment results through sampling. The results of this testing are reflected in RCSAs and considered during audit reviews;
- **Key Risk Indicators ("KRIs")**: QUK has defined a set of KRIs (some of which are forward-looking, and some of which are backward-looking) for all of its material risk classes. These are monitored regularly, the frequency varying depending on QUK's view of how proactively the particular (sub-) risk needs to be managed.
- **Incidents**: these are to materialised operational risks. All events with a potential impact aligned with the criteria per the Incident and Issue Management Standard are recorded in QUK's risk management system;
- **Issues management**: when a weakness/gap in the control environment has been identified, this is the management activity required to resolve the issue. All issues and actions must be recorded in the risk management system and QUK management must monitor the successful completion of these actions and resolution of these issues. The process recognises that some shortcomings identified are less important than others (i.e. their impact is considered to be low) – these are recorded as 'Improvement Opportunities' and therefore can their resolution can be approached with less urgency.
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4.39 The QBE Group has a Board-approved Business Continuity Management Policy, which is followed throughout the QBE Group, including within QUK. In accordance with the Business Continuity Management Policy, QUK maintains a suite of Business Continuity and Disaster Recovery plans that covers a range of scenarios concerning loss of people, premises, technology, resources and suppliers. I have not reviewed the plans but I have been told that they are all risk based and are designed to ensure the timely recovery and resumption of critical activities, thus enabling the continued delivery of QUK products and services. QUK undertakes an annual schedule of tests, exercises and validation activities to ensure that the plans and arrangements remain fit for purpose and appropriate to the requirements of QUK and its stakeholders.

Group risk

4.40 QUK is exposed to group risk, i.e. the risk to QUK arising specifically from it being part of the wider QBE Group, and therefore exposed, indirectly, to the performance, reputation, etc. of other members of the QBE Group. This risk is common across the QBE Group which aims to manage it by a range of controls including independent directors on the main regulated boards and contractual arrangements in place for material services provided by other QUK Group divisions and companies, all wrapped up within a formal Group Risk Management Framework.

Strategic risk

4.41 QUK is exposed to strategic risk, i.e. the current and prospective impact on earnings and/or capital arising from strategic business decisions and responsiveness to external change. This risk is managed through a number of risk management processes such as:

- Risk appetite statements in relation to strategic risk and strategic risk preferences;
- Stress and scenario testing (for example long term horizon climate change stress testing);
- Performance monitoring; and
- Emerging risk management.

Capital Policy

4.42 QUK's capital risk appetite is for the ratio of the EOF to the regulatory solvency capital requirement (the "**Capital Cover Ratio**") to be above 130% at all times, which it has evaluated as corresponding to a probability of no more than 5% of the Capital Cover Ratio falling below 100% within a 12 month period (and assuming no management intervention). It targets a Capital Cover Ratio of 140%, which it has evaluated as corresponding to a probability of no more than 2.5% of the Capital Cover Ratio falling below 100% within a 12 month period (and assuming no management intervention).

4.43 If QUK's Capital Cover Ratio were to fall to below the target level of 140% then it would provide no capital remittances to its parent until such time as the Capital Cover Ratio exceeded the target level. If it were to fall below the risk appetite level of 130% then action would be taken to restore the Capital Cover Ratio to at least the level of the risk appetite. I note that, if the Capital Cover Ratio of QEO (on a group basis) falls below 120% then, by a contingent capital facility agreement between QEO and QBE Strategic Capital Company Pty Limited ("**QSCC**"), QEO can request from QSCC a capital injection sufficient to restore its Capital Cover Ratio (on a group basis) to at least 120%. That additional capital can then be made available by QEO to whichever of its subsidiaries most needs it to restore its own Capital Cover Ratio.

4.44 As at 30 September 2021, QUK's SCRs and the EOFs available within QUK to meet those requirements were as set out in Figure 4.3, below[14]. As can be seen, as at 30 September 2021, QUK comfortably complied with its strategic objective regarding its Capital Cover Ratio.

FIGURE 4.3 QUK'S ELIGIBLE OWN FUNDS AND SOLVENCY REQUIREMENTS AS AT 30 SEPTEMBER 2021 (£'000)

	SCR	MCR
Eligible own funds	1,047.4	887.4
Solvency Requirements	647.2	267.6
Capital Cover Ratio	162%	332%

Conduct Risk – TCF

4.45 Conduct risk for QUK is overseen by the CRG (which performs the role across all of the regulated entities within the QEO Group). The CRG's key responsibilities include:

- Monitoring high product risk areas of the business and providing proportionate and fair challenge in respect of the effects of that business;
- Assessing the conduct risk inherent in the QEO Group's products and distribution methods and whether mitigating controls and oversight are appropriate;
- Designing and providing effective management information around conduct risk within the QEO Group; and
- Reporting to the RCC on the design and effectiveness of the QEO Group's conduct risk framework.

4.46 QUK's various policies demonstrate that it is committed to ensuring that:

- all regulatory and relevant legislative requirements and obligations are met at all times through a system of policies and procedures, reporting and controls; and
- that a strong conduct risk culture is embedded throughout QUK

4.47 This appetite is cascaded down to all areas of the business, with a detailed conduct risk appetite articulated in the relevant policies and guidance.

[14] These figures were taken from QUK's QRTs as at 30 September 2021 (s23.01).

4.48 All QUK employees receive training on conduct matters. They are required to complete mandatory online conduct risk training and tailored training sessions are delivered to relevant business areas as appropriate, particularly those in customer-facing roles.

4.49 The CRG meets quarterly to exercise oversight of conduct matters, and supports the QEO Group Boards and Board committees with the identification, assessment, and mitigation of conduct risk. Where operational risks are identified that may result in conduct risks for customers, the QEO Group companies (including QUK) are proactive in escalating and agreeing appropriate actions and communicating clearly with customers and delegated underwriting authority partners to ensure a fair consumer outcome is achieved.

The QUK Transferring Business

4.50 The QUK Transferring Business comprises legacy business (primarily UK EL and PL policies), written or assumed by QUK, prior to 1 January 2008. The QUK Transferring Business comprises approximately 2.4 million QUK Transferring Policies that, in turn, cover approximately 0.8 million individual QUK Transferring Policyholders. For most of these policies/policyholders, any claims that they had have been long since been settled. However, there are approximately 1,500 claims that remain open, covering approximately 700 policyholders.

4.51 Most of the QUK Transferring Business had originally been written by Iron Trades Insurance Company Ltd ("**ITIC**"). ITIC had been bought by the QBE Group in 2000 and its business was transferred to QUK, via a Part VII transfer, in 2005.

4.52 The QUK Transferring Business also includes exposures relating to the "**EIROS Pool**", which was a market-wide scheme established in 1949 to meet the insurance needs of the then newly nationalised electricity industry in the UK. The EIROS Pool provided EL and PL insurance cover until it effectively closed to new business in 1977. QUK has a 1.17% share of the EIROS Pool.

4.53 The open claims all relate to industrial diseases: mesothelioma, other asbestos-related illnesses, other cancers, other respiratory illnesses, deafness and vibration white finger. As at 30 September 2021, QUK estimated that the unpaid claims liabilities in respect of the QUK Transferring Business totalled £58.0 million on a UK GAAP basis (less than 3% of QUK's total gross claims reserves as at 30 September 2021). The majority (86%) of this relates to mesothelioma claims.

4.54 In June 2016, QUK entered into a loss portfolio transfer agreement ("**LPTA**") with ILS Property & Casualty Re Limited ("**ILS P&C**"), under which ILS P&C 100% reinsured the QUK Transferring Business. At the same time, under an outsourcing agreement, an affiliate of ILS P&C assumed from QUK the administration of the QUK Transferring Business. With effect from 8 April 2021, the LPTA with ILS P&C and the outsourcing agreement were novated, the LPTA to R&Q Re (Bermuda) Ltd ("**R&Q Re**") and the outsourcing agreement to RQCS, which is the UK services division of the R&Q Group. Under the novated LPTA with R&Q Re (the "**R&Q LPTA**"), 100% QS reinsurance is provided to QUK in respect of the QUK Transferring Business; under the novated outsourcing agreement (the "**R&Q Services Agreement**"), the QUK Transferring Business is wholly administered by RQCS.

4.55 Aside from the R&Q LPTA, there are no outwards reinsurance arrangements relating to the QUK Transferring Business.

4.56 Because of the R&Q LPTA, QUK has held since April 2021 nil net reserves in respect of the QUK Transferring Business on both a UK GAAP basis and a Solvency II basis. Its net reserves / TPs have been nil since June 2016 due to the LPTA with ILS P&C.

QUK's current plans

4.57 QUK's strategy is updated annually as part of the usual business cycle and is subject to review by the boards of QUK, QEO and the QBE Group. The current strategic priorities are covered under the following broad headings: Customer; Modernisation; Performance; Regulation; and Talent & Culture. Its priorities, and the planned actions to achieve the strategic objectives, would not be affected by the Scheme. The only impact of the plans were the Scheme not to go ahead would be that on-going management of the QUK Transferring Business would create an unwanted distraction for QUK's management. I have been informed by QUK that, in the event that the Scheme were not to proceed (or that it were to proceed but with the QUK Transferring Business being wholly excluded), QUK would examine the reasons why it did not proceed and would then seek (if possible) a new Scheme/transferee that could and would (subject to legal sanction) accept the QUK Transferring Business. Pending a subsequent Part VII Transfer, the QUK Transferring Business would remain 100% reinsured by R&Q Re.

ETA

Background

4.58 Eta is an insurance company, registered as a private limited company in England and Wales (registered number 05008295). Since 31 December 2018, Eta has been a wholly owned indirect subsidiary of RQIH, having previously been owned by the Medical Protection Society Limited ("**MPS**"). RQIH is registered in Bermuda (registered number 47341). Prior to becoming a member of the R&Q Group, Eta was known as MPS Risk Solutions Limited.

4.59 Eta is regulated by the PRA and the FCA. It ceased writing new business in 2012 since when its primary activity has been the orderly run-off of its liabilities.

4.60 Since its establishment in 2004 until its closure to new business in 2012, Eta wrote professional negligence and medical malpractice risks in the UK and Ireland, on a "claims made" basis, for entities providing services in the healthcare sector. It also offered clients the opportunity to buy medico-legal assistance and, for some of its smaller clients, it provided covers for product and public liability. In total, it provided cover to 427 different clients.

4.61 Eta's financial year runs 1 January - 31 December.

Key financial information

4.62 As at 31 December 2021, on both a UK GAAP basis and a Solvency II basis, technical provisions for outstanding liabilities were nil. I note that, during 2021, the last remaining outstanding claims were closed. As this business was written on a "claims made" basis, there is no possibility of new claims being reported, and further liabilities could arise only from the reopening of an existing closed claim. Eta considers this possibility to be very remote and has reduced its UK GAAP reserves and its TPs to zero as at 31 December 2021.

4.63 I discuss Eta's reserves in more detail in paragraphs 6.23-6.26, below.

4.64 As at 31 December 2021, on a UK GAAP basis, the total assets and the total liabilities of Eta amounted to £7,736k and £54k[15] respectively, giving net assets of £7,682k. The net assets represent the capital of the company under UK GAAP (it should be noted that this is not the same as the own funds available to meet the solvency capital requirements under Solvency II).

4.65 As at 31 December 2021, on an UK GAAP basis, Eta held investment assets[16] valued at £7,488k. Eta's balance sheet also shows £74k of accrued income. Eta's portfolio is managed by Conning Investment Managers and is held in corporate bonds (57%), government securities (41%) and cash (2%). Included in the above amounts are £6.8 million deposited as Funds at Lloyd's (**"FAL"**) in support of the R&Q Group's underwriting activities at Lloyd's. Lloyd's has the right to apply these monies in the event that R&Q Capital No. 1 Limited, a R&Q Group corporate member, fails to meet its underwriting obligations. As Lloyd's effectively has a call on these assets, the FAL is not available to meet Eta's own working capital requirements, despite being part of Eta's balance sheet, and can only be released with Lloyd's permission. FAL also only form part of an entity's EOF to the extent that they cover the solvency requirement that they generate – the excess of the value of the FAL over the solvency requirement necessitated by the FAL is inadmissible for solvency capital purposes. The R&Q Group expects these FAL to be redeemed prior to the 2022 year-end.

Reinsurance and guarantees

4.66 Eta benefits from no outwards reinsurance contracts.

Governance

4.67 All companies of the R&Q Group (including Eta and, as described below, WMG and Inceptum) are subject to a common system of governance, based on a number of principles. In particular, across its entities the R&Q Group requires:

- a clear organisational structure;
- effective communication and dissemination of information; and
- common directors and senior managers, wherever possible.

[15] Based on Eta's Annual Report and Financial Statements for the year ending 31 December 2021, Page 12.

[16] Based on Eta's Annual Report and Financial Statements for the year ending 31 December 2021, Page 12.

4.68 The Compliance Framework, which comprises policy standards that are applicable to all R&Q Group companies and additional standards that ensure compliance with local regulation. This framework defines the scope of the R&Q compliance function as follows:

- Governance
- Oversight of Internal Controls
  - Whistleblowing
  - Conflicts of interest
  - Interaction with regulators
  - Financial crime
  - Data protection
  - Outsourcing
  - Conduct.

Risk management strategy

4.69 The objective of the risk management framework, including the risk appetite statements, is to support the achievement of the business strategy of each company of the R&Q Group. The risk appetite statements for each such entity are linked to the business's strategic objectives, the risk categories to which they relate and to any risk-taking activity with a potentially material impact on business performance.

4.70 The risk appetite statements consist of a detailed set of thresholds, limits, triggers, and monitoring processes designed to guide day-to-day decision making in line with the pre-defined board metrics. They are designed to ensure that risk taking is being managed in line with the boundaries pre-defined by the board of directors of the R&Q Group. They are set by the Board of the relevant entity and are reviewed at least annually.

4.71 Each risk appetite statement has the following attributes:

- A statement of context designed to provide a high-level explanation;
- An appetite statement, which articulates the specific entity's appetite for that risk;
- Where appropriate, a statement of tolerance and/ or preferences, tolerance being a hard line that the entity is not prepared to cross, and preference being a desired exposure;
- An outline of the entity's approach/ processes to the managing and monitoring the risk; and
- A set of key risk indicators.

4.72 Each identified risk in the risk register is linked to the business objectives, and is assessed for impact and likelihood, having regard to these elements both before and after the effect of mitigating controls.

4.73 The Eta Board ensures that Eta implements risk policies, delivers the business plan within risk appetite and manages adherence to the Eta's risk profile, through a combination of quantitative and qualitative risk management, delivered through a mature risk culture, effective risk governance and risk transparency. The Board to monitor the risk indicators it considers most important as part of the management information presented to it on a quarterly basis.

Own Risk and Solvency Assessment

4.74 In common with other companies of the R&Q Group, Eta prepares an ORSA overview report at least once each year. Eta uses the ORSA process to help to manage its financial and solvency position over the period of its Business Plan. The ORSA overview reports provide summaries of this process and are approved by the Boards of the relevant entities. As such, the ORSA is an intrinsic part of each entity's business planning process.

4.75 The key elements of the ORSA process are:

- An analysis of the entity's recent performance
- Assessment of the entity's risk profile
- Consideration of business planning and stress scenarios.

Risks

4.76 For the purposes of managing its risk, Eta classifies risk into the following categories:

- Insurance risk (which covers only reserving risk, this business having been in run-off for many years);

- Market risk;
- Credit risk;
- Liquidity risk;
- Operational risk; and
- Strategic risk.

4.77 I note that, in this subsection of the Report, I do not repeat the descriptions of the risk types that I included in paragraphs 4.26-4.41, above.

Insurance risk

4.78 Eta has outsourced the claims handling to a specialised service provider, which is contracted to investigate and adjust all claims. The last open claim was closed in the first half of 2021 but, prior to then, claims were reviewed individually on a regular basis. Eta pursued early settlement for claims to reduce its exposure to unpredictable developments. As at now, with no claims remaining open and no prospect of new claims being notified, the insurance risk is minimal and relates only to the possibility of a closed claim reopening.

Market risk

4.79 Eta manages this risk through strict adherence to detailed investment guidelines. The Eta Board monitors and manages compliance as well as reviewing performance, formally on a quarterly basis. I note that, based on its investment portfolio as at 31 December 2021, Eta has no exposure to either currency risk or equity risk.

Credit risk

4.80 As Eta does not benefit from any reinsurance protection, its exposure to credit risk primarily through the banks at which its cash and cash equivalents are held.

4.81 Eta's investment strategy means that its cash is placed only with financial institutions of sufficient credit standing and it ensures that control structures are in place to assess and monitor these risk thresholds. Eta limits, as far as possible, its exposure to a single counterparty or groups of counterparties.

Liquidity risk

4.82 Eta's cash position is monitored on a regular basis to ensure that sufficient funds are available to meet its liabilities as they fall due, although noting that there are no open claims. Historically, funds required to meet immediate and short-term needs have been invested in short term deposits; funds in excess of short-term needs have been managed by external fund managers whose performance has been closely monitored.

Operational risk

4.83 To mitigate its exposure to regulatory and legal Risk, Eta has regular meetings with its regulators and closely monitors legal developments in involved jurisdictions and any regulatory pronouncements. This is in compliance with the Tier 2 Compliance Policy approved by the Eta Board, which incorporates the Tier 1 Policy Standards, which are approved by the RQIH Board and are applicable to all R&Q Group companies.

4.84 It manages its outsourcing risk through regular formal performance review meetings with major outsourced service providers, measuring against service level agreements, both internal and external.

4.85 While Eta remains exposed to external risk, it benefits from the R&Q Group's business continuity and disaster recovery plans, which are regularly tested.

4.86 Cyber risk is the risk of an entity being adversely affected by data loss, theft of intellectual property or financial loss as a result of cyber-attacks. Eta outsources the management of its IT and Cyber security to RQCS, which employs a Chief Information Security Officer who has responsibility for ensuring that the threat of a cyber-attack is minimised and who deploys various software and controls to mitigate the threat.

Strategic risk

4.87 The material strategic risk that Eta faces is the potential inability to oversee the run-off of all outstanding claims (although, as noted in paragraph 4.78, above, all claims had been closed by 30 June 2021, there remained the possibility that a claim might subsequently reopen). To mitigate this risk, the claims handling was outsourced (as also noted in paragraph 4.78 above) to a specialised service provider. That specialist service provider had been MPS, in order to maintain consistency of approach and retain expertise relating to medical professional indemnity claims. Following the closure of the final claim in 2021, Eta has terminated the contract with MPS. Should Eta require any further administration in respect of claims or any other aspect of its business, then that will be provided by RQCS, to which all relevant claims information has been transferred from MPS. I have considered the contracts between Eta and RQCS and between Eta and MPS, in particular those parts stipulating service levels. I have no reason to believe that RQCS would handle claims (not that any are expected to re-open) any differently from how they would have been handled by MPS.

Capital Policy

4.88 Eta aims to maintain its EOF, i.e. the capital available to meet its regulatory SCR, at a level of at least 125% of the SCR.

4.89 As at 31 December 2021, Eta's SCR and the EOFs available to meet those requirements were as set out in Figure 4.4, below. The SCR amount comprises almost entirely market risk, specifically equity and concentration risk, which in turn are driven by the significant amount of the investible assets that has been pledged as FAL to support the R&Q Group's underwriting activities at Lloyd's. Had those assets not been pledged as FAL then the calculated SCR would have been much less, less than the MCR. Moreover, had those assets not been pledged as FAL then the amount inadmissible for solvency purposes as at 31 December 2021 (£2.7 million) would have been available to be part of the EOF.

FIGURE 4.4 ETA'S ELIGIBLE OWN FUNDS AND SOLVENCY REQUIREMENTS AS AT 31 DECEMBER 2021 (£ MILLIONS)

	SCR	MCR
Eligible own funds	5.0	5.0
Solvency Requirements	4.1	3.1
Capital Cover Ratio	122%	160%

4.90 As can be seen, as at 31 December 2021, Eta was in breach of its strategic objective regarding its Capital Cover Ratio. I comment on this further in paragraph 6.88, below.

Conduct Risk policy

4.91 All employees of the R&Q Group are required to complete annual mandatory training including Conduct Risk training, which outlines the principles of Treating Customers Fairly. This runs alongside ongoing training to ensure updating of knowledge where customer outcomes are concerned.

4.92 The exposure of legacy firms, such as Eta, WMG and Inceptum, to Conduct Risk is reduced as there are no ongoing policies with unexpired exposure. However, Conduct Risk remains in respect of any claim that has not been fully settled. Hence, complaints (if any) continue to be monitored by the entities' management.

4.93 The R&Q Group's Compliance Framework. comprises:

- Tier 1 Group Compliance Policy (referred to in paragraph 4.83, above), which is applicable to all R&Q Group companies;
- Tier 2 Compliance Policy, which incorporates the Tier 1 Policy Standards and includes additional Regulator-specific standards applicable to the respective subsidiary;
- A Compliance Manual (setting out Guidance and Procedures);
- An Internal Control Register; and
- A Compliance Monitoring Plan

4.94 The following are the component parts of the conduct policy standards within the Compliance Framework:

Corporate culture

- The R&Q Group company must take reasonable steps to ensure customers are confident that they are dealing with a company where the fair treatment of customers is central to the corporate culture, and must ensure that the risk of poor customer outcomes/detriment is mitigated. This corresponds to Outcome 1 of the FCA's document "*Fair treatment of customers*", as described in paragraph 3.13, above.

Product design and marketing

- Products and services marketed must be designed to meet the needs of identified consumer groups and are targeted accordingly. This corresponds to Outcome 2 of the FCA's document "*Fair treatment of customers*", as described in paragraph 3.13, above.
- If the target market is likely to include vulnerable customers, care must be taken to ensure the product, product services and the marketing of the product are appropriate to their needs. This corresponds, at least in part, to Outcome 4 of the FCA's document "*Fair treatment of customers*", as described in paragraph 3.13, above.

Clear information

- Customers must be provided with clear information about the product, and must be kept appropriately informed before, during and after the point of sale. This corresponds to Outcome 3 of the FCA's document "*Fair treatment of customers*", as described in paragraph 3.13, above.

Products and services

- Products and services (including administration, claims handling, and complaint handling) must be delivered in accordance with the standards customers were led to expect at the point of sale. This corresponds to Outcome 5 of the FCA's document "*Fair treatment of customers*", as described in paragraph 3.13, above.

Complaint handling

- Complaints must be acknowledged, handled and resolved promptly, and in accordance with local regulatory requirements.
- Complaints must be investigated competently, impartially and in a timely way, ensuring the underlying cause of complaint is identified and addressed.
- Where a complaint has suffered detriment as a result of an R&Q Group company's actions, suitable redress must be offered.
- A senior executive must be appointed to have oversight of the entity's compliance with the complaints regulations.

Post sale barriers

- Customers must not face unreasonable post-sale barriers, including the ability to amend or to change product, or to change provider, or to submit a claim or make a complaint. This corresponds to Outcome 6 of the FCA's document "*Fair treatment of customers*", as described in paragraph 3.13, above.

Overall

- Each R&Q Group company must establish a Product Oversight Group (or equivalent) to ensure that the principles set out above are enforced
- The Product Oversight Group for each R&Q Group company must have defined terms of reference, must monitor customer outcomes, must coordinate the remediation of issues arising, and must regularly report to the relevant Board (or other governing body)
- To ensure compliance with the above principles, each R&Q Group company must develop and implement sub-policies covering: Product Development; Marketing; Sales; Policy Administration; Claims Handling; and Complaint Handling (which shall form the R&Q Group company's customer conduct framework and must be in accordance with local regulatory requirements and expectations); and must establish and maintain the means of monitoring and reporting customer outcomes and compliance with such sub-policies

4.95 Quarterly compliance reports are submitted to and challenged by the relevant board committees (Compliance & Risk Committee) on a quarterly basis. They and the aforementioned conduct sub-policies are also subject to annual monitoring by the board of each of the R&Q Group companies.

4.96 I note that, in the relatively short period in which Eta has been part of the R&Q Group and during which the above Conduct Policy has been operational, no complaints have been received from any Eta policyholder.

The Eta Transferring Business

4.97 The Eta Transferring Business comprises all of the business written or assumed by Eta. It is expected that, post-Scheme, no business will remain within Eta.

4.98 As noted in paragraph 4.62, above, there were no open claims relating to Eta business at 31 December 2021, the last remaining claims having been closed during the first half of 2021. Eta is holding no reserves as at 31 December 2021 in respect of this business.

Eta's current plans

4.99 Post-Scheme, assuming that the Eta Transferring Business includes no Excluded Policies, Eta will be a company without liabilities. It is intended that it will apply to the PRA for cancellation of its permissions and de-authorisation, after which it will be dissolved pursuant to the Court Order.

WMG

Background

4.100 WMG is an insurance company, registered as a private limited company in England and Wales (registered number 00042652). Since 2020, WMG has been a wholly owned indirect subsidiary of RQIH, having previously been owned by BHP Group Limited (1987-2020), by Leslie & Godwin (Holdings) Ltd ("**LGH**") (1972-1987) and by Commercial Union (1894-1972).

4.101 WMG is regulated by both the PRA and the FCA. It ceased writing new business in 2001 since when its primary activity has been the orderly run-off of its liabilities.

4.102 Since its establishment in 1894 until its closure to new business in 2001, WMG wrote a mix of direct, reinsurance, property, marine, and casualty business. Between 1987 and the late 1990s, it also wrote a portfolio of London market business, as well as some business for BHP Group Limited, covering fire, marine, product liability, engineering, contractors, professional indemnity and bankers' property risks.

4.103 WMG business covering the period from 1973 to 1987 (i.e. while owned by LGH) is referred to as the Richard & Pearson ("**R&P**") book. The R&P business relates to non-marine risks Asbestos, Pollution, Health Hazard ("**APH**") and other mostly non-liability exposures written by Leslie and Godwin Agencies.

4.104 The "**Pre-1973"** business of WMG relates to liability business with exposures from at least 1941-1972. Exposures include US APH liabilities. When WMG was sold to LGH, Commercial Union provided an indemnity in respect of the Pre-1973 non-marine policies, which it also continued to administer and pay all the claims. This business continues to be 100% indemnified, now, as a result of mergers in the intervening period, by Aviva International Insurance Ltd ("**AIIL**"), and is handled by Resolute Management Services Ltd ("**RMSL**"), part of the Berkshire Hathaway group of companies, which administers the business and pays claims. The indemnity wording implies that costs are included in the indemnity.

4.105 The business written between 1950 and 1973 has been commuted or removed by other means (e.g. scheme of arrangements), leaving only 1940s exposure on which claims may still be made against WMG in respect of the Pre-1973 business. In addition, marine business written prior to 1987 through the St Helen's Trust pool was finalised via a scheme of arrangement that terminated in 2004. WMG's exposure to Lloyd's syndicates through the Pre-1973 business has all been commuted.

4.106 The profile of the business remaining within WMG, in terms of numbers of policies and policyholders, is as set out in Figure 4.5-Figure 4.8, below. The numbers of policyholders in Figure 4.5 and Figure 4.6 includes some who have policies in more than one grouping, i.e. they are double counted. There is a minor discrepancy in the numbers of policies shown in Figure 4.5 compared with the numbers shown in the other Figures.

FIGURE 4.5 NUMBERS OF WMG'S REMAINING POLICIES AND POLICYHOLDERS: SPLIT BY PORTFOLIO GROUPING[17]

	Number of identified policyholders	Number of policies
Pre-1973	19	95
R&P	1,045	5,628
Other	2,837	10,365
Total	**3,901**	**16,088**

FIGURE 4.6 NUMBERS OF WMG'S REMAINING POLICIES AND POLICYHOLDERS: SPLIT BY LINE OF BUSINESS[18]

	Number of identified policyholders	Number of policies
Property	1,789	7,457
Financial	1,067	3,879
Liability	730	4,024
Marine	271	641
Accident & Health	21	42
Motor	13	22
Aviation	10	20
Total	**3,901**	**16,085**

FIGURE 4.7 NUMBERS OF WMG'S REMAINING POLICIES AND POLICYHOLDERS: SPLIT BY LOCATION OF THE POLICYHOLDER

	Number of identified policyholders	Number of policies	Number of policyholders with reserves	Number of policies with reserves
UK	1,281	5,546	25	15
North America	664	2,704	15	19
Europe	691	2,277	16	17
Middle East	156	854	4	4
South America	313	1,831	4	6
Africa	98	320	3	4
Australasia	262	913	1	1
Asia	316	1,503	3	3
Unknown	2	137	0	0
Total	**3,783**	**16,085**	**71**	**69**

FIGURE 4.8 NUMBERS OF WMG'S REMAINING POLICIES: SPLIT BETWEEN DIRECT AND REINSURANCE BUSINESS

	Number of policies
Direct	5,111
Inwards reinsurance	10,974
Total	**16,085**

4.107 No claims have been notified to WMG since 2003.

4.108 Prior to WMG becoming a member of the R&Q Group, its financial year ran 1 July - 30 June. It now runs 1 January – 31 December, in line with that of the other R&Q Group companies.

Key financial information

4.109 As at 31 December 2021, on a UK GAAP basis, the booked reserves for outstanding liabilities were as set out in Figure 4.9, below.

17 This includes 206 policyholders who appear in more than one portfolio

18 This includes a number of policyholders who have cover across more than one line of business.

FIGURE 4.9 WMG'S RESERVES ON A UK GAAP BASIS AS AT 31 DECEMBER 2021 (£'000)

	Claims Outstanding	UPR	TOTAL
Gross	986	0	986
Ceded	-891	0	-891
Net	95	0	95

4.110 WMG management considers that the UK GAAP booked reserves remain reasonable and comply with WMG's reserving policy. I discuss WMG's reserves in more detail in paragraphs 6.27-6.34, below.

4.111 As at 31 December 2021, on a UK GAAP basis, the total assets and the total liabilities of WMG amounted to £13.7 million and £1.0 million respectively, giving net assets of £13.7 million. The net assets represent the capital of the company under UK GAAP (it should be noted that this is not the same as the own funds available to meet the solvency capital requirements under Solvency II).

4.112 As at 31 December 2021, on an UK GAAP basis, WMG held investment assets of £4.4 million. WMG's balance sheet also shows £57k of accrued income. WMG's portfolio is managed by Conning Investment Managers and is held in corporate bonds (98%), government bonds (1%) and cash (1%). Included in the above amounts are £1.99 million deposited as FAL in support of the R&Q Group's underwriting activities at Lloyd's. These monies are not available to meet WMG's own working capital requirements and can only be released with Lloyd's permission. It is intended that WMG's FAL will transfer to Inceptum under the Scheme.

4.113 As at 31 December 2021, on a Solvency II basis, the technical provisions were as set out in Figure 4.10, below.

FIGURE 4.10 WMG'S TECHNICAL PROVISIONS ON A SOLVENCY II BASIS AS AT 31 DECEMBER 2021 (£'000)

	Premium Provision			Claim Provision			Risk margin	TOTAL		
	Gross	Ceded	Net	Gross	Ceded	Net		Gross	Ceded	Net
General liability insurance	0.0	0.0	0.0	960.2	-834.1	126.1	5.3	965.5	-834.1	126.1
TOTAL	**0.0**	**0.0**	**0.0**	**960.2**	**-834.1**	**126.1**	**5.3**	**965.5**	**-834.1**	**126.1**

Reinsurance and guarantees

4.114 As explained in paragraph 4.104, above, WMG is 100% indemnified in respect of the Pre-1973 portfolio by AIIL. I note that AIIL has credit ratings of AA- (Stable), Aa3 (Stable), A (Positive) and AA- (Stable) from Standard & Poor's, Moody's, AM Best and Fitch respectively.

Governance

4.115 The governance of WMG is very similar to that described for Eta in paragraphs 4.67-4.68, above, as all companies of the R&Q Group are subject to a common system of governance.

Risk management strategy

4.116 WMG's risk management strategy is much as described for Eta in paragraphs 4.69-4.75, above.

Risks

4.117 For the purposes of managing its risk, WMG classifies risk into the following categories:

- Insurance risk (which covers only reserving risk, this business having been in run-off for many years);
- Market risk;
- Credit risk;
- Liquidity risk; and
- Operational risk.

- WMG considers the other risk types that it has identified as largely immaterial in the context of the company.

Insurance risk

4.118 WMG has outsourced the claims handling to a specialised service provider, which is contracted to investigate and adjust all claims. Claims are reviewed individually on a regular basis. WMG pursues early settlement for claims to reduce its exposure to unpredictable developments.

4.119 WMG has in place reinsurance protection for certain portfolios of business. The type of reinsurance cover, and the level of retention, is based on WMG's internal risk management assessment, which takes into account the risk being covered and the sums assured. The level of cover can be adjusted if thought appropriate, through purchase of additional covers or commutation of existing covers.

4.120 All reserves in respect of WMG's business are subject to actuarial review.

Market risk

4.121 WMG manages this risk through strict adherence to detailed investment guidelines. The WMG Board monitors and manages compliance as well as reviewing performance, formally on a quarterly basis. I note that, unlike Eta (as described above), WMG is exposed to currency risk as its liabilities are denominated in several currencies. WMG tries as far as possible to match its currency exposure on the assets and liabilities in order to minimise its overall currency exposure.

Credit risk

4.122 Unlike Eta (as described above), WMG is exposed credit risk through its outwards reinsurance covers, as well as through the institutions at which its cash assets are held and with whose bonds WMG has invested.

4.123 WMG's investment strategy means that its cash is placed only with financial institutions of sufficient credit standing and that the providers of its bond holdings have to meet certain credit standards. WMG limits, as far as possible, its exposure to a single counterparty or groups of counterparties.

4.124 Reinsurance recoveries are evaluated each quarter for credit risk and existing bad debt provisions are evaluated for adequacy. WMG believes that significant adverse credit risk development is unlikely, due to the security ratings of each reinsurer or reinsured and the likely attitude of those from whom amounts will become due.

Liquidity risk

4.125 WMG's cash position is monitored on a regular basis to ensure that sufficient funds are available to meet its liabilities as they fall due. Historically, funds required to meet immediate and short-term needs have been invested in short term deposits; funds in excess of short-term needs have been managed by external fund managers whose performance has been closely monitored throughout.

Operational risk

4.126 WMG's approach to managing and mitigating Operational risk is identical to that taken by Eta, as described in paragraphs 4.83-4.86, above.

Capital Policy

4.127 WMG aims to maintain its EOF, i.e. the capital available to meet its regulatory SCR, at a level of at least 125% of the SCR.

4.128 As at 31 December 2021, WMG's SCR and the EOFs available within WMG to meet those requirements were as set out Figure 4.11, below. The calculated SCR amount (i.e. the amount calculated using the Standard Formula) comprises mostly (97%) market risk, specifically equity, spread and concentration risk (equity and concentration risk being driven by the amount of the investible assets that has been pledged as FAL to support the R&Q Group's underwriting activities at Lloyd's). Had those assets not been pledged as FAL (and hence partially inadmissible) then the calculated SCR would have been much less, and the EOF would have been £0.8 million more. In practice, because WMG's calculated SCR is below the absolute floor of the MCR (€3.7 million – see paragraph 3.31, above), WMG's actual solvency requirements as at 31 December 2021 were set equal to the MCR.

FIGURE 4.11 WMG'S ELIGIBLE OWN FUNDS AND SOLVENCY REQUIREMENTS AS AT 31 DECEMBER 2021 (£ MILLIONS)

	SCR	MCR
Eligible own funds	11.8	11.8
Calculated Solvency Requirements	1.7	3.1
Capital Cover Ratio	690%	379%

4.129 As can be seen, as at 31 December 2021, WMG comfortably complied with its strategic objective regarding its Capital Cover Ratio.

Conduct Risk policy

4.130 Like Eta, WMG is required to follow the R&Q Group Conduct Risk policy. I outlined this in paragraphs 4.91-4.96 above, and, rather than repeat that summary here, I refer readers to those paragraphs.

4.131 The administration of WMG, and servicing of all of its policies and claims other than those relating to the pre-1973 portfolios (which, as explained in paragraphs 4.103-4.104, above, has been outsourced to RMSL), has been delegated to RQCS.

The WMG Transferring Business

4.132 The WMG Transferring Business comprises all of the business written or assumed by WMG. It is expected that, post-Scheme, no business will remain within WMG.

WMG's Current Plans

4.133 Post-Scheme, assuming that the WMG Transferring Business includes no Excluded Policies, WMG will be a company without liabilities. It is intended that it will apply to the PRA for cancellation of its permissions and de-authorisation, after which it will be liquidated.

INCEPTUM

Background

4.134 Inceptum is an insurance company, registered as a private limited company in England and Wales (registered number 3581552). Since 2020, Inceptum has been a wholly owned indirect subsidiary of RQIH, having previously been owned by Syndicate Holding Corp., and, as such, was part of the Vibe Group of Companies ("**Vibe**"). Inceptum was previously known as:

- HSBC Insurance (UK) Limited (January 2005 - October 2011)
- Corinthian Insurance Company Limited (October 1998 - January 2005)
- Duntrade Limited (June 1998 - October 1998).

4.135 Inceptum is regulated by the PRA and the FCA. It is authorised to carry out contracts of insurance falling within the following classes of insurance business: 1 (Accident); 2 (Sickness); 3 (Land Vehicles); 7 (Goods in transit); 8 (Fire and natural forces); 9 (Damage to property); 10 (Motor vehicle liability); and 13 (General liability). It has applied for additional authorisation in respect of the following classes of insurance business, which are included within the WMG Transferring Business: 4 (Railway rolling stock); 5 (Aircraft); 6 (Ships); 11 (Aircraft liability); 12 (Liability for ships); 14 (Credit); 15 (Suretyship); and 17 (Legal expenses). Inceptum expects that its application will be approved prior to the date of the Court hearing at which the application to sanction the Scheme will be heard. I note that the Transferring Business contains no insurance business within classes 16 (Miscellaneous financial loss) or 18 (Assistance) and so Inceptum does not require authorisation in respect of those classes to be able to accept the Transferring Business. I further note that, without approval of its application for authorisation to carry out contracts of insurance for these additional classes, Inceptum would be unable to accept the WMG Transferring Business, although it would still be able to accept the QUK Transferring Business and the Eta Transferring Business, subject to the approval of the Court.

4.136 Since its establishment in 1998 until its closure to new business in 2009, Inceptum wrote personal and commercial UK motor business. In total, it wrote 3,142,571 policies. Since its portfolio's exposure to risk ceased in October 2010, Inceptum's primary activity has been the orderly run-off of its liabilities. It last received notification of a new claim in 2015.

4.137 Inceptum's financial year runs 1 January - 31 December.

Key financial information

4.138 As at 31 December 2021, 19 claims remained open (some other claims remain open for which all indemnity payments have been made but some recoveries remain outstanding). There is negligible possibility of further claims being reported although it is possible that one or more closed claims could be reopened.

4.139 As at 31 December 2021, on a UK GAAP basis, the booked reserves for outstanding liabilities were as set out in Figure 4.12, below.[19]

[19] Based on Inceptum's Annual Report and Financial Statements for year ending 31 December 2021, Note 13.

FIGURE 4.12 INCEPTUM'S RESERVES ON A UK GAAP BASIS AS AT 31 DECEMBER 2021 (£MILLION)

	Claims Outstanding	UPR	TOTAL
Gross	88.4	0.0	88.4
Ceded	-84.1	0.0	-84.1
Net	4.2	0.0	4.2

4.140 Inceptum's management considers that the UK GAAP booked reserves remain reasonable and comply with Inceptum's reserving policy. I discuss Inceptum's reserves in more detail in paragraphs 6.59-6.70, below.

4.141 As at 31 December 2021, on a UK GAAP basis, the total assets and the total liabilities of Inceptum amounted to £104.5 million and £88.6 million[20] respectively, giving net assets of £15.8 million. The net assets represent the capital of the company under UK GAAP (it should be noted that this is not the same as the own funds available to meet the solvency capital requirements under Solvency II).

4.142 As at 31 December 2021, on an UK GAAP basis, Inceptum held investment assets valued at £16.6 million[21]. This comprised almost entirely debt securities, all of which were rated either BBB or higher by Standard & Poor's, Moody's or Fitch. Included in the above amounts is £2.53 million deposited as FAL in support of the R&Q Group's underwriting activities at Lloyd's. These monies are not available to meet Inceptum's own working capital requirements and can only be released with Lloyd's permission. The R&Q Group expects these FAL to remain in place as at 31 December 2022 but to be redeemed prior to the 2023 year-end.

4.143 As at 31 December 2021, on a Solvency II basis, the technical provisions were as set out in Figure 4.13, below.[22]

FIGURE 4.13 INCEPTUM'S TECHNICAL PROVISIONS ON A SOLVENCY II BASIS AS AT 31 DECEMBER 2021 (£MILLION)

	Premium Provision			Claim Provision			Risk	TOTAL		
	Gross	Ceded	Net	Gross	Ceded	Net	margin	Gross	Ceded	Net
Motor vehicle liability insurance	0.0	0.0	0.0	64.2	-60.1	4.1	1.8	66.0	-60.1	5.9
Life and health similar to life	0.0	0.0	0.0	61.8	-58.5	3.3	1.7	63.5	-58.5	5.0
TOTAL	**0.0**	**0.0**	**0.0**	**126.0**	**-118.6**	**7.4**	**3.6**	**129.5**	**-118.6**	**11.0**

Reinsurance and guarantees

4.144 Inceptum has in place both Excess of Loss ("**XoL**") and QS reinsurance covers.

4.145 The XoL reinsurance provides cover in excess of a relatively low retention limit on each and every motor claim (prior to application of the QS reinsurance below). The limits were (by underwriting year): £175,000 (1996-2001); £250,000 (2002); £350,000 (2003-2004); £500,000 (2005-2006); £1,000,000 (2007-2009).

4.146 The retention limits are subject to an indexation clause. I list below the main providers of XoL (measured by reserves ceded to each by Inceptum as at 31 December 2021) and also include their respective AM Best credit ratings:

- General Reinsurance AG (24%) A++
- Swiss Re Europe SA (19%) A+
- SCOR UK Company Limited (15%) A+
- Munich Reinsurance Company (13%) A+
- Lloyd's Syndicate 4472 (Liberty) (8%) A
- XL Re Europe SE (6%) A+
- Everest Reinsurance (Bermuda) Ltd (5%) A+
- Chubb European Group SE (5%) A++

4.147 The QS reinsurance programme covered underwriting years 1996-2006 and was for varying percentage of the book, net of XoL cover. With the exception of a single claim, the incurred amounts on all the relevant open losses have long since exceeded the applicable XoL retentions. It appears that the QS arrangements were syndicated and many reinsurers participated. Some of those participations have since been commuted although the original programme remains largely in place.

20 Based on Inceptum's Annual Report and Financial Statements for year ending 31 December 2021, Pages 17 and 18.

21 Based on Inceptum's Annual Report and Financial Statements for year ending 31 December 2021, Note 11.

22 Based on Inceptum's SFCR Report 2021, page 16.

Governance

4.148 The governance of Inceptum is very similar to that described for Eta in paragraphs 4.67-4.68, above, as all companies of the R&Q Group are subject to a common system of governance.

Risk management strategy

4.149 Inceptum's risk management strategy is much as described for Eta in paragraphs 4.69-4.75, above.

Risks

4.150 The Inceptum risk appetite is documented in risk appetite statements, reviewed and approved by the Inceptum Board at least annually. The statement is a qualitative and quantitative articulation of the tolerance levels for risk that Inceptum is prepared to accept in the execution of its strategic and businesses objectives and provides the link between the Board's strategy and the risk profile, risk register and reporting triggers.

4.151 For the purposes of managing its risk, Inceptum classifies risk into the following categories:

- Insurance risk (which covers only reserving risk, this business having been in run-off for many years);
- Market risk;
- Credit risk;
- Liquidity risk;
- Operational risk;
- Strategic risk; and
- Group risk.

Inceptum considers the other risk types that it has identified as largely immaterial.

Insurance Risk

4.152 Inceptum has outsourced the claims handling to a specialised service provider, which is contracted to investigate and adjust all claims. Claims are reviewed individually on a regular basis. Inceptum pursues early settlement for claims to reduce its exposure to unpredictable developments.

4.153 Inceptum has in place XoL reinsurance agreements in respect of its business, which, as can be seen in Figure 4.13, above, provide material protection to its balance sheet. The Board will approve the reinsurance assumed at the time a portfolio of business is written. In addition, the Board could decide to purchase additional reinsurance, or to commute existing treaties, should it feel it appropriate and beneficial to do so. The reinsurance protections in place are with highly rated reinsurers, with over 99% (as at 31 December 2021) being with companies rated A or better.

4.154 All reserves in respect of Inceptum's business are subject to actuarial review.

4.155 I note that the presence within the outstanding claim liabilities of Periodical Payment Orders ("**PPOs**") introduces mortality risk as part of the insurance risk.

Market risk

4.156 The key market risk for Inceptum is that the proceeds from its financial assets are not sufficient to fund the obligations arising from its insurance risk. Inceptum's investment strategy is managed by its Board and by implementing detailed investment guidelines. Inceptum has outsourced the day-to-day management of its investment portfolio to Conning, an experienced investment management firm. Inceptum management regularly monitors Investment performance, including volatility in credit spreads, against market-based benchmarks.

4.157 Inceptum is not exposed to any currency as all the assets and liabilities are held in sterling.

4.158 Inceptum mitigates concentration risk by spreading its investments over multiple counterparties.

Credit risk

4.159 This is the risk that counterparties are not capable of fulfilling their obligations to Inceptum, or when a change in their credit status takes place. Reinsurance credit risk is by far the most material risk that Inceptum is exposed to. This is because most of Inceptum's claims have breached retention and gross reserves are much larger than net reserves, and are therefore material in the context of capital levels and net reserves. Reinsurance credit risk is also increased by the presence within the outstanding claim liabilities PPOs. PPOs are paid over a claimant's lifetime, which means that Inceptum relies on reinsurers' longevity. While the exposure reduces over time, the risk of default (or probability of default) increases over longer time horizons.

4.160 There is a risk of reinsurers defaulting on recoverable balances and financial institutions holding the Company's cash assets defaulting. Reinsurance recoveries are evaluated each quarter for credit risk and existing bad debt provisions are evaluated as to adequacy. As shown in paragraph 4.146, above, over 95% of the reinsurers' share of outstanding claims liabilities in Inceptum's UK GAAP balance sheet as at 31 December 2021 is with insurers rated A+ or better by AM Best.

4.161 There is also credit risk in respect of Inceptum's other assets. Inceptum places limits on the level of credit risk undertaken from the main categories of financial instruments. These limits give due consideration of the solvency restrictions imposed by the relevant regulations. Inceptum's investment strategy considers the credit standing of its respective counterparties and control structures are in place to assess and monitor these risk thresholds.

4.162 Inceptum places its cash with financial institutions of sufficient credit standing, thereby reducing the concentration of counterparty credit risk to an acceptable level.

Liquidity risk

4.163 Liquidity risk is the risk that cash may not be available to pay obligations when due at a reasonable cost. Inceptum monitors its cash position on a regular basis to ensure that sufficient funds are available to meet its liabilities as they fall due. Funds required to meet immediate and short-term needs are invested in short term deposits.

Operational risk

4.164 Operational risk is the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events. In particular, this includes the risk of business interruption, of compliance or regulatory breaches, of cyber risks or of poor service delivery by outsourced service providers, any of which could result in damage to Inceptum's reputation and could adversely affect its ability to meet its stated objectives. Inceptum manages this risk through:

- regular formal performance review meetings with major outsourced service providers and measures against service level agreements, both internal and external;
- regular meetings with Inceptum's regulator and close monitoring of legal developments and regulatory pronouncements;
- the R&Q Group's business continuity and disaster recovery plans, which are regularly tested; and
- the software and other controls deployed by RQCS, to which Inceptum outsources the management of its IT and cyber security.

Capital Policy

4.165 Inceptum operates a capital management policy to ensure that regulatory capital minima, supervisory targets and internal target are met at all times. According to the capital management policy, Inceptum:

- Will operate within the constraints of the risk appetite, as agreed by its Board;
- Will maintain a Capital Cover Ratio in excess of 125% (of the SCR) and will reassess this in the event of a voluntary or involuntary material change in its risk profile;
- Will comply fully with the Solvency II requirements in respect of TPs;
- Will keep under review the appropriateness of the Solvency II Standard Formula in setting the SCR and, in the event that it is considered at any point to be inappropriate, will so notify the PRA without undue delay; and
- Will notify the relevant regulators regulator without undue delay in the event of an actual or anticipated breach of Solvency II or other regulatory requirements relating to capital, solvency, or technical provisions in accordance with its ORSA policy.

4.166 As at 31 December 2021, Inceptum's SCR and the EOFs available within Inceptum to meet those requirements were as set out in Figure 4.14, below[23]. As can be seen, as at 31 December 2021, Inceptum comfortably complied with its strategic objective regarding its Capital Cover Ratio.

FIGURE 4.14 INCEPTUM'S ELIGIBLE OWN FUNDS AND SOLVENCY REQUIREMENTS AS AT 31 DECEMBER 2021 (£'000)

	SCR	MCR
Eligible own funds	8.0	8.0
Calculated Solvency Requirements	4.7	3.1
Capital Cover Ratio	169%	257%

Conduct Risk policy

4.167 Like Eta and WMG, Inceptum is required to follow the R&Q Group Conduct Risk policy. I outlined this in paragraphs 4.91-4.96, above, and, rather than repeat that summary here, I refer readers to those paragraphs.

4.168 The administration of Inceptum, and servicing of all of its policies and claims, has been delegated to RQCS.

Current Plans

4.169 Inceptum's strategy is the acquisition and management until extinction of portfolios of direct insurance and reinsurance business that are in, or are about to enter, run-off. Inceptum is also able to provide temporary reinsurance of run-off portfolios and adverse development coverages. To facilitate this strategy, Inceptum has received permission from the PRA to effect contracts of (re)insurance, subject to a restriction imposed by the PRA stating that Inceptum is closed to new business and that, in its case, "effecting contracts of insurance" is limited to adjustments to existing policies. Inceptum has applied to the PRA for a variation of permission that would lift this restriction. I have been informed that this is consistent with the business plan that RQIH submitted to the PRA when it acquired Inceptum, which set out that Inceptum would be used as a consolidator vehicle. Inceptum expects that its application will be approved prior to the date of the Court hearing at which the application to sanction the Scheme will be heard. I understand that, without approval of the application for the variance of permission, Inceptum would be unable to accept the Transferring Business and the Scheme could not proceed. I further understand that Inceptum will update the Court on the status of this application prior to the hearing for the sanctioning of the proposed Scheme. I will also address this matter within the Supplemental Report.

4.170 As at the date of this Report, I am unaware of any other plans of Inceptum (e.g. specific potential acquisitions or portfolio transfers) that are material to the Scheme.

[23] These figures were taken from QRT S.23.01.01, shown in the Solvency and Financial Condition Report for Inceptum as at 31 December 2020.

5. The proposed Scheme

SUMMARY OF THE SCHEME

5.1 In this section of the Report, I summarise the terms of the Scheme, as set out in the Scheme Document. For the avoidance of doubt, the terms of the Scheme as set out in the Scheme Document are definitive.

5.2 Assuming that the Court approves the Scheme as proposed, the Transferring Business will be transferred from the Transferors to Inceptum (the Transferee) at and with effect from 00.01 hours GMT on the Effective Date (expected to be 2 December 2022).

5.3 There will be no changes to the terms and conditions of any policy included within the Transferring Business as a result of the Scheme. The rights and obligations of QUK, Eta and WMG under the policies that comprise the QUK Transferring Business, the Eta Transferring Business and the WMG Transferring Business respectively will be transferred, without alteration, to Inceptum. Similarly, it is intended that there will be no change in how the Transferring Business is administered as a result of the Scheme. All holders of policies included within the QUK Transferring Business, Eta Transferring Business and WMG Transferring Business will be entitled to the same rights against Inceptum as were available to them against QUK, Eta and WMG respectively under such policies and will be accountable to Inceptum for any further or additional premiums or other amounts attributable or referable thereto as and when the same become due and payable.

5.4 Any pending or current proceedings or complaints issued or served before the Effective Date by or against QUK in connection with the QUK Transferring Business shall be continued by or against Inceptum in place of QUK, and QUK shall cease to have any direct legal liability under those proceedings following the Effective Date. Any proceedings or complaints issued or served on or after the Effective Date that would hitherto have been by or against QUK will instead be by or against Inceptum. Inceptum shall be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to QUK before the Effective Date in respect of the QUK Transferring Business.

5.5 Any pending or current proceedings or complaints issued or served before the Effective Date by or against Eta in connection with the Eta Transferring Business shall be continued by or against Inceptum in place of Eta, and Eta shall cease to have any direct legal liability under those proceedings following the Effective Date. Any proceedings or complaints issued or served on or after the Effective Date that would hitherto have been by or against Eta will instead be by or against Inceptum. Inceptum shall be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to Eta before the Effective Date in respect of the Eta Transferring Business.

5.6 Any pending or current proceedings or complaints issued or served before the Effective Date by or against WMG in connection with the WMG Transferring Business shall be continued by or against Inceptum in place of WMG, and WMG shall cease to have any direct legal liability under those proceedings following the Effective Date. Any proceedings or complaints issued or served on or after the Effective Date that would hitherto have been by or against WMG will instead be by or against Inceptum. Inceptum shall be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to WMG before the Effective Date in respect of the WMG Transferring Business.

5.7 Any judgment, order or award in respect of the QUK Transferring Business, the Eta Transferring Business and the WMG Transferring Business that is not fully satisfied before the Effective Date will become enforceable by or against Inceptum in the place of QUK, Eta and WMG respectively.

5.8 Inceptum shall indemnify:

5.8.1. QUK against any loss or expense incurred by QUK, whether before or after the Effective Date, that is attributable to the QUK Transferring Business.

5.8.2. Eta against any loss or expense incurred by Eta, whether before or after the Effective Date, that is attributable to the Eta Transferring Business.

5.8.3. WMG against any loss or expense incurred by WMG, whether before or after the Effective Date, that is attributable to the WMG Transferring Business.

5.9 No members of staff of QUK or any member of the R&Q Group will be transferred from their current employer to a new employer as a result of the Scheme.

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

MOTIVATION FOR THE SCHEME

5.11 Through the R&Q LPTA, QUK's net liability in respect of the QUK Transferring Business is currently nil (indeed, it has been since June 2016); R&Q Re ultimately carries the economic liability for the QUK Transferring Business. One purpose of the proposed Scheme is to align the legal liability for the QUK Transferring Business with the economic liability for the QUK Transferring Business. This will also provide finality to QUK.

5.12 The Scheme also fits with the R&Q Group's ongoing strategy, to streamline and amalgamate acquired business to achieve capital and governance efficiencies, through combining the businesses of three of its entities within a single entity, thus leaving two of those entities ready to be wound up.

POLICYHOLDERS AFFECTED

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

- the Transferring Policyholders;
- the QUK Non-Transferring Policyholders (including holders of any Excluded Policies that were part of the QUK Transferring Business);
- holders of any Excluded Policies that were part of either the Eta Transferring Business or the WMG Transferring Business;
- the current policyholders of Inceptum.

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

EXCLUDED POLICIES

5.15 The Scheme has not identified any Transferring Polices to be Excluded Policies. However, it is possible that an individual Transferring Policyholder (or a group of Transferring Policyholders) has both personal circumstances and objections to the Scheme that cause the Court, when sanctioning the Scheme, to exclude from the implementation of the Scheme specifically the policy or policies relating to that Transferring Policyholder (or a group of Transferring Policyholders). Such policies would be Excluded Policies.

5.16 If there are any Excluded Policies post the Effective Date then the Parties shall work towards subsequently transferring each and every Excluded Policy to Inceptum, by novation or other means. In addition, for each Excluded Policy, the relevant Transferor and Inceptum shall enter into a reinsurance agreement ("**Excluded Policy Reinsurance Agreement**") whereby Inceptum provides 100% reinsurance to the relevant Transferor in respect of the Excluded Policy, with any and all Excluded Policy Reinsurance Agreements to be effective from the Effective Date. Until such time (if ever) that an Excluded Policy is transferred to Inceptum, by whatever means, the legal liability for the Excluded Policy will remain with the relevant Transferor. For the avoidance of doubt, if Eta retains any legal liability for Excluded Policies, RQIH will not seek its de-authorisation as a consequence of the Scheme. Likewise, if WMG retains any legal liability for Excluded Policies, RQIH will not seek its de-authorisation as a consequence of the Scheme.

POLICY ADMINISTRATION

5.17 As discussed in paragraph 4.54, above, all policy administration, claims handling, etc. in respect of the QUK Transferring Business is currently conducted by RQCS, under the terms of the R&Q Services Agreement. The R&Q Services Agreement will be among the Transferring Assets transferred by the Scheme from QUK to Inceptum, and thus will continue to operate post-Scheme in exactly the same way as it has done prior to the Scheme, i.e. the administration will continue to be performed by RQCS, operating in accordance with unaltered standards and requirements. Therefore, the Scheme is expected to have no effect whatsoever in the way that the QUK Transferring Business is administered.

5.18 As discussed in paragraph 4.87, above, all servicing (if any)for Eta policies will be conducted by RQCS. The agreement that secured this will be among the Transferring Assets transferred by the Scheme from Eta to Inceptum, and the agreement will continue to operate post-Scheme in exactly the same way as it has done prior to the Scheme, i.e. the administration will continue to be performed by RQCS, operating in accordance with unaltered standards and requirements. Therefore, the Scheme is expected to have no effect whatsoever in the way that the Eta Transferring Business is administered.

5.19 As discussed in paragraph 4.131, above, WMG has outsourced policy administration to RQCS (save in respect of the Pre-1973 business, which, as discussed in paragraph 4.104, above, is administered by RMSL). The agreement that secured this will be among the Transferring Assets transferred by the Scheme from WMG to Inceptum, and thus will continue to operate post-Scheme in exactly the same way as it has done prior to the Scheme, i.e. the administration will continue to be performed by RQCS, operating in accordance with unaltered standards and requirements. Therefore, the Scheme is expected to have no effect whatsoever in the way that the WMG Transferring Business is administered.

5.20 On and with effect from the Effective Date, Inceptum shall:

- succeed to all rights, liabilities and obligations of QUK, Eta and WMG in respect of any personal data which relates to the Transferring Business or Transferring Policyholders to the extent transferred by this Scheme;
- become the data controller of any personal data which relates to the Transferring Business or Transferring Policyholders, to the extent required by the Data Protection Laws and shall be deemed to have been the controller of all such data at all material times when personal data is processed; and
- in respect of any personal data which relates to the Transferring Business or Transferring Policyholders be under the same duty as the relevant Transferor was under to respect the confidentiality and privacy of any person in relation to that personal data and shall be bound by any specific notice or consent given, or request made by, the data subject which was binding on the relevant Transferor and which required the relevant Transferor not to use the personal data for marketing purposes, and in any consent given by a data subject in respect of such data as is mentioned in this paragraph any reference to the relevant Transferor shall be deemed to include a reference to Inceptum.

REINSURANCE

5.21 Post-Scheme, it is intended that Inceptum will be protected by two reinsurance arrangements, as follows:

- An Adverse Development Cover (“**ADC**”) provided by Accredited Insurance (Europe) Limited (“**AIEL**”). Under the ADC, AIEL would indemnify Inceptum for all claims made in respect of the QUK Transferring Business in excess of £65 million, to a limit of £45 million. I note that AIEL is a member of the R&Q Group and has an AM Best credit rating A-.
- A QS cover provided by R&Q Re, whereby R&Q Re will meet 50% of the cost of claims arising from the QUK Transferring Business, net of the ADC (in practice the R&Q Re LPTA will be transferred from QUK to Inceptum by the Scheme and will be amended so that, from the Effective Date, it provides 50%, rather than 100%, QS cover).

5.22 The reinsurance arrangements currently in place that relate to the WMG Transferring Business shall be transferred by the Scheme to Inceptum.

EFFECT OF THE SCHEME ON THE BALANCE SHEETS OF QUK, ETA, WMG AND INCEPTUM

5.23 Figure 5.1, below, shows simplified balance sheets on a UK GAAP basis for QUK as at 30 September 2021:

- The “Pre-Scheme” column shows the actual balance sheet as at 30 September 2021.
- The “Transferring Business” column shows the value of the assets and liabilities that will transfer under the Scheme, based on figures as at 30 September 2021.
- The “Post-Scheme” column shows what the balance sheet would have looked like as at 30 September 2021 had the Scheme been approved and become effective as at that date.

FIGURE 5.1 SIMPLIFIED UK GAAP BALANCE SHEETS FOR QUK AS AT 30 SEPTEMBER 2021 (IN £ MILLIONS)

£m	Pre-Scheme	Transferring Business	Post-Scheme
Assets			
Cash and investments	2,562.8		2,562.8
Reinsurers share of technical provisions	883.0	58.0	825.0
Receivables	488.6		488.6
Other assets	214.0		214.0
Total Assets	**4,148.4**	**58.0**	**4,090.4**
Liabilities			
Outstanding claims	2,230.8	58.0	2,172.8
Unearned premium	623.9		623.9
Payables	367.7		367.7
Other liabilities	35.2		35.2
Total Liabilities	**3,257.6**	**58.0**	**3,199.6**
Net Assets	**890.7**	**0.0**	**890.7**

5.24 Figure 5.2, below, shows similar simplified balance sheets for QUK as at 30 September 2021, but on a Solvency II basis. QUK's solvency capital requirements and associated Capital Cover Ratios are also shown on pre- and post-Scheme bases.

FIGURE 5.2 SIMPLIFIED SOLVENCY II BALANCE SHEETS FOR QUK AS AT 30 SEPTEMBER 2021 (IN £ MILLIONS)

£m	Pre-Scheme	Transferring Business	Post-Scheme
Assets			
Cash and investments	2,594.0		2,594.0
Reinsurers share of technical provisions	822.3	59.2	763.0
Receivables	426.8		426.8
Other assets			0.0
Total Assets	**3,843.0**	**59.2**	**3,783.8**
Liabilities			
Technical provisions	2,556.6	59.2	2,497.4
Payables	353.4		353.4
Other liabilities	36.4		36.4
Total Liabilities	**2,946.4**	**59.2**	**2,887.1**
Net assets (own funds)	**896.7**	**0.0**	**896.7**
Plus ancillary own funds	*160.0*		*160.0*
Eligible own funds	**1,056.7**	**0.0**	**1,056.7**
SCR	**647.2**		**647.0**
Ratio of eligible own funds to SCR	**163%**		**163%**
MCR	**267.6**		**267.6**
Ratio of eligible own funds to MCR	**395%**		**395%**

5.25 The following observations can be made:

- The only change to QUK's balance sheet that will result from the Scheme is a reduction in technical provisions and associated reinsurance asset relating to the QUK Transferring Business.
- QUK's Capital Cover Ratio increases slightly following the transfer. This is driven by a small reduction to QUK's SCR resulting from reduced counterparty default risk associated with the transferring reinsurance asset.

5.26 Figure 5.3, below, shows simplified balance sheets on a UK GAAP basis for Eta:

- The "Pre-Scheme Actual 31/12/2021" column shows the actual balance sheet as at 31 December 2021.
- The "Pre-Scheme Projected 31/12/2022" column shows R&Q Group's projection of Eta's balance sheet as at 31 December 2022, on the basis that the Scheme had not been implemented as at that date.
- The "Transferring Business Projected 31/12/22" column shows the value of the assets and liabilities that are expected to transfer from Eta to Inceptum under the Scheme, based on projected figures as at 31 December 2022.
- The "Post-Scheme Projected 31/12/22" column shows what Eta's balance sheet is expected to look like as at 31 December 2022 if the Scheme were approved and became effective as at that date.

FIGURE 5.3 SIMPLIFIED UK GAAP BALANCE SHEETS FOR ETA (IN £ MILLIONS)

£m	Pre-Scheme Actual 31/12/2021	Pre-Scheme Projected 31/12/2022	Transferring Business Projected 31/12/22	Post-Scheme Projected 31/12/22
Assets				
Investments	7.6	6.6	0.0	6.6
Reinsurers share of technical provisions	0.0	0.0	0.0	0.0
Debtors	0.0	0.0	0.0	0.0
Cash	0.2	1.4	1.0	0.4
Total Assets	**7.7**	**8.0**	**1.0**	**7.0**
Liabilities				
Technical provisions	0.0	0.0	0.0	0.0
Creditors	0.0	0.0	0.0	0.0
Total Liabilities	**0.0**	**0.0**	**0.0**	**0.0**
Net Assets	**7.7**	**8.0**	**1.0**	**7.0**

5.27 Figure 5.4, below, shows the same simplified balance sheets for Eta, but on a Solvency II basis.

FIGURE 5.4 SIMPLIFIED SOLVENCY II BALANCE SHEETS FOR ETA (IN £ MILLIONS)

£m	Pre-Scheme Actual 31/12/2021	Pre-Scheme Projected 31/12/2022	Transferring Business Projected 31/12/22	Post-Scheme Projected 31/12/22
Assets				
Investments	7.6	6.6	0.0	6.6
Reinsurers share of technical provisions	0.0	0.0	0.0	0.0
Debtors	0.0	0.0	0.0	0.0
Cash	0.2	1.4	1.0	0.4
Total Assets	**7.7**	**8.0**	**1.0**	**7.0**
Liabilities				
Technical provisions	0.0	0.0	0.0	0.0
Other liabilities	0.0	0.0	0.0	0.0
Total Liabilities	**0.0**	**0.0**	**0.0**	**0.0**
Net assets (own funds)	**7.7**	**8.0**	**1.0**	**7.0**
less inadmissible assets	*-2.7*	*-2.7*	*0.0*	*-2.7*
Eligible own funds	**5.0**	**5.3**	**1.0**	**4.3**
SCR	**4.1**	**4.1**		
Ratio of eligible own funds to SCR	**122%**	**129%**		
MCR	**3.1**	**3.1**		
Ratio of eligible own funds to MCR	**160%**	**169%**		

5.28 The following observations can be made:

- Although all of Eta's insurance business will transfer to Inceptum under the Scheme, the reserves for this business are currently nil.
- The only noticeable change to Eta's balance sheet that will be a reduction of £1 million of cash that will transfer to Inceptum under the Scheme.
- Post Scheme, Eta will be left with no insurance business. However, it will retain assets to cover its pledged funds at Lloyd's and its solvency requirements (prior to having its permissions withdrawn and being wound up).

5.29 Figure 5.5, below, shows simplified balance sheets on a UK GAAP basis for WMG:

- The "Pre-Scheme Actual 31/12/2021" column shows the actual balance sheet as at 31 December 2021.
- The "Pre-Scheme Projected 31/12/2022" column shows R&Q Group's projection of WMG's balance sheet as at 31 December 2022, on the basis that the Scheme had not been implemented as at that date.
- The "Transferring Business Projected 31/12/22" column shows the value of the assets and liabilities that are expected to transfer from WMG to Inceptum under the Scheme, based on projected figures as at 31 December 2022.

5.30 The "Post-Scheme Projected 31/12/22" column shows what WMG's balance sheet is expected to look like as at 31 December 2022 if the Scheme were approved and became effective as at that date.

FIGURE 5.5 SIMPLIFIED UK GAAP BALANCE SHEETS FOR WMG (IN £ MILLIONS)

£m	Pre-Scheme Actual 31/12/2021	Pre-Scheme Projected 31/12/2022	Transferring Business Projected 31/12/22	Post-Scheme Projected 31/12/22
Assets				
Investments	4.4	4.6	4.6	0.0
Reinsurers share of technical provisions	0.9	0.6	0.6	0.0
Intra-group loans	8.3	8.3		8.3
Cash & other assets	0.1	0.2	0.2	0.0
Total Assets	**13.7**	**13.6**	**5.3**	**8.3**
	.			
Liabilities				
Technical provisions	1.0	0.6	0.6	0.0
Other liabilities	0.0	0.0	0.0	0.0
Total Liabilities	**1.0**	**0.6**	**0.6**	**0.0**
Net Assets	**12.7**	**13.0**	**4.7**	**8.3**

5.31 Figure 5.6, below, shows the same simplified balance sheets for WMG, but on a Solvency II basis.

FIGURE 5.6 SIMPLIFIED SOLVENCY II BALANCE SHEETS FOR WMG (IN £ MILLIONS)

£m	Pre-Scheme Actual 31/12/2021	Pre-Scheme Projected 31/12/2022	Transferring Business Projected 31/12/22	Post-Scheme Projected 31/12/22
Assets				
Investments	4.5	4.6	4.6	0.0
Reinsurers share of technical provisions	0.8	0.5	0.5	0.0
Intra-group loans	8.3	8.3		8.3
Cash & other assets	0.0	0.2	0.2	0.0
Total Assets	**13.7**	**13.6**	**5.3**	**8.3**
Liabilities				
Technical provisions	1.0	0.6	0.6	0.0
Creditors	0.0	0.0	0.0	0.0
Total Liabilities	**1.0**	**0.6**	**0.6**	**0.0**
Net assets (own funds)	**12.7**	**13.0**	**4.7**	**8.3**
less inadmissible assets	*-0.8*	*-0.8*	*-0.8*	*0.0*
Eligible own funds	**11.8**	**12.2**	**3.9**	**8.3**
SCR	**1.7**	**1.7**		
Ratio of eligible own funds to SCR	**690%**	**709%**		
MCR	**3.1**	**3.1**		
Ratio of eligible own funds to MCR	**379%**	**390%**		

5.32 The following observations can be made:

- All of WMG's insurance business will transfer under the Scheme, leaving it with no technical provisions post-Scheme.
- In addition to the insurance business, cash and investments totalling approximately £4.7 million will transfer to Inceptum, causing WMG net assets to fall by the same amount.

5.33 Figure 5.7, below, shows simplified balance sheets on a UK GAAP basis for Inceptum:

- The "Pre-Scheme Actual 31/12/2021" column shows the actual balance sheet as at 31 December 2021.
- The "Pre-Scheme Projected 31/12/2022" column shows R&Q Group's projection of Inceptum's balance sheet as at 31 December 2022, on the basis that the Scheme had not been implemented as at that date.
- The "Transferring Business Projected 31/12/22" column shows the value of the assets and liabilities that are expected to transfer to Inceptum under the Scheme, based on projected figures as at 31 December 2022. It also allows for additional capital that is expected to be received from the R&Q Group.

FIGURE 5.7 SIMPLIFIED UK GAAP BALANCE SHEETS FOR INCEPTUM (IN £ MILLIONS)

£m	Pre-Scheme Actual 31/12/2021	Pre-Scheme Projected 31/12/2022	Transferring Business Projected 31/12/22	Post-Scheme Projected 31/12/22
Assets				
Investments	16.6	18.6	45.1	63.7
Reinsurers share of technical provisions	84.1	75.6	27.1	102.7
Debtors	1.1	0.6	0.0	0.6
Cash	2.6	0.4	2.2	2.6
Total Assets	**104.5**	**95.3**	**74.4**	**169.7**
Liabilities				
Technical provisions	88.4	79.6	51.8	131.4
Creditors	0.3	0.3	0.0	0.3
Total Liabilities	**88.7**	**79.8**	**51.8**	**131.7**
Net Assets	**15.8**	**15.4**	**22.6**	**38.0**

5.34 Figure 5.8, below, shows the same simplified balance sheets for Inceptum, but on a Solvency II basis.

FIGURE 5.8 SIMPLIFIED SOLVENCY II BALANCE SHEETS FOR INCEPTUM (IN £ MILLIONS)

£m	Pre-Scheme Actual 31/12/2021	Pre-Scheme Projected 31/12/2022	Transferring Business Projected 31/12/22	Post-Scheme Projected 31/12/22
Assets				
Investments	16.6	18.6	45.1	63.7
Reinsurers share of technical provisions	118.6	100.3	26.1	126.4
Debtors	1.1	0.6	0.0	0.6
Cash	2.6	0.4	2.2	2.6
Total Assets	**138.9**	**120.0**	**73.4**	**193.4**
Liabilities				
Technical provisions	129.5	110.1	54.8	164.9
Creditors	0.3	0.3	0.0	0.3
Total Liabilities	**129.9**	**110.4**	**54.8**	**165.2**
Net assets (own funds)	**9.1**	**9.6**	**18.6**	**28.1**
less inadmissible assets	*-1.0*	*-1.0*	*-0.8*	*-1.8*
Eligible own funds	**8.0**	**8.6**	**17.8**	**26.4**
SCR	**4.7**	**4.5**		**15.2**
Ratio of eligible own funds to SCR	**169%**	**190%**		**173%**
MCR	**3.1**	**3.1**		**3.8**
Ratio of eligible own funds to MCR	**257%**	**275%**		**691%**

5.35 The following observations can be made:

- The Scheme will cause Inceptum's gross technical provisions to increase by £51.8 million (£54.8 million on a Solvency II basis), most of which relates to the QUK Transferring Business.
- Once the Scheme is effected, the QUK Transferring Business will be protected by QS and ADC reinsurance covers, as explained in paragraph 5.21 above. This, together with the reinsurance asset transferring from WMG is expected to total £27.1 million (£26.1 million on a Solvency II basis).
- Together with assets transferring from Eta and WMG, as well as reserves, net of reinsurance premium from R&Q Re, the R&Q Group will inject capital into Inceptum such that its Capital Cover Ratio relative to its SCR post-Scheme is at least 170%. For the purpose of the figures shown, the value of the capital injection is assumed to be £10 million.

5.36 I discuss the reserving strength of QUK, Eta, WMG and Inceptum in more detail in Section 6, below.

APPROACH TO COMMUNICATION WITH POLICYHOLDERS

5.37 The Parties have set out the approach that they intend to take in communicating information about the proposed Scheme to the affected policyholders and other parties. Their plans will be subject to approval by the Regulators and by the Court before the Parties can implement them.

5.38 The main objectives of the communications are to:

- Give those policyholders and others who might be affected by the Scheme the information that they need to understand the proposed changes;

- Inform those policyholders and others who might be affected by the Scheme about the implications for them of the proposed changes;
- Give those policyholders and others who might be affected by the Scheme access to further relevant information (beyond that in the communications pack);
- Let those policyholders and others who might be affected by the Scheme know what steps they should take if they object to any of the proposed changes;
- Maintain customers' confidence in Inceptum's willingness and ability to continue to meet its obligations in respect of the Transferring Business; and
- Meet legal and regulatory requirements.

5.39 I note that, in FG22/1 and in the context of who should be notified and for which groups of policyholders should dispensations be sought, the FCA has defined "policyholder" to include "employers under an employers' liability policy", "third-party claimants under a motor insurance policy where the insurer has notice of the claim and the address of the claimant" and "any potential claimant under a policy, regardless of whether the possibility of claiming is remote"[24]. In following this guidance, I have adopted the same definition in this Report, i.e. when referring to policyholders in respect of communications with policyholders, I include claimants and employees covered by any EL policy that is involved in the Scheme.

5.40 The Parties intend to provide some direct notification. This will comprise an overview of the Scheme, a set of questions and answers about the Scheme, a statement summarising the terms of the Scheme, the summary of the Scheme Report and the Notice (collectively, the "**Information Pack**"), together with a covering letter (the covering letter will be customised for the different groups of recipients).

5.41 The Parties intend to notify the following groups about the Scheme:

- All QUK Transferring Policyholders who either have an open claim under a QUK Transferring Policy or who have notified at least one industrial disease claim since 1 January 2017;
- each broker through whom, according to QUK's records, a QUK Transferring Policy was placed by, or a claim under a QUK Transferring Policy was handled, for a QUK Transferring Policyholder falling within the scope of notifications under the preceding bullet point – the brokers will be asked to forward a copy of the Information Pack to those of their clients who may be affected by the Scheme;
- the solicitors of third party claimants in relation to the QUK Transferring Policyholders (who will be asked to forward a copy of the Information Pack to their clients, who may be affected by the Scheme);
- Electricity Industry Run Off Services Limited (EIROS) in respect of exposures in the QUK Transferring Policies relating to QUK's participation in the EIROS Pool (EIROS will be asked to forward a copy of the Information Pack to its clients, who may be affected by the Scheme);
- All WMG Transferring Policyholders who have an open claim under a WMG Transferring Policy;
- The reinsurers of the WMG Transferring Business;
- RMSL;
- any solicitors who act for claimants in connection with open claims brought under Inceptum policies (who will be asked to forward a copy of the Information Pack to their clients, who may be affected by the Scheme).

5.42 The Parties will be applying to the Court for waivers in respect of the requirement to make similar direct notification to the following groups:

- the QUK Non-Transferring Policyholders;
- those QUK Transferring Policyholders who neither have an open claim under a QUK Transferring Policy nor have notified an industrial disease claim since 1 January 2017;
- the Eta Transferring Policyholders;
- those WMG Transferring Policyholders who do not have an open claim under a WMG Transferring Policy
- those Inceptum policyholders who do not have an open claim under an Inceptum policy.

[24] *FG22/1, Paragraph 7.5.*

5.43 The Parties will take appropriate and proportionate steps to find addresses for the recipients noted in paragraph 5.41, above, and to find alternate contact details for those to whom notification letters have been sent but then returned. Where communication has been via a broker, the Parties will request that they receive regular updates on which policyholders have been notified. The Parties will monitor the contact process, recording the dates on which letters are sent (and returned and resent, also noting all address changes), any queries or objections raised by policyholders or other interested parties and, in each such case, their response.

5.44 In addition to direct, written correspondence, the Parties also plan to make indirect notification. FSMA indicates that such indirect notification will include notices in at least two national newspapers in the UK and in the London Gazette, the Edinburgh Gazette and the Belfast Gazette. Therefore, the Parties intend that a notice regarding the Scheme should be published in *The Times* and *Daily Mail* newspapers as well as in the aforementioned Gazettes. Notices will also be placed in the following UK professional and specialist trade publications: *Insurance Times*; *Machinery*; *New Civil Engineer*; and *Construction Plant News*. The notifications will also be placed on the websites of the following bodies:

- Association of Insurance and Reinsurance Run-Off Companies ("**AIRROC**");
- Insurance and Reinsurance Legacy Association ("**IRLA**");
- Employers' Liability Tracing Office ("**ELTO**");
- Association of Insurance and Risk Managers in Industry and Commerce ("**AIRMIC**");
- British Insurance Brokers Association ("**BIBA**"); and
- London and International Insurance Brokers Association ("**LIIBA**")

5.45 The Information Pack, notices and advertisements will refer all queries to a postal address or a telephone number or a website address, all of which will respond promptly to any such queries. It is intended that both this Report and the Supplemental Report will be published on the R&Q Group and QUK websites, on pages dedicated to the Scheme, and that copies will be sent to any policyholders who request them. The Report will be made available in this way immediately following the directions hearing relating to the Scheme and the Supplemental Report will likewise be made available at least one week before the date of the Court hearing at which the Scheme might be sanctioned.

5.46 I comment on this proposed approach to communications with policyholders in Section 10, below.

COSTS

5.47 All costs and expenses, including, without limitation, fees and disbursements of legal and financial advisers and accountants, incurred in connection with the Scheme and the transactions contemplated by the Scheme shall be paid by Inceptum.

6. The impact of the Scheme on the Transferring Policyholders

INTRODUCTION

6.1 Under the Scheme, the Transferring Business will be transferred from QUK, Eta and WMG to Inceptum. The main issues affecting the Transferring Policyholders as a result of the Scheme are likely to arise from relative differences in:

- The financial strength of Inceptum post the Effective Date compared with that of QUK, Eta and WMG pre the Effective Date. Financial strength is derived from:
  - the strength of the reserves held, relative to a best estimate of the outstanding liabilities;
  - excess assets or capital; and
  - specific financial support arrangements.
- The risk exposures in Inceptum compared with those in QUK, Eta and WMG.
- The policy servicing levels provided by Inceptum post the Effective Date compared with those currently enjoyed by the Transferring Policyholders.

In this section of this Report, I deal with each of these in turn.

6.2 I note that the reserves held on a UK GAAP basis differ from the TPs that are used to determine an insurer's funds available to meet its solvency capital requirements under both Solvency II and the UK solvency regime (which, as noted in paragraph 3.24, above, are essentially synonymous with each another). However, the best estimate of the claims liabilities that underlie those shown in the UK GAAP Accounts is used as the base for the best estimate of the claims provision, which then forms a key part of the TPs.

6.3 Key metrics under Solvency II and the UK solvency regime, such as the SCR, MCR and EOF, are intended to be made public as part of each insurer's annual SFCR. However, other relevant metrics (for example, projected values of own funds and of solvency capital requirements as set out in insurers' ORSAs or in their quarterly Quantitative Reporting Templates ("**QRTs**")) are private matters between the entities and the relevant regulators. Therefore, I am not at liberty to disclose in this Report the actual values of those private metrics, or figures by which those values could be calculated, other than where consented to by the company concerned. In this Report, I have considered the extent to which QUK, Eta, WMG and Inceptum each hold capital in excess of regulatory solvency capital requirements. Where permitted (e.g. when dealing with publicly available information), I have expressed Capital Cover Ratios in numeric terms. In other instances, for comparative purposes in this Report, I have defined the following terms:

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

RESERVE STRENGTH OF QUK (PRE-SCHEME)

6.4 QUK is a large insurance company with reserves for outstanding claims (based on its UK GAAP accounts as at 30 September 2021) totalling more than £2.2 billion, gross of reinsurance. QUK's reserves for the QUK Transferring Business as at the same date amounted to £58.0 million, gross of reinsurance, i.e. less than 3% of the total gross outstanding claims reserves of QUK. Furthermore, as the reserves for the QUK Transferring Business are nil on a net of reinsurance basis, the Scheme will lead to no change in QUK's reserves, net of reinsurance. As such, the Scheme will not materially impact the strength of QUK's reserves as a whole. Therefore, I have not attempted to review in detail the claims reserves held generally by QUK. However, QUK has provided me with the following documentation concerning its reserves:

- External actuarial reports on the reserves of QUK (and other entities within the QBE Group) as at 31 October 2020 and 31 October 2021;
- Internal Actuarial Results Report for QEO Group as at 30 September 2020;
- Technical Provisions component of the Actuarial Function Report ("**AFR**") for QUK (and QBE Europe) as at 31 December 2020;
- The QBE Group Actuarial Reserving Standard.

My review of these documents suggests that QUK has appropriate policies and procedures in place to ensure that reserves are calculated, on a UK GAAP basis, by appropriately experienced personnel using suitable actuarial techniques and that there exists appropriate oversight of the reserves, both at subsidiary and group level. I note that the results of the external actuarial review as at 31 October 2021 showed a surplus in QUK's reserves as compared to the estimates generated by the external actuaries.

6.5 The UK GAAP reserves form the starting point for QUK's Solvency II TPs, the results of which are documented in its AFR as at 31 December 2021. A number of adjustments have been made to the UK GAAP reserves to calculate the TPs, as follows:

- The UPR and adjustment for deferred acquisition costs have been removed. The GAAP reserves also included a small margin for prudence that has also been removed;
- An allowance has been made for expected future premium in-flows, offset by expected cash out-flows (claims and expenses);
- An allowance has been made for Bound But Not Incepted ("BBNI") business, based on one month of business;
- an addition has been made for ENIDs, based on a log-normal distribution of outcomes and assuming that the 5% tail is missing from the historic data;
- an expense loading has been added to allow for all expenses that would be incurred in running-off the existing business, both allocated and unallocated (such as acquisition/commission, general unallocated loss adjustment expenses, investment management, administration costs and overheads);
- the reserves have been discounted for the time value of money; and
- A risk margin has been added, using a cost of capital approach.

6.6 The approach taken by QUK is broadly consistent with the approaches that I have seen taken by other insurers of similar size and business mix. Overall, QUK's calculation of its TPs appears to me to be reasonable.

6.7 On a gross of reinsurance basis, the reserves of the QUK Transferring Business will represent a significant portion of the reserves of Inceptum, post-Scheme, and the strength and uncertainty inherent within those reserves could materially affect the financial security of Inceptum's policyholders post-Scheme (including those of the Transferring Business). My review of QUK's reserves has therefore concentrated on reviewing its reserves for the QUK Transferring Business.

QUK Transferring Business

6.8 As the reserves for the QUK Transferring Business do not represent a material part of QUK's overall portfolio, the approach taken to reserving for these claims is not documented in any detail in either the internal or external actuarial reports mentioned above. However, the QUK actuarial team has provided me with copies of the working files that it has used to estimate reserves for the QUK Transferring Business and I have also discussed the approach with the actuaries concerned. The files provided show the analysis undertaken in the third quarter of 2021, based on data as at 30 June 2021.

6.9 For reserving purposes, QUK splits the data relating to the QUK Transferring Business by six disease types: mesothelioma, other asbestos, cancer, respiratory, vibration white finger and other. It holds a separate provision related to its participation in the EIROS Pool. The exposures in the EIROS Pool are a similar mixture of long tailed disease claims.

6.10 Over 80% of reserves for the QUK Transferring Business relate to asbestos-related claims, with mesothelioma claims accounting for more than 90% of this. The standard industry approach to projecting UK asbestos claims is to use a frequency-severity model whereby the numbers of future claims reported in each future year (frequency) are projected together with the average costs of those claims in each future year (severity). The product of the frequency and severity gives the total cost in each future year. Summing across all future years until the claims have all run-off gives the total expected future cost. The IFoA's UK Asbestos Working Party ("**AWP**") has produced models that project total numbers of claims for the insurance industry as a whole. Insurance companies and third party actuarial consultants typically use these models as the basis for projecting claims for individual portfolios or companies.

6.11 Much of the liability faced by insurers in relation to asbestos claims results from compensation paid to claimants with (or who have already died from) mesothelioma. Mesothelioma is a non-curable cancer that is usually caused by exposure to asbestos. The AWP has constructed a detailed model to project the cost to insurers of settling future mesothelioma claims.

6.12 There are a number of other disease types that can result from exposure to asbestos, in particular other lung cancers, asbestosis and pleural thickening. These tend to be less costly to insurers than mesothelioma claims as compensation amounts and/or claims numbers are smaller. The AWP has also produced models to project these claim types, although they are less sophisticated.

6.13 The QUK actuaries have used a frequency-severity model, similar to models that I have seen used in similar circumstances by other insurers, to project future costs associated with the mesothelioma claims. They have projected separately future numbers of claims that will settle at cost and those that will settle for nil indemnity cost (although these may incur some expense costs). Fewer than half of reported claims are projected to settle at cost. The number of claims expected to be reported in the remainder of 2021 and in 2022 are selected based on looking at averages of claims reported in recent years, and numbers for each future calendar year are projected based on pattern of future insurance claims projected by the AWP. Average costs per claim are projected based on QUK's historical claims, with amounts assumed to increase according to inflation rates in the AWP's model.

6.14 Based on my review of QBE's projections I have the following observations:

- QUK has not used the AWP's most recent models in making its projections. The most recent models show claim numbers dropping more quickly over time than allowed for in the QUK models, although the recent models allow for a slightly longer run-off period. They also use lower inflation rates, although actual price and earnings inflation rates in the last year have exceeded those used in the AWP model. I have estimated that, had QUK adopted these models but kept at the same levels its claim number and average cost per claim assumptions for 2021 and 2022, it would have reduced its estimate of the IBNR numbers by around 10%.

- QUK has used the AWP's projections of total industry claims as the basis for projecting the run-off of its portfolio. This implicitly assumes that the profile of QUK's liabilities mirrors that of the market as a whole. However, QUK's exposures are considerably more recent than those of many other insurers, being primarily exposed from 1990 onwards. This would imply that QUK's claim numbers may peak later than those of the industry as a whole. That said, the number of claims that QUK has actually received has followed a downward trend since 2016, which is not dissimilar to the industry as a whole. Furthermore, the number of claims actually seen in 2020 and 2021 is materially lower than QUK's estimated number for 2022. Should claims continue to follow the downward trend seen in the last two years, claims costs could ultimately be materially less than those estimated by QUK.

- QUK has allowed for a material amount of additional reserves over and above the outstanding reserves on the claims already reported (an incurred but not enough report, or "**IBNER**", reserve). The methodology used by the QUK actuaries to derive these additional reserves appears to me to be conservative.

6.15 QUK has projected the other asbestos disease types on a combined basis, again using a frequency-severity approach. In general, it is not considered best practice to combine asbestos disease types when projecting ultimate claim costs. However, given the relative immateriality of the claims relating to these other asbestos disease types, this approach seems to me to be reasonable.

6.16 The next most material disease type after mesothelioma is deafness. The volume of deafness claims has been falling materially across the market in recent years and QUK's own experience has been consistent with that market trend. Many deafness claims ultimately settle for no cost and, as a result of this, QUK has allowed for a material negative IBNER reserve, which, in my experience, is typical for such portfolios. There is no industry model available with which to estimate future claim numbers. QUK has assumed that claim number will continue to diminish and will cease completely by 2035. This is inevitably subjective and there remains considerable uncertainty around how quickly future claim number will run-off, but the approach is not dissimilar to that used by other companies.

6.17 Reserves for the other disease types are much smaller but a similar frequency-severity approach has been taken. QUK's reserves for the EIROS portfolio are based on an actuarial review of the pool as a whole, which uses similar frequency-severity methodologies to derive estimates of unpaid losses. QUK has applied its pool participation (which is 1.17%) to the results of the actuarial review to derive its loss estimates.

6.18 In calculating the TPs for the QUK Transferring Business, QUK has followed the process outlined in paragraph 6.5, although, as the QUK Transferring Business is in run-off, there has been no need for allowance for future premiums or BBNI. The risk margin and the ENID allowance were calculated on a whole account basis and so, for the purposes of this Report, part of that risk margin and ENID allowance have been hypothecated to the TPs relating to the QUK Transferring Business.

Conclusion with regard to the reserve strength of QUK pre-Scheme

6.19 Although I have not reviewed in detail the reserves of QUK, based on my review of the results of the internal and external actuarial reviews and its reserving policies, I have no reason to believe that the reserves of QUK are not currently reasonable, both on UK GAAP and Solvency II bases.

6.20 With regard to the reserves held for the QUK Transferring Business, based on my review of the working documents provided to me, I believe that QUK has used appropriate methodologies to derive reserves for this business and that the resulting reserves are a reasonable estimate of the ultimate future cost of settling these claims. However, there exists significant uncertainty in the future outcome of these claims, both because of the inherent uncertainty in any projection of long tailed liabilities and because it is unclear whether the pattern of this portfolio's run-off will materially differ from that of the industry models used to derive the reserve amounts.

RESERVE STRENGTH OF QUK (POST-SCHEME)

6.21 I have discussed with QUK's management what, if any, plans it has to change its approach to reserving post the Effective Date, for both its UK GAAP reserves and its TPs. It intends to make no changes.

Conclusion with regard to the strength of QUK's technical provisions post-Scheme

6.22 **I therefore conclude that implementation of the Scheme will cause no change in the strength of either QUK's best estimate reserves on a UK GAAP basis or QUK's TPs.**

RESERVE STRENGTH OF ETA (PRE AND POST-SCHEME)

6.23 I have been provided with a "briefing note" prepared for the board of Eta by the R&Q Group Chief Actuary, which details the results of a review of the reserves as at 31 December 2021. I have also been provided with the AFR for Eta as at 31 December 2021, which details the reserve on a Solvency II basis.

6.24 On both UK GAAP and Solvency II bases, as at 31 December 2021, Eta held no reserves for insurance claims. As explained in the briefing note, and in paragraph 4.62, above, the last remaining outstanding claims were closed in the first half of 2021 whereupon the corresponding case reserves were released. As the business was written on a claim made basis, no more claims can be reported. While there is a theoretical chance of a claim reopening, Eta regards this likelihood as being remote.

6.25 Based on the information available to me, there would appear to be no need for Eta to hold any UK GAAP reserves or TPs as at 31 December 2021 and, as such, the reserves held appear reasonable.

6.26 Post Scheme, all of Eta's business would have transferred to Inceptum and Eta will no longer need to hold any reserves (unless there were any Excluded Policies relating to Eta).

RESERVE STRENGTH OF WMG (PRE- AND POST-SCHEME)

6.27 I have been provided with a "briefing note" prepared for the board of WMG by the R&Q Group Chief Actuary, which details the results of a review of the reserves as at 31 December 2021. My conclusions about the reserve strength of WMG have been based on my review of this document as well as conversations with the R&Q Group actuaries responsible for reserving for WMG.

6.28 WMG's remaining gross insurance liabilities relate mainly to periods of exposure prior to the WMG's sale to LGH in 1972. Just four insureds make up the total outstanding case reserves of £184k as at 31 December 2021, all of which were in respect of US asbestos claims. WMG holds gross IBNR reserves for these claims of £693k, around 390% of the case reserves. I have no information about the amount of limits remaining on these insureds, or the history of payments on the account, but industry benchmarks would suggest that an IBNR-to-outstanding ratio of 390% is likely to be more than adequate for a portfolio of this age. In any case, this business is fully indemnified by Aviva, so the net reserve is nil.

6.29 Case reserves relating to business written after 1972 total roughly £2k. I understand that the R&Q Group actuaries have little information concerning the claims that give rise to these case reserves. WMG is holding an IBNR of just over £100k for the post-1972 business, which does not benefit from any outwards reinsurance.

6.30 In total, as at 31 December 2021, WMG has booked UK GAAP reserves of £986k gross of reinsurance and £95k net. These amount are unchanged from those booked at 31 December 2020, and are also consistent with the Actuarial Function's estimates for the business.

6.31 The UK GAAP reserves form the starting point for WMG's Solvency II TPs, the results of which are documented in its AFR as at 31 December 2021. A number of adjustments have been made to the UK GAAP reserves to calculate the TPs, as follows:

- an addition has been made for ENIDs;
- an expense loading has been added; and
- the reserves have been discounted for the time value of money.

6.32 The ENID and expense loadings have been made on a simplistic basis, based on a percentage of gross claims reserves. Given the relatively small amounts of reserves, this approach appears reasonable. Overall, the calculation of the TPs appears to me to be reasonable.

Conclusion with regard to the reserve strength of WMG pre-Scheme

6.33 **Based on my review, as described above, I conclude that WMG's claims reserves on a UK GAAP basis and TPs on a Solvency II basis appear reasonable as at 31 December 2021.**

Reserve strength of WMG post-Scheme

6.34 If the Scheme is sanctioned, all of WMG's business would be transferred to Inceptum. As such, it will no longer need to hold a reserves (other than in respect to any Excluded Policies that relate to WMG).

RESERVE STRENGTH OF INCEPTUM (PRE-SCHEME)

6.35 I have been provided with both an actuarial report prepared by the Vibe Actuarial Function on the reserves of Inceptum as at 31 December 2020 and a "briefing note" prepared for the board of Inceptum by the R&Q Group Chief Actuary detailing the results of a review of the reserves as at 31 December 2021. In the following paragraphs, I discuss both in turn.

6.36 The scope of the actuarial report prepared by the Vibe Actuarial Function concerned just the motor business written by Inceptum, although the report notes that there were no open claims outside of the motor book and that the scope for any claims outside of the motor book to emerge was minimal. The report details the Vibe Actuarial Function's best estimate of reserve requirements for Inceptum, based on its evaluation of data as at 30 November 2020.

6.37 Gross of reinsurance, the Vibe Actuarial Function's best estimate of reserves totalled £87.3 million, of which £86.6 million related to PPOs and £0.7 million to non-PPO claims. Net of XoL reinsurance (i.e. excluding recoveries from QS reinsurance), the liabilities were estimated to total £4.4 million, with all recoveries relating to the PPO claims.

6.38 I have not reviewed in detail the calculations undertaken by the Actuarial Function, but I have reviewed the methodologies and major assumptions they have used, as set out in their report, in order to satisfy myself that it is reasonable for me to rely on the results of their work.

PPO Claims

6.39 The vast majority of the remaining liability of Inceptum's existing business relates to a small number of liability claims that are either subject to a PPO (referred to in the reserve report as known PPOs), or where there is the possibility of a PPO being granted (referred to as potential PPOs). As at 30 November 2020, there were eleven known PPOs and four potential PPOs. For the purpose of assessing reserve requirements, each of these claims is assessed separately using the same approach.

6.40 The lump sum and periodical elements of each PPO are projected based on details of the claim provided to the claims managers. An allowance for future inflation is made using the assumption that earnings-related benefits will increase at a rate of 3% per annum, and other benefits will increase at a rate of 2.5% per annum. These assumptions are based on average inflation rates over the prior five years, using the ASHE tables[25] and Retail Price Index, respectively.

6.41 The projected future cash flows are weighted by the estimated likelihood of the claimant surviving to the each future year. This likelihood is based on survival rates according to a standard life table for England and Wales, multiplied by an impairment factor. Inceptum's claims managers estimate the life expectancy of each claimant. The impairment factor is determined such that each claimant's expected life expectancy (as implied by the product of the standard factors and the impairment factor) matches that assessed by the claims manager.

6.42 The estimated future cash flows (allowing for future inflation and the survival probabilities) are then discounted for the time value of money. Inceptum uses a discount rate of 2% per annum. This is noted as being broadly consistent with the observed yield on Inceptum's current investment portfolio.

6.43 It should be noted that, were the potential PPO claims to be settled without a court granting a PPO, then the cost of settlement could be less than that implied by the reserving methodology employed by Inceptum. Lump sum settlements for bodily injury claims are made with reference to the Ogden tables[26], and future cash flows (unadjusted for inflation) are discounted at a real discount rate (known as the Ogden discount rate), as set from time to time by the Lord Chancellor. The Ogden discount rate is currently set in England and Wales at -0.25% (lower rates apply for settlements in Scotland and Northern Ireland). As the real yield (i.e. 2% investment return less the inflation rate of between 2.5% and 3%) implied by Inceptum's investment return and inflation selections is less than -0.25%, the resulting reserves are larger than what would result from using the Ogden discount rate to calculate a lump sum settlement.

6.44 The methodology employed by the Actuarial Function in calculating the reserves for Inceptum's PPO claims is in line with market practice for such liabilities. Based on my review of the reserve report and conversations with the actuaries responsible for the report, I believe that the assumptions used by the Actuarial Function and the resulting reserves appear reasonable.

Non-PPO claims

6.45 The non-PPO claims are far less material. The Actuarial Function divides these claims between several reserving segments based on business distribution channel, type of cover and claim type. This sort of segmentation is typical for reserving for this type of business, although this portfolio is so mature that most segments have little in the way of outstanding claims. Most of the non-PPO case reserves relate to just seven open claims, which are expected to account for any future development for the non-PPO claims.

6.46 Based on my review of the reserve report and conversations with the actuaries responsible for the report, I believe that the approach taken for the non-PPO claims and the resulting reserves appear reasonable.

Outwards Reinsurance

6.47 The portfolio benefits from XoL reinsurance that removes a large proportion of Inceptum's liability in relation to the PPO claims. The reinsurance is provided on an unlimited basis, above a retention that is subject to indexation.

6.48 The Actuarial Function model the reinsurance recoveries applicable to each claim as part of the projection process, including allowing for the indexation of the retention based on the timing of the expected cashflows.

6.49 None of the non-PPO claims are expected to be large enough to benefit from the XoL reinsurance.

6.50 The portfolio further benefits from some QS reinsurance (which also protects the XoL reinsurers). However, Inceptum has assumed that it will make no further (material) recoveries on this programme as most of the claims have long since exceeded the XoL retentions. Outstanding recoveries on the QS programme amount to only £1k.

[25] The Annual Survey of Hours and Earnings ("ASHE") tables are published by the Office of National Statistics and provide estimates of the levels and distribution of earnings and paid hours worked, by different categories of employee in the UK.

[26] The Ogden tables are a set of statistical tables and other information for use in court cases in the UK. Their purpose is to make it easier to calculate future losses in personal injury and fatal accident cases.

Reserving Update to 31 December 2021

6.51 The "briefing note", prepared for the board of Inceptum by the R&Q Group Chief Actuary, states that a full actuarial analysis of the gross and net reserves was conducted as at 31 December 2021. I understand that a separate actuarial report in support of this review is being drafted, but it was unavailable as at the time of this Report. The "briefing note" documents the results of that analysis and the changes since the previous analysis, conducted as at 30 November 2020 by the Vibe Actuarial Function. It shows the movements in each of the PPO claims, the present value of which deteriorated in total by about £7.7 million, gross of reinsurance. The overall approach to reserving for these claims was unchanged since the 30 November 2020 review. However, there were changes to the assumptions for individual claims, driven by emerging experience. Much of the deterioration was due to a potential PPO claim settling (as a PPO) at a greater cost than had been expected. Other movements in the reserves for individual claims resulted from claimant fatality, the receipt of settlement offers for potential PPO claims, unwinding discount rates, and changes to mortality probabilities. There was little overall movement in estimates for the non-PPO claims.

6.52 The best estimate of reserve requirements as at 31 December 2021, as calculated by the R&Q Group actuaries, were £88.4 million, gross of reinsurance, and £4.2 million, net of reinsurance. These figures are consistent with those booked by Inceptum in its UK GAAP accounts as at 31 December 2021.

Reserve uncertainty

6.53 The Vibe Actuarial Function illustrated, in its report as at 30 November 2020, the uncertainty in its estimates of outstanding claim costs by performing sensitivity analyses varying the major assumptions used in the projections of the PPO claims (i.e. using different inflation, investment return and mortality assumptions). These show that there is significant uncertainty in the estimates, gross of reinsurance, but that the uncertainty is materially mitigated by the reinsurance programme. The most extreme sensitivity considered is inflation of 5% (which, together with an assumed 2% investment return, gives a real discount rate of -3%). In this scenario, the gross estimate for PPO claims would increase in total by around £44.5 million (over 50%). The net estimate would also increase in this scenario, due to the indexation of the retention levels, but the aggregate increase would be roughly £4 million.

Solvency II Technical Provisions

6.54 Inceptum's approach to calculating Solvency II basis TPs is set out in its AFR as at 31 December 2021.

6.55 The starting point for calculating TPs was the UK GAAP basis unpaid claims estimates, calculated based on the results of the actuarial review as described above, prior to discounting for the time value of money. A number of additions were made to these claims estimates:

- an allowance for unallocated loss adjustment expenses
- a management expense load;
- a loading for ENIDs; and
- a bad debt provision relating to the reinsurance.

6.56 The resulting estimates are discounted using the standard risk-free discount rates specified by the PRA. Note that, as these rates are materially lower than the 2% used for preparing the reserves in the UK GAAP accounts, the TPs are considerably higher than the UK GAAP reserves.

6.57 The process and assumptions are typical of those that I have seen adopted by other UK insurance companies in respect of similar types of outstanding claims.

Conclusion with regard to the reserve strength of Inceptum pre-Scheme

6.58 Based on my review, as described above, of the technical provisions of Inceptum (on both UK GAAP and Solvency II bases) as at 31 December 2021, I have concluded that

- the methodologies and major assumptions underlying the reserve analyses as performed by Inceptum as at 31 December 2021 are reasonable; and
- the best estimates of unpaid claim amounts also appear reasonable.

I therefore conclude that Inceptum's claims reserves on a UK GAAP basis and TPs on a Solvency II basis appear reasonable as at 31 December 2021, notwithstanding the uncertainty present.

RESERVE STRENGTH OF INCEPTUM (POST-SCHEME)

6.59 I have discussed with Inceptum's management what, if any, plans it has to change its approach to reserving post the Effective Date. Inceptum intends to continue to reserve for its existing business using the same approach as outlined above. The reserving for the business transferring from WMG and Eta will continue to be undertaken by the same teams within the R&Q Group and no changes are expected to be made to the approach as a result of the Scheme. Post-Scheme, Inceptum will need to establish reserves for the QUK Transferring Business. I have been provided with details of unpaid claims estimates that have been made by the R&Q Group actuarial team for the QUK Transferring Business that are used currently for reserving within R&Q Re and that have been used for the purposes of projection of Inceptum's excess assets post-Scheme, as described below.

6.60 The R&Q Group actuaries have adopted a similar methodology to the QUK actuaries for projecting the ultimate cost of the QUK Transferring Business. They have divided the portfolio by disease type and have mainly used frequency severity models to project future claims. However, the R&Q Group actuaries have divided the portfolio into slightly more granular reserving segments, for example by dividing the non-mesothelioma asbestos claims into asbestosis, pleural thickening and lung cancer. They have also identified a small amount of outstanding claims reserves relating to abuse claims, which were not identified separately in the reserve figures provided to me by QUK.

6.61 The R&Q Group actuaries provided me with the results and detailed calculations behind the latest full analysis they undertook on the portfolio as at 30 September 2021. They separately provided me with the results of a roll-forward of these reserves to 31 December 2021. I note that both analyses included a small amount of EEA business that will not transfer to Inceptum under the Scheme. Based on figures as at 31 December 2021, the R&Q Group actuaries estimated that the EEA business accounted for about 4% of their reserve estimates.

6.62 The R&Q Group actuaries' estimates of reserve requirements for the portfolio are, overall, similar to those of QUK, but there are a number of differences in the estimates for the individual components. As at 30 September 2021, the R&Q Group actuaries have estimated reserve requirements of £59.5 million, including the EEA business. Excluding the EEA business (i.e. considering only the QUK Transferring Business), this would amount to approximately £57.2 million, as compared to QUK's estimate of £58.0 million. Reserves for mesothelioma claims dominate the R&Q Group actuaries' estimates, but they are somewhat smaller than QUK's estimates. On the other hand, the R&Q Group actuaries have estimated relatively higher reserves for other claim types, in particular for deafness claims. One of the reasons for this discrepancy is that the R&Q Group actuaries have not allowed for IBNER reserves on the portfolio. As discussed above, I would generally expect to see negative IBNER reserves for deafness portfolios and QUK has estimated a material positive IBNER reserve for mesothelioma claims. In QUK's estimates, these positive and negative reserves to a large extent offset each other so that the overall IBNER reserve is relatively small (less than £0.4m). Nevertheless, I believe it is appropriate to hold IBNER reserves for claims from historical reporting periods and I have raised this point with the R&Q Group actuaries.

6.63 Another key difference in the projection of mesothelioma claims is that the R&Q Group actuaries have used the latest AWP models to project future claims. This also results in a relatively quicker run-off of projected claims numbers, but another factor is that QUK has selected a higher number of claims for the start of the projection period (51 claims for 2022 compared to R&Q Group's 45).

6.64 As discussed above in relation to QUK's estimates for the QUK Transferring Business, it is unclear whether the run-off profile of the QUK Transferring Business will mirror that implied by the AWP's estimates of future claims to the whole insurance industry. The R&Q Group actuaries have also used the industry pattern as a basis for projecting future claims, although its methodology for selecting claim number for the first year of projection, which is based on an average its claim numbers compared to those of the industry as a whole over recent years, is given a 10% uplift in recognition of the uncertainty.

6.65 I note that, unlike QUK, the R&Q Group actuaries have not projected nil claims separately from non-nil claims for any of the disease types. This is not a problem as long as the nil claim rate remains constant, but a separate projection can help to identify any changes in the nil rates and, as such, is likely to result in a more reliable projection of future claim costs.

6.66 With regard to other claim types, as noted above, the R&Q Group actuaries have identified a small number of outstanding amounts in respect of abuse claims (roughly £0.1 million). There is a material degree of uncertainty surrounding such claims. The R&Q Group actuaries have selected an IBNR judgementally, equal to three times the outstanding reserves. For the EIROS Pool exposure, the R&Q Group actuaries have used the reserves for another entity in its group that participates in the EIROS Pool for the purpose of estimating reserves for the QUK Transferring Business. This results in a slightly smaller reserve than that estimated by QUK.

6.67 Overall, I believe that, despite being different from the equivalent estimates made by QUK, the reserve estimates made by the R&Q Group actuaries for the QUK Transferring Business as at 30 September 2021 are a reasonable estimates of the total unpaid claim costs for the portfolio. However, as noted above in relation to QUK's reserves for the business, there is significant uncertainty within the portfolio that could lead to the ultimate cost of settling the claims varying significantly from any estimates made (and which also means that the estimates of QUK and of the R&Q Group actuaries can both be reasonable while being different). I also note that there are a number of areas where the R&Q Group actuaries could make improvements in their approach to reserving for the portfolio. I have discussed these with the R&Q Group actuaries who have told me that their approach to reserving for the portfolio will develop further once the Scheme has completed. I have no reason to suspect that such further development might result in any systemic weakening, post-Scheme, of the reserving for the QUK Transferring Business.

6.68 As described in paragraph 5.21, above, post-Scheme, Inceptum will be protected in relation to the QUK Transferring Business by a 50% QS reinsurance agreement, provided by R&Q Re, and by an ADC, provided by AIEL, which will attach if claims for the portfolio exceed £65 million from the point at which the business is transferred. The R&Q Group actuaries have projected reserve requirements for the QUK Transferring Business of £51.2 million as at 31 December 2022, i.e. shortly after the expected Effective Date of the Scheme. The R&Q Group actuaries have made stochastic projections of the portfolio (assuming that the portfolio conforms to a lognormal distribution with a mean gross of reinsurance loss equal to £51.2 million). They have simulated 100,000 possible outcomes and, in each case, estimated the losses recoverable under the reinsurance. Modelling in this way enabled the expected loss under the ADC to be estimated. The modelling suggests an expected loss to the ADC of £1.9 million, with a negligible chance of the loss exceeding the limit of the cover. The modelling shows total expected reinsurance recoveries of £26.5 million under both covers, giving an expected net loss of £24.6 million. Based on my experience, the approach to modelling the losses in this way is reasonable and in line with market practice. However, it should be noted that there is a considerable degree of uncertainty involved in modelling long tailed claims.

6.69 The R&Q Group actuaries have used these figures for the purpose of estimating total reserves for Inceptum post-Scheme, and for use in its projections of Inceptum's capital requirements. I note, that in order to estimate technical provisions on a Solvency II basis for use in these projections, the R&Q Group actuaries have discounted their reserve estimates for the QUK Transferring Business for the time value of money using cash flow patterns derived from their reporting year projections of the claims. [It has also added an allowance for ENIDs and expenses based on applying loading to the estimated reserves for the Inceptum business as a whole.]

Conclusion with regard to the strength of Inceptum's technical provisions post-Scheme

6.70 **Based on my review of the R&Q Group's projected reserves for Inceptum post-Scheme, both on a UK GAAP and Solvency II basis, I conclude that the Scheme will result in no change to the reserve strength of Inceptum's existing business nor to the strength of reserves held in relation to either the Eta Transferring Business or the WMG Transferring Business, as compared to the reserves held by those companies in respect of that business. I also conclude that the reserves that Inceptum intends to establish for the QUK Transferring Business and has used for its projected capital requirements, are reasonable, albeit that there is a considerable degree of uncertainty it the reserve requirements for the portfolio and that the R&Q Group actuaries will likely need make some refinements to their reserving methodology.**

EXCESS ASSETS OF QUK

6.71 QUK has been approved to use an internal model in order to calculate its SCR. In addition to discussing the internal model with QUK's capital modelling team, I have been provided with a report entitled "*Capital Model Design and Operation*" and dated 14 June 2021, which contains a description of the QEO Internal Model that is used to calculate the SCR for QUK and other QEO subsidiaries. The report sets out in detail the results of the QEO Internal Model's calculations for QUK and other QEO Group entities, and shows the projected QUK's SCR for 2021, based on QUK's financial position as at 31 December 2020.

6.72 The QEO Internal Model is used to calculate the SCR on two bases: one year and to-ultimate:

- The one year basis considers the expected variability over the current year in relation to both 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.

6.73 In both cases the SCR is calculated to a one in 200 year confidence level.

6.74 Although the one year basis only considers risk emergence over the forthcoming year, it benefits from just one year's investment income and also includes a risk margin that must be established at the end of the year. On the other hand, the to-ultimate basis considers the emergence of all risks over the run-off of the business (risks are assumed to have fully emerged after 10 years), but allows for 10 years of investment income on assets and requires no risk margin to be established at the end of the 10 year period. For QUK, the one year SCR is greater than the to-ultimate SCR, implying that a large portion of the risk is expected to emerge over the first year, with far less risk emerging over the subsequent run-off of the business.

6.75 The most significant component of QUK's SCR is insurance risk, which QBE considers in three parts:

- earned reserve risk, the risk relating to business that has been fully earned as at the valuation date;
- unearned reserve risk, the risk relating to business that has been written as at the valuation date but which has not yet been earned; and
- underwriting risk, the risk associated with the business to be written in the coming year, which in turn can be split between three claim types: attritional, large and catastrophe.

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

6.77 I have reviewed the work undertaken in estimating capital requirements for QUK, as documented in the aforementioned Capital Model Design and Operation report, in order to satisfy myself that it is reasonable for me to rely on that work. This included reviewing the process by which capital estimates have been made, the approach followed by the QEO Group's modelling team, the key assumptions employed, and the resulting capital amounts. Based on my review, I consider the methodology and modelling techniques used by the QEO Group's modelling team to be in line with industry practice and generally appropriate. I note that the capital estimates have been produced by suitably qualified actuaries (and other individuals) within the QEO Group, and that they have been reviewed and agreed by senior members of the QEO Group's modelling team. The QEO Internal Model is also subject to validation from external actuarial consultants.

6.78 As a result, I believe it is reasonable for me to rely on the work of the QEO Group's modelling team, and therefore I have not attempted to review in detail the calculations performed by the QEO Group's modelling team when it estimated QUK's SCR.

6.79 I have been provided with QEO's QRTs as at 30 September 2021, which indicate that QUK is well capitalised relative to its SCR with a Capital Cover Ratio of 162% (as shown in Figure 4.3, above). I note that this Capital Cover Ratio is reduced from 179% reported as at 31 December 2020 due to a planned distribution of capital from QUK to its parent.

6.80 I have also been provided with a report entitled *QEO Annual ORSA Report* and dated 30 March 2021 ("**QEO ORSA 2021**"), which includes a forward looking assessment of SCR and own funds over the period 2021-2024 for QEO Group entities, including QUK. The SCRs have been produced on both the one year and to-ultimate bases, with the latter generating lower values. I have reviewed the QEO ORSA 2021, I have noted that the estimates contained therein have been produced using the QEO Internal Model, which itself has been approved by the PRA, and I have concluded that the approach taken to assessing and projecting the capital requirements was reasonable and that the assumptions and therefore the conclusions are well formed.

6.81 The QEO ORSA 2021 shows QUK's Capital Cover Ratio relative to its one year time horizon SCR was expected to reduce between 2020 and 2021 due to the planned capital distribution, but then to increase modestly in 2022 and 2023. At all dates considered, QUK was, or was expected to be, a well-capitalised company.

Conclusion regarding the excess assets of QUK

6.82 **I have explained above why I consider that QUK's calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of QUK, including those who will transfer under the proposed Scheme, currently benefit from the financial strength provided by a well-capitalised company.**

EXCESS ASSETS OF ETA

6.83 In assessing its SCR for regulatory purposes, Eta uses the Standard Formula. Its own view of the level of capital required does not differ from that of the Standard Formula calculation. The Standard Formula SCR is at a 1 in 200 risk level on a one-year time horizon basis. Eta does not perform an assessment of solvency capital requirements on a to-ultimate basis.

6.84 Eta's Own Solvency Capital Requirement Assessment ("**OSNA**") represents the minimum target level of capital that it wishes to hold. This is based upon holding a buffer in excess of its regulatory SCR such that its Capital Cover Ratio is at least 125%. This is documented in the report entitled *"Own Risk & Solvency Assessment The R&Q Eta Company Limited",* dated 24 September 2021 (the "**Eta ORSA 2021**").

6.85 As at 31 December 2021, Eta has pledged FAL of £6.8 million to support the R&Q Group's corporate member. For the purpose of the calculation of the Standard Formula SCR, Eta considers the pledged assets as a ring-fenced fund, meaning that the FAL investment is considered separately from the remaining assets and liabilities of Eta in the valuation for solvency purposes. Any excess of the value of the FAL investment over the FAL SCR (in this case, £2.7 million, as stated in paragraph 4.89 above) is inadmissible for covering the SCR of Eta. The FAL SCR as at 31 December 2021 has been calculated using the equity risk and market risk concentrations module. It is uncertain whether Eta's FAL pledge will be redeemed before the Effective Date of the Scheme, but, in any case, the FAL will not transfer to Inceptum under the Scheme.

6.86 As at 31 December 2021, market risk makes up 100% of Eta's regulatory SCR. As noted above, Eta is holding no insurance reserves as at 31 December 2021 and, as a result, its underwriting risk charge is nil Counterparty risk is non-zero, but immaterial.

6.87 Eta has considered which parts of its risk profile are not captured by the Standard Formula. It has identified strategic risk and reputational risk but has then explained that the omission of these additional risks from the Standard Formula is unlikely to have a material impact upon the calculated SCR as these risks are not best managed through capital requirements.

6.88 As shown in Figure 4.4, above, as at 31 December 2021, Eta was a more than sufficiently capitalised insurer relative to its regulatory SCR, with a Capital Cover Ratio of 122%. I note that this breaches its stated risk appetite of a Capital Cover Ratio of at least 125%. However, this breach does not cause me concern as:

- Eta's insurance liabilities are thought to have completely run-off;
- Eta's SCR is inflated, and its EOF deflated, by it having pledged 87% of its financial assets as FAL;
- Eta's Capital Cover Ratio relative to its MCR as at 31 December 2021 was 160%.

6.89 Eta does not make use of any ancillary own funds items, or other non-Tier 1 capital, to cover its SCR.

6.90 I have reviewed the work undertaken by the R&Q Group actuaries in estimating capital requirements for Eta, in order to satisfy myself that it is reasonable for me to rely on that work. Based on my review, I consider the approach taken by Eta is in line with industry practice and is generally appropriate. As a result, I believe it is reasonable for me to rely on the work of Eta, and therefore I have not attempted to review in detail the calculations performed by Eta in order to estimate its SCR.

Conclusion regarding the excess assets of Eta

6.91 **I have explained above why I consider that Eta's calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of Eta currently benefit from the financial strength provided by a more than sufficiently capitalised company as at 31 December 2021.**

EXCESS ASSETS OF WMG

6.92 In assessing its SCR for regulatory purposes, WMG uses the Standard Formula. Its own view of the level of capital required does not differ from that of the Standard Formula calculation. The Standard Formula SCR is at a 1 in 200 risk level on a one-year time horizon basis. WMG does not perform an assessment of solvency capital requirements on a to-ultimate basis.

6.93 WMG's OSNA represents the minimum target level of capital that it wishes to hold. This is based upon holding a buffer in excess of its regulatory SCR such that its Capital Cover Ratio is at least 125%. This is documented in the report entitled *"The World Marine & General Insurance Plc ORSA Report",* dated December 2021 (the "**WMG ORSA 2021**").

6.94 As at 31 December 2021, WMG has pledged FAL of £2.0 million to support the R&Q Group's corporate member. For the purpose of the calculation of the Standard Formula SCR and the valuation for solvency purposes, WMG has used an approach consistent with that of Eta, as described in paragraph 6.85, above. Immediately pre-Scheme, WMG's FAL pledge is expected to be unchanged from that as at 31 December 2021. The pledged FAL will transfer to Inceptum as part of the Scheme.

6.95 As shown in Figure 4.11, above, as at 31 December 2021, WMG was a very well-capitalised insurer relative to its regulatory SCR (which is equal to its MCR), with a Capital Cover Ratio of 379%.

6.96 The most significant component of WMG's expected Solvency II SCR as at 31 December 2021 is market risk, being 95% of the SCR, prior to the application of diversification benefits. As at the same date, operational risk, counterparty default risk, and non-life underwriting risk are expected to each be approximately 2% of the Standard Formula SCR prior to the application of diversification benefits.

6.97 WMG has considered which parts of its risk profile are not captured by the Standard Formula. It has identified liquidity risk, strategic risk and group risk and has explained that the omission of these additional risks from the Standard Formula is unlikely to have a material impact upon the calculated SCR as these risks are not best managed through capital requirements.

6.98 WMG does not make use of any ancillary own funds items, or other non-Tier 1 capital, to cover its SCR.

6.99 I have reviewed the work undertaken in estimating capital requirements for WMG, as documented in the WMG ORSA 2021, in order to satisfy myself that it is reasonable for me to rely on that work. Based on my review, I consider the approach taken by WMG is in line with industry practice and is generally appropriate. As a result, I believe it is reasonable for me to rely on the work of WMG, and therefore I have not attempted to review in detail the calculations performed by WMG in order to estimate its SCR.

6.100 The WMG ORSA 2021 shows some stress testing, with only one scenario shown and no reverse stress test. The scenario covers the reduction of the value of intercompany loan assets, devaluation of bond markets, and further FAL investment. Under that one stress test, WMG is expected to remain very well-capitalised as at 31 December 2021.

Conclusion regarding the excess assets of WMG

6.101 **I have explained above why I consider that WMG's calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of WMG currently benefit from the financial strength provided by a very well-capitalised company as at 31 December 2021.**

EXCESS ASSETS OF INCEPTUM (PRE-SCHEME)

6.102 In assessing its SCR for regulatory purposes, Inceptum uses the Standard Formula. Its own view of the level of capital required does not differ from that of the Standard Formula calculation. Within the report *"Inceptum Insurance Company Limited ORSA Report"*, dated March 2022 (the "**Inceptum ORSA 2022**"), Inceptum has identified the following as the main differences between the Standard Formula and its risk profile.

- The risks related to PPO exposures may not be adequately reflected in the Standard Formula. This was noted by the PRA in an update to directors in July 2015[27]. PPOs are a material component of the (pre-Scheme) reserves of Inceptum, but Inceptum considers that its outwards reinsurance programme mitigates most of the potential for future volatility in the portfolio.
- The inflation risk with respect to future PPO payments may be underestimated by the Standard Formula as the life underwriting risk module only provides a capital requirement based on a shock on mortality rates. The Inceptum ORSA 2022 includes a (post-Scheme) stress test to assess the impact of an inflation shock on the earnings index to represent the impact of a labour shortage. In the scenario modelled, Inceptum remains a more than sufficiently capitalised company.

6.103 The PRA has highlighted that firms should make appropriate allowance for PPOs within the risk margin. This is addressed through two adjustments:

- Potential PPOs – for those claimants considered as potential PPOs and not reflected within life underwriting risk, the non-hedgeable SCR is run off in line with the best estimate reserves, assuming a PPO payment pattern.
- Lag – in addition, the non-hedgeable SCR is run off assuming a lag to the reserves run-off to reflect lost diversification and components such as operational risk that would not necessarily run-off in line with the best estimate reserves.

6.104 As at 31 December 2021, Inceptum has pledged FAL of £2.5 million to support the R&Q Group's corporate member. For the purpose of the calculation of the Standard Formula SCR and the valuation for solvency purposes, Inceptum has used an approach consistent with that of Eta, as described in paragraph 6.85, above. This is expected to be unchanged as at 31 December 2022.

6.105 Inceptum's OSNA represents the minimum target level of capital that Inceptum wishes to hold. This is based upon holding a buffer in excess of its regulatory SCR such that its Capital Cover Ratio is at least 125%.

6.106 As noted earlier in this Report, the Standard Formula SCR is at a 1 in 200 risk level on a one-year time horizon basis. Inceptum does not perform an assessment of solvency capital requirements on a to-ultimate basis.

6.107 The most significant component of Inceptum's Solvency II SCR as at 31 December 2021 was market risk, being 37% of the SCR, prior to the application of diversification benefits. Counterparty default risk, non-life underwriting risk, operational risk, and life underwriting risk are expected to be 25%, 20%, 13%, and 4%, respectively. As at 31 December 2021, Inceptum was a well-capitalised company with a Capital Cover Ratio of 169% (as shown in Figure 4.14, above).

6.108 I have reviewed the work undertaken in estimating capital requirements for Inceptum, as documented in the Inceptum ORSA 2022, in order to satisfy myself that it is reasonable for me to rely on that work. Based on my review, I consider the approach taken by Inceptum (pre-Scheme) is in line with industry practice and is generally appropriate. As a result, I believe it is reasonable for me to rely on the work of the Inceptum, and therefore I have not attempted to review in detail the calculations performed by Inceptum in order to estimate its pre-Scheme SCR.

Stress and scenario tests

6.109 The Inceptum ORSA 2022 does not show any stress tests, scenario tests, or a reverse stress test on a pre-Scheme basis.

[27] https://www.bankofengland.co.uk/-/media/boe/files/prudential-regulation/letter/2015/solvency-ii-directors-update-july-2015.pdf

Conclusion regarding the excess assets of Inceptum (Pre-Scheme)

6.110 **I have explained above why I consider that Inceptum's calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of Inceptum currently benefit from the financial strength provided by a well-capitalised company as at 31 December 2021.**

EXCESS ASSETS OF INCEPTUM (POST-SCHEME)

6.111 If the Scheme is implemented, Inceptum intends to continue to use the Standard Formula to calculate its regulatory SCR as its own view of the level of capital required does not differ from that of the Standard Formula calculation. The Inceptum ORSA 2022 considers the impact of the Scheme, and retains the views set out in paragraph 6.102, above, regarding differences between the Standard Formula and its risk profile. I note that the Inceptum ORSA 2022 does not specifically address the appropriateness of the Standard Formula in relation to the Transferring Business (of which the QUK Transferring Business is by far the most significant part). The Standard Formula is intended to consider risk emergence over a one year time horizon only. For portfolios containing mainly long tailed exposures, such as the QUK Transferring Business, risks are likely to emerge over many years and it may therefore be appropriate to consider the amount of capital required over a longer time horizon. In Inceptum's case, if the Scheme is sanctioned, it will benefit from the QS and ADC reinsurance protection that applies to the QUK Transferring Business. As is explained further below, the R&Q Group has undertaken modelling of the portfolio that suggests that the likelihood of the limit of the ADC being breached is very remote.

6.112 Post-Scheme, Inceptum will have pledged a total of £4.5 million to the FAL of the R&Q Group's corporate member (£2.5 million pre-Scheme, pus £2 million transferred by the Scheme from WMG). In its projections of its SCR and economic balance sheet as at 31 December 2022, a different method has been used to calculate the impact of the ring-fenced funds to that used as at 31 December 2021, which I had described above. The approach used in the projections is based on a "look-through analysis", allocating the capital requirements of the Lloyd's syndicates, in which the R&Q Group's corporate member participates, in line with the proportion of the total FAL of the R&Q Group's corporate member. This analysis was performed separately for the Inceptum pledged FAL and the WMG pledged FAL, and the two allocated capital requirements added to the overall SCR of Inceptum excluding FAL. I have been informed that the FAL pledged by Inceptum and WMG would not be drawn down until the FAL pledged by the remainder of the R&Q Group had been drawn, so a proportional allocation of the risk is, in a sense, prudent.

6.113 The most significant component of Inceptum's expected SCR, post-Scheme as at 31 December 2022, is expected to be non-life underwriting risk, being 47% of the SCR, prior to the application of diversification benefits. As at the same date, market risk, operational risk, counterparty default risk, and life underwriting risk are expected to be 20%, 19%, 13%, and 1% respectively of the Standard Formula SCR prior to the application of diversification benefits. As at 31 December 2022, it is expected that Inceptum will be a well-capitalised company. As at subsequent year ends thereafter, it is expected that Inceptum will be a very well-capitalised company and remain as such until at least 31 December 2024.

6.114 I have reviewed the work undertaken in estimating capital requirements for Inceptum, as documented in the Inceptum ORSA 2022, in order to satisfy myself that it is reasonable for me to rely on that work. Based on my review, I consider the approach taken by Inceptum (post-Scheme) is in line with industry practice and is generally appropriate. As a result, I believe it is reasonable for me to rely on the work of the Inceptum, and therefore I have not attempted to review in detail the calculations performed by Inceptum in order to estimate its post-Scheme SCRs.

Stress and scenario tests

6.115 The Inceptum ORSA 2022 includes several stress tests, three scenario tests and a reverse stress test, all applied to Inceptum post-Scheme.

6.116 The stress tests cover single risks. In each of the stress tests, Inceptum remains, at least, a more than sufficiently capitalised company. The stress tests include:

- Increase in frequency of UK asbestos claims in QUK portfolio;
- Reinsurance failure;
- Investment asset loss;
- All potential PPOs become actual PPOs; and

- Labour shortage leading to an increase in earnings index and hence increase in Inceptum reserves (as highlighted in paragraph 6.102, above).

6.117 The three scenario tests cover combinations of the risks mentioned in paragraph 6.116, above, in two cases with the addition of a cyber-risk event in parallel. In each scenario test, Inceptum's capital cover is reduced to between 100% and 119%. These scenarios are expected to occur with a probability of, at most, 1-in-200 years. In each case, the redemption of the FAL investment during 2023 restores Inceptum to being a more than sufficiently capitalised company. The reverse stress test, by definition, causes the Capital Cover Ratio to drop below 100%. This scenario appears to me to be a plausible but very unlikely event due to the low probability of occurrence of each of the events in this combination of events. I discuss in more detail in paragraphs 6.121-6.147, below, some of the more material stress and scenario tests considered.

Conclusion regarding the excess assets of Inceptum (Post-Scheme)

6.118 **I have explained above why I consider that Inceptum's calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of Inceptum, including those who will transfer under the proposed Scheme, will benefit from the financial strength provided by a well-capitalised company as at 31 December 2022.**

RELATIVE FINANCIAL STRENGTH ENJOYED BY TRANSFERRING POLICYHOLDERS PRE- AND POST-SCHEME

6.119 I have concluded, above, that the QUK Transferring Policyholders currently benefit from the financial strength provided by a well-capitalised company, that the Eta Transferring Policyholders currently benefit from the financial strength provided by a more than sufficiently capitalised company and that the WMG Transferring Policyholders currently benefit from the financial strength provided by a very well-capitalised company. I have also concluded that, if the Scheme is implemented, the Transferring Policyholders will become policyholders of a company that is expected to be a well-capitalised company. Therefore, relative to the solvency capital requirements of the respective entities, the QUK Transferring Policyholders and the Eta Transferring Policyholders will see, respectively, broadly no change or an improvement in the financial security afforded to them. On the other hand, the WMG Transferring Policyholders will see, *prima facie*, a diminution in the financial security afforded to them.

6.120 Notwithstanding the actual and projected financial strength of Inceptum relative to each of the transferring entities, as indicated by the Capital Cover Ratios, I have considered the impact upon the balance sheet of Inceptum of various "shocks" in order to illustrate the financial strength that will be afforded to all policyholders of Inceptum post-Scheme. I will then go on to consider in more detail the relative financial strength of each group of transferring policyholders.

Stress and Scenario Testing

6.121 As is described from paragraph 6.115, above, the R&Q Group has considered a range of stress and scenario tests on the financial position of Inceptum post-Scheme. I elaborate below on the key tests it has considered and their impacts. I have also supplemented these with some of my own tests and, for each of the main risks, I have looked at the most extreme stress that could be tolerated while still maintaining Inceptum's solvency.

Reserves in the QUK portfolio

6.122 I have discussed above the uncertainties associated with the QUK Transferring Business and that there are a number of reasons why the ultimate costs of settling these claims could be materially higher than the estimates used in the projected balance sheets. In its ORSA, QUK has considered a stress whereby the frequency of the UK asbestos claims is greater than expected, giving rise to a reserve consistent with the estimated 90th percentile of the distribution of outcomes (i.e. this is an outcome that would be expected to have a 1 in 10 likelihood of occurring). This is equivalent to an increase in gross reserves of just under £20 million. Under this scenario, Inceptum is projected, post-Scheme, to be a more than sufficiently capitalised company.

6.123 I note that this stress is assumed to occur immediately. In reality, the reasons that would cause the reserves to increase by this order of magnitude would likely materialise over a period of years.

6.124 In this scenario, the ADC would be triggered and, because of this cover, even a further increase in reserves of the same order of magnitude would not have a material effect on the balance sheet of Inceptum and would only increase its SCR through additional counterparty risk with AIEL.

6.125 Due to the existence of the ADC, this stress has indicated that Inceptum would be able to withstand very significant reserve deteriorations on the QUK Transferring Business and still meet regulatory capital requirements. I have calculated that, all else being unchanged, Inceptum would be able to withstand deterioration in the gross reserves of the QUK Transferring Business of £88 million (or about 170%) before its own funds would be depleted. I would regard such a scenario as being extremely remote; R&Q Group's modelling of the business suggests that the likelihood of such a scenario is less than 1 in 1,000.

Reserves in the existing Inceptum portfolio

6.126 I discussed the uncertainty in the reserves of the existing Inceptum business in paragraph 6.53, above. One of the key uncertainties is the impact of inflation on the PPO claims. For the purposes of its ORSA, Inceptum has considered the impact of an uplift in the ASHE index to 5% per annum (the existing assumption is 3% per annum). This index is used to allow for cost of care inflation in Inceptum's reserves. Under this scenario, there would be a material increase in reserves, gross of reinsurance, of almost £60 million (or around 55%), but the increase would be largely mitigated by the XoL reinsurance that protects the portfolio. However, due to the existence of indexed retentions, the net of reinsurance reserves are also projected to increase in this scenario (the best estimate by around £3 million and the risk margin by around £1 million), leading to a reduction in own funds of around £5 million. This would materially reduce Inceptum's Capital Cover Ratio, but Inceptum would remain more than sufficiently capitalised.

6.127 While it is possible that the ASHE index could increase by 5% or more on an annual basis for a limited period of time, based on historical experience, consistent increases of 5% per annum throughout the run-off of Inceptum's existing business appear a very remote possibility. Due to the existence of the XoL reinsurance, the impact on Inceptum's own funds of any increase in the gross reserves is relatively limited. Post-Scheme, even if the net reserves of Inceptum's existing business were to triple, it would not be sufficient to consume all of Inceptum's own funds. As such, post-Scheme, Inceptum's solvency is extremely unlikely to be threatened by deteriorations in the reserves of Inceptum's existing business alone.

Reinsurer failure

6.128 As noted above, Inceptum is reliant on external XoL reinsurers to protect its existing portfolio. In the Inceptum ORSA 2022, Inceptum has considered a stress that sees its largest external reinsurer (which accounts for just under a quarter of its reinsurance asset pre-Scheme) downgraded from a credit rating of AA+ to BB, with an assumption that, if there were a default, there would be a 50% loss of recoveries. This is noted as being a very remote scenario given the strength of the insurer implied by its credit rating. The impact of this scenario is an increase in the SCR due to an increase in counterparty default risk, as well as a reduction in own funds due to net technical provisions increasing, particularly due to an increase in the risk margin. However, Inceptum would remain a more than sufficiently capitalised company.

6.129 In the event that there was a default by the largest external reinsurer post-Scheme, then, based on the projected position as at 31 December 2022, Inceptum would have sufficient own funds to remain solvent even if all recoveries from this reinsurer were lost (assuming that there were no other changes to Inceptum's balance sheet). In reality, an event causing one reinsurer to default is likely to have an impact on other reinsurers as well, including on R&Q Re which, post-Scheme will be Inceptum's largest reinsurer.

6.130 I note that, pre-Scheme, in the event of R&Q Re defaulting, the QUK Transferring Policyholders would have recourse to QUK and, given that the reinsurance asset relating to the QUK Transferring Business is a relatively small item on QUK's balance sheet (less than 2% of total assets, and less than 6% of EOF), even a loss of all of the R&Q Re reinsurance would not have a very significant impact on QUK's financial strength. Post-Scheme, the QUK Transferring Policyholders will be more exposed to R&Q Re as Inceptum is a smaller company and the R&Q Re reinsurance asset will be (relatively) a more significant item on its balance sheet (around 13% of total assets and 99% of EOF). Nevertheless, as explained further below, as the likelihood of R&Q Re defaulting so much as to jeopardise Inceptum's solvency appears to be very remote, I do not believe that this increased exposure to R&Q Re will materially adversely affect the QUK Transferring Policyholders.

6.131 I have been provided with R&Q Re's consolidated financial statements as at 31 December 2021, as well as its Commercial Insurer Solvency Self-Assessment (which is the Bermudian equivalent to an ORSA). This shows that, as at 31 December 2021, R&Q Re was a more than sufficiently capitalised company relative to its regulatory solvency capital requirements in Bermuda. Based on its business plan (which includes the impact of it no longer reinsuring the QUK Transferring Business on a 100% basis, but moving to a 50% QS post-Scheme), R&Q Re projects that, by 31 December 2022, it will be a very well-capitalised company and will continue to be for at least the following two years of its business plan.

6.132 I note that R&Q Re is exposed to several different legacy portfolios that it has acquired or reinsured. As at 31 December 2021, the QUK Transferring Business was the largest of these portfolios, accounting for about 36% of net reserves as at that date. Of the other portfolios, only two have exposure to asbestos and environmental liabilities (these account for around 3% of R&Q Re's net reserves). Workers' compensation claims account for about a third of the remaining reserves, general liability about a quarter, and the rest is a mixture of other lines of commercial insurance and inwards reinsurance business. Therefore, there is limited correlation between the QUK Transferring Business and the other business within R&Q Re.

6.133 Based on its projected financial strength, it would appear very unlikely that R&Q Re would default. Nevertheless, I have calculated that, post-Scheme, Inceptum would be able to withstand a loss given default of around 80% of its recoverables under the 50% QS provided by R&Q Re before all of its own funds were depleted. To put this into context, for R&Q Re to default to the extent that it was only able to fund 20% of its liabilities (across all of its portfolios), it would need to have experienced an increase in its technical provisions of almost 800% or a loss in assets (most of which are held in bonds) of over 80%, or some combination of the two. Such scenarios would appear very remote.

6.134 I note that R&Q Re is registered as a Segregated Accounts Company ("**SAC**")[28] and has a number of segregated accounts into which it has assumed business from a variety of cedants. One of its segregated accounts contains the business reinsured from QUK and this account will continue to contain this business post-Scheme (albeit with the cession reduced to 50%, as discussed above). In addition, there is a "general account" from which funds could be used to provide additional assets to any of the segregated accounts if the need were to arise. The segregation of accounts gives the QUK Transferring Policyholders a degree of protection from any deteriorations in R&Q Re's other business (and vice versa). I have been informed by the R&Q Group that, post-Scheme, the terms of the LPTA will be varied such that the segregated account that has assumed the LPTA will need to collateralise to 105% of the reserves under the LPTA. This means that reserve deterioration affecting other portfolios covered by R&Q Re (within other segregated accounts) would not, in isolation, affect the ability of R&Q Re to meets its obligations under the LPTA. The segregation of accounts also means that R&Q Re's excess assets that are held in other segregated accounts would not be available to fund any deteriorations in the QUK Transferring Business; however, over 85% of R&Q Re's excess assets are currently held either in the segregated account for the QUK Transferring Business or in R&Q Re's general account.

6.135 In order to illustrate Inceptum's exposure to reinsurer default risk more generally, I have considered the extent to which it could withstand defaults by all of its reinsurers and remain solvent. For this purpose, I have calculated that if it were to suffer a 20% loss of recoveries from its most highly rated reinsurers (which represent around two thirds of recoveries) and 30% for all other reinsurers then it would suffer a loss approximately equal to its own funds, based on the projected position as at 31 December 2021. I would regard defaults of this magnitude across a whole range of reinsurers to be an extremely remote scenario, given the credit ratings of those reinsurers.

Reduction in value of the investment portfolio

6.136 Inceptum adopts a conservative investment strategy and is invested mainly in government and investment grade corporate bonds. Post-Scheme, it is expected to continue with a similar investment policy. As such, it is not significantly exposed to investment risk. In the Inceptum ORSA 2022, Inceptum has considered the effects of an immediate post-Scheme fall of 10% in its investment portfolio, which it has attributed to a scenario such as a global recession. This would lead to a material reduction in Inceptum's own funds, although its SCR would also reduce, albeit only slightly. Inceptum would be a more than sufficiently capitalised company if this eventuality occurred. It has also considered the impact of a 15% fall in the value of its investment portfolio, which would still leave it sufficiently capitalised.

[28] In Bermuda, a SAC is a company which is granted the statutory power to create "segregated accounts" in order to legally segregate the assets and liabilities attributable to a particular segregated account from those attributable to other segregated accounts and from the SAC's general account (which comprises the assets and liabilities that are not otherwise linked to a segregated account).

6.137 The likelihood of a 15% fall in Inceptum's investment portfolio is remote. Such a fall is more than three times the market risk charge in Inceptum's SCR, and the impact seen on the R&Q Group's investment portfolio of both the COVID-19 pandemic and Ukraine 2022 conflict were only around 4%.

6.138 Post-Scheme, Inceptum would be able to withstand a fall in its investments of around 40% and continue to remain solvent. I would regard a drop in investment values of this magnitude as being extremely unlikely.

Scenario tests

6.139 In addition to the individual stress tests, Inceptum considers in the Inceptum ORSA 2022 three scenario tests that assess the impact of a number of stresses occurring simultaneously. The likelihood of multiple stresses occurring at the same time is less than that of an individual loss occurring in isolation. As such, each of the scenarios considered has been assessed by Inceptum to be more remote that a 1 in 200 year likelihood, a view with which I concur.

6.140 The first scenario considers the stress to Inceptum's reserves caused by an uplift in the ASHE earnings index to 5% per annum in combination with a 5% impairment of the reinsurance asset from the largest external reinsurer and a 5% reduction in bond values.

6.141 The second scenario considers the above reserve stress to the QUK Transferring Business together with a 5% fall in bond values and a cyber event that is assumed to cost Inceptum £0.5 million.

6.142 The third scenario also considers the above reserve stress to the QUK Transferring Business, but combines this with a 10% impairment of the reinsurance asset from the largest external reinsurer and a cyber event that is assumed to cost Inceptum £0.5 million.

6.143 The first scenario has the most extreme impact on Inceptum's solvency position, leaving it with just enough capital to cover its SCR. The other scenarios would also reduce materially Inceptum's Capital Cover Ratios relative to its SCR, leaving it only sufficiently capitalised. Nevertheless, Inceptum would be able to withstand all these scenarios and its position under each is projected to materially improve from 2023, aided significantly by the redemption of its FAL pledge (which both reduces its market risk and hence its SCR and increases its EOF).

6.144 For illustrative purposes I have also considered a further scenario that is intended to test the limits of Inceptum's solvency. I have looked at the combination of a 10% fall in the investment portfolio, an increase of 50% in the gross TPs of the QUK business and defaults by both R&Q Re and AIEL (the ADC being trigged by the 50% increase in the gross TPs) giving rise to a loss of 20% of the recoverables. This scenario would deplete almost all of Inceptum's own funds. I would regard such a scenario (which combines a number of stresses that, when looked at in isolation are already very unlikely) as being very remote.

6.145 As discussed from paragraph 6.131, above, the likelihood of R&Q Re defaulting appears remote. I note that a 50% increase in the gross TPs of the QUK Transferring Business (even if combined with the same increase in R&Q Re's other asbestos portfolios) and 10% fall in its investment portfolio would not, in isolation, be sufficient to cause R&Q Re to become insolvent, based on its projected position as at 31 December 2022.

6.146 With regard to AIEL (which is engaged in writing ongoing business, as well as maintaining legacy portfolios), as at 31 March 2022, it reported a Capital Cover Ratio relative to its SCR equivalent to that of a well-capitalised company and, as noted in paragraph 5.21, above, it has a credit rating with AM Best of A-. Therefore, the likelihood of its default also appears remote. I further note that, while AIEL contains some exposures of a similar nature to those of the QUK Transferring Business, these are a relatively small part of AIEL's overall portfolio, and it is not very exposed to concentrations of liabilities of any one type. As at 31 December 2021, reserves for UK asbestos and other UK EL claims (i.e. claims with a similar profile to those of the QUK Transferring Business) accounted for about 12% of total net reserves and reserves for US and Australian asbestos liabilities a further 7%. I note that AIEL has also written an adverse development cover relating to another portfolio containing UK asbestos liabilities; however, based on figures as at 31 December 2021, the gross reserves in respect of that portfolio would need to deteriorate very significantly (27%) before AIEL would have liability for any payments. Were AEIL to also experience a deterioration of its asbestos portfolios of 50% and a 10% fall in its investment portfolio (along with the increased reserves associated with its ADC of the QUK Transferring Business), based on it projected position as at 31 December 2022, these impacts would not, in isolation, be sufficient to cause AIEL to become insolvent.

Conclusions from the stress and scenario test

6.147 The results of the stress and scenario tests show that, post-Scheme, Inceptum would be able to withstand a wide range of adverse outcomes in relation to some of its key risks, should they occur. These tests illustrate Inceptum's financial strength and reinforce its characterisation as a well-capitalised company, as indicated by its Capital Cover Ratio relative to its SCR.

Relative financial strength for the QUK Transferring Policyholders

6.148 As has been noted above, should the Scheme be implemented, then the QUK Transferring Policyholders would transfer from one well capitalised company to another. The stress and scenario tests have shown that, although Inceptum is a considerably smaller, less diversified company than QUK, its financial strength is nevertheless sufficient to withstand significantly adverse outcomes. I therefore believe this illustrates that there will not be any materially adverse impact in the financial security enjoyed by the QUK Transferring Policyholders as a result of the Scheme.

6.149 Pre-Scheme, in the event that R&Q Re were unable to meet its obligations to QUK under the 100% reinsurance agreement then the QUK Transferring Policyholders would benefit from the additional layer of security provided by QUK retaining the legal liability for their benefits. Post-Scheme, the payment of the QUK Transferring Policyholders' claims will be entirely funded by Inceptum, supported through reinsurance by other entities within the R&Q Group. Therefore, post-Scheme, the security of the QUK Transferring Policyholders' benefits will be wholly dependent on the R&Q Group. While having the additional security of the QUK balance sheet is currently a benefit for the QUK Transferring Policyholders that they would lose through the Scheme, I do not regard that benefit to be material as, due to the financial strength of Inceptum and R&Q Re, I consider remote the likelihood of Inceptum being unable to meet its obligations towards the QUK Transferring Policyholders. I discuss further, in paragraphs 6.159 to 6.164, below, what would happen in the event that either QUK or Inceptum became insolvent, both were that to occur pre-Scheme and were it to occur post-Scheme.

6.150 Post-Scheme, Inceptum will remain sufficiently capitalised to absorb the potential impacts of reinsurer downgrades while remaining a well-capitalised company.

Relative financial strength for the WMG Transferring Policyholders

6.151 Although the WMG Transferring Policyholders will move from a very well-capitalised company to one that is only well-capitalised, I do not believe that this will materially adversely affect the WMG Transferring Policyholders. In reaching this conclusion I have considered the fact that Inceptum is a considerably larger, more diversified company than WMG and that, as illustrated by the stress and scenario testing, there would appear to be a remote risk of Inceptum failing. Furthermore I note that both WMG and Inceptum operate the same target of maintaining capital of not less than 125% of its SCR. While in practice the R&Q Group make seek to have a Capital Cover Ratio of materially greater than 125% for its insurance entities, and, as insurers in run-off both would require the non-objection of the PRA prior to releasing any capital, the current level of capitalisation of WMG appears to be particularly high and I would expect that, absent the Scheme, the R&Q Group may seek to use some of that excess capital for other purposes.

Relative financial strength for the Eta Transferring Policyholders

6.152 The Eta Transferring Policyholders will move from a small, more than sufficiently capitalised company to a larger, well-capitalised company. As a result the Eta Transferring Policyholders should see an improvement in the financial strength afforded to them as a result of the Scheme.

Conclusion regarding the relative financial strength enjoyed by Transferring Policyholders pre- and post-Scheme

6.153 **I am therefore satisfied that all Transferring Policyholders will not be materially adversely affected due to relative differences in the financial strength of Inceptum post-Scheme to those of QUK, Eta and WMG pre-Scheme.**

CHANGES IN RISK EXPOSURES

6.154 If the Scheme is sanctioned:

- the QUK Transferring Policyholders will no longer be exposed to the other risks within QUK but will now be exposed to the risks within Inceptum plus the risks of the Eta Transferring Business (although these appear negligible) and the WMG Transferring Business. As such, they would be exposed to smaller risks, Inceptum being, post-Scheme, a much smaller company than QUK, but the risks to which they would be exposed are less diversified;
- the Eta Transferring Policyholders will no longer be exposed to just the risks within Eta but will now be exposed to the risks within Inceptum plus the risks of the QUK Transferring Business and the WMG Transferring Business. As such, they would be exposed to much bigger risks, Inceptum being, post-Scheme, a much larger company than Eta, but the risks to which they would be exposed are more diversified; and
- the WMG Transferring Policyholders will no longer be exposed to just the risks within WMG but will now be exposed to the risks within Inceptum plus the risks of the QUK Transferring Business and the Eta Transferring Business (although these appear negligible). As such, they would be exposed to much bigger risks, Inceptum being, post-Scheme, a much larger company than WMG, but the risks to which they would be exposed are more diversified.

6.155 As mentioned previously, the Board of QUK has set its target minimum Capital Cover Ratio at 130%. The Boards of Eta, WMG and Inceptum have set their capital risk appetite with a target minimum Capital Cover Ratio of 125%. Therefore, the reduced risks to the QUK Transferring Policyholders post-Scheme are countered by a slightly less prudent risk appetite regarding capital coverage than that which they enjoy pre-Scheme. As noted in several places in this Report, in practice, both QUK, WMG and Inceptum hold capital well above their target minimum Capital Cover Ratios.

6.156 Different risk profiles, insofar as they might affect the future financial security of policyholders, are reflected in the capital requirements of QUK, Eta, WMG and Inceptum. As I have already concluded, Inceptum is currently a well-capitalised company (and is projected to remain at least well-capitalised post the Effective Date) and QUK is also a well-capitalised company. Therefore, I am satisfied that, even were the Scheme to result in adverse change to the QUK Transferring Policyholders' risk exposures, the capital protection available to them post-Scheme will not be materially different to that which they enjoyed pre-Scheme. Therefore, I conclude that any change in their risk exposure will not have a materially adverse impact on the security of the Transferring Policyholders.

6.157 Whilst the Eta Transferring Policyholders and WMG Transferring Policyholders will be exposed to different risks, as I have already concluded above, post-Scheme Inceptum will be a well-capitalised company and the WMG and Eta Transferring Policyholders will not be materially adversely affected by changes in financial strength as a result of the Scheme. As such I do not believe that any changes in risk exposure will materially adversely affect these groups of policyholders. Indeed, The WMG Transferring Policyholders and Eta Transferring Policyholders will both benefit from the increased diversification associated with being policyholders of a larger insurance company.

Conclusion regarding the effect of the Scheme on the Transferring Policyholders’ exposure to risk

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

IN THE EVENT OF INSOLVENCY

6.159 In this subsection of the Report, I consider the effect on the Transferring Policyholders of QUK, Eta, WMG becoming insolvent pre-Scheme and of or Inceptum becoming insolvent post-Scheme. I then compare the effects pre- and post-Scheme to determine the effect of the Scheme on the Transferring Policyholders in the event of insolvency.

6.160 The QUK Transferring Policyholders, the Eta Transferring Policyholders and the existing Inceptum policyholders are all direct policyholders, i.e. the QUK Transferring Business, the Eta Transferring Business and the existing Inceptum business includes no inwards reinsurance. However, the WMG Transferring Policyholders includes a material number of cedant policyholders (Figure 4.8, above, shows over 2/3rds of WMG’s remaining policies being inwards reinsurance).

6.161 As I discussed in paragraph 3.22, above, in the event that an insurer is wound up direct policyholders rank equally and above inwards reinsurance policyholders and all other unsecured/non preferential creditors. Therefore, pre-Scheme, were any of QUK, Eta or WMG to become insolvent, the direct policyholders would rank behind holders of preferential debt in accessing the remaining assets of the respective company but ahead of other creditors, which, in the case of WMG, would include the cedant holders of reinsurance contracts with WMG. Post-Scheme, were Inceptum to become insolvent, the QUK Transferring Policyholders, the Eta Transferring Policyholders, the WMG Transferring Policyholders who are direct policyholders and the existing Inceptum policyholders would all rank equally with one another but ahead of those WMG Transferring Policyholders who are holders of inwards reinsurance policies, i.e. in the event of post-Scheme insolvency of Inceptum, a sizeable proportion of the WMG Policyholders would be further behind in the queue for remaining assets that they would have been had WMG failed pre-Scheme. In this respect, it is possible that the WMG Transferring Policyholders who are holders of inwards reinsurance policies would be adversely affected by the Scheme in that they might not receive all of the contractual benefits to which they are entitled, the degree of shortfall being dependent on the extent of the insolvency.

6.162 I note that the insolvency of any member of the R&Q Group could have significant repercussions on other parts of the R&Q Group, depending on the terms of its various third party agreements and, therefore, were Inceptum (for example) to become insolvent then RQIH could be expected to provide additional capital at least sufficient to restore its solvency. However, there is no guarantee or other legal agreement between RQIH and Inceptum that would ensure that such additional capital would be provided.

6.163 While Inceptum becoming insolvent post-Scheme might be disadvantageous to those WMG Transferring Policyholders who are holders of inwards reinsurance policies, the likelihood of this event occurring is remote, due to Inceptum being a well-capitalised company post-Scheme. Therefore, I do not consider that the possibility of the post-Scheme insolvency of Inceptum materially adversely affects the Transferring Policyholders, not even those WMG Transferring Policyholders who are holders of inwards reinsurance policies.

6.164 Pre-Scheme, were Inceptum to become insolvent, it would have no impact on the Transferring Policyholders, Inceptum having no pre-Scheme involvement with QUK, Eta or WMG.

Conclusion regarding the effect of the Scheme on the Transferring Policyholders in the event of the insolvency of either QUK or Inceptum

6.165 **I am satisfied that the Transferring Policyholders will not be materially adversely affected due to relative differences in their rights pre- and post-Scheme in the event of the insolvency post-Scheme of Inceptum.**

POLICY SERVICING

6.166 Currently, Eta, WMG and Inceptum have delegated to RQCS the servicing of their respective businesses (aside for, in WMG's case, the Pre-1973 business, which is instead serviced by RMSL), including the handling of all claims. Post-Scheme, the Eta Transferring Business and the WMG Transferring Business will be within Inceptum and (other than the Pre-1973 business transferred from WMG) will continue to be serviced by RQCS. Post-Scheme, the Pre-1973 business transferred to Inceptum from WMG will continue to be serviced by RMSL, the agreement under which RMSL services the business having been part of the assets transferred by the Scheme from WMG to Inceptum.

6.167 Likewise, in accordance with the R&Q Services Agreement, RQCS currently provides, on behalf of QUK, all policy servicing, including handling all claims, in respect of the QUK Transferring Business. Post-Scheme, RQCS will continue to provide all policy servicing in respect of the QUK Transferring Business, but then it will be on behalf of Inceptum. This means that QUK Transferring Policyholders will enjoy continuity of service post-Scheme in terms of the servicing of their policies, in particular their claims.

6.168 There are no planned changes, post-Scheme, to the services standards, policy management and administration practices, processes or procedures (other than RQCS having to report to and liaise with only one entity post-Scheme, in respect of the Transferring Business and of the existing business in Inceptum rather than with four pre-Scheme), or to the RQCS employees performing the policy administration and servicing for the different groups of Transferring Policies. Therefore, there should be no change to the policy administration arrangements of the Transferring Business as a result of the Scheme.

6.169 It is also intended that RQCS employees will continue to operate the existing administration systems. Therefore, there will be no change in this respect for the Transferring Business.

6.170 On and from the Effective Date, Inceptum shall become the data controller of any personal data that relates to the Transferring Business or Transferring Policyholders, to the extent required by the Data Protection Laws and shall be deemed to have been the controller of all such data at all material times when personal data is processed.

6.171 I note that Eta sold some business in Ireland and that four of the 427 separate clients identified by Eta are based in Ireland. Following the UK's withdrawal from membership of the European Union, UK-regulated insurers have lost their right, under EU Freedom of Services arrangement, to provide insurance services in EU states. Hence, if a claim were to emerge relating one of these Ireland-domiciled clients of Eta, then RQCS would not be authorised to administer the claim. I consider this risk to be negligible:

- of the four Ireland-based clients, one has never made a claim (and, as discussed in paragraph 4.62, above, would no longer be able to make a claim);
- while the other three have notified possible claims, none has resulted in the payment of damages or claimant costs. It is very unlikely that any of these claims would be reopened.

6.172 In view of the very low likelihood of it needing to service any of these policies for Ireland-based policyholders, RQCS has made no specific contingency arrangements for such an eventuality. However, were this eventuality to materialise then RQCS would approach the Central Bank of Ireland (the insurance regulator in Ireland) to discuss and agree a pragmatic solution. I am informed by R&Q Group that if claims handling arrangements in Ireland were needed for Eta, it would likely appoint a Dublin-based claims administrator that currently handles certain claims for its Irish subsidiary.

6.173 I note that this situation is unaltered by Scheme.

Conclusion regarding the effect of the Scheme on the policy servicing of the Transferring Business

6.174 **Because there are no intended post-Scheme changes to the policy administration arrangements, the policy administration systems or (in the main) the policy administration personnel, I believe that the Scheme is unlikely to have any impact on the standards of policy servicing experienced by the Transferring Policyholders compared to their current position.**

COMPENSATION AND COMPLAINTS

6.175 I have explained in paragraphs 3.8-3.10 above, that in the event that a UK-authorised financial firm had insufficient assets to meet its liabilities, the FSCS would compensate eligible customers of the firm in question. I have also explained, in paragraphs 3.11-3.12, that the FOS provides eligible customers with a free, independent service to help settle disputes with financial firms (including insurers). The FOS has compulsory jurisdiction in respect of complaints raised by eligible policyholders.

6.176 Under the Scheme, business will be transferred between UK-authorised financial firms. The Scheme would not alter the eligibility of policyholders for compensation from the FSCS. Therefore, those Transferring Policyholders who are currently eligible to seek compensation from the FSCS would be equally eligible post-Scheme.

6.177 Likewise, the Scheme would not alter the eligibility of policyholders to access the FOS. Therefore, those Transferring Policyholders who are currently eligible to seek assistance or advice from the FOS would be equally eligible post-Scheme.

6.178 QUK and the R&Q Group have both confirmed to me that none of the Transferring Policyholders have a complaint lodged with the FOS that is currently outstanding. Moreover, they are unaware of any Transferring Policyholder having lodged a complaint with the FOS within the last several years.

CONCLUSION FOR THE TRANSFERRING POLICYHOLDERS

6.179 **I am satisfied that the Scheme will not affect in a materially adverse way either the security or the policy servicing levels of the Transferring Policyholders.**

7. The impact of the Scheme on the policyholders of QUK not transferring to Inceptum under the Scheme

7.1 In this section of the Report, I consider the impact of the Scheme on the QUK Non-Transferring Policyholders. I also consider in this section the impact of the Scheme on holders of Excluded Policies, should there be any that relate to the QUK Transferring Business.

7.2 Post the Effective Date, the insurance liabilities of QUK will essentially be unchanged. The only difference would be that the QUK Transferring Business, which previously had been 100% reinsured by R&Q Re under the terms of the R&Q LPTA, will now be wholly off QUK's balance sheet. Under Solvency II, both the TPs and the capital requirements are slightly reduced, the TPs by the removal of the counterparty default provision and the SCR by the removal of the credit risk in relation to the arrangement with R&Q Re. I do not believe that implementation of the Scheme would create any additional risks within QUK. Therefore, I consider that the Scheme will have no material impact upon the security of benefits of the QUK Non-Transferring Policyholders, or of any QUK holders of Excluded Policies.

7.3 There are no planned changes to the policy service standards within QUK post-Scheme. The staff who service QUK policies pre-Scheme will continue to service the policies post-Scheme, using the same processes and practices. Therefore, neither the QUK Non-Transferring Policyholders nor any QUK holders of Excluded Policies should experience any change in the servicing of their business.

7.4 In the event of the insolvency of QUK, post-Scheme, there would be no change in the ranking of QUK Non-Transferring Policyholders and of any holders of Excluded Policies in having access to the remaining assets of QUK, compared with the ranking had the insolvency occurred pre-Scheme. The only difference is that they no longer need to share in those remaining assets with the QUK Transferring Policyholders. On the other hand, they would not really have needed to compete for those assets with the QUK Transferring Policyholders, as the QUK Transferring Policies (including any that would have become Excluded Policies) would have been covered by a dedicated asset, i.e. the 100% reinsurance provided by R&Q Re. In any event, based on the current and expected post-Scheme financial strength of QUK, I consider it unlikely that QUK would become insolvent in the foreseeable future.

7.5 As described in paragraph 5.15, above, if there are any Excluded Policies post the Effective Date that relate to the QUK Transferring Business then QUK and the R&Q Group shall work towards subsequently transferring each and every Excluded Policy to Inceptum, by novation or other means. While they remain direct policyholders of QUK, the QUK holders of any Excluded Policies will be treated by RQCS no less favourably than those holders of business successfully transferred to Inceptum under the Scheme. The Excluded Policies will continue to be 100% reinsured by R&Q Re.

CONCLUSION FOR THE POLICYHOLDERS OF QUK NOT TRANSFERRING UNDER THE SCHEME

7.6 **I am satisfied that the security of the contractual rights or the standards of policy servicing currently enjoyed by the QUK Non-Transferring Policyholders, and by any holders of QUK policies that become Excluded Policies, will not be adversely affected by the Scheme.**

8. The impact of the Scheme on the policyholders of Eta or of WMG not transferring to Inceptum under the Scheme

8.1 In this section of the Report, I consider the impact of the Scheme on any policyholder of Eta or of WMG who holds a policy that is not transferred to Inceptum by the Scheme (i.e. which becomes an Excluded Policy). There will be no other policyholders of either Eta or WMG whose policies are not transferred by the Scheme to Inceptum.

8.2 I note that no Excluded Policies are expected. As described in paragraph 5.15, above, if there are any Excluded Policies post the Effective Date that relate to the Eta Transferring Business then the R&Q Group shall work towards subsequently transferring each and every such Excluded Policy to Inceptum, by novation or other means. Similarly, if there are any Excluded Policies post the Effective Date that relate to the WMG Transferring Business then the R&Q Group shall work towards subsequently transferring each and every such Excluded Policy to Inceptum, by novation or other means. While they remain direct policyholders of either Eta or WMG, the holders of any such Excluded Policies will be treated by RQCS no less favourably than those holders of business successfully transferred to Inceptum under the Scheme.

8.3 Those Eta policyholders with Excluded Policies will continue to benefit from the financial security offered by a more than sufficiently capitalised insurer. Similarly, those WMG policyholders with Excluded Policies will continue to benefit from the financial security offered by a very well-capitalised insurer. As such, the Scheme will have no impact upon such holders of Excluded Policies.

CONCLUSION FOR THE POLICYHOLDERS OF ETA AND WMG NOT TRANSFERRING UNDER THE SCHEME

8.4 **I am satisfied that neither the security of the contractual rights nor the standards of policy servicing currently enjoyed by those policyholders of Eta and WMG who hold policies that become Excluded Policies will be adversely affected by the Scheme.**

9. The impact of the Scheme on the existing Inceptum policyholders

9.1 In this Section, I consider the impact of the Scheme on the existing policyholders of Inceptum.

RELATIVE FINANCIAL STRENGTH ENJOYED BY THE EXISTING INCEPTUM POLICYHOLDERS PRE- AND POST-SCHEME

9.2 I have concluded, above, that the existing Inceptum policyholders currently benefit from the financial strength provided by a well-capitalised company. Inceptum's estimates of its Capital Cover Ratios, assuming the successful completion of the Scheme, suggest that Inceptum will be a well-capitalised company as at year-end 2022 and very well-capitalised at year ends 2023 and 2024. Were the Scheme not to take place, the projected Capital Cover Ratio for Inceptum as at year-end 2022 would have been slightly higher, but still consistent with Inceptum being a well-capitalised company. In my view, while implementation of the Scheme will slightly reduce the financial strength of Inceptum in relative terms, in practice the existing Inceptum policyholders will see no material difference in the financial strength afforded to them, it being only a remote possibility that a well-capitalised insurer will become insolvent in the foreseeable future (and an even remoter possibility that a very well-capitalised will become insolvent in the foreseeable future).

9.3 In Section 6, above, I considered the effect of a number of stress tests on Inceptum's balance sheet post-Scheme (see commentary from paragraph 6.121 onwards). Pre-Scheme, Inceptum is less able to withstand some scenarios due to it currently being a considerably smaller company than it will be post-Scheme. As can be seen in Figure 5.8, above, Inceptum's EOF will increase by around £18 million (or 200%) as a result of the Scheme. This means that, pre-Scheme, Inceptum is less able to withstand an increase in the reserves of its existing portfolio, or a failure of one of its existing XoL reinsurers (assuming that such shocks occur in isolation). Although Inceptum's investment strategy is not expected to change as a result of the Scheme, as the ratio of its investment assets to own funds is expected to be slightly higher post-Scheme, it will be slightly more exposed to falls in assets values post-Scheme. However, as is explained in paragraph 6.138, above, it would still be able to maintain its solvency even in the event of reductions in the value of its investment assets of extremely unlikely magnitudes. As such, I do not believe that this change will materially adversely affect the existing policyholders of Inceptum.

9.4 Post-Scheme, the Inceptum policyholders will become exposed to the risks of the Transferring Business (principally those of the QUK Transferring Business). The main risks are that the reserves for the QUK Transferring Business deteriorate and/or that there is a reinsurer failure relating to the QUK Transferring Business. As explained in paragraph 6.125, above, due to the QS reinsurance with R&Q Re and the ADC, Inceptum would be able to withstand extreme deteriorations in its gross reserves before its own funds would be exhausted. I have also considered in paragraph 6.132, above, the impact of defaults across all of Inceptum's reinsurers, post-Scheme. This has shown that Inceptum would be able to maintain its solvency even in the event of the loss of very material amounts of its reinsurance asset – a scenario that would appear very remote given the financial strength of the reinsurers. Furthermore, in paragraph 6.144, above, I have considered a scenario involving the combined impact of a reserve deterioration, reduction in asset values and a material default by both R&Q Re and AIEL. As I have noted in paragraph 6.132, above, the other liabilities of R&Q Re are mainly not asbestos-related claims, so there is unlikely to be significant correlation between the QUK Transferring Business and R&Q Re's other liabilities. As noted in paragraph 6.144, above, this is also the case for AIEL. This scenario test showed that, post-Scheme, Inceptum would be able to withstand a combination of stresses, the magnitude and likelihood of occurring in combination would appear very remote. Given this, as well as the results of the scenario testing described in Section 6, above, I do not believe that the existing Inceptum policyholders will see any material difference in the financial strength afforded to them.

Conclusion regarding the impact of the Scheme on the financial security of existing Inceptum policyholders

9.5 **I am therefore satisfied that the existing policyholders of Inceptum will not be materially adversely affected due to relative differences in the financial strength of Inceptum pre-Scheme and post-Scheme.**

CHANGES IN RISK EXPOSURES

9.6 Post-Scheme, existing Inceptum policyholders will be subject to additional risks associated with the Transferring Business. As such, they will be exposed to much bigger risks, Inceptum being, post-Scheme, a much larger company than it currently is, pre-Scheme, but the risks to which they would be exposed would be more diverse.

9.7 As mentioned previously, the Board of Inceptum has set its target minimum Capital Cover Ratio at 125%. This risk appetite is unchanged by the Scheme. As noted in several places in this Report, in practice, Inceptum holds capital well above its target minimum Capital Cover Ratio.

9.8 Different risk profiles, insofar as they might affect the future financial security of policyholders, are reflected in the capital requirements of different insurers. As I have already concluded, Inceptum is currently a well-capitalised company and is projected to remain well-capitalised post the Effective Date. Therefore, I am satisfied that, even were the Scheme to result in adverse change to the existing Inceptum policyholders' risk exposures, the capital protection available to them post-Scheme will not be materially different to that which they enjoyed pre-Scheme. Therefore, I conclude that any change in their risk exposure will not have a materially adverse impact on the security of the existing Inceptum policyholders.

Conclusion regarding the effect of the Scheme on the existing Inceptum policyholders' exposure to risk

9.9 **I am satisfied that the Scheme will not lead to a material change in the risk exposures of the existing policyholders of Inceptum.**

POLICY SERVICING

9.10 Neither Inceptum nor RQCS is planning any changes to the policy administration arrangements in respect of the existing Inceptum business as a result of the Scheme. The staff who service Inceptum policies pre-Scheme will continue to service the policies post-Scheme, using the same processes and practices. Therefore, the existing policyholders of Inceptum should experience no change in the servicing of their business.

Conclusion regarding the effect of the Scheme on the policy serving for existing Inceptum policyholders

9.11 **I believe that the Scheme is unlikely to have any impact on the standards of policy servicing experienced by the existing Inceptum policyholders compared to their current position.**

IN THE EVENT OF INSOLVENCY

9.12 As noted in paragraph 6.160, above, the QUK Transferring Policyholders, the Eta Transferring Policyholders and the existing Inceptum policyholders are all direct policyholders, but the WMG Transferring Policyholders includes a material number of cedant policyholders.

9.13 Pre-Scheme, in the unlikely event that Inceptum were to become insolvent, the existing policyholders would rank equally with one another in accessing the remaining assets of Inceptum, behind holders of preferential debt and ahead of other creditors. Post-Scheme, this situation is broadly unchanged, save that those WMG Transferring Policyholders who are holders of inwards reinsurance policies would rank behind the other policyholders, including the existing Inceptum policyholders. In this respect, the existing Inceptum policyholders would be advantaged by the Scheme, albeit to a negligible extent bearing in mind the relatively small size of net liabilities associated with the WMG Transferring Business and the very low likelihood of Inceptum becoming insolvent post-Scheme.

Conclusion regarding the effect of the Scheme on the existing Inceptum policyholders in the event of the insolvency of Inceptum

9.14 **I do not envisage circumstances in which the existing Inceptum policyholders would be in a materially worse position post-Scheme than they would have been pre-Scheme in the event of the insolvency of Inceptum. Moreover, the very low likelihood of Inceptum becoming insolvent post-Scheme satisfies me that the existing Inceptum policyholders will not be materially adversely affected due to relative differences in their rights pre- and post-Scheme in the event of the insolvency of Inceptum.**

CONCLUSION FOR THE EXISTING INCEPTUM POLICYHOLDERS

9.15 **I am satisfied that the Scheme will not affect in a materially adverse way either the security, membership rights or the policy servicing levels of the existing Inceptum policyholders.**

10. Other considerations

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

10.1 In this Report, I have shown balance sheet data for QUK as at 31 December 2020, and balance sheet data for Eta, WMG and Inceptum as at 31 December 2021 (these being the most recent dates for which audited financial information is available). I have also shown pro forma balance sheets, which have been based on those actual balance sheets but which include data that relates to subsequent transactions, such as the Scheme.

10.2 I expect that the current activities of QUK, Eta, WMG and Inceptum have continued, and will continue, between 31 December 2021 and the Effective Date. QUK has continued, and will continue until the Effective Date and beyond, to write new business (none of which is part of the QUK Transferring Business), and QUK, Eta, WMG and Inceptum have continued, and will continue until the Effective Date, 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.

10.3 I discuss later in this section the impact of the COVID-19 pandemic upon QUK, Eta, WMG and Inceptum. I believe that it is unlikely that any events occurring between 31 December 2021 and the Effective Date would affect any conclusion that I have reached based on my review of the data as at these dates.

10.4 The conflict in Ukraine (which started in February 2022 and which, as at the date of this Report, is on-going) has led to significant sanctions against Russia, as well as disturbing the economies of countries with material dealings with either Ukraine or Russia. It is uncertain what will be the long-term economic consequences worldwide. Both QUK and the R&Q Group have confirmed to me that they have no ongoing exposures to, or investments in, Russian-related interests, and, currently, the conflict is not expected to have any direct impact on any of the Companies. However, both are affected by the recent falls in investment values, which have been exacerbated by the conflict, and are well aware of the inflationary impact of the conflict, which is compounding other inflationary pressures such as pent-up consumer demand, wider supply chain shortages and commodity price increases.

10.5 I note that QUK and the R&Q Group have both explicitly referenced the potential impact of the conflict on their respective businesses in their recent papers published from March 2022 onwards (e.g. ORSAs, SFCRs). In the case of QUK, I note that it has been investigating the potential impact on the cost of claims and the implications for pricing, business planning and reserving, to be reported to the RCC.

10.6 A short time before the final Court hearing, I will consider the extent to which actual changes in assets and liabilities have been in line with expectations (relative to the position as 31 December 2021) and hence whether there have been any changes (including those associated with the conflict in Ukraine and the current economic conditions) that would affect my overall opinion. I will report on these separately in the Supplemental Report.

MIS-SELLING LIABILITIES

10.7 In her judgement regarding the case of PA(GI) Limited v (1) GICL 2013 Limited (2) Cigna Insurance Services (Europe) Limited (2015), Mrs Justice Andrews DBE said that *"...an intention to make provision for the transfer of mis-selling liabilities would qualify as an unusual feature which might have a material financial impact on the scheme, and which one would therefore expect to be expressly disclosed in the context of an application for a transfer under a Part VII scheme.*" I consider the risk of mis-selling liabilities separately for the QUK Transferring Business and for the business transferring from Eta and WMG.

10.7.1. QUK is unaware of any actual or potential mis-selling liabilities within its business. The QUK Transferring Business comprises only commercial insurance business and no personal lines direct business. While it is possible for commercial insurance to be mis-sold, it is, in general, considered less likely to occur than in respect of personal lines policies, especially on a systemic basis. Therefore, I consider the likelihood of any mis-selling liabilities emerging in relation to the QUK Transferring Business to be very small, especially as it is now many years ago that it was sold, and it would be reasonable to assume the expected cost of such liabilities to be at most negligible. In any event, it is intended that all mis-selling liabilities relating to the QUK Transferring Business (should there be any) will be transferred by the Scheme from QUK to Inceptum.

10.7.2. The R&Q Group is unaware of any actual or potential mis-selling liabilities within either Eta or WMG. The WMG Transferring Business comprises only commercial insurance business and no personal lines direct business. As explained in paragraph 10.7.1, above, it is highly unlikely that this business would give rise to any mis-selling liabilities, especially as no business has been sold or renewed by WMG since 2001. The Eta Transferring Business also comprises commercial insurance but, as it was marketed primarily to small/medium enterprises, it is business that could give rise to mis-selling claims. However, the last Eta policy was sold ten years ago and the business is considered to be fully run-off. Therefore, I consider it to be very unlikely that such a claim would emerge and that it would be reasonable to assume the expected cost of such liabilities, relating to either Eta or WMG, to be at most negligible. I note that it is intended that all mis-selling liabilities (should there be any) relating to the Eta Transferring Business or to the WMG Transferring Business will be transferred by the Scheme to Inceptum. I further note that the transfer to Inceptum of the Eta Transferring Business and of the WMG Transferring Business is an intra-group transfer and that, post-Scheme, any mis-selling liabilities relating to either Eta or WMG would remain within the R&Q Group.

THE LIKELY EFFECTS OF THE SCHEME UPON REINSURERS OF THE TRANSFERRING BUSINESS

10.8 In accordance with the PRA Statement of Policy and SUP18, I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts cover the Transferring Business.

10.9 Of the Transferring Business, only the WMG Transferring Business benefits from outwards reinsurance that will transfer under the Scheme. There is no outwards reinsurance in respect of the other parts of the Transferring Business, other than the R&Q LPTA, which relates only to the QUK Transferring Business and which will be transferred from QUK to Inceptum on the Effective Date, at which point it will be amended to provide 50% QS cover, rather than 100% QS cover.

10.10 All reinsurance contracts benefiting the WMG Transferring Business will continue to provide the same benefit under the Scheme.

10.11 The amount of the liabilities of each external reinsurer of the WMG Transferring Business will not change as a result of the Scheme.

10.12 WMG and Inceptum are both managed by RQCS. The Scheme will not result in a change in the way in which RQCS manages recoveries under the reinsurance arrangements. I have no reason to expect the Scheme to result in any change in the standards of claims handling or management of the WMG Transferring Business. As the same staff will continue, post-Scheme, to administer the WMG Transferring Business, operating to the same policies, processes, practices and procedures, I believe that the magnitude and timing of recoveries claimed against reinsurance contracts relating to the WMG Transferring Business will be unaffected by the Scheme.

10.13 I have considered whether the Scheme is likely to lead to any changes in the rights of "set-off"[29] for creditors or debtors of QUK, Eta, WMG or Inceptum. In the context of reinsurers of any parties to the transfer, this is relevant where those reinsurers also have outwards reinsurance contracts with the same party. Any mutual debits or mutual credits would be available, post-Scheme, to be set-off by Inceptum, as if the mutual relationship always existed (this also means that any offsets that previously existed within QUK, Eta or WMG would be lost). As the Eta Transferring Business and QUK Transferring Business contain no inwards reinsurance contracts and are not protected by any reinsurance that will transfer under the Scheme, I believe there should be no changes in rights of set-off relating to the transfer of these portfolios. The WMG Transferring Business does include small amounts of inwards reinsurance business; however, while Inceptum remains a solvent company, paying and receiving recoveries in respect of valid claims, any changes in right of set-off would not be an issue, although there is a possibility of changes in the right of set-off on the insolvency of Inceptum post-Scheme. However, as the likelihood of insolvency of Inceptum is remote (particularly in the short-term), I do not believe the right of set-off affects my conclusions on the impact of the Scheme on reinsurers.

Conclusion regarding the impact of the Scheme on the reinsurers of the Transferring Business

10.14 **For the reasons discussed above, I am satisfied that the Scheme will have negligible effect on the those reinsurers whose contracts of reinsurance cover the Transferring Business.**

[29] "Set-off" allows parties to cancel or offset mutual debts with each other by subtracting one from the other, and paying only the balance.

THE APPROACH TO COMMUNICATION WITH POLICYHOLDERS

10.15 Regulations made under the FSMA require a communication regarding the proposed Scheme to be sent to every policyholder of the Parties. 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 paragraph 2.53 of the Policy Statement, paragraph 2.46G of SUP18 and Sections 7 and 8 of FG22/1, the Parties would be expected to notify the policyholders, or interested persons (which would include all reinsurers of the business to be transferred), at least six weeks before the date of the Court hearing at which the application to sanction the Scheme will be heard.

10.16 The Parties' approach to communicating the Scheme to affected policyholders is outlined in paragraphs 5.37-5.46, above.

10.17 I consider the approach being taken to policyholders to be reasonable.

10.18 The Parties will be applying to the Court for waivers in respect of the requirement to make direct notification to the following groups:

- the QUK Non-Transferring Policyholders;
- those QUK Transferring Policyholders who neither have an open claim under a QUK Transferring Policy nor have notified an industrial disease claim since 1 January 2017;
- the Eta Transferring Policyholders;
- those WMG Transferring Policyholders who do not have an open claim under a WMG Transferring Policy
- those Inceptum policyholders who do not have an open claim under an Inceptum policy.

10.19 I consider the proposed waivers to be reasonable for the following reasons.

- As I discuss in Section 7 above, the impact of the Scheme on the QUK Non-Transferring Policyholders is expected to be negligible and their relationship with QUK will not be affected by the Scheme. Moreover, the cost of direct notification of such policyholders would be disproportionately large (printing and postage alone has been estimated to be £824k).
- As I discuss in Section 6 above, the impact of the Scheme on the QUK Transferring Policyholders who do not have an open claim is expected to be negligible.
    - There will be no change to the administration of their policies - RQCS will continue to administer the QUK Transferring Policies post-Scheme in accordance with the R&Q Services Agreement (which will be transferred to Inceptum as part of the Scheme), in accordance with the same standards and procedures as it did pre-Scheme.
    - There will be no change to the legal or regulatory regimes governing the policies - like QUK, Inceptum is a UK domiciled insurer authorised by the PRA and regulated by the PRA and the FCA.
    - Those of the QUK Transferring Policyholders who, pre-Scheme, are eligible to access the FOS and/or the FSCS will continue to be eligible to access the FOS and/or the FSCS post-Scheme. Those of the QUK Transferring Policyholders who, pre-Scheme, are ineligible to access either the FOS or the FSCS will remain, post-Scheme, ineligible to access either the FOS or the FSCS.
    - The cost of tracing QUK Transferring Policyholders for whom QUK does not currently hold contact details, and of directly notifying QUK Transferring Policyholders who do not have an open claim, would be disproportionately large (estimated to be in excess of £5.9 million).
- As discussed in paragraph 4.62, above, Eta has no outstanding claims. As this business was written on a 12 month “claims made” basis only up to 2012, there is no possibility of new claims being reported, and further liabilities could arise only from the reopening of an existing closed claim. Eta considers this possibility to be very remote. Moreover, as discussed in Sections 6 and 8, above, the Scheme is not expected to have a material impact upon Eta Transferring Policyholders, whether or not the Scheme successfully transfers their policies to Inceptum.

- The WMG Transferring Business has been in run-off since 2001 and no new claims have been notified in respect of this business since 2003. Although theoretically possible, it is extremely unlikely that any further claims will be reported that relate to the WMG Transferring Business, Therefore, WMG considers that, other than those with open claims, there would be little or no benefit to the WMG Transferring Policyholders in notifying them directly about the proposed Scheme.
- The Inceptum business has been in run-off since 2009 and no new claims have been reported to Inceptum since 2015. Inceptum wrote mostly direct motor insurance business, and also small volumes of personal household and school fee insurance business. It is extremely unlikely that, this long after expiry of the covers, any further claims will be notified under them in the future. Therefore, Inceptum considers that, other than those with open claims, there would be little or no benefit to the Inceptum policyholders in notifying them directly about the proposed Scheme.

10.20 I have reviewed draft copies of the proposed notices and letters, including the draft summary of the Scheme and of the Report. I am not an expert in such communications. However, I consider the draft notices and letters to be clear and concise, to contain all of the information that I would expect them to contain, to be fair, and to be appropriate for their intended audiences.

Conclusion regarding communication with policyholders

10.21 **I am satisfied that the proposed approach to communication with policyholders in respect of the Scheme is both proportionate and reasonable.**

POLICYHOLDER EXPECTATIONS

10.22 I have not considered the expectations of the Transferring Policyholders other than whether their policies will continue to be serviced post-Scheme to the same service levels as they were pre-Scheme and the relative likelihood pre- and post-Scheme that they will receive whatever benefits to which they are contractually entitled. For example, I have not considered what factors the Transferring Policyholders might have taken into consideration in selecting their respective insurance providers and whether the Scheme would negate any of those factors. However, I note that:

- the Transferring Business comprises wholly commercial risks;
- the majority of the Transferring Policyholders are QUK Transferring Policyholders, and that the majority of them became QUK policyholders following an earlier Part VII Transfer, having formerly been policyholders of ITIC;
- the remaining Transferring Policyholders are insured by companies that have changed ownership several times.

10.23 I have no reason to suspect that policyholders' expectations (other than their policies continuing to be serviced to consistent standards and the benefits to which they are contractually entitled continuing to be paid) would (reasonably) be adversely affected to a material extent.

WHAT WOULD HAPPEN WERE THE SCHEME NOT TO PROCEED?

10.24 The Scheme is not an "all or nothing" transfer. If it were deemed by the Court that one or two of the QUK Transferring Business, the Eta Transferring Business and the WMG Transferring Business should not be transferred by the Scheme to Inceptum, it would still be possible for the Court to sanction the transfer of the rest of the Transferring Business to Inceptum.

10.25 If the Court decided that the QUK Transferring Business should not transfer to Inceptum as part of the Scheme then the QUK Transferring Business would remain part of QUK. The legal liability for the QUK Transferring Business would remain with QUK. The economic liability would remain with R&Q Re.

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10.26 If the Court decided that the Eta Transferring Business should not transfer to Inceptum as part of the Scheme then the Eta Transferring Business would remain part of Eta. Eta would retain the legal and economic liability for the Eta Transferring Business. In such circumstances, it would not be possible for Eta to be wound-up, at least not for some time to come.

10.27 If the Court decided that the WMG Transferring Business should not transfer to Inceptum as part of the Scheme then the WMG Transferring Business would remain part of WMG. WMG would retain the legal and economic liability for the WMG Transferring Business. In such circumstances, it would not be possible for WMG to be wound-up, at least not for some time to come.

LEGAL JURISDICTION

10.28 I understand that an insurance business transfer scheme as defined in Section 105 of FSMA would be effective as a result of the Court Order sanctioning the business transfers for all policies governed by English law. For cases where such an insurance business transfer scheme aimed to transfer policies that were governed under laws other than English law, it might be possible holders with such policies to challenge the validity of the sanctioned transfer subsequent to its effective date.

10.29 QUK has told me that all of the QUK Transferring Policies were written under English law. Therefore, there is minimal risk that QUK Transferring Policyholders might challenge the Scheme subsequent to the Court's approval (should that be granted).

10.30 I have been told by representatives of Eta that all of the Eta Transferring Policies were written under English law. Therefore, there is minimal risk that Eta policyholders might challenge the Scheme subsequent to the Court's approval (should that be granted).

10.31 I have been told by representatives of WMG that they believe that not all of the WMG Transferring Policies were written under English law. As indicated in Figure 4.7, above, roughly 2/3rds of the WMG Transferring Policies relate to policyholders domiciled outside the UK, and I have been told that some of those might have been written under laws other than those of England & Wales. Therefore, there is risk that WMG policyholders might challenge the Scheme subsequent to the Court's approval (should that be granted).

10.32 I note that:

- All of the WMG Transferring Policies with open claims have been written under English law.
- Some legal jurisdictions operate the principle of comity (i.e. legal reciprocity), although I understand that the circumstances in which they would recognise the rulings of another nation's courts vary from country to country. If a court before which a WMG Transferring Policyholder challenged the Scheme were to apply the principle of comity then I understand that it would effectively accept the sanctioning of the Scheme by the Court.

10.33 Because the number of Transferring Policyholders whose policies are not written under English law is small and because none of them has an open claim, I consider the likelihood of any policyholders challenging the right of the Court to transfer their policies to Inceptum to be small, and, because principle of comity is widely accepted in courts, I consider the likelihood of such a challenge being successful to be even smaller.

10.34 Were a WMG Transferring Policyholder whose policy was not written under English law to challenge successfully the transfer of the policy, then that policy would become an Excluded Policy. I have discussed the effect of the Scheme upon Excluded Policies relating to WMG in Section 8, above.

COVID-19

10.35 The COVID-19 pandemic and the responses to it of various national governments have had far-reaching consequences across society and business, worldwide. In the following few paragraphs, I discuss the impact that the COVID-19 pandemic has had, and is expected to have, upon Eta, WMG and Inceptum. I then discuss its effect on QUK.

Operational

10.36 Based on what I have been told, on documentation in the relevant ORSA documents, and on my own dealings with the R&Q Group, I believe that the R&Q Group implemented a smooth transition to remote working for all its offices, including those serving Eta, WMG and Inceptum. There has been no material change in the standards of service enjoyed by Eta, WMG and Inceptum, and it appears that all systems and processes continue to operate as they did prior to the COVID-19 pandemic.

Premiums and Claims

10.37 Eta, WMG and Inceptum are businesses that have been in run-off for several years and that, at the start of the COVID-19 pandemic, had no outstanding premiums and very few claims that remained open (and all in relation to incidents that occurred many years earlier). Therefore, there was little scope for the premiums and claims of Eta, WMG or Inceptum to be affected by the COVID-19 pandemic.

Assets

10.38 The COVID-19 pandemic initially had a severe adverse impact on investment valuations, although much of the effect was subsequently reversed. Eta's investments included aircraft leasing securities, which were badly affected and which Eta subsequently sold, realising a material loss in 2020. Otherwise, over the length of the pandemic, the investments of Eta, WMG and Inceptum have not been materially affected by the pandemic.

Capital and Solvency

10.39 Taking into consideration current laws and regulations, none of Eta, WMG and Inceptum expect its liquidity or solvency position to be materially affected by the COVID-19 pandemic. However, throughout the pandemic, the R&Q Group has been conducting stress and scenario testing to help it to understand better the possible effects of the continuing pandemic on the wider business as well as market, liquidity, operational, and capital risks of its member companies, including Eta, WMG and Inceptum.

Impact on QUK

10.40 Operationally, QUK has been able to maintain its business processes throughout the duration of the pandemic. Its business continuity framework has proven resilient to the operational challenges encountered during the prolonged COVID-19 situation. Alongside the lifting of COVID-19 restrictions and return to the office in the majority of its locations, flexible working arrangements were introduced to ensure staff wellbeing and enhance performance.

10.41 As an on-going business, QUK's premiums and claims were more affected by the COVID-19 pandemic than those of the R&Q Group. Its commercial lines included some policies that were subject to business property interruption claims and which were therefore affected by the 2020 FCA test case and the subsequent Supreme Court judgment. These increased QUK's claims costs. On the other hand, personal lines claims, particularly in respect of motor business, were reduced as a result of the change in consumer behaviour induced by the COVID-19 pandemic. Moreover, claim development patterns were also disturbed, which complicated reserving and increased the uncertainty in the ultimate claim costs. This experience has been common throughout the industry.

10.42 Although most restrictions have now been lifted in the UK, consumer behaviour has not returned fully to its pre-pandemic patterns. Some behaviours necessitated by the restrictions (such as working from home) appear to have become a long-term preference for some people (and businesses, including QUK, have responded by introducing flexible working arrangements. This and the longer-term impacts of the COVID-19 pandemic on the UK economy (compounded by the recent and ongoing conflict in Ukraine, which is discussed in Section 10, below) have magnified the normal uncertainty within the business.

10.43 Despite the above challenges, QUK has maintained its Capital Cover Ratio at a level consistent with being a well-capitalised company as at 30 September 2021 (as shown above in Figure 4.3).

Conclusion

10.44 The COVID-19 pandemic has had virtually no impact on WMG or Inceptum and has affected Eta only insofar as it experienced a reduction in the value of part of its asset portfolio that it has now sold (and hence crystallised the loss). I agree with the view of the R&Q Group that the COVID-19 pandemic is very unlikely to have any ongoing material impact on any of Eta, WMG and Inceptum or on the insurance policies that they carry.

10.45 The COVID-19 pandemic has had more effect on QUK, with disruption (both benign and adverse) of its claims experience in several of its business lines. QUK management continues to monitor the situation closely. However, I agree with its view that it is unlikely that there will be any issues relating to the COVID-19 pandemic that would materially affect its current ability to perform its duties in respect of the QUK Transferring Business.

TAX

10.46 The tax implications of the Scheme are expected to be negligible. In addition, I have been told that the Scheme has been structured as a Transfer of a Going Concern[30] and, as such, no VAT will be levied on the transaction.

COSTS OF THE SCHEME

10.47 The external costs of the Scheme will be met by Inceptum and are expected to total approximately £456,000. These costs would not be such as to affect the solvency of Inceptum or the security of any group of policyholders.

[30] The sale of assets by a VAT registered business is generally treated as a taxable supply and hence subject to VAT at the standard rate (unless explicitly exempt under the legislation). However, when assets are sold as part of a “Transfer of a Going Concern”, the transfer is considered to be ‘neither a supply of goods nor a supply of services’ and hence outside the scope of VAT. I have been told that, if the business sold is a going concern prior to sale and the purchaser intends to carry on the transferring business, and if the seller is VAT registered and the purchase is, or will become, VAT registered, then. HMRC will generally accept that it is a Transfer of a Going Concern.

11. Final conclusions

11.1 In summary, in my opinion, provided the proposed Scheme operate as intended, and I have no grounds for believing that they will not do so:

- the Scheme will not materially adversely affect the security of benefits to policyholders of QUK (both those policyholders being transferred under the Scheme and those who will remain, post-Scheme, policyholders of QUK), of Eta, of WMG, or of Inceptum; and
- the Scheme will not have any impact on service standards experienced by the policyholders of QUK (both those policyholders being transferred under the Scheme and those who will remain, post-Scheme, policyholders of QUK), of WMG, or of Inceptum.

11.2 In reaching this opinion I have applied the following principles:

- I have considered which parties might be affected by the Scheme and in what way. I have documented my findings.
- I have not performed my own modelling, rather I have relied on the results of models developed and operated on behalf of QUK, Eta, WMG and Inceptum. 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 the QUK and R&Q Group actuaries having adopted alternative plausible assumptions.
- I have not considered alternative arrangements, other than what would happen were the Scheme not to proceed.

Derek Newton / 18 July 2022

Fellow of the Institute and Faculty of Actuaries

Appendix A Definitions

TERM	DEFINITION
ABI	Association of British Insurers.
ADC	Adverse Development Cover, a type of reinsurance.
AFR	Actuarial Function Report, a report prepared at least annually by the Actuarial Function for the Board of the relevant insurer.
AIEL	Accredited Insurance (Europe) Limited.
AIIL	Aviva International Insurance Ltd.
AIRMIC	Association of Insurance and Risk Managers in Industry and Commerce.
AIRROC	Association of Insurance and Reinsurance Run-Off Companies.
APH	Asbestos, Pollution and Health Hazard – these are all latent claim types.
AWP	The Asbestos Working Party, as constituted by the IFoA.
Available Capital	Capital available to meet solvency capital requirements.
BBNI	Bound But Not Incepted.
Best estimate	This term is used in this Report in reference to an estimate of outstanding claim amounts and is intended to represent an expected value over a reasonable range of estimates. As such, a "best estimate" is not deliberately biased upwards or downwards, and does not include any margins. However, the limitations of actuarial projection methods mean that a "best estimate" is not a statistically rigorous estimate of the mean of the underlying distribution of all possible outcomes.
BIBA	British Insurance Brokers Association.
Brexit	"Brexit" refers to the exit of the UK from the European Union, following the referendum on continuing membership held in the UK in June 2016.
Capital Cover Ratio	The ratio of Available Capital to Required Capital. This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the company.
CBTL	Consumer Buy-to-Let.
Correlation	Correlation (in the context of this Report) is a number that describes the statistical relationship between two variables (e.g. equity prices and interest rates).
The Court	The High Court of Justice of England and Wales.
EEA	The European Economic Area ("EEA") was established by the EEA Agreement on 1 January 1994. The EEA unites the 27 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.
EEA State	A state that is, as at the date of this Report, a contracting party to the EEA Agreement on the European Economic Area 1992.
Effective Date	The date on and from which the Scheme shall become effective.
EIOPA	The European Insurance and Occupational Pensions Authority ("EIOPA") was established in consequence of the reforms to the structure of supervision of the financial sector in the European Union, with the goals of: better protecting consumers and rebuilding trust in the financial system; ensuring a high, effective and consistent level of regulation and supervision taking account of the varying interests of all Member States and the different nature of financial institutions; greater harmonisation and coherent application of rules for financial institutions & markets across the European Union; strengthening oversight of cross-border groups; and promoting coordinated European Union supervisory responses.
EL	Employers' Liability, a type of insurance cover.
ELTO	Employers' Liability Tracing Office.

EMB	Executive Management Board (of QUK), which acts as a Management Committee for QUK.
ENID	In estimating the technical provisions under Solvency II, insurers must make allowance for events not in data ("ENID"), i.e. those possible future events or developments that have not been seen in the historic claims experience of the insurer.
EOF	Eligible Own Funds, i.e. the funds available in an insurer to meet its regulatory SCR.
Eta	R&Q Eta Company Limited
Eta Non-Transferring Policyholders	The policyholders of Eta policies that are not transferred by the Scheme to Inceptum. These would be holders of Excluded Policies that have been written or assumed by Eta.
Eta Transferring Business	The business of Eta that is to be transferred to Inceptum under the Scheme.
Eta Transferring Policies	The insurance policies within the Eta Transferring Business.
Eta Transferring Policyholders	The policyholders of Eta Transferring Policies.
EU	European Union.
Excluded Policy	A contract of insurance written or assumed by one of the Transferors under which any liability remains unsatisfied or outstanding as at the Effective Date and which would have formed part of the Transferring Business but which, for any reason, is not transferred by order of the Court pursuant to Part VII of FSMA on the Effective Date.
Excluded Policy Reinsurance Agreement	A reinsurance agreement whereby Inceptum provides 100% reinsurance to the relevant Transferor in respect of an Excluded Policy, providing cover between the Effective Date and the eventual transfer of the Excluded Policy to Inceptum.
FAL	Funds at Lloyd's, which is the capital provided by each member of Lloyd's as security to support the member's Lloyd's underwriting.
FCA	The Financial Conduct Authority ("FCA") is the UK regulatory agency that focuses on the regulation of conduct by retail and wholesale financial services firms. The FCA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
FG22/1	Guidance published by the FCA in January 2011 relating to Part VII Transfers.
FIN-NET	An international partnership of financial complaint institutes.
FOS	Set up by the UK Parliament, the Financial Ombudsman Service ("FOS") is the UK's official expert in sorting out problems with financial services.
FSCS	The Financial Services Compensation Scheme ("FSCS") is the compensation fund of last resort for customers of UK authorised financial services firms.
FSMA	Financial Services and Markets Act 2000, the legislation under which Part VII governs the transfer of (re)insurance business between (re)insurance undertakings.
FSMA Report	A report on the terms of a transfer under Part VII of FSMA, to be prepared by an independent person. The FSMA Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.
GAAP	Generally accepted accounting principles ("GAAP") form the standard framework of guidelines for financial accounting used in any given jurisdiction.
GMT	Greenwich Mean Time.
IBNR	Incurred but not reported.

IBNR reserves	These are reserves in respect of claims that relate to claim events that have occurred before the valuation date but which were still to be reported to the insurer as at that date. For the purposes of this Report, they also include reserves in respect of any perceived shortfall between the projected ultimate costs and the case estimates for claims already notified (**IBNER reserves**).
IDD	The Insurance Distribution Directive, which has applied in the UK (and in all other EU Member States) with effect from 1 October 2018.
IFoA	The Institute and Faculty of Actuaries, the professional body for actuaries in the UK.
IFRS	International Financial Reporting Standards ("IFRS") form a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
ILS P&C	ILS Property & Casualty Re Limited.
Inceptum	Inceptum Insurance Company Limited.
Inceptum ORSA 2022	The report entitled "*Inceptum Insurance Company Limited ORSA Report*" and dated March 2022.
Independent Expert	The Independent Expert prepares the FSMA Report and provides it to the Court in order that it may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question. In the case of the Scheme, I have been appointed as the Independent Expert.
Independent Peer Review	Work Review undertaken by one or more individual(s) who is, or are, not otherwise involved in the work in question and who would have had the appropriate experience and expertise to take responsibility for the work themselves.
Information Pack	Collectively, the statement summarising the terms of the Scheme, the summary of the Scheme Report and the Notice of the Scheme.
IRLA	Insurance and Reinsurance Legacy Association.
ITIC	Iron Trades Insurance Company Ltd.
KRI	Key Risk Indicator.
LGH	Leslie & Godwin (Holdings) Ltd.
LIIBA	London and International Insurance Brokers Association.
LPTA	Loss portfolio transfer agreement
MCR	The Solvency II Minimum Capital Requirement ("MCR") is lower than the SCR, and defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over one year (compared to 99.5% for the SCR).
Milliman	Milliman LLP, a member of the Milliman Group.
The Milliman Group	The group of entities whose ultimate parent is Milliman, Inc.
MPS	Medical Protection Society Limited.
ORMF	Operational Risk Management Framework.
ORSA	The Own Risk Solvency Assessment ("ORSA") is a fundamental set of processes under Solvency II constituting a tool for decision-making and strategic analysis. It aims to assess, in a continuous and prospective way, the overall solvency needs related to the specific risk profile of the insurance company.
OSNA	Own Solvency Needs Assessment.
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 AOFs (e.g. additional premiums from members), which require regulatory approval.
Part VII Transfer	An insurance business transfer scheme performed in accordance with the requirements set out in Part VII of FSMA.
The Parties	The collective term for QUK, Eta, WMG and Inceptum.

PL	Public Liability, a type of insurance cover.
The Policy Statement	The Statement of Policy issued by the PRA entitled *Insurance business transfers*, issued in January 2022.
PPO	Periodical Payment Order.
PRA	The Prudential Regulation Authority ("PRA") is part of the Bank of England and carries out the prudential regulation of financial firms in the UK, including banks, investment banks, building societies and insurance companies. The PRA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
Pre-1973	Business of WMG that relates to liability business with exposures up to and including 1972.
QBE Europe	QBE Europe SA/NV.
QBE Group	The collective term for QIGL and its direct and indirect subsidiaries.
QEO	QBE Holdings (EO) Ltd.
QEOEM	The QEO Executive Management Board or Committee.
QEO Group	The collective term for QEO and its direct and indirect subsidiaries.
QEO Internal Model	The internal model developed (and approved by the PRA) for assessing regulatory capital requirements for QEO and its subsidiaries under Solvency II.
QEO ORSA 2021	The report entitled "*QEO Annual ORSA Report*" and dated 30 March 2021.
QIGL	QBE Insurance Group Limited.
QRTs	Quantitative Reporting Templates, which 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.
QS	Quota share, a type of reinsurance.
QSCC	QBE Insurance Group Limited.
QUK	QBE UK Limited.
QUK Non-Transferring Policyholders	Holders of those QUK policies that are not being transferred under the Scheme to Inceptum.
QUK Transferring Business	The business of QUK that is to be transferred to Inceptum under the Scheme.
QUK Transferring Policies	The insurance policies within the QUK Transferring Business.
QUK Transferring Policyholders	The holders of the QUK Transferring Policies.
R&P	The Richard & Pearson book, which was the WMG business written in the period 1973-1987.
RQCS	R&Q Central Services Limited.
R&Q Group	The collective term for RQIH and its direct and indirect subsidiaries.
R&Q LPTA	The agreement under which R&Q RE provides 100% QS reinsurance to QUK in respect of the QUK Transferring Business.
R&Q Re	R&Q Re (Bermuda) Ltd.
R&Q Services Agreement	The agreement under which the QUK Transferring Business is wholly administered by RQCS.
RAS	The QBE Group's Risk Appetite Statement.
RCC	The Risk and Capital Committee of the QEO Group.
RCSA	Risk and Control Self-Assessment.

Required Capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (for example the SCR).
Reinsurance	An arrangement with another insurer whereby risks are shared (or passed on). If reinsurance is termed as being “inwards” then the reinsurer in question has accepted risk from an(other) (re)insurer; if reinsurance is termed as being “outwards” then the (re)insurer in question has passed risk to a(nother) reinsurer.
Report	References to the “Report” refer to this report.
Report Summary	The summary of this Report, prepared specifically to be included in a document that also summarises the Scheme and which will be made available to policyholders of the Parties and to others who might be affected by the Scheme.
RMS	The Risk Management Strategy of the QBE Group.
RMSL	Resolute Management Services Ltd.
RPPD	The Responsibilities of Providers and Distributors for the Fair Treatment of Customers, a guidance document published by the FCA in January 2018.
The Scheme	In the context of this Report, the proposal that the transferring business of QUK be transferred to Inceptum under the provisions of Part VII of FSMA.
SAC	Segregated Accounts Company.
Scheme Document	The document that sets out the terms of the Scheme.
SCR	Solvency Capital Requirement, which, under Solvency II, is the amount of capital required to ensure continued solvency over a one-year trading time frame with a likelihood of 99.5%.
SFCR	Solvency and Financial Condition Report, which, under Solvency II, each insurer is expected to publish annually, and which will contain certain qualitative and quantitative information, the quantitative information being in the format of certain prescribed QRTs.
Solvency II	The system for establishing (among other things) minimum capital requirements for EU (re)insurers under the Solvency II Directive 2009/138/EC.
Standard Formula	The standard formula for calculating an insurer’s SCR, as specified in detail in the Solvency II legislation to be used by all insurers other than those who have an approved internal model.
SUP18	Section 18 of the FCA Supervision Manual.
Supplemental Report	A report I will prepare in advance of the Court hearing to sanction the Scheme covering any relevant matters that might have arisen since the date of this Report.
TCF	The TCF (“treating customers fairly”) principles aim to raise standards in the way firms carry on their business by introducing changes that will benefit consumers and increase their confidence in the financial services industry. Specifically, TCF aims to: help customers fully understand the features, benefits, risks and costs of the financial products they buy; and minimise the sale of unsuitable products by encouraging best practice before, during and after a sale.
Technical Provisions	Liabilities determined for regulatory purposes. In particular, the provisions for the ultimate costs of settling all claims arising from events that 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 H for further details).
TPs	Technical provisions as calculated for Solvency II purposes. As such, they differ from technical provisions calculated on an IFRS basis.
Transferee	The entity to which business is being transferred – in the case of the Scheme, this is Inceptum.
Transferor	An entity from which business is being transferred – in the case of the Scheme, QUK, Eta and WMG are each a Transferor.

Transferring Business	The business that is to be transferred to Inceptum under the Scheme.
Transferring Policies	The insurance policies within the Transferring Business.
Transferring Policyholders	The holders of the Transferring Policies.
UPR	Unearned premium reserve.
WMG	The World Marine & General Insurance PLC.
WMG Non-Transferring Policyholders	The policyholders of WMG policies that are not transferred by the Scheme to Inceptum. These would be holders of Excluded Policies that have been written or assumed by WMG.
WMG Transferring Business	The business of WMG that is to be transferred to Inceptum under the Scheme.
WMG Transferring Policies	The insurance policies within the WMG Transferring Business.
WMG Transferring Policyholders	The policyholders of WMG Transferring Policies.
Work Review	Process by which a piece of actuarial work is considered by at least one other individual for the purpose of providing assurance as to the quality of the work in question.
XoL	Excess of Loss, a type of reinsurance.

Appendix B Key Sources of Data

B.1 In writing this Report, I relied upon the accuracy of certain documents provided by QUK and the R&Q Group (on behalf of WMG, Eta and Inceptum). These included, but were not limited to, the following:

Background and governance

- QUK Annual Report and Financial Statements as at 31 December 2020
- QUK unaudited balance sheet as at 30 September 2021
- QBE EO Operational Risk Policy (dated 9 December 2021)
- QBE EO Delegated Underwriting Authority Underwriting & Operational Guidelines (dated 12 April 2021)
- QBE EO Compliance Framework (dated 25 March 2022)
- QBE EO Internal Control Framework (dated 27 September 2021)
- QBE EO Conduct Risk Policy (dated 13 August 2019)
- QBE EO Conduct Risk Guidelines (dated 22 September 2021)
- QBE EO High Product Risk Requirements (dated 24 March 2021)
- WMG Annual Report and Financial Statements for the year ended 30 June 2020
- WMG Annual Report and Financial Statements for the 18 months ended 31 December 2021
- Work order form between WMG and RQCS, dated 1 January 2021, regarding claims handling, reinsurance, commutations, credit control and reporting (by RQCS to WMG)
- Eta Annual Report and Financial Statements for the year ended 31 December 2020
- Eta Annual Report and Financial Statements for the year ended 31 December 2020
- Eta Regular Supervisory Report in respect of the reporting period ended 31 December 2020
- Services agreement between Eta and RQCS, dated 13 January 2020
- Services agreement between Eta and MPS, dated 7 January 2019
- Inceptum Annual Report and Financial Statements for the year ended 31 December 2020
- Inceptum Annual Report and Financial Statements for the year ended 31 December 2021
- Inceptum Regular Supervisory Report in respect of the reporting period ended 31 December 2020
- Work order form between Inceptum and RQCS, dated 1 January 2021, regarding claims handling, reinsurance, commutations, credit control and reporting (by RQCS to Inceptum)

Scheme

- Scheme Document (draft dated 9 March 2021)

Reserving

- External actuaries reserve reports for QEO entities as at 31 October 2020 and 31 October 2021
- QEO Actuarial Function Report, Technical Provisions component as at 31 December 2020
- QEO Actuarial Function Report, Technical Provisions component as at 31 December 2021
- QBE Group Actuarial Reserving Standard document, effective 31 December 2020
- QEO Actuarial Results Report as at 30 September 2020
- QEO Reserving Overview document, dated 30 June 2020
- QEO Actuarial Function Terms of Reference document, dated 18 August 2020
- Spreadsheet showing QUK's reserves for the QUK Transferring Business on a GAAP basis as at 30 September 2020.
- Series of spreadsheet showing QUK's calculations of the reserves of the transferring business, based on data as at 30 June 2021
- Eta Reserve Review as at 30 September 2021: Briefing Note for the Board (dated 7 December 2021)
- Eta draft Reserve Review as at 31 December 2021: Briefing Note for the Board (dated 4 February 2022)
- Eta 2020 Actuarial Function Report, dated 26 March 2021

- Eta draft 2021 Actuarial Function Report, dated 17 March 2022
- WMG Reserve Review as at 30 September 2021: Briefing Note for the Board (dated 16 November 2021)
- WMG draft Reserve Review as at 31 December 2021: Briefing Note for the Board (dated 14 February 2022)
- WMG 2021 Actuarial Function Report, dated 18 March 2022
- Inceptum Analysis of Reserves and Actuarial Function Report as at 31 December 2020, dated 31 March 2021
- Inceptum Reserve Review as at 30 September 2021: Briefing Note for the Board (dated 1 December 2021)
- Inceptum Reserve Review as at 31 December 2021: Briefing Note for the Board (dated 9 February 2022)
- Inceptum draft 2021 Actuarial Function Report, dated 23 March 2022
- Series of spreadsheet showing R&Q Group's calculations of the reserves of the QUK Transferring Business, based on data as at 30 September 2021 and 31 December 2021

Risks and Solvency Capital

- QRTs for QUK as at 31 December 2020 and as at 30 September 2021
- QUK SFCR for the year ended 31 December 2020
- QUK SFCR for the year ended 31 December 2021
- Update to the Capital Appetite Framework for QEO and QUK, dated 30 March 2021
- QEO Capital Model Design and Operation document, dated 14 June 2021
- Internal QUK memo concerning internal model changes, dated 17 June 2021
- QEO annual ORSA as at 31 December 2020
- Email correspondence from QUK confirming the impact of the Scheme on QUK's SCR
- Eta SFCR for the year ended 31 December 2020
- Eta ORSA as at 31 December 2020 with updated balance sheet numbers for June 2021, dated 24 September 2021
- Extract from Eta's QRTs as at 30 September 2021
- WMG ORSA Report, approved December 2021
- Extract from WMG's QRTs as at 30 September 2021
- Inceptum SFCR for the year ended 31 December 2020
- Extract from Inceptum's QRTs as at 30 September 2021
- Inceptum draft 2022 ORSA report, based on data as at 31 December 2021
- A spreadsheet summarising the Solvency II balance sheets and SCRs for each of Inceptum, WMG and Eta as at 31 December 2021
- Spreadsheets containing the input to and results of the SCR calculations for each of of Inceptum, WMG and Eta as at 31 December 2021
- A spreadsheet showing the projected balance sheet for Inceptum and the transferring portfolios at year-ends 2021-24.
- A spreadsheet showing the projected SCR of Inceptum at year-ends 2022-24 and separate spreadsheet files showing the input assumptions behind the calculations.

Other

- First Witness Statement of Richard Finney, on behalf of Eta
- First Witness Statement of Richard Finney, on behalf of WMG
- First Witness Statement of Paul Corver, on behalf of Inceptum
- First Witness Statement of Gavin Bridges, on behalf of QUK.

B.2 Information relating to the items listed above was also gathered during discussions with staff of Inceptum and QUK.

Appendix C CV for Derek Newton

C.1 Derek Newton is a principal and actuarial consultant in Milliman's London office. He is leader of Milliman's UK General Insurance practice. He joined the firm in 2003.

C.2 Derek started his actuarial career in 1983. Since 1994 he has worked exclusively within General Insurance, where he has experience with reserving, mergers and acquisitions (M&A) activity, portfolio transfers, Solvency II, the underwriting process, management reporting, designing and evaluating risk transfer mechanisms, premium rating, risk modelling, and capital and solvency evaluation. His experience includes:

C.2.1 Leading teams reviewing reserves (and the internal reserving processes) for various insurers and reinsurers, including, where relevant providing statements of actuarial opinion for Lloyd's, for the Central Bank of Ireland, for the Bermudan Monetary Authority and for the relevant US insurance departments.

C.2.2 Assisting insurers with the preparation of solvency capital assessments, both internal and in accordance with prevailing regulatory requirements.

C.2.3 Leading assignments to review the underwriting effectiveness of several insurance operations, both commercial and personal lines, resulting in improved efficiency and additional profits to the insurers.

C.2.4 Providing independent expert support to insurers arranging transfers of business between themselves (see below).

C.2.5 Providing Chief Actuary / Actuarial Function support to several insurers.

C.2.6 Leading the evaluation of the reinsurance strategy and reinsurance programme for a major insurer.

C.2.7 Leading the review of various European insurers as part of due diligence assignments.

C.3 Of particular relevance in this context, Derek acted as the independent expert in respect of the following Part VII transfers:

C.3.1 The transfer of the general insurance business of RL(CIS) Limited to CIS General Insurance Limited, a transfer that was sanctioned in 2014;

C.3.2 The transfer of general insurance business relating to the Tower pool from Royal & Sun Alliance Insurance PLC to Knapton Insurance Limited, a transfer that was sanctioned in 2015;

C.3.3 The transfer of the general insurance business of Dowa Insurance Company (Europe) Limited to Aioi Nissay Dowa Insurance Company of Europe Limited, a transfer that was sanctioned in 2016;

C.3.4 The transfer of general insurance business relating to the Ridgwell, Fox & Partners pool from QBE Insurance (Europe) Limited and from Moorgate Insurance Company Limited to Bothnia International Insurance Company Limited, a transfer that was sanctioned in 2017;

C.3.5 The transfer of general insurance business from Royal & Sun Alliance Insurance PLC and from The Marine Insurance Company Limited to Mercantile Indemnity Company Limited, a transfer that was sanctioned in 2019;

C.3.6 The transfer of EEA general insurance business from Assurant General Insurance Limited and from London General Insurance Company Limited to Assurant Europe Insurance N.V., a transfer that was sanctioned in 2020;

C.3.7 The transfer of general insurance business from Sunderland Marine Insurance Company Limited to The North of England Protecting and Indemnity Association Limited, a transfer that was sanctioned in 2020;

C.3.8 The transfer of general insurance business from TTI to UKNV, a transfer that was sanctioned in 2021.

C.4 In addition, Derek has been peer reviewer to the Independent Expert in the following transfers:

C.4.1 The general insurance business of various UK-regulated subsidiaries of the Royal Sun Alliance Insurance Group to a smaller number of UK-regulated subsidiaries of Royal Sun Alliance Insurance Group. The transfers were approved by the Court on 12 December 2011;

C.4.2 The general insurance business of PA(GI) Limited to Royal Sun Alliance Insurance and to Marine Insurance Company Limited. The transfers were approved by the Court on 12 December 2011;

C.4.3 Certain general insurance business of the Italian branch of Sompo Japan Insurance Company of Europe Limited to Berkshire Hathaway International Insurance Limited. The transfer was effective 31 March 2013;

C.4.4 The general insurance business of Chevanstell Limited to R&Q Insurance (Malta) Limited. The transfer was effective 31 December 2013;

C.4.5 The European branch general insurance business of Mitsui Sumitomo Insurance Company (Europe) Limited to MSIG Insurance Europe AG. The transfer was effective 31 December 2013;

C.4.6 The EEA general insurance businesses of Sompo Japan Nipponkoa Insurance Company of Europe Limited and Endurance Worldwide Insurance Limited to SI Insurance (Europe), SA and the non-EEA business of Sompo Japan Nipponkoa Insurance Company of Europe Limited to Endurance Worldwide Insurance Limited. The transfer was effective 31 December 2018;

C.4.7 The business of the Irish, Dutch, French and German branches of Travelers Insurance Company Limited to Travelers Insurance DAC. The transfer was effective 1 October 2019;

C.4.8 The business of the business of the UK branch of Basler Versicherung AG to Bothnia International Insurance Company Limited. The transfer was effective 2 July 2021.

C.5 Before joining Milliman, Derek was:

- A director of Heath Lambert's ART division (2002-2003)
- A partner within Ernst & Young's UK property & casualty consulting practice (1998-2001)
- In a variety of roles within Prudential plc (1983-1998), culminating in finance director and actuary for Prudential's UK general insurance operation.

C.6 Derek was awarded Fellowship of the Institute of Actuaries in 1988. He was a member of the General Insurance Board of the Institute & Faculty of Actuaries (2002-2014) and chaired the Board 2005-2007. He also served on the Council of the Institute of Actuaries (2005-2010). He has chaired various actuarial working parties and authored or co-authored several papers. In 2013, Derek received a special award from the profession to mark his Outstanding Contribution to General Insurance Research.

Appendix D Scope of the Work of the Independent Expert in relation to the Scheme

The following was included within the letter of engagement that was agreed between the Parties, Milliman and me, and which was shown to the PRA prior to the approval by the PRA and FCA of my appointment as the Independent Expert in respect of the Scheme. As such, the following constitutes my terms of reference in respect of this assignment.

> *"The Independent Expert's report (the Scheme Report) will consider the terms of the Scheme generally and the effect that the Scheme will have on the holders of (re)insurance policies of the Parties.*
>
> *His review and Scheme Report will address generally the way in which the Parties have conducted their (re)insurance business but taking into account the particular circumstances of each of the different groups of policyholders of the Parties involved in the Scheme. It will deal inter alia with the following aspects:*
>
> - *The likely scope for deteriorations in each of the Parties' claims reserves (i.e. the likelihood and extent to which each of the Parties' reserves may prove inadequate);*
> - *The impact of the Scheme on the security of / financial strength afforded to the different groups of policyholders of the Parties involved in the Scheme;*
> - *The corporate governance structures operating in the Parties involved in the Scheme and the impact on the different groups of policyholders in the Parties involved in the Scheme;*
> - *The impact of the Scheme on the levels of service provided to the different groups of policyholders of the Parties involved in the Scheme;*
> - *The relative solvency margins of the Parties;*
> - *The future business plans and the capital management policy to be adopted by the Parties following implementation of the Scheme;*
> - *The existing and proposed agreements between the Parties and their reinsurers;*
> - *Guarantees and/or agreements (if any) between the Parties;*
> - *Guarantees and/or agreements (if any) between each of the Parties and their respective parent company;*
> - *Transactions (outside the Scheme) that impact upon one or both of the Parties;*
> - *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 April 2015 Statement of Policy on its approach to insurance business transfers and of Chapter 18 of the supervision manual in the FCA's Handbook (including the guidance contained within the FCA's May 2018 paper on Part VII Transfers (FG18/4[31]));*
> - *A review of the communications made to policyholders;*
> - *Any other matters drawn to my attention by the Regulators or which are required by the Regulators to be addressed within the report.*
>
> *The above list is not intended to be exclusive to any other aspects that may be identified during the completion of the project and which are considered to be relevant.*
>
> *The Independent Expert shall not be directly involved in the formulation of the proposed transfers although he should expect to give guidance during the evolution of the detailed proposals on those issues that concern him, or that he considers unsatisfactory.*
>
> *The Independent Expert will meet with the Parties at an early stage to identify key issues and will also discuss the initial findings in respect of the Scheme with the Parties.*
>
> *The Independent Expert will support the Parties in their liaison with and provision of information to the Regulators and will also participate in discussions with the Regulators as required.*

[31] *Since the agreement between the Parties, Milliman and me was signed, this guidance has been superseded by FG22/1. I have therefore followed that guidance rather than the now obsolete guidance.*

The Independent Expert will produce (i) the Scheme Report for submission to the Court; (ii) a supplemental report to the Scheme Report for submission to the Court at the final court hearing; and (iii) a summary of the Scheme Report that forms part of the Scheme summary for inclusion within letters to policyholders (or approve such a summary if prepared by the Parties). He will share the Scheme Report (and drafts) and any supplemental report with those noted at paragraph 7(b) of the engagement letter.

If required, the Independent Expert will attend the Court hearings. For the avoidance of doubt, Milliman's fee estimates included in this agreement include its attendance at the directions court hearing and final court hearing for the Scheme.

The Independent Expert will not provide any advice with respect to the merits of the proposed Scheme."

Appendix E General Considerations of the Independent Expert in relation to the Scheme

INTRODUCTION

E.1 I have compiled my Report in accordance with the Policy Statement, with SUP18 and with FG18/4.

E.2 Under FSMA, the concept of TCF must be applied. To help ensure that customers are treated fairly in the future it is necessary to understand how they have been treated in the past. From the policyholders' perspective, the acceptability of the Scheme must be on the basis that it will not have a materially adverse effect on their benefits or fair treatment.

E.3 In order to fulfil my obligations as Independent Expert I have considered the terms of the Scheme generally and how the different groups of policyholders are likely to be affected by the Scheme. In particular, I have considered:

- The likely effects of the Scheme on the security of the policyholders' benefits, including the likelihood and potential effects of the insolvency of the insurer; and
- The likely effects of the Scheme on policyholder servicing levels (e.g. claims handling).

MATERIALITY

E.4 After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 5.13, 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.

E.5 In order to determine whether any effects of the Scheme on any group of policyholders are *materially* adverse it has been necessary for me to exercise my professional judgement in the light of the information that I have reviewed.

E.6 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, and also at the nature of the assets that constitute each company's capital and surplus. 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 subject to regulatory approval) 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 level of financial security projected to be in place 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

E.7 As noted above, I need to consider the security of policyholder benefits, i.e. the likelihood that policyholders will receive their benefits when due.

E.8 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.

E.9 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.

E.10 I also need to consider the impact on policyholders' security in the event of the default of an insurer (e.g. the role of the FSCS).

TREATING CUSTOMERS FAIRLY

E.11 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, expense levels and regulation.

E.12 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

E.13 Paragraph 2.34(4)(b) of the Policy Statement and paragraph 2.36 of SUP18 both require me, as Independent Expert, to consider the likely effects of the Scheme on matters such as investment management, new business, administration, expense levels and valuation bases insofar as they might impact on levels of service to policyholders or on the security of policyholders' benefits.

E.14 I am also required to consider the cost of the Scheme and the tax effects of the Scheme insofar as they might impact on the security of policyholders' benefits.

Appendix F Compliance with the PRA Policy Statement

The table below indicates how I have complied with the provisions of the PRA Policy Statement ("*Insurance business transfers*", dated January 2022) that pertain to the form of the Report. I have not included references to paragraphs in the Executive Summary of this Report; there should be nothing in the Executive Summary that has not been stated or explained in other parts of the Report.

I note that, in preparing this Report, I have also been mindful of the contents of SUP18 and FG22/1.

PRA Policy Statement Reference	Requirement	Scheme Report paragraph reference
2.30 (1)	Who appointed the Independent Expert and who is bearing the costs of that appointment	1.3, 1.11, 1.17, 5.47, 10.47
2.30 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator	1.3, 1.11
2.30 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that fits him for the role	1.12, Appendix C
2.30 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties that might be thought to influence his independence, and details of any such interest	1.13-1.15
2.30 (5)	The scope of the report	1.18-1.31
2.30 (6)	The purpose of the Scheme(s)	5.11, 5.12
2.30 (7)	A summary of the terms of the scheme in so far as they are relevant to the report	5.1-5.10
2.30 (8)	What documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided	1.34, 1.44, Appendix B
2.30 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgment of others	1.34, 6.38, 6.77, 6.78, 6.90, 6.99, 6.108, 6.114, 11.2
2.30 (10)	The people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable	1.34, 6.38, 6.77, 6.78, 6.90, 6.99, 6.108, 6.114
2.30 (11)	His opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee	 Section 6 Section 7, Section 8 Section 9
2.30 (12)	His opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme	10.8-10.14
2.30 (13)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the scheme	None of which I am aware.

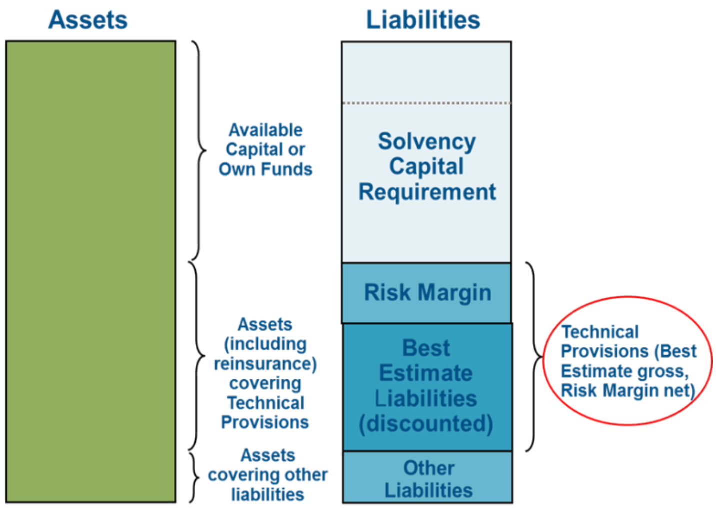
2.30 (14)	For each opinion that the independent expert expresses in the report, an outline of his reasons	6.19-6.20, 6.22, 6.33-6.34, 6.58, 6.70, 6.82, 6.91, 6.101, 6.110, 6.118, 6.147, 6.153, 6.153, 6.158, 6.174, 6.174, 6.179, 7.6, 8.4, 9.5, 9.9, 9.11, 9.14, 9.15, 10.14, 10.21, Section 11
2.32 (1)	The summary of the terms of the scheme should include a description of any reinsurance agreements that it is proposed should pass to the transferee under the scheme	4.104, 5.22
2.32 (2)	The summary of the terms of the scheme should include a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	5.21
2.33 (1)	The independent expert's opinion of the likely effects of the scheme on policyholders should include a comparison of the likely effects if it is or is not implemented	6.119 onwards, with opinions stated in 6.153, 6.158, 6.165, 6.174 and 6.179
2.33 (2)	The independent expert's opinion of the likely effects of the scheme on policyholders should state whether he considered alternative arrangements and, if so, what	1.19
2.33 (3)	The independent expert's opinion of the likely effects of the scheme on policyholders should, where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders	5.13, Section 6, Section 7, Section 9
2.33 (4)	The independent expert's opinion of the likely effects of the scheme on policyholders should include his views on:	
	(a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;	5.3, 6.165, 6.174, 7.3, 7.4, 7.6, 8.2, 8.4, 9.11, 9.14
	(b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:	
	(i) the security of policyholders' contractual rights;	6.148-6.153, 7.6, 8.4, 9.15
	(ii) levels of service provided to policyholders; or	6.166-6.174
	(iii) for long-term insurance business, the reasonable expectations of policyholders; and	Not applicable
	(c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations	10.46, 10.47
2.35 (1)	For any mutual company involved in the scheme, the report should describe the effect of the scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes that could affect their entitlements as policyholders	Not applicable

2.35 (2)	For any mutual company involved in the scheme, the report should state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights	Not applicable
2.35 (3)	For any mutual company involved in the scheme, the report should comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without	Not applicable, as there would be no diminution
2.36 (1)	For a scheme involving long-term insurance business, the report should describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits	Not applicable
2.36 (2)	For a scheme involving long-term insurance business, the report should, if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders	Not applicable
2.36 (3)	For a scheme involving long-term insurance business, the report should describe the likely effect of the scheme on the approach used to determine: (a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and (b) the levels of any discretionary charges	Not applicable
2.36 (4)	For a scheme involving long-term insurance business, the report should describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm	Not applicable
2.36 (5)	For a scheme involving long-term insurance business, the report should include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders	Not applicable
2.36 (6)	For a scheme involving long-term insurance business, the report should state whether the independent expert is satisfied that for each firm the scheme is equitable to all classes and generations of its policyholders	Not applicable
2.36 (7)	For a scheme involving long-term insurance business, the report should state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented	Not applicable

Appendix G Solvency II Balance Sheet

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

FIGURE G.1 SOLVENCY II BALANCE SHEET



G.2 The Solvency II balance sheet is intended to be a tool for management to assess an entity's solvency and hence an important consideration for significant decisions. It is also a tool for regulators to assess the solvency of an insurer.

G.3 A key consideration for management in making significant decisions will be the excess of assets over TPs, 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.

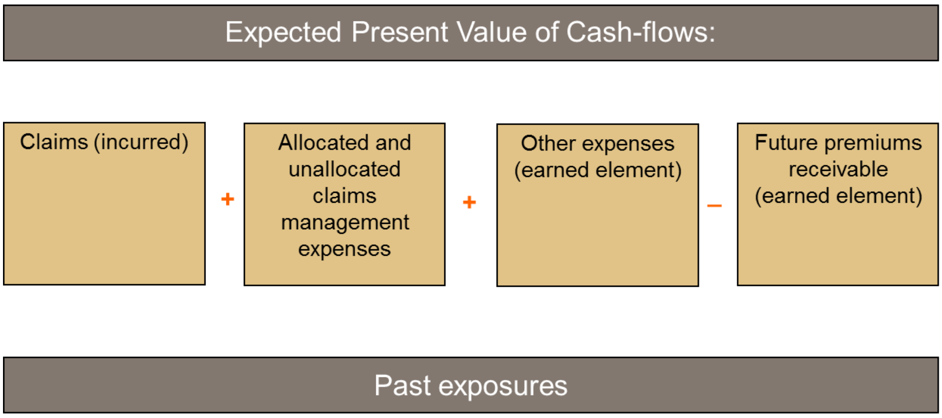
G.4 The TPs are a direct input to the balance sheet, and are therefore a fundamental input in to the SCR calculation that models the potential movement in the balance sheet over a one-year time horizon.

G.5 Solvency II requires the TPs (as at the valuation date) to be determined using a market consistent valuation of the liabilities relating to insurance contracts. 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 TPs 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 TPs are made up as follows:

Claims provision + Premium provision + Risk margin

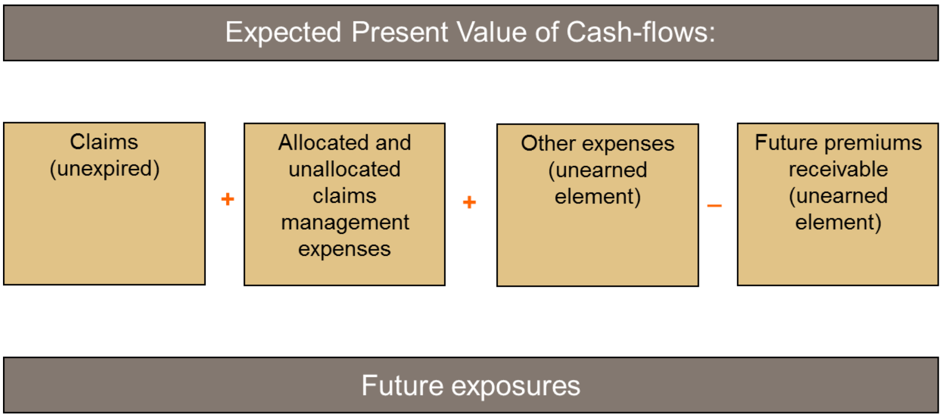
G.6 The claims provision is the expected present value/discounted 'best estimate' of all future cash-flows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date. G.2, below, illustrates the components of the claims provision calculation.

FIGURE G.2 CLAIM PROVISION



G.7 The premium provision is the expected present value/discounted 'best estimate' of all future cash-flows (claim payments, expenses and future premiums due) relating to future exposures arising from policies that the insurer is obligated to at the valuation date. Figure G.3, below, illustrates the components of the premium provision calculation.

FIGURE G.3 PREMIUM PROVISION



G.8 The risk margin ("'RM") is intended to be the balance that another (re)insurer taking on the liabilities at the valuation date would require over and above the discounted 'best estimate'. Under Solvency II, the RM is calculated using a cost-of-capital ("CoC") approach (presently employing a 6% CoC parameter as provided by EIOPA). More specifically, the calculation is as follows:

$$RM = CoC \times \sum_{t \geq 0} \frac{SCR(t)}{(1 + r_{t+1})^{t+1}}$$

where:

- SCR(t) as employed for the RM formula consists of underwriting risk (with respect to existing business); counterparty risk (e.g. reinsurance); operational risk; and market risk (if unavoidable, i.e. not hedge-able); and
- r_t is the risk-free discount rate(s) at time t, as provided by EIOPA for all major currencies.

Appendix H Key Differences Between UK GAAP and Solvency II Technical Provisions

H.1 A summary of the key differences between UK GAAP reserves and Solvency II TPs is set out in the table below:

Area of change	UK GAAP Reserves	Solvency II Technical Provisions	Balance sheet impact
Earned business	Claims reserve = point estimate within a reasonable range ("not insufficient'')	Claims provision = probability weighted average of future cash flows	Reduces liabilities (removes margins)
Unearned business	UPR, net of Deferred Acquisition Costs	Premium provision = probability weighted average of future cash flows	Reduces liabilities (expected profit)
Risk Margin	n/a	Explicit item, based on cost of capital approach	Increases liabilities
Discounting	Undiscounted	Discounted cash flows	May reduce or increase liabilities depending on currency and duration.
Contract recognition	Policies written	Policies written and legally bound BBNI policies	Reduces liabilities (due to expected profit on BBNI policies)
Expenses	Claims handling expense reserve	More explicit treatment of expenses (including those not relating to claims handling)	Increases liabilities
Events Not In Data (''ENIDs'')	Limited allowance for contingent liabilities	Allowance for possible outcomes that have not historically occurred (and hence are not in the data used for reserving)	Increase liabilities
Reinsurance Bad Debt Provision	n/a	Explicit provision required for possibility of reinsurer default	Decreases assets