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**Report of the Independent Expert on the proposed transfer of the  
Ridgwell, Fox & Partners Pool business from QBE Insurance (Europe)  
Limited and from Moorgate Insurance Company Limited to Bothnia  
International Insurance Company Limited**

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## 1. PURPOSE AND SCOPE

### PURPOSE OF THE REPORT

- 1.1 It is proposed that a particular block of business of QBE Insurance (Europe) Limited (“QBE”) and all of the business of Moorgate Insurance Company Limited (“Moorgate”) (together, QBE and Moorgate are the “Transferors”) be transferred to Bothnia International Insurance Company Limited (“Bothnia” 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”).
- 1.2 Section 109 of FSMA requires that an application to the High Court of Justice in England and Wales (“the Court”) for an order sanctioning an insurance business transfer scheme must be accompanied by a report on the terms of the transfer (“the FSMA Report”) by an independent person (“the Independent Expert”) having the skills necessary to make the report and who is nominated or approved by the Prudential Regulation Authority (“PRA”), having consulted with the Financial Conduct Authority (“FCA”). The FSMA Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.
- 1.3 QBE, Moorgate and Bothnia have nominated me to act as Independent Expert to provide the FSMA Report in respect of the Scheme, and the PRA has approved my appointment in consultation with the FCA (see paragraph 1.17 below).
- 1.4 This report (“the Report”) describes the proposed transfer and discusses its possible effects on the policyholders of Bothnia, Moorgate and QBE (in respect of all business of Bothnia, Moorgate and QBE), including effects on security and levels of service. As such, the Report fulfils the requirements of the FSMA Report.
- 1.5 QBE and Moorgate are domiciled and regulated in the UK, while Bothnia is domiciled and regulated in Finland.
- 1.6 QBE is an indirect subsidiary of QBE Insurance Group Limited (“QIGL”), and Bothnia and Moorgate are subsidiaries (the former direct, the latter indirect) of Compre Holdings Limited (“CHL”). In this Report I refer to CHL and its direct and indirect subsidiaries collectively as “the Compre Group” and to QIGL and its direct and indirect subsidiaries collectively as “the QBE Group”.
- 1.7 A list of terms defined in the Report is shown in Appendix A. Otherwise I use the same defined terms as are in the document that sets out the terms of the Scheme (the “Transfer Document”).

### THE PROPOSED SCHEME

- 1.8 The business to be transferred under the Scheme (“the Transferring Business”) is that business underwritten by QBE and by Moorgate (or by their predecessors), including the associated reinsurance assets and rights of subrogation, as members of the Ridgwell, Fox & Partners Pool (“RFP”) where the liability of each member company was underwritten on a several only liability basis through Ridgwell, Fox & Partners (Underwriting Management) Limited (“RFPUM”), together with inwards retrocession contracts written by QBE and by Moorgate in respect of business originally underwritten by other members of RFP.
- 1.9 RFP was active between 1978 and 1991 and wrote a mixture of inwards reinsurance business. It did not write any direct business.
- 1.10 As explained further below, the RFP business is currently owned or 100% reinsured by Bothnia. The Transferring Business is 100% reinsured by Bothnia.
  - 1.10.1 For the purposes of this Report, the business underwritten by QBE relating to RFP includes that business written by other insurers that were members of RFP but which was subsequently reinsured by QBE.
  - 1.10.2 That part of the Transferring Business pertaining to QBE comprises a small proportion of the overall insurance liabilities of QBE. No part of the insurance liabilities of QBE other than that relating to RFP will be transferred under the Scheme.
- 1.11 That part of the Transferring Business pertaining to Moorgate comprises the remaining insurance liabilities of Moorgate.

- 1.12 For convenience I refer in this Report to the portion of the Transferring Business emanating from QBE as the “QBE Transferring Business” and that emanating from Moorgate as the “Moorgate Transferring Business”. Together, the QBE Transferring Business and the Moorgate Transferring Business comprise the entire Transferring Business.
- 1.13 The assets to be transferred to Bothnia under the Scheme (“the Transferring Assets”) comprise all outwards reinsurance contracts that relate to the Transferring Business.
- 1.14 The run-off of the Transferring Business, together with that of the other members of RFP, is currently the responsibility of Bothnia which has subcontracted the administration of the Transferring Business to Compre Services (UK) Limited (“CSUK”), Compre Services (Finland) Oy, Compre Services (Germany) GmbH and Compre Services (Sweden) Ab (collectively referred to as “Compre Services”). These companies are each members of the Compre Group.
- 1.15 The Effective Date of the Scheme is expected to be 30 November 2017.
- 1.16 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 9 of the Report.

## THE INDEPENDENT EXPERT

- 1.17 I, Derek Newton, have been appointed by QBE, Moorgate and Bothnia 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 24 October 2016.
- 1.18 I am a Principal of Milliman LLP (“Milliman”) and I am based in its UK General Insurance practice in London. I am a Fellow of the Institute and Faculty of Actuaries which was established in 2010 by the merger of the Institute of Actuaries and the Faculty of Actuaries. I became a Fellow of the Institute of Actuaries in 1988. My experience of general insurance includes the (reserved) roles as the Signing Actuary to Lloyd’s syndicates and Irish non-life insurance companies, as well as acting as the Independent Expert in three insurance business transfer schemes that were sanctioned in 2014, 2015 and 2016 respectively. I have included my Curriculum Vitae in Appendix B in which I explicitly note the insurance business transfer schemes in which I have acted as the Independent Expert, as well as those for which I have provided peer review support to the Independent Expert.
- 1.19 I do not have, and have never had, any policies issued by any part of the QBE Group or the Compre Group. I am not a shareholder of either QIGL or CHL. I have undertaken no work for any part of either the QBE Group or the Compre Group. I note that Milliman is part of a global consulting business, the parent company of which is Milliman, Inc. I refer to Milliman, Inc. and its direct and indirect subsidiaries collectively as “the Milliman Group”. Individual practices within the Milliman Group have worked with parts of the QBE Group on assignments in other countries. The overall fee income that the Milliman Group has received from the QBE Group worldwide in any of the last 7 years (2010 to 2016) has not exceeded 0.11% of the Milliman Group’s corresponding annual global revenue. The main assignments carried out for QIGL worldwide over the last six years were Casualty exercises undertaken by the Milliman Group’s offices in New York, San Francisco and Hong Kong. Over the same period the Milliman Group has received no fee income from the Compre Group worldwide. In addition:
- Gary Wells, another Principal of Milliman LLP, was appointed by QBE in 2014 to be Independent Expert in respect of a proposed transfer of the assets and liabilities of two of its European branches (this transfer did not take place) and (at the time of drafting this Report) is currently acting as Independent Expert in respect of a proposed transfer of the assets and liabilities of three of its European branches to a third party insurer.
  - In 2014 Milliman LLP was engaged by a private equity investment firm to provide due diligence assistance in its potential purchase of certain subsidiaries of CHL, including Bothnia. The engagement was discontinued before completion at the request of the client who had decided not to pursue the potential purchase. I was not involved in this engagement.
- 1.20 I do not believe that the involvement of other consultants within the Milliman Group with QIGL, CHL or their subsidiaries affects my ability to act independently in my assessment of the Scheme.
- 1.21 The Scheme is subject to sanction by the Court under Section 111 of FSMA.

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- 1.22 QBE, Moorgate and Bothnia will share the costs of my work as Independent Expert and Independent Actuary. No costs of the Scheme will be borne by any of the policyholders of any of QBE, Moorgate and Bothnia.

## THE SCOPE OF MY REPORT

- 1.23 My terms of reference have been reviewed by the PRA and are set out in Appendix C.
- 1.24 I have considered the terms of the Scheme only and have not considered whether any other scheme or alternative arrangement might provide a more efficient or effective outcome.
- 1.25 The Report describes the Scheme and the likely effects on policyholders of QBE, Moorgate and Bothnia, including effects on security and levels of service.
- 1.26 The Report should be read in conjunction with the full terms of the Scheme.
- 1.27 My work has required an assessment of the liabilities of QBE, Moorgate and Bothnia for the purposes of describing the effect of the Scheme. My review of the liabilities was based on the actuarial reserve assessments conducted by internal actuaries of QBE, Moorgate and Bothnia. I have reviewed the methodology and assumptions used in their work and assessed the key areas of uncertainty in relation to these liabilities. I have not attempted to review in detail the calculations performed by the internal actuaries of QBE, Moorgate or Bothnia or to produce independent estimates of the liabilities.
- 1.28 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 QBE, Moorgate and Bothnia pre and post Scheme. Again, I have not attempted to review in detail the calculations of the capital position performed by QBE, Moorgate or Bothnia or to produce independently my own estimates.
- 1.29 As far as I am aware, there are no matters which I have not taken into account in undertaking my assessment of the Scheme and in preparing the Report, but which nonetheless should be drawn to the attention of policyholders in their consideration of the Scheme.
- 1.30 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 QBE, to Moorgate and / or to Bothnia. I confirm that I have complied with this duty.
- 1.31 I am aware of the requirements regarding experts set out in Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Protocol for Instruction of Experts to give Evidence in Civil Claims.
- 1.32 I confirm that I have made clear which facts and matters referred to in the Report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.
- 1.33 Shortly before the date of the Court hearing at which an order sanctioning the Scheme will be sought, I will prepare a supplementary report (“the Supplementary Report”) covering any relevant matters which might have arisen since the date of the Report.
- 1.34 It is intended that both this Report and the Supplementary Report will be published on the QBE and Compre websites, on pages dedicated to the Scheme, and that copies of this Report and the Supplementary Report will be sent to any policyholders who request them. The Report will be made available in this way immediately following the directions hearing relating to the Scheme (or as soon thereafter that the dedicated pages on the QBE and Compre websites have been set up) and the Supplementary Report will likewise be made available at least one week before the date of the Court hearing.

## THE STRUCTURE OF MY REPORT

- 1.35 The remainder of the Report is set out as follows:
- Section 2: I provide an executive summary of the Report.
  - Section 3: I summarise the key provisions of the Scheme.

- Sections 4 & 5: I provide some background information regarding the regulatory environments in which QBE, Moorgate and Bothnia (collectively, “the Companies”) operate, and then regarding the Companies themselves as well as RFP.
- Section 6: I consider the likely impact of the Scheme on the policyholders whom the Scheme would move from QBE and from Moorgate to Bothnia (collectively “the Transferring Policyholders”, respectively “the QBE Transferring Policyholders” and “the Moorgate Transferring Policyholders”).
- Section 7: I consider the likely impact of the Scheme on the policyholders who would remain within QBE and Moorgate after the transfer has taken place.
- Section 8: I consider the likely impact of the Scheme on the current policyholders of Bothnia.
- Section 9: I cover more general issues relating to the Scheme and the management of QBE, Moorgate and Bothnia.

1.36 I summarise my conclusions in Section 10.

## RELIANCES AND LIMITATIONS

- 1.37 In carrying out my review and producing the Report, I have relied, without detailed verification, upon the accuracy and completeness of the data and information provided to me, in both written and oral form, by Bothnia, Moorgate and QBE. Reliance has been placed upon, but not limited to, the information detailed in Appendix E. 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 my colleagues at Milliman but I have not relied on their work or their advice. I note in paragraph 9.23 that I have seen some legal advice sought by QBE and Moorgate and I have described there how I have used that advice and why I thought it reasonable to use it in that way. I have neither sought nor relied on any legal advice.
- 1.38 The Report has been prepared for the purposes of the Scheme in accordance with Section 109 of FSMA. A copy of the Report will be sent to the FCA and PRA, and will accompany the Scheme application to the Court.
- 1.39 The Report must be considered in its entirety as individual sections, if considered in isolation, may be misconstrued.
- 1.40 Neither the Report, nor any extract from it, may be published without me having provided my specific written consent, save that copies of the Report may be made available for inspection by policyholders and by the financial regulatory authorities in Finland (“FIN-FSA”), and copies may be provided to any person requesting the same in accordance with legal requirements. I also consent to the Report being made available on the QBE and Compre websites, on pages dedicated to the Scheme.
- 1.41 No summary of the Report may be made without my express consent. I will provide a summary of the Report (the “Report Summary”) for inclusion in a document that will be made available to the policyholders of Bothnia, Moorgate and QBE, to the reinsurers of Moorgate and QBE, and to others affected, e.g. anyone with an interest in the policies being transferred who has notified QBE, Moorgate or Bothnia of their interest. That document will be sent to the FCA and PRA, will accompany the Scheme application to the Court, will be available for inspection by the FIN-FSA, and will be available on the QBE and Compre websites, on pages dedicated to the Scheme.
- 1.42 The Report has been prepared within the context of the assessment of the terms of the Scheme, and must not be relied upon for any other purpose. No liability will be accepted by Milliman, or me, for any application of the Report to a purpose for which it was not intended or for the results of any misunderstanding by any user of any aspect of the Report. In particular, no liability will be accepted by Milliman or me under the terms of the Contracts (Rights of Third Parties) Act 1999.

- 1.43 Actuarial estimates are subject to uncertainty from various sources, including changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, economic and investment conditions. Therefore, it should be expected that the actual emergence of claims, premiums, expenses and investment income will vary from any estimate. Such variations in experience could have a significant effect on the results and conclusions of the Report. No warranty is given by Milliman or me that the assumptions, results and conclusions on which the Report is based will be reflected in actual future experience.
- 1.44 This review does not comprise an audit of the financial resources and liabilities of QBE, Moorgate or Bothnia.
- 1.45 The Report should not be construed as investment advice.
- 1.46 Nothing in the Report should be regarded as providing a legal opinion on the effectiveness of the Scheme.
- 1.47 In considering the background to the companies involved in the Scheme, and in considering the likely impact of the Scheme, I have made extensive use of financial information as at 31 December 2016 as that is, in general, the most recent date at which audited financial information is available. I have also taken into account updated financial information which has been made available to me, although I note that this updated information has not been audited. I have asked the managements of QBE, Moorgate and Bothnia for information regarding any developments since 31 December 2016 that would have affected those companies, in particular any development that might have affected the security of their policyholders and the standards of service provided to them. I have referred in the Report to the developments that they have reported to me. The managements of QBE, Moorgate and Bothnia have assured 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 the Report, I am not aware of any material changes in circumstances since 31 December 2016 other than those referred to in the Report. The Report also takes no account of any information that I have not received, or of any inaccuracies in the information provided to me. I will review all further audited financial statements as at 31 December 2016 of QBE, Moorgate and Bothnia as and when they become available, and will comment on this information in my Supplementary Report.
- 1.48 We have relied on the currency exchange rates found in the financial statements and in other information provided. When conversion of currency values were necessary, unless stated otherwise, the rates of exchange used in the Report are £1.00 = \$1.2341 = €1.1707 as at 31 December 2016.
- 1.49 The use of Milliman's name, trademarks or service marks, or reference to Milliman directly or indirectly in any media release, public announcement or public disclosure, including in any promotional or marketing materials, websites or business presentations, is not authorised without Milliman's prior written consent for each such use or release, which consent shall be given in Milliman's sole discretion.

## PROFESSIONAL AND REGULATORY GUIDANCE

- 1.50 I am required to comply with relevant professional standards and guidance maintained by the Financial Reporting Council and by the Institute and Faculty of Actuaries, including *TAS 100: Principles for Technical Actuarial Work* and *TAS 200: Insurance*. I confirm that I have complied with such standards, subject to the principles of proportionality and materiality.
- 1.51 In accordance with Actuarial Profession Standard ("APS") X2, as issued by the Institute and Faculty of Actuaries, I have considered whether this Report should be subject to review ("Work Review"). I concluded that it should and I have also decided that the Work Review should be conducted by an individual who has not otherwise been involved in the analysis underlying this Report or in the preparation of the Report, but who would have had the appropriate experience and expertise to take responsibility for the work himself. In other words I have decided that the Report should be subject to Independent Peer Review. I confirm that this Report has been subject to Independent Peer Review prior to its publication.
- 1.52 The Report has been prepared under the terms of the guidance set out in the Statement of Policy entitled *The Prudential Regulation Authority's approach to insurance business transfers* ("the Policy Statement"), issued in April 2015, and in Section 18 of the FCA Supervision Manual ("SUP18") contained in the Handbook of Rules and Guidance to cover scheme reports on the transfer of insurance business.



## 2. EXECUTIVE SUMMARY

### CONCLUSION

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

- The security of benefits to policyholders of QBE, Moorgate and Bothnia will not be materially adversely affected by the implementation of the Scheme on the Effective Date; and
- The Scheme will have no impact on service standards (operated in accordance with Treating Customers Fairly (“TCF”) criteria) experienced by the policyholders of QBE, Moorgate and Bothnia.

I have explained in Appendix D what I mean by “materially adversely” and how I have evaluated whether I would consider something to be “materially adverse”.

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 Supplementary Report.

### THE SCHEME

2.4 Under the Scheme, the Transferring Business, together with all associated rights, benefits, powers and liabilities, together with the Transferring Assets, will be transferred to Bothnia (the Transferee) from QBE and Moorgate (the Transferors). Since the Transferring Business, net of the benefit of any attaching reinsurance, is already entirely reinsured by the Transferee, the Transferring Assets are the legal ownership of reinsurance covers purchased by RFPUM to reinsure the Transferring Business at the time the risks were originally written, other third party contracts, reinsurance recoveries, salvage and subrogation rights, and the books and records of the Transferring Business.

#### Motivation for the Scheme

2.5 QBE and Moorgate are both current members of RFP. As well as being a member of RFP, QBE also 100% reinsures the net participations of some of the other members of RFP (including Moorgate). With effect from 12 February 2016, QBE entered into an agreement whereby Bothnia 100% reinsures QBE’s direct and indirect net involvement in RFP.

2.6 The purpose of the proposed Scheme is to align the legal liability and the economic liability for the Transferring Business and also to provide finality to both QBE and Moorgate. I understand that it is intended that the Scheme will result in no policy liabilities remaining within Moorgate and that CHL intends that, post the Effective Date and subject to regulatory permissions, Moorgate be wound up. The Regulators have been advised of this intention in Moorgate’s Business Plan submission to the PRA.

#### Policyholders Affected

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

- Group A those holders of policies issued by RFP and covered in part by QBE - responsibility for those parts of their liabilities will be transferred by the Scheme from QBE to Bothnia;
- Group B those members of RFP (excluding Moorgate) that have ceded their liabilities to QBE - those reinsurance contracts will be transferred by the Scheme from QBE to Bothnia;
- Group C those holders of policies issued by RFP and covered in part by Moorgate - responsibility for those parts of their liabilities will be transferred by the Scheme from Moorgate to Bothnia;
- Group D those members of RFP that have ceded their liabilities to Moorgate - those reinsurance contracts will be transferred by the Scheme from Moorgate to Bothnia;



Group E the current policyholders of QBE who have policies that are not being transferred; and

Group F the current policyholders of Bothnia.

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

2.9 When reviewing the likely impact of the Scheme on the policyholders, I believe that the likely impact of the Scheme on the policyholders in Groups A and B (collectively referred to as the QBE Transferring Policyholders) would be similar. I believe that the likely impact of the Scheme on the policyholders in Groups C and D (collectively referred to as the Moorgate Transferring Policyholders) would also be similar. In this Report have therefore set out what I consider to be the impact of the Scheme on the policyholders, grouped as the QBE Transferring Policyholders, the Moorgate Transferring Policyholders, the current policyholders of QBE who have policies that are not being transferred and the current policyholders of Bothnia

### Administration

2.10 Bothnia currently has responsibility for the administration of all of the RFP business and this arrangement will be unaffected by the implementation of the Scheme.

## THE IMPACT OF THE SCHEME UPON THE TRANSFERRING POLICYHOLDERS

2.11 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:

2.11.1 the reserves of the Companies as at 31 December 2016 (and subsequently where available);

2.11.2 the excess assets of the Companies as at 31 December 2016 (and subsequently where available);

2.11.3 the risk exposures in the Companies and the impact that the scheme might have on those; and

2.11.4 the standards of policy servicing in each of the Companies.

2.12 I concluded that:

2.12.1 the reserves of QBE, Moorgate and Bothnia appeared reasonable as at 31 December 2016;

2.12.2 there is no reason to think that the reserve strength of QBE, Moorgate or Bothnia will be impacted by the Scheme;

2.12.3 as at 31 December 2016, QBE is a more than sufficiently capitalised company, Moorgate is a well-capitalised company and Bothnia is a very well-capitalised company (I have defined these terms in paragraph 6.5 below);

2.12.4 the policyholders of the Transferring Business will not be materially adversely affected due to relative differences in the financial strength of Bothnia post Scheme to those of QBE and Moorgate pre-Scheme;

2.12.5 although the proposed Scheme will lead to a change to the risk exposures of the QBE Transferring Business and to a lesser extent for the Moorgate Transferring Business, this will not have a materially adverse impact on the security of policyholder benefits; and

2.12.6 the proposed Scheme is unlikely to have any impact on the standards of policy servicing experienced by the QBE Transferring Policyholders and the Moorgate Transferring Policyholders compared to their current position.

## THE IMPACT OF THE SCHEME UPON THOSE POLICYHOLDERS REMAINING WITHIN THE TRANSFERORS

2.13 I have concluded that the Scheme would have negligible impact on those policyholders remaining within the Transferors.

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- 2.14 In reaching this conclusion I have noted that the Moorgate Transferring Business constitutes the entire business remaining within Moorgate and that therefore no policyholders are expected to remain within Moorgate post-Scheme. I have also noted that the QBE Transferring Business represents a very small proportion (i.e. 0.40%) of the gross liabilities within QBE and the QBE Transferring Business liabilities have already been 100% reinsured into Bothnia.

#### THE IMPACT OF THE SCHEME UPON THOSE POLICYHOLDERS CURRENTLY WITHIN BOTHNIA

- 2.15 I am satisfied that the Scheme will not have a materially adverse effect on the security of existing Bothnia policyholders. Further, the service levels provided to the policyholders of Bothnia will not be adversely affected by the Scheme.
- 2.16 In reaching this conclusion I have taken account of the fact that Bothnia already 100% reinsures the Transferring Business, and that it already has responsibility for managing the run-off of the RFP business, including the Transferring Business, and that it will retain responsibility for the management of the run-off post-Scheme.

#### THE IMPACT OF THE SCHEME IN RESPECT OF OTHER MATTERS

- 2.17 I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts cover those parts of the RFP business to be transferred by the Scheme from QBE and Moorgate to Bothnia. I am satisfied that the Scheme will not have a materially adverse effect on those reinsurers. The administration of the RFP business, including the management and handling of claims, will remain the responsibility of Bothnia post-Scheme so the magnitude and timing of recoveries claimed against reinsurance contracts relating to the business to be transferred will be unaffected by the Scheme. Similarly, all matters between RFP and the reinsurers are currently dealt with by Bothnia and that will remain the case post-Scheme.
- 2.18 I have been informed that the Scheme is not expected to have tax implications that would affect any of the Companies or any of the groups of policyholders identified in paragraph 2.7 above.
- 2.19 I have been provided with an estimate of the external costs of the Scheme. I consider it unlikely that the costs of the Scheme will be such as to jeopardise the security of any of the groups of policyholders.

#### APPROACH TO COMMUNICATION WITH POLICYHOLDERS

- 2.20 CHL will be writing to the QBE Transferring Policyholders and the Moorgate Transferring Policyholders (the latter being all of the policyholders of Moorgate), and to the reinsurers of the RFP Pool business (or, where CHL does not have contact details for the reinsurer, to the broker authorised to act on behalf of that reinsurer). It proposes not sending individual policyholder notifications to existing policyholders of Bothnia on the basis that, as the relevant liabilities are already with Bothnia through its reinsurance arrangement with QBE, the costs of such communication would be disproportionate to the likely benefits to the affected parties.
- 2.21 Similarly, QBE does not intend to notify directly any of its non-RFP policyholders for very similar reasons to those underlying Bothnia's intention not to communicate individually regarding the Scheme with its existing policyholders. In addition, the liability, gross of reinsurance, of the QBE Transferring Business, is not material in the context of the overall reserves of QBE.
- 2.22 In addition to direct, written correspondence, the Companies also plan indirect notification via advertisements in appropriate publications, including *The Times*, *The Financial Times* and *Insurance Day*.
- 2.23 The letters, notices and advertisements will refer all queries to a postal address or a telephone number or a website address, all of which will be dedicated to responding promptly to any such queries.
- 2.24 In the circumstances I regard the proposed approach to communications to be reasonable and proportionate.

### 3. BACKGROUND REGARDING THE REGULATORY ENVIRONMENTS

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

#### OVERVIEW OF THE UK INSURANCE MARKET

##### Background

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

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

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

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

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

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

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

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

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

##### Taxation

3.8 In the UK, general insurance companies are taxed on profits achieved at the main rate of corporation tax (currently 19%<sup>1</sup> for the financial year ending 31 March 2018).

<sup>1</sup> The UK Corporation Tax rate is expected to reduce to 17% with effect from 1 April 2020.

### Financial Services Compensation Scheme

3.9 As well as through the PRA and FCA regulations, consumer protection is also provided by the 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<sup>2</sup> that hold eligible policies in the situation when an insurer is unable to meet fully its liabilities. For general insurance business, the FSCS will pay 100% of any claim incurred before the default:

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

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

### Financial Ombudsman Service

3.10 The Financial Ombudsman Service (“FOS”) provides private individuals (and micro enterprises<sup>3</sup>) with a free, independent service for resolving disputes with financial companies. It is not necessary for the private individual (or micro enterprise) to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the FOS; it is necessary for the insurance policy concerned to be, or have been, administered from within the UK.

3.11 I note that Bothnia has submitted itself to the jurisdiction of the FOS with effect from 30 October 2015 as part of the process regarding another transfer from the UK involving direct policyholders.

### FCA Conduct Principles

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

- Outcome 1: Consumers can be confident that they are dealing with insurers where the fair treatment of customers is central to the corporate culture;
- Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly;
- Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale;
- Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances;
- Outcome 5: Consumers are provided with products that perform as insurers have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect; and

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

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

- 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.

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

#### **The Insurers (Reorganisation and Winding-Up) Regulations 2004**

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

## **OVERVIEW OF THE FINNISH INSURANCE MARKET**

### **Background**

- 3.15 Finland is the thirteenth largest economy in Europe and the tenth largest European insurance market with 2015 premium income of €24 billion<sup>4</sup> written by domestic companies, of which €4.5 billion is associated with non-life insurance.
- 3.16 Insurance and reinsurance companies in Finland are authorised and regulated by the Financial Supervising Authority (“FIN-FSA” or, in Finnish, “Finanssivalvonta”). The FIN-FSA is the authority that licences undertakings to underwrite insurance business in Finland and which gives consent (if thought appropriate) to portfolio transfers. The FIN-FSA supervises the service providers’ code of conduct and the legality and sound practice of contractual terms in policy wording, marketing and other contacts with customers.
- 3.17 The FIN-FSA was established on 1 January 2009, following a merger of the former Banking Supervision Office and the Insurance Supervisory Authority. As much as 95% of FIN-FSA activities are funded by the supervised entities with the remainder being provided by the Bank of Finland. Administratively, the FIN-FSA is independent of, but operates in connection with, the Bank of Finland. The FIN-FSA has about 200 employees and its main office is located in Helsinki.
- 3.18 The objectives of the FIN-FSA are as follows:
- to enable the balanced operations of credit institutions, insurance and pension companies and other supervised entities in stable financial markets;
  - to protect the rights of the insured and foster public confidence in financial market operations; and
  - to promote compliance with good practice in financial markets.
- 3.19 The main law governing insurance in Finland is the Insurance Contracts Act (543/1994). It has been renewed with the implementation of Solvency II regulations into Finnish legislation (we discuss Solvency II in paragraphs 3.36 onwards). The Finnish Insurance Contracts Act does not apply to reinsurance contracts, and any provisions protecting third parties are not applicable to reinsurers.
- 3.20 The Solvency II directive is embedded in the Finnish Insurance Companies Act (521/2008).
- 3.21 According to the FIN-FSA website, there were 44 locally established insurance companies operating in 2016. The market share of the five largest insurer groups is more than 93%.

<sup>4</sup> <http://www.finanssiala.fi/en/material/FK-julkaisu-Finnish-insurance-in-2015.pdf>

- 3.22 Finland has maintained its local accounting requirement for an equalisation provision, which has been in use since the early 1950s and is applicable and obligatory for all liability classes. The equalisation provision is intended to enhance the solvency of insurance companies and to protect policyholders and claimants. The equalisation provision calculation has been updated for use by insurers in their year-end accounts for 2016 and thereafter. In summary, the target equalisation provision level is intended to be equivalent to the solvency capital components relating to insurance risk and counterparty risk. The annual equalisation provision accrual has been parameterised with the objective of reaching the target equalisation provision level over a number of years<sup>5</sup>. Under Solvency II, Finnish equalisation provisions are generally treated as Tier 1 Own Funds.

### Conduct Principles

- 3.23 Within the FIN-FSA, the Supervision of Markets and Conduct of Business department supervises the codes of conduct of the insurance sector vis à vis customer relations. The objective is to promote the clarity and high quality of customer information.
- 3.24 This FIN-FSA department supervises the business practices of insurance corporations, insurance agents, insurance brokers and payment institutions, as well as the sales and marketing of their products and services, information provision to customers, and adherence to the law as regards contract terms and conditions.

### Consumer Protection

- 3.25 In addition to the insurance specific bodies, Finland operates a more general mechanism to raise complaints through the Consumer Ombudsman or Consumer Disputes Board who are also empowered to pursue insurance related cases on behalf of claimants and policyholders.
- 3.26 Consumer protection is a major focus of the Insurance Contracts Act and a special authority, the Finnish Financial Ombudsman Service ("FINE")<sup>6</sup> has been set up to promote the interests of customers and enhance their trust in financial operations, to improve financial literacy among consumers, and otherwise to develop everyday practices in the financial sector in line with sound development principles. However, as noted above in paragraph 3.19, the Insurance Contracts Act does not apply to reinsurance and, similarly, FINE does not apply to reinsurers or to cedants. Therefore, aside from the day-to-day regulation provided by FIN-FSA, there is no specific consumer protection available in Finland to cedants under reinsurance contracts.

### Intervention and winding-up legislation

- 3.27 Directive 2001/17/EC on the reorganisation and winding-up of insurance undertakings has been implemented into Finnish legislation under Chapter 23 of the Insurance Companies Act. There are separate provisions on reorganisation and bankruptcy. Other providers of insurance or reinsurance-related services are subject to general bankruptcy laws.
- 3.28 If and when an insurance company's working capital becomes inadequate, the board of the insurance company must call a shareholders' meeting to decide on a reorganisation. Executors would then be appointed to run the company and creditors would be notified through public announcements. Under reorganisation, efforts may be made to continue the company's activities. Plans to this effect must be submitted to the FIN-FSA for approval.
- 3.29 Where continuing the company's activities is impossible, there must be a winding-up and the executors must set out an account of how all the debts are to be paid. In the event of the winding-up of an insurance company under the Insurance Companies Act, insurance debts (principally outstanding claim payments) take precedence over other claims on the insurance undertaking with the only possible exceptions being claims by employees arising from employment contracts and employment relationships, claims by public bodies on taxes, claims by social security systems, or claims on assets subject to rights *in rem*. Further, the receivables of private customers have a preference over other receivables. If the executors find that the assets of the company are insufficient to pay the debts, bankruptcy proceedings must be initiated.

<sup>5</sup> Changes in the equalisation provision are based on the difference between ultimate net claims and claims related expenses in a given period. If the difference is positive (negative), then the equalisation provision increases (decreases).

<sup>6</sup> <https://www.fine.fi/en/>

- 3.30 Under Finnish winding-up rules, payments to creditors are prioritised in the order set in the Ranking of Payments Act (1578/1992). However, pursuant to the Insurance Companies Act, insurance claims of direct policyholders are afforded preferential treatment over other creditors.
- 3.31 Generally, the priority ranking of creditors of insurance companies in case of winding-up and liquidation can be presented as follows:
- Administrative expenses incurred after the bankruptcy, including wages (so called mass debts)
  - Direct policyholders' claims and certain secured creditors (such as holders of real estate mortgage, business mortgage or chattel mortgage). Consumers' insurance claims (including housing companies) are given priority to other direct policyholders' claims
  - Other secured creditors
  - Unsecured creditors (including, inter alia, taxes and wage expenses incurred before the bankruptcy): Note that reinsurance claims, such as the Transferring Business, would rank as unsecured debtors unless the reinsurance agreement was secured
  - Claims of low preference (including, inter alia, tax penalties and certain other sanctions imposed by the authorities)
  - Preference shareholders
  - Equity shareholders.
- 3.32 Although the funds of an insurance company might be allocated to different insurance classes, funds devoted to one class can be used to pay the claims of another in the event that there are insufficient allocated funds to pay the claims of a particular class.
- 3.33 When an insurance company is insolvent, any reinsurer with which the insolvent insurer has an existing contract must still comply with its obligations under the reinsurance contract. Finnish law largely operates within the doctrine of privity (by which a contract cannot confer rights or impose obligations arising under it on any person or agent except the parties to it). Therefore, a claimant on the insolvent insurer cannot enforce their claim directly against a reinsurer. In practice, however, the bankruptcy estate of the bankrupt primary insurer can claim the reinsurer's share of the insurance compensation it owes to the claimants to repay the insured.
- 3.34 Other than for specific insurance covers, Finland does not have any form of insurance guarantee scheme that compensates customers in the event of an insolvency (or other defined default) of a financial services firm authorised by the FIN-FSA. Instead, there is an observed practice of requiring distressed companies to merge with stronger entities. The specific insurance covers for which Finland does have some form of insurance guarantee scheme are those that are considered compulsory (motor third party liability, statutory employment accident insurance, statutory employment pension scheme and statutory patient insurance), but these do not form any part of the RFP liabilities and hence are not considered further.

## Taxation

- 3.35 In Finland, corporation tax of 20% is levied on the taxable income of the insurer as determined under Finnish Statutory accounts.

## SOLVENCY CAPITAL FRAMEWORK (SOLVENCY II)

- 3.36 The regulatory solvency reporting requirements for (re)insurers regulated within the EU underwent a major change with effect from 1 January 2016. The new regime, which is commonly referred to as Solvency II, has introduced, consistently across the EU, solvency requirements that reflect the risks that individual (re)insurers actually face. The previous pan-European regime, Solvency I, was based purely on the level of premiums received and claims paid by an insurer, and did not consider the risks faced by the business. Regulators in several countries, including the UK, overlaid a more rigorous regime, resulting in inconsistency between EU member countries. Solvency II has superseded all of these locally imposed solvency regimes.



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- 3.37 Under Solvency II, EU (re)insurers are now required to adhere to a set of risk-based capital requirements, some of the results of which will be shared with the public.
- 3.38 Solvency II is a principles-based regime, based on three so-called pillars:
- Under Pillar I, quantitative requirements define a market consistent framework for valuing the company's assets and liabilities, and determining the Solvency Capital Requirement ("SCR").
  - Under Pillar II, insurers must meet minimum standards for their corporate governance, and also for their risk and capital management. There is a requirement for permanent internal audit and actuarial functions. Insurers must regularly complete an Own Risk and Solvency Assessment ("ORSA").
  - Under Pillar III, there are explicit requirements governing disclosures to supervisors and policyholders.
- 3.39 A key change under Solvency II, compared to Solvency I, is that both the assets and liabilities are valued on a market consistent basis (whereas, under Solvency I, only the assets were assessed at a market value, subject to admissibility rules). Therefore, under Solvency II, the 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 that would have been calculated under the Solvency I regime and under current requirements for IFRS/GAAP.
- 3.40 I set out in Appendix F simplified details for the balance sheet, and the calculation of Technical Provisions (in respect of claims incurred and losses arising from unexpired exposures), for an insurer under Solvency II.
- 3.41 The Technical Provisions required under Solvency II as relating to general insurance business are:
- the premium provision – the expected present value (with no allowance for optimism or prudence) of all future cash-flows (claim payments, expenses and future premiums due) relating to future exposures arising from policies that the insurer is obligated to at the valuation date;
  - the claims provision – the expected present value (with no allowance for optimism or prudence) of all future cash-flows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date; and
  - the risk margin – the risk margin is intended to be the balance that another (re)insurer taking on the liabilities at the valuation date would require over and above the sum of the premium provision and claims provision. Under Solvency II, the risk margin is calculated using a cost-of-capital approach (presently employing a 6% cost of capital parameter as set out in EU regulation<sup>7</sup>).
- 3.42 The Technical Provisions in respect of claims required under Solvency II differ from the GAAP claims reserves as follows:
- The Technical Provisions contain no element of conservatism above a best estimate that may be held in the undiscounted GAAP reserves;
  - The Technical Provisions include an allowance for events not in data ("ENID"), which are events or future developments that might occur but which are not represented in the historical data upon which the actuarial projections are based;
  - The Technical Provisions include a discount to account for the time value of money in the future cashflows; and
  - The Technical Provisions include a risk margin.
- 3.43 The SCR under Solvency II is the amount of capital required to ensure continued solvency over a one-year time frame with a probability of 99.5%. There are two main approaches to calculating the SCR:

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<sup>7</sup> Commission Delegated Regulation (EU) 2015/35 dated 10 October 2014

- Using an internal model approved by the local supervisor: an internal model calculation of the SCR is based upon an assessment of the risks specific to an insurer, and is calibrated so as to correspond to a confidence level of 99.5% over a one-year trading period that net assets remain positive (i.e. the insurer remains solvent); or
- Using the standard formula specified in detail in the Solvency II legislation: the standard formula is designed to be applicable to all insurers and is not therefore tailored to the circumstances of an individual insurer. In summary, the basic SCR consists of 5 risk modules (non-life, life, health, market and counterparty) that are in turn further subdivided into 18 sub-modules (e.g. premium and reserve risk, catastrophe risk and currency risk). The results for each sub-module are aggregated using a correlation matrix to arrive at a capital charge for each of the 5 main modules, which in turn are aggregated using a further correlation matrix to determine the basic SCR. A further module is used to calculate operational risk which is added to the basic SCR to produce the (standard formula) SCR.

3.44 The Minimum Capital Requirement under Solvency II (“MCR”) defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over a one-year time frame (compared to 99.5% for the SCR). The MCR is calculated as a linear function of the Technical Provisions and written premium but must be between 25% and 45% of the firm’s SCR, subject to an absolute floor of €2.5 million (or €3.6m for (re)insurers writing liability, credit or suretyship classes).

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

3.46 Article 30 of the Solvency II Directive states that “*the financial supervision of insurance and reinsurance undertakings, including that of the business they pursue either through branches or under the freedom to provide services, shall be the sole responsibility of the home Member State*”. The financial supervision of the Transferring Business (i.e. the business written by or transferred to QBE and Moorgate) is currently the responsibility of the PRA. If the Scheme is sanctioned then the Finnish regulator (the FIN-FSA) will assume responsibility for the financial regulation of the Transferring Business.

## Brexit

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

3.48 I consider some of the other possible impacts of Brexit as they might affect the Scheme later in this Report, but at this stage I note that, following Brexit, the UK Government might seek to cancel certain pieces of legislation that were enacted in accordance with EU Directives. One such legislative item might be that which implemented Solvency II. A Treasury Select Committee was formed in September 2016 which, according to its Chairman, Rt Hon Andrew Tyrie MP, will “*take a look at the Brexit inheritance on insurance to see what improvements can be made in the interests of the consumer*”. However, I note the following:

- The UK played a prominent role in the development of Solvency II;
- The costs for the insurance industry of implementing Solvency II were considerable and it is likely that the costs of implementing a replacement solvency regime that was materially different from Solvency II would also be very large;

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

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

## COMPARISONS BETWEEN THE UK AND FINLAND

### Capital and Reserve Requirements

3.50 All EU insurers have implemented the solvency regime, known as Solvency II (see paragraph 3.36 above) from 1 January 2016. This has had the effect of putting regulatory capital and reserve requirements in the UK and Finland onto essentially the same basis.

### Security under Winding-Up

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

### Consumer Protection

3.52 In the UK, the FSCS compensates eligible customers of authorised financial firms (including insurers) in the event that the firm has insufficient assets to meet claims, and the FOS provides eligible customers with a free, independent service to help settle disputes with financial firms (including insurers).

3.53 There are no directly equivalent bodies in Finland, although FINE helps customers to settle disputes with financial firms (including insurers). However, the Insurance Contracts Act does not apply to reinsurance contracts and hence cedants under such contracts are not eligible to access FINE for protection or support.

## 4. BACKGROUND REGARDING THE ENTITIES CONCERNED IN THE SCHEME

### THE RFP UNDERWRITING POOL

4.1 RFPUM was registered as a private limited company in England and Wales (registered number 01326793) on 23 August 1977. It provided underwriting management services to RFP for the years 1978 to 1991. The members of the pool varied from year-to-year as did their shares of the business written in each year (which was split between marine and non-marine business). The members were:

- Assurances Generales de France (“AGF”)
- Allstate Reinsurance Company (UK) Limited (“ARCO”)
- Gothaer Versicherungsbank VVaG (“Gothaer”)
- Minster Insurance Company Limited
- The New Zealand Insurance Company (UK) Limited, The New Zealand South British Insurance plc and The New Zealand Reinsurance Company (UK) Limited (collectively, “The New Zealand Companies”)
- Groupe des Assurances Nationales and GAN Incendie Accidents (collectively, “GAN”)
- Württembergische Feuer (“Württ”)
- Pohjola Insurance Company (UK) Limited.

### AGF

4.2 This company was subsequently bought by, and its liabilities subsequently reorganised into, Allianz IARD (“Allianz”). Its liabilities arising from business written by RFP have been 100% reinsured by Bothnia. Allianz has applied to the French Regulator (“ACPR”) to transfer its RFP business to Bothnia (as at the time of drafting this Report that application was under consideration by the ACPR). These liabilities are therefore outside the scope of the Scheme, although, as part of this Report, we have considered the impact on Bothnia should that application be successful.

### ARCO

4.3 Following a take-over, ARCO became part of QBE Insurance Group Limited in 1996 and was renamed QBE Reinsurance (UK) Limited (and is now named QBE Re (Europe) Limited). Its liabilities arising from business written by RFP (including those relating to the New Zealand Companies – see below) were subject to a portfolio transfer to QBE in 2011 and therefore form part of the QBE Transferring Business. I note that ARCO also owned RFPUM.

### Gothaer

4.4 In 1991 Gothaer 100% retroceded its share of the RFP business to the other members of RFP surviving at the date at which Gothaer decided to exit the Pool (in 1987). As such, some of the Gothaer business will be included within the Transferring Business.

### Minster Insurance Company Limited

4.5 This company was subsequently bought by Groupe des Assurances Mutuelles Agricoles (“Groupama”) (and later sold on). Its share of the RFP business was transferred via a portfolio transfer to Hamburger Internationale Rückversicherung AG (“HIR”) which was bought by CHL in 2014. This RFP involvement has been transferred to Bothnia under European transfer rules authorised by the German Regulator, BaFin, on 7 November 2016. These liabilities are outside the scope of the Scheme.

### The New Zealand Companies

- 4.6 These companies have undergone several name changes as well as changes of ownership and are now part of Insurance Australia Group Limited (“IAG”). While the New Zealand Companies were under previous ownership and were part of the group of companies comprising Aviva plc and all of its direct and indirect subsidiaries (“Aviva Group”), their involvement in the RFP business was transferred to Ocean Marine Insurance Company Limited (“Ocean”) through a series of business transfers, which were sanctioned by the Court or by the Court of Session in 2004 and 2011 (by the time of the transfers The New Zealand Insurance Company (UK) Limited had been renamed CGU Bonus Limited). Ocean has since retained this business and its gross liability in respect of the RFP business is not included within the Scheme.
- 4.7 However, in 1988, the New Zealand Companies’ share of the RFP business was retroceded 100% to ARCO. That retrocession agreement remains in force, albeit since transferred under the 2011 portfolio transfer to QBE. The retroceded liabilities of the New Zealand Companies’ share of the RFP business therefore form part of the QBE Transferring Business.

### GAN

- 4.8 GAN was bought by Groupama in 1999 and its share of the RFP business was transferred via a portfolio transfer to HIR. This RFP involvement has been transferred to Bothnia under European transfer rules authorised by BaFin on 7 November 2016. These liabilities are outside the scope of the Scheme.

### Württ

- 4.9 Württembergische Feuer was reorganised into Württembergische Versicherung AG in 1991 and Wüstenrot und Württembergische AG in 1999. Württ’s RFP involvement has been transferred to Bothnia under European transfer rules authorised by BaFin on 14 December 2016. These liabilities lie outside the scope of the Scheme.

### Pohjola Insurance Company (UK) Limited

- 4.10 This company was subsequently renamed Moorgate – see below – and its liabilities arising from business written by RFP forms part of the Moorgate Transferring Business. In 2004 Moorgate 100% retroceded to QBE its liabilities arising from business written by RFP.
- 4.11 In summary, at the time of drafting this Report, the following companies retained a gross liability in respect of the RFP business: Allianz (although an application to transfer its RFP business to Bothnia is on-going), Bothnia, Gothaer, Moorgate, Ocean and QBE, and, of those, the gross RFP liabilities of Gothaer have been wholly retroceded to the other pool members and those of Moorgate and Ocean, including the inwards retrocession from Gothaer, have been wholly retroceded to QBE. The gross RFP liabilities of Allianz and QBE, including the inwards retrocession of other RFP business, have been wholly retroceded to Bothnia.

### Business written

- 4.12 The business written by RFP comprised reinsurance and retrocessional programmes. No direct business was written. RFP covered a wide range of classes of business underwritten on a worldwide basis. Property was the main classification, and there was substantial exposure throughout RFP business to London Market Excess of Loss (“LMX”) business. The Casualty account consisted of a varied book of business, including reinsurance of compulsory third party insurance, such as motor, employers’, public and general third party liability. The Property, Marine and Casualty books of business still contain outstanding claims relating to exposure to the LMX spiral from the late 1980s and residual Asbestos, Pollution and Health Hazard (“APH”) exposure emanating from the years 1978 to 1985 from US writings of LMX and Marine business. UK and worldwide Casualty business also forms a large element of the remaining liabilities.
- 4.13 The business was written in a variety of currencies, including Sterling, US Dollar, Canadian Dollar, (predecessor currencies to the) Euro, Japanese Yen and Swiss Franc.

- 4.14 I have been provided with a geographical breakdown of the laws governing the policies that comprise the Transferring Business. This shows that 71.3% were written under EEA laws (60.2% under UK law), 11.0% were written under US laws and the remaining 17.7% were written under the laws of 84 other non-EEA countries. However, roughly half of the policies have been commuted. Net of the commuted policies, 43.4% of the policies comprising the Transferring Business were written under EEA laws (25.2% under UK law), 21.9% were written under US laws and the remaining 34.7% were written under the laws other non-EEA countries. Other than the US or within the EEA, there is no country for which the proportion of policies subject to its law is 5% or more of the total number of policies within the Transferring Business (either before or after commutation).

### Policy servicing

- 4.15 With effect from 12 February 2016, the administration of the Transferring business, including handling of claims, has been the responsibility of Bothnia, under a run-off management agreement of the same date ("ROMA"). Previously, RFPUM had been responsible for the administration, although it had outsourced this since 2010, initially to Apetrop Limited and then, from June 2012, to Aureus Asset Management Limited<sup>8</sup>. The fees for the outsourcing agreements are paid by the member companies of RFP. The ROMA is not for a fixed term, rather its duration is indefinite.

### Outstanding claims liabilities

- 4.16 As at 31 December 2016 the total gross outstanding liability for all of the RFP business (i.e. including that which is not being transferred as part of the Scheme) was £20.6 million and the expected recoveries against that were £4.8 million, leaving a net outstanding liability of £15.8 million. Of this amount, roughly 57% of the gross outstanding amount is IBNR and 64% of the net outstanding amount is IBNR, the remainder being case estimates.

## QBE

### Background

- 4.17 QBE is an insurance company, registered as a private limited company in England and Wales (registered number 01761561) under the Companies Act 2006. QBE's immediate parent company is QBE Holdings (EO) Limited, which is itself a wholly owned subsidiary of QBE European Operations plc ("QEO"). QEO is registered as a public limited company in England and Wales (registered number 2641728) under the Companies Act 2006. QIGL, which is incorporated in Australia, is the ultimate holding company of QBE.
- 4.18 Prior to 30 September 2005 QBE 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).
- 4.19 QBE is authorised by the PRA to write general insurance and reinsurance business, and regulated by the FCA and the PRA. The active business of QBE (measured by gross written premiums during 2016) is written largely in Europe (circa 77%) but also on a world-wide basis (with business in Asia, the Middle East, Australia, North America, the Caribbean, Central/South America and Africa).

<sup>8</sup> Aureus Asset Management Limited is an entirely separate company to Apetrop Limited and all of the employees of Apetrop Limited who were administering the RFP business became employees of Aureus Asset Management Limited when responsibility for that administration was transferred.

- 4.20 QBE's issued and fully paid share capital as at 31 December 2016 comprised 625,905,272 ordinary shares of £1 each<sup>9</sup>.
- 4.21 The main elements of the business written by QBE are as follows (percentages in brackets are the proportions of total gross premiums written in 2016 which totalled £1,359 million<sup>10</sup>):
- Motor Third Party Liability (21%);
  - Fire and other damage to Property (21%);
  - Third Party (ex-Motor) Liability (38%);
  - Marine, Aviation and Transport (7%);
  - Other direct insurance (3%); and
  - Inwards Treaty Reinsurance (10%).

### Key financial information

- 4.22 As at 31 December 2016, on a UK GAAP basis, the gross outstanding claims reserves<sup>11</sup> within QBE were £3,095 million. In addition, as at 31 December 2016, QBE held a gross provision for unearned premiums<sup>12</sup> of £798 million. The reinsurers' share of claims outstanding and unearned premiums<sup>13</sup> was £1,074 million as at 31 December 2016.
- 4.23 QBE management considers that the UK GAAP booked reserves remain reasonable and within a range of best estimates for QBE.
- 4.24 As at 31 December 2016, QBE booked reserves in respect of the QBE Transferring Business equal to £14.6 million (including £1.5 million in respect of the Moorgate business reinsured into QBE), gross of reinsurance. As this business is in run-off, all of the reserves relate to outstanding claims and there are no premium provisions. The booked reserves in respect of the QBE Transferring Business are the equivalent of 0.38% of the gross technical provisions and 0.48% of gross outstanding claims reserves as at 31 December 2016. This business has been 100% reinsured by Bothnia since 12 February 2016, and therefore its net liability for QBE as at 31 December 2016 is nil.
- 4.25 As at 31 December 2016, on a UK GAAP basis, the total assets<sup>14</sup> of QBE amounted to £5,905 million, and the total liabilities<sup>15</sup> amounted to £4,513 million respectively, giving net assets of £1,392 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).
- 4.26 QBE's financial strength is rated as follows:
- A+ (positive outlook) by Standard & Poor's (last updated 11 May 2016)
  - A (stable outlook) by A M Best (last updated 10 March 2016)
  - A+ (stable outlook) by Fitch (last updated 5 August 2016).

<sup>9</sup> Based on QIEL's Annual Report as at 31 December 2016, Note 25

<sup>10</sup> Based on QIEL's Annual Report as at 31 December 2016, Note 4

<sup>11</sup> Based on QIEL's Annual Report as at 31 December 2016, Note 14

<sup>12</sup> Based on QIEL's Annual Report as at 31 December 2016, Note 14

<sup>13</sup> Based on QIEL's Annual Report as at 31 December 2016, Note 14

<sup>14</sup> Based on QIEL's Annual Report as at 31 December 2016

<sup>15</sup> Based on QIEL's Annual Report as at 31 December 2016



## Reinsurance

4.27 QBE operates a number of reinsurance programmes, including quota share, facultative and treaty reinsurance and participates in QBE Group's global reinsurance programme. As at 31 December 2016, 42% of the ceded claims provisions was in respect of covers provided by other members of the QBE Group. 93% of the remaining ceded claims provisions was provided by non-QBE Group reinsurers with an S&P credit rating of 'A-' or better. Only 4% of the total ceded claims provisions was attributable to reinsurers with an S&P credit rating lower than 'A-'.

## Assets

4.28 As at 31 December 2016, on a UK GAAP basis, QBE held investment assets<sup>16</sup> valued at approximately £3.51 billion. Just over £3.1 billion was held in bonds, £0.2 billion in collective investments and the remainder a mixture of equities, deposits and derivatives. Of the £3.1 billion of bonds, £2.1 billion was in respect of corporate bonds, £0.7 billion government bonds and £0.3 billion collateralised securities<sup>17</sup>.

## Risks

4.29 QBE'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 QBE being comfortable that the QEO's approach meets the risk management needs of QBE).

4.30 For the purposes of managing its risk, QEO 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;
- Group risk; and
- Strategic risk.

### *Insurance risk*

4.31 QBE manages its insurance risk through

- 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.

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<sup>16</sup> Based on QBE Insurance (Europe) Limited's Annual Report as at 31 December 2016

<sup>17</sup> Based on QBE Insurance (Europe) Limited's solo Solvency II economic balance sheet as at 31 December 2016 (S.02.01.02). While the valuation basis for bonds in the QRT and the UK GAAP accounts are not identical, the breakdown in the QRT of the bonds held as at 31 December 2016 into broad categories is expected to be a reasonable proxy for the breakdown of bonds held as at 31 December 2016 in the UK GAAP accounts.

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

#### *Credit risk*

- 4.33 The primary sources of credit risk within QBE are in respect of investment and treasury activities and 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, QBE maximises the amount of reinsurance it can place with highly rated and regarded counterparties, while limiting concentrating exposures.

#### *Market risk*

- 4.34 Market risks arise from QBE's investment portfolios. 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 QBE. To mitigate this risk, QBE actively manages investment assets, maintains a diversified portfolio and hedges residual net asset exposures. To the extent that any mismatch remains, this will be captured in the SCR.
- 4.35 Pension risk (including longevity risk), to which QBE is exposed in relation to its final salary pension scheme, is considered as part of market risk. Apart from longevity risk, the principle components of QBE pension risk are changes in bond yields in equity markets, leading to a materially different valuation of the pension fund assets, only partially matched by changes in the present value of the future liabilities.
- 4.36 QBE is also conscious of the market risks arising from Brexit.
- 4.37 Liquidity risk is the risk of a company being unable to meet its cash outflows without recourse to planned contingent funding. QBE manages its liquidity such that it maintains minimum levels of liquid, short-term marketable securities. QBE stress tests its liquidity relative to major catastrophe events, and matches assets and liabilities by major currency positions.

#### *Operational risk*

- 4.38 Operational risks are the risks to which QBE is exposed during its day-to-day operations, mainly arising from possible failures of control and from external events. Such risks include the ability of existing finance systems and resources to cope with increasing pressure, information security concerns and staff engagement. QBE manages operational risk by actively monitoring key processes, by conducting scenario reviews to identify and quantify potential exposures for mitigation, and by segregating duties, access controls, authorisation and reconciliation procedures.

#### *Group risk*

- 4.39 QBE is exposed to group risk, i.e. the current or prospective risk to earnings and capital arising from adverse perception of the image of QBE (and/or to other members of the QBE Group) on the part of customers, shareholders, investors or regulators. 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 QBE Group divisions and companies.

#### *Strategic risk*

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

### **Capital Policy and Risk Appetite**

- 4.41 The risk appetite of an organisation is the level of risk that the board and management of the organisation are willing to accept to achieve the organisation's strategic objectives. For QEO and QBE it is managed:
- through board-approved risk appetite statements and risk tolerances;

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

4.42 QEO and QBE received approval from the PRA in December 2015 to use the internal (economic capital) model developed for assessing regulatory capital requirements for QEO and its subsidiaries under Solvency II (“the QEO Internal Model”).

### Investment Policy

4.43 QBE’s investments (along with those of the other QEO companies) are managed by QBE Group Services Pty Limited which is a direct subsidiary of QBE Insurance Group Limited.

### Conduct Risk – TCF

4.44 Conduct risk for QBE is overseen at the level of QEO.

4.45 I have been told that QEO 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, to ensure that conduct risk is mitigated and a strong conduct risk culture is embedded throughout the firm. This appetite is cascaded down to all areas of the business, with a detailed conduct risk appetite articulated in the relevant policies and guidance.

4.46 The Boards and senior management of each company below QEO are committed to ensuring that the core values of the QBE Group are embedded throughout the business, and that the appropriate level of training on conduct matters is given to all staff. All QEO employees 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.

4.47 The Boards have overall responsibility for ensuring that QEO’s conduct objectives are met, and a governance structure has been implemented to ensure that those objectives are fully embedded within the organisation. A formal Conduct Risk Group meets quarterly to exercise oversight of conduct matters, and supports the Boards and Board committees with the identification, assessment, and mitigation of conduct risk. Where operational risks are identified which may result in conduct risks for customers, QEO is 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.

4.48 Customer-facing business areas are responsible for determining the appropriate level of qualitative and quantitative Management Information, according to the nature and conduct risk profile of their business. This information is reported to the both the Conduct Risk Group and to the Boards where requested, and used to demonstrate the appropriate identification and effective mitigation of QEO’s conduct risk, in line with the established risk appetite.

### RFP

4.49 As noted above, QBE is exposed to RFP business through:

- the 100% retrocession to QBE of Moorgate’s RFP business, including that RFP business underwritten by Gothaer and retroceded to Moorgate in 1991, net of the outwards reinsurance programme put in place by RFPUM, the agreement being effective from 29 December 2004 (the agreement was originally with ARCO and therefore was included within the liabilities transferred to QBE in 2011); and
- its acceptance of a transfer of business from ARCO in 2011. The business transferred comprised that RFP business underwritten by ARCO, that RFP business underwritten by Gothaer and retroceded to ARCO in 1991, and that 100% retrocession to ARCO of the RFP business of the New Zealand Companies.

4.50 On 12 February 2016, QBE entered into a Loss Portfolio Transfer arrangement with Bothnia (“LPT2016”) whereby Bothnia has 100% reinsured QBE’s RFP liabilities with effect from that date.

## Brexit

- 4.51 QEO has told me that it intends to form a new (re)insurance entity which will be authorised in Belgium and which will establish a network of EU branches replicating those currently writing business for QBE. It then intends to transfer QBE's current EU branch business to the new entity by an insurance business transfer scheme as defined in Section 105 of FSMA. I have been further told that QEO has shared this plan with the PRA and FCA and is regularly updating the PRA and FCA on progress made.

## MOORGATE

### Background

- 4.52 Moorgate is an insurance company, registered as a private limited company in England and Wales (registered number 147862) under the Companies Act 2006. Moorgate's immediate parent company is Finnex Holdings Limited, which is itself a wholly owned subsidiary of CHL. CHL is registered as a private limited company in England and Wales (registered number 02579785) under the Companies Act 2006. Cambridge TopCo Limited, a private company incorporated in Malta, is the ultimate holding company of Moorgate.
- 4.53 Prior to 7 September 1995 Moorgate was known as
- Moorgate Insurance Company Limited (The) (from the date of its incorporation, 12 July 1917, until 31 December 1978)
  - Pohjola Insurance Company (U.K.) Limited (from 31 December 1978 until 7 September 1995).
- 4.54 The Moorgate Transferring Business represents the last piece of business written by Moorgate in its lifetime, with all other business either resolved via solvent Schemes of Arrangement or transferred to third parties under various legal transfer processes.
- 4.55 The Scheme, if approved, will allow CHL to de-register the company and liquidate its remaining assets for distribution to the shareholders. It will also meet the Business Plan strategy shared with the regulators in the UK for which Moorgate was given exemption from compliance with Solvency II reporting requirements.

### Reinsurance

- 4.56 Moorgate has an interest in respect of the Moorgate Transferring Business in the reinsurance programme purchased by RFPUM on behalf of the RFP members. The gross technical provisions in Moorgate as at 31 December 2016 (all relating to the Moorgate Transferring Business) totalled £1.9 million; offsetting this was £0.4 million in respect of the reinsurance programme purchased by RFPUM. In addition, as explained above in paragraph 4.11, as at 31 December 2016 Moorgate has 100% reinsured its net RFP liabilities (the booked provisions for which totalled £1.5 million as at 31 December 2016) with QBE.

### Key financial information

- 4.57 The Moorgate Transferring Business represents Moorgate's last exposure and, net of the outwards reinsurance programme put in place by RFPUM, it is currently fully reinsured by QBE. Consequently, the net insurance liabilities within Moorgate's accounts are nil. This has been the position for many years.

### Capital Policy and Risk Appetite

- 4.58 As at 31 December 2016, Moorgate's held capital is £3.1 million against solvency capital requirements of £2.0 million. Moorgate is considered by the PRA to be a non-directive firm due to undertaking the transitional measure of terminating its activity before 1 January 2019. It meets the criteria of having ceased to conduct new insurance business and it does not have a Part 4A permission to effect contracts of insurance. As a non-directive firm, Moorgate is outside the scope of Solvency II. Its solvency capital requirements are therefore equal to the base capital resources requirement.
- 4.59 The PRA has received, and is monitoring Moorgate's progress to meet, its submitted business plan to deregister following the approval of Scheme.

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## Conduct Risk

- 4.60 The Compre Group (including Moorgate) is fully committed to TCF insofar as it is relevant to the business that it conducts. As an insurance and reinsurance legacy specialist, it is highly unlikely that the Compre Group will engage with retail customers or be involved in marketing to consumers. However, it may reinsure or transfer into its own business portfolios of policies where claims are being or could be made by policyholders who are regarded by the FCA as consumers. Therefore CHL has a TCF Policy which sets out the principles to which CHL and its subsidiaries adhere when dealing with such consumers as well as its commercial policyholders and claimants.
- 4.61 CHL's TCF mission statement is that the Compre Group will act with integrity and professionalism in everything that it does and work to create a respectful and respected relationship with its policyholders.
- 4.62 Its TCF principles are that:
- Policyholders will be provided with clear information requests and kept appropriately informed through regular dialogue at each stage of their claim.
  - The Compre Group's level of service and responsiveness will meet the expectations of its policyholders as far as reasonably possible.
  - It will ensure that there is no barrier for policyholders to express their requests, concerns or complaints, and will always be responsive to them.
- 4.63 CHL has set up policies and procedures throughout the Compre Group that are relevant to the fair treatment of claimants and also achieve adherence to FCA requirements, including the following:
- Claims Handling Procedures
  - Conflicts of Interest Policy
  - Data Protection Policy
  - Compliance Manual.
- 4.64 CHL ensures that all claims handlers and staff are familiar with the fundamental principles of TCF. In addition, where applicable, claims staff are trained in order to suitably advise on and efficiently explain their responses to claims. All members of staff must achieve the qualifications and training deemed necessary for them to carry out their job functions with the required level of competence. CHL undertakes regular monitoring and assessment of the Compre Group staff so that it can be certain of their competence.
- 4.65 CHL has an independent internal auditor function that regularly monitors all key areas of regulatory compliance throughout the Compre Group, including adherence to the TCF policy.
- 4.66 The Compre Group aims to deal with policyholders' complaints fairly and objectively. Any and all complaints are to be recorded and reported to the Board. Due to the nature of the business that it assumes, it has to date never received a complaint regarding its claims handling. However, should such a complaint be received, the standards require it to be responded to within one week and, depending on the nature of the complaint, to be dealt with within a month.
- 4.67 In the commercial and reinsurance arena the Compre Group seeks to resolve disputes fairly and amicably but occasionally there is a need to pursue or defend more formal dispute resolution processes. These shall always be pursued as a last resort or will be defended rigorously where it believes that claims are not validly payable according to a policy's terms and conditions.

## Brexit

- 4.68 Assuming that the Scheme takes place as planned, all insurance liabilities will be transferred from Moorgate and it is intended by CHL that, subject to regulatory permission, Moorgate will have been wound up (see paragraph 5.13 below) by the time that Brexit is enacted. Therefore, it is expected that Moorgate will be unaffected by Brexit and it has made no specific Brexit-related plans. We discuss in Section 9 what would happen were the Scheme not to take place.

## BOTHNIA

### Background

- 4.69 Vakuutusosakeyhtiö Bothnia International, or Bothnia International Insurance Company Limited, is an insurance company registered in Finland (Business ID: 0947118-3). It is authorised and regulated by the FIN-FSA to carry out contracts of non-life insurance except for:
- classes 1 and 10 in accordance with the Finnish Motor Liability Insurance Act (275/59);
  - class 13 in accordance with the Finnish Patient Injuries Act (585/86) and the Finnish Nuclear Liability Act (484/72); and
  - insurance in accordance with Finnish Workers' Compensation Insurance Act (608/48).
- 4.70 Bothnia has also been conducting insurance business in the UK on a cross-border basis from its head office in Finland since 2015.
- 4.71 Bothnia is a wholly owned subsidiary of CHL. CHL actively seeks to acquire run-off portfolios of insurance and reinsurance business. It has used Bothnia as a vehicle to accept run-off portfolios of reinsurance business and may use it in the future to accept further such portfolios. The main portfolios (aside from those related to the RFP business) added since Bothnia's acquisition by CHL's acquisition vehicle Finnex Holdings Limited in 2006 are shown in Table 4.1 below.

**Table 4.1**  
**Summary of Portfolios Assumed by Bothnia**

Year of Transaction	Summary of Portfolios Assumed
2009	The international energy insurance portfolio from TRYGVESTA Forsikring A/S (also known as Tryg Forsikring A/S and/or Baltica Forsikring A/S), covering underwriting years 1985 up to 1990, was transferred into Bothnia on 13 November 2009.
2013	The direct energy and inwards reinsurance portfolios from SPAREBANK 1 Skadeforsikring AS (also known as Samvirke Forsikring), covering underwriting years 1960-1990, were transferred into Bothnia via a demerger-merger process on 30 September 2013.
2013	The direct marine and energy insurance business from UNISON Forsikring AS (also known as Bluewater Insurance AS and/or Zurich Protector), covering underwriting years 1992-2008, was transferred into Bothnia via a demerger-merger process on 30 September 2013.
2014	Insurance business from Atlantic Mutual International Limited ("AMIL"), covering underwriting years 2002-2003, and the UK Branch of Atlantic Mutual Insurance Company ("AMIC UK Branch"), covering underwriting years 1968-2001, was assumed by Bothnia via a quota share reinsurance agreement.
2015	Insurance business from LVM Landwirtschaftlicher Versicherungsverein Münster A.G., covering underwriting years 1996-1999, was assumed by Bothnia via a quota share reinsurance agreement.
2016	Gibbon Underwriting Pool business from A G Belge d'Assurances, covering underwriting years 1950-1972, was assumed by Bothnia via a quota share reinsurance agreement.
2016	Gibbon Underwriting Pool business from Swiss Re International SE, covering underwriting years 1950-1972, was assumed by Bothnia via a quota share reinsurance agreement.
2016	All insurance and reinsurance business from Stockholm Re was assumed by Bothnia via merger on 31 December 2016.
2016	The involvement of GAN in RFP, that share having been transferred via a portfolio transfer to HIR, was assumed by Bothnia pursuant to a European directive insurance business transfer approved by BaFin on 7 November 2016.
2016	The involvement of Württ in RFP was assumed by Bothnia pursuant to a European directive insurance business transfer approved by BaFin on 14 December 2016.
2017	The involvement of AGF in RFP, that business having been reorganised into Allianz, was assumed by Bothnia via a quota share reinsurance agreement in advance of a European directive insurance business transfer, approval of which by the ACPR remains pending.

- 4.72 I note that there is an ongoing project to transfer the insurance business from AMIL and AMIC UK Branch to Bothnia, the economic value of the business having already been transferred to Bothnia via 100% quota share reinsurance, as indicated in Table 4.1 above. Should the transfer of the AMIL and AMIC UK Branch business be approved there will be no impact on the balance sheet of Bothnia or on its risk profile. I have therefore paid this proposed transfer no further attention. However, I have met with the independent expert who has been appointed in respect of that transfer and we have discussed, in broad terms, our respective findings. Nothing emerged from those discussions that has caused me concern or has prompted me to revise my findings or conclusions as set out in the Report. Whether or not the proposed transfer of the AMIL and AMIC UK Branch business were to go ahead does not affect my conclusions as set out in sections 6 - 10 below.
- 4.73 The operations of Bothnia are administered by the run-off management service companies, which are subsidiaries of CHL. Compre Services ("CS") companies exist in the UK, Finland, Sweden, Switzerland, and Germany.



- 4.74 The servicing of the run-off business of Bothnia is undertaken by CS under a Services Agreement between Bothnia and CHL, which operates according to service standards and claims handling procedures as set-out in the aforesaid agreement.
- 4.75 As at 31 December 2016, the authorised share capital of Bothnia comprised 2,250,004 ordinary shares with a value of €3,825,007. The shares had a par value per share of €1.70, but this nominal value was removed by resolution in 2015. Total capital as at 31 December 2016 is €24,495,347, the difference being run-off profits of €11,865,017 brought forward as at 31 December 2016 plus an Unrestricted Equity Reserve Account totalling €8,805,322.
- 4.76 As mentioned in paragraph 4.49 above, on 12 February 2016 Bothnia agreed to reinsure, under LPT2016, QBE's outstanding liabilities relating to RFP (i.e. the QBE Transferring Business), with effect from that date. Bothnia received a premium of £14.4 million which comprised a float account in the amount of \$0.6 million, designated accounts in the amounts of CAD2.8 million, €1.3 million, £2.4 million, and US\$11.1 million, letters of credit ("LOCs") in the amount of \$0.3 million<sup>18</sup>; and a risk premium of £1.2 million as consideration for the assumption of the net loss reserves.

### Key financial information

- 4.77 As at 31 December 2016, Bothnia held total provisions, gross of reinsurance, in respect of outstanding claims and unallocated loss adjustment expenses ("ULAE") totalling €73.6 million, with reinsurers' share of these reserves booked at €16.0 million. Therefore, Bothnia held net claims reserves as at 31 December 2016 of €57.6 million<sup>19</sup> in addition to an equalisation provision of €4.8 million. As at 31 December 2016, its business wholly comprising (re)insurance portfolios in run-off, Bothnia did not hold any reserve for unearned premiums.
- 4.78 The main components of Bothnia's claim portfolio are listed below together with their respective contributions to Bothnia's gross claims reserves as at 31 December 2016:
- Asbestos (35%)
  - Pollution (2%)
  - Other Health Hazards (3%)
  - Non-APH (16%)
  - Miscellaneous, including some new acquisitions (44%)
- 4.79 As at 31 December 2016 (Bothnia's total own funds available to meet its regulatory capital requirements under Solvency II amounted to €34.0 million, compared with a SCR of €22.5 million and a MCR of €6.2 million, i.e. the assets in excess of regulatory requirements as at 31 December 2016 were €11.5 million<sup>20</sup>.

### Reinsurance

- 4.80 Bothnia's business wholly comprises acquired (re)insurance portfolios that are in run-off, and its reinsurance programme comprises those outwards reinsurances that were acquired by or transferred to Bothnia at the same time as Bothnia acquired the gross liabilities.
- 4.81 In May 2017 Bothnia entered into a whole account reinsurance contract. This adverse development cover (the "Bothnia ADC") is intended to protect Bothnia against adverse reserve development and to optimise its regulatory capital requirement.
- 4.82 Bothnia considers the detailed terms of the Bothnia ADC to be commercially sensitive and therefore I am unable to describe fully the reinsurance structure in this Report. However, I can provide the following outline of the Bothnia ADC:

<sup>18</sup> The LOCs have yet to be transferred to Bothnia and are still held at Citibank in RFPUM's name. Bothnia is holding these balances as a debtor.

<sup>19</sup> Figures taken from Bothnia's Financial Statements for the year ended 31 December 2016

<sup>20</sup> All figures in this paragraph taken from Bothnia's QRT S.23.01.01 as at 31 December 2016

- The cover has been provided by a reinsurer regulated within the EU and with financial strength and counterparty credit ratings of AA from Standard & Poor's.
- The contract applied retrospectively with effect from 1 January 2017.
- It operates at a whole account level responding to claims in aggregate.
- In outline, the Bothnia ADC comprises two sections of cover, which are referred to as in-the-money ("ITM") and out-of-the-money ("OTM") sections.
  - Under the ITM section, Bothnia can recover from the reinsurer the cost of claims paid in excess of the attachment point up to the level of the undiscounted best estimate claims reserve. Thus the claims liabilities, net of reinsurance, are reduced which results in a reduction in Bothnia's SCR.
  - The OTM section provides additional cover which, together with the newly calculated SCR, provides equivalent cover to the SCR that would have applied immediately prior to the application of the Bothnia ADC. There is a loss corridor between the best estimate claims reserve and the attachment point of the OTM section.
- The Bothnia ADC includes a Cancel and Rewrite clause by which, should further deals be done by Bothnia, the limits and retention can be increased.

4.83 Bothnia has no other outwards reinsurance.

## Risks

4.84 Bothnia has established a risk management framework which focuses on the main risks to which it is exposed. Risk management is integrated into the culture of Bothnia and is led by the Board. All areas of the business are required to keep the Board informed of relevant risks and changes in profile on a regular basis.

4.85 A risk register is maintained which is updated on an annual basis and encompasses current and emerging risks. All risks on the register are reviewed with key management personnel and the Board reviews the key risks on a quarterly basis. The severity and likelihood of each risk is assessed, taking into account the risk management controls. Key risk indicators are identified to ensure that events are identified before a risk materialises.

4.86 Bothnia has identified the following six key risks and its approach to managing these risks in its ORSA dated 28 December 2016:

- **Acquisition risk:** the risk associated with the purchase of businesses which result in undesirable accumulation or concentration of certain risks or types of business, where Bothnia (and the Compre Group) does not have experience. The risk is managed by Bothnia (and the Compre Group) in the recruitment of experienced consultants in markets for which Bothnia (and the Compre Group) seeks to do deals, leveraging an extensive network of contacts in the European markets as well as internal research and market intelligence. Further, the risk appetite and tolerance levels in relation to acquisitions are set by the Board, with all acquisitions being conditional on the Board's approval.
- **Group risk:** the risk that the outsourcing arrangement does not meet the needs of the Compre Group. The risk is managed by service level agreements ("SLAs"), which are reviewed annually and approved by the Board.
- **Insurance risk:** this is the risk associated with making invalid claim payments or making inappropriate assessments of the technical provisions (case reserves and IBNR). The risk is managed through the claims management process, quarterly actuarial reserve reviews, operational interaction, and data quality reviews. Further, the payment of large claims requires prior approval by the Board. The Bothnia ADC provides further insurance risk mitigation.

- **Investment risk:** the risk associated with the financial loss due to investment management and strategy failure or due to investment underperformance. There are several risk mitigation actions, including: co-ordinated communication between parties before a transaction is actioned; appointment of experienced contact persons with the investment manager; the establishment and governance of an investment policy; annual review of the investment management agreement; and delivery of investment performance metrics in the management accounts which enable review of performance.
- **Operational risk:** the risk associated with processes, people, systems, and external factors. There are several risk mitigation actions, including: the adherence to the business plan, which is produced by the Board, broken down by weekly-monitored key performance indicators for each department, and which ultimately defines the objectives for each employee (which is part of the appraisal process); regular organisational meetings; adherence to the document retention policy; the outsourcing of tasks to experts (e.g. human resources, legal services, etc.); and adherence to the annually-tested disaster recovery plan.
- **Regulatory risk:** the risk that Bothnia fails to comply with regulatory and legal requirements, including related to the Compre Group (e.g. capital management policy). The risk is managed through internal and external audit, the compliance function, monitoring publications with respect to regulatory updates, and regular reports to the Board on regulatory and compliant issues.

4.87 Bothnia is also exposed to the risk of a fall in the market value of its assets, which could adversely affect its financial position to the extent that a fall in asset values was not matched by a corresponding movement in liability values. As at 31 December 2016 Bothnia held €56.1 million of financial investments. Most of this amount was held in debt securities, including government bonds, corporate bonds, and structured notes, with the remaining held in loans and mortgages. I note that, to the extent that there is any mismatch of assets and liabilities, the SCR will generate a capital requirement.

### Capital Policy and Risk Appetite

4.88 The Compre Group Capital Management Policy applies to all of its subsidiaries including Bothnia. The objectives in managing its capital are:

- To document how members of the Compre Group are capitalised to meet both their and the regulator’s requirements in terms of capital;
- To describe the process of monitoring and review of capital levels; and
- To describe the framework for preventing and/or rectifying appropriately any capital shortfall in an orderly way.

4.89 Bothnia manages its regulatory capital by reference to the risk-based capital determined under Solvency II. Specifically, Bothnia ensures that 50% (or more) of its SCR is covered by Tier 1 capital and no more than 15% is covered by Tier 3 capital. Further, at least 80% of its MCR is covered by Tier 1 capital with the remainder being Tier 2 capital.

4.90 As part of the ORSA process, CHL assesses compliance of the Compre Group members with the capital management policy on a continuous basis. They have defined thresholds and specific actions upon the breach of a threshold, as follows:

Threshold	Action
Capital > 110% of SCR	Monitor capital levels quarterly
100% of SCR < Capital < 110% of SCR	Detailed analysis of all possible actions to ensure capital coverage exceeds 110% of SCR
Capital < 100% of SCR	Emergency Board meeting to be convened to approve immediate action to be taken to restore threshold to above 110%

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

4.92 In order to ensure the risk appetite remains aligned with Bothnia strategy, risk appetite and risk tolerances are reviewed annually and updated as part of the ORSA process. Bothnia’s risk appetite aligns with the key risks as follows:

- **Acquisition risk:** Bothnia has a high risk appetite supporting its strategy to grow the economic value of its business. Bothnia has defined risk tolerance in terms of the resulting solvency ratio (based on Solvency II required capital).
- **Group risk:** Bothnia has a low appetite for group risk, defined as problems which hinder providing services or funding to entities within the group. Bothnia has defined risk tolerance in terms of existence and ability to resolve any breach in a service level agreement.
- **Insurance risk:** Bothnia has a low appetite for insurance risk supporting its strategy to target well reserved books and to pay valid claims in full. Bothnia has defined risk tolerance in terms of the risk deterioration quarter on quarter.
- **Investment risk:** Bothnia has a low appetite for investment risk supporting its preference for shorter duration high quality assets with low levels of counterparty exposure, and for consistent returns over volatile returns. Bothnia has defined risk tolerance in terms of bond sector defaults and level of asset matching by currency.
- **Operational risk:** Bothnia has a low appetite for operational risks. Bothnia has defined risk tolerance in terms of the number of open issues within the financial control environment, the level of staff turnover, and the performance of IT systems.
- **Regulatory risk:** Bothnia has a low appetite for regulatory risk supporting its strategy to maintain a relationship with the regulators and to avoid material breaches of laws and regulations. Bothnia has defined risk tolerance in terms of the number of compliance issues identified.
- **Reputational risk:** Bothnia has a low appetite for reputational risk and considers damaging incidents that will lead to a loss in confidence in management unacceptable. Bothnia has defined risk tolerance in terms of the number of complaints, level of negative feedback or adverse press.

#### Other intra-group relationships

- 4.93 I have been informed by CHL that, under a loss portfolio agreement by which Bothnia 100% reinsured the Gibbon Underwriting Pool (“Gibbon”) business written or accepted by AG Belge d’Assurances, it irrevocably guarantees the performance of all obligations and liabilities of Bothnia. I have been told that Bothnia benefits from no other guarantees.
- 4.94 As noted above, Bothnia now owns or 100% reinsures all of the outstanding RFP business, net of the outwards reinsurance programme put in place by RFPUM.

#### Conduct Risk – TCF

- 4.95 Bothnia is committed to the fair treatment of customers, and to ensure that fair outcomes are delivered to customers. This is primarily achieved through its CSUK’s complaints handling procedures. These are applied in accordance with UK regulatory guidelines, but are applied across all policyholders, not just individuals and small businesses. The Bothnia board receives quarterly reports of all customer complaints. Otherwise, the comments set out in paragraphs 4.60-4.66 above apply equally to Bothnia.

#### Brexit

- 4.96 As noted above in paragraph 4.69, Bothnia is a Finnish company, authorised and regulated by FIN-FSA. Its existing licence would not be impacted by Brexit.
- 4.97 As noted above in paragraph 1.14, Bothnia has subcontracted the administration of the Transferring Business, as well as all other business that Bothnia is running-off, to Compre Services. All of the member companies of Compre Services are currently based in EU-member countries, and post-Brexit, all but CSUK will remain so. Although Compre Services considers and adjusts claims on behalf of Bothnia, its role is advisory. Bothnia management ultimately decides whether liability should be accepted, claims should be settled and the level of appropriate reserves to maintain. The authority to conclude commutations rests wholly with Bothnia. Therefore, CSUK provides no services that are subject to regulation. This will remain so post-Brexit.

- 4.98 There are currently data protection rules that preclude certain types of data, including personal details, being transferred from inside to outside the EU. Post-Brexit, Bothnia would have to ensure that no such data was transferred from within the EU to CSUK, to another UK entity or to (or even via) a server based outside the EU. CHL is working with its outsourced IT service providers to ensure that its IT practices, processes and procedures are wholly EU-compliant throughout the Compre Group. This has little relevance to the Transferring Business, the data for which, it being wholly reinsurance and retrocessional business, contains no personal details.
- 4.99 Although the terms of Brexit are currently far from being settled, there is a strong possibility that UK (re)insurers will lose passported rights to undertake business within the EU and that EU (re)insurers, including Bothnia, will similarly lose their passported rights to undertake business within the UK.

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## 5. THE PROPOSED SCHEME

### SUMMARY OF THE SCHEME

- 5.1 The following is intended to summarise the terms of the Scheme, as set out in the Transfer Document. For the avoidance of doubt, the terms of the Scheme as set out in the Transfer Document are definitive.
- 5.2 Assuming that the Court approves the Scheme as proposed, the Transferring Business and the Transferring Assets will be transferred to Bothnia (the Transferee) from QBE and Moorgate (the Transferors) on or with effect from the Effective Date (31 October 2017). Specifically, by order of the Court, the following shall be transferred to and vested in Bothnia on or with effect from the Effective Date:
- 5.2.1 the rights, benefits and powers of the Transferors in relation to the Transferring Business or arising as a result of either of the Transferors having carried on the Transferring Business;
  - 5.2.2 all assets relating directly to the Transferring Business and all the interest and title of the Transferors in them; and
  - 5.2.3 all liabilities of the Transferors under or in respect of the Transferring Policies or attributable to the Transferring Business (which will then cease to be liabilities of the Transferors).
- 5.3 For the avoidance of doubt, I wish to make it clear that no policies of QBE other than those within the QBE Transferring Business will be transferred under the Scheme. Similarly, no assets or liabilities of QBE other than those directly relating to the QBE Transferring Business (including those outwards reinsurance and retrocession agreements in respect of the QBE Transferring Business) will be transferred under the Scheme. However, it is intended that all of Moorgate's reinsurance business, supporting assets (including those outwards reinsurance and retrocession agreements in respect of that business) and liabilities will be transferred under the Scheme.
- 5.4 As the Transferring Business is currently 100% retroceded, the Transferring Assets essentially comprise outwards reinsurance or retrocession contracts. On or with effect from the Effective Date, all rights, benefits and powers conferred or vested in, and all liabilities imposed on, the Transferors in respect of the Transferring Business in respect of these outwards reinsurance or retrocession contracts will be transferred to Bothnia. The Part VII Transfer provides that the reinsurers and retrocessionaires in respect of the Transferring Business will have no greater or lesser liability to Bothnia under any reinsurance or retrocession contracts relating to the Transferring Business than they would have had to the Transferors (under the same reinsurance or retrocession contracts) in the absence of the Scheme.
- 5.5 There will be no changes to the terms and conditions of any policy included within the Transferring Business as a result of the Scheme. QBE's and Moorgate's respective rights and obligations under the policies that comprise the Transferring Business will be transferred, without alteration, to Bothnia. Similarly 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 Transferring Business will be entitled to the same rights against Bothnia as were available to them against the relevant Transferor under such policies and will be accountable to Bothnia for any further or additional premiums or other amounts attributable or referable thereto as and when the same become due and payable.
- 5.6 Any pending or current proceedings or complaints issued or served before the Effective Date by or against either Transferor in connection with the Transferring Business shall be continued by or against Bothnia in place of the relevant Transferor, and the Transferors shall cease to have any liability under those proceedings following the Effective Date. Any proceedings or complaints issued or served on or after the Effective Date that would hitherto have been by or against either Transferor will instead be by or against Bothnia. Bothnia shall be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to the Transferors in respect of the Transferring Business.
- 5.7 Any judgment, order or award in respect of the Transferring Business which is not fully satisfied before the Effective Date will become enforceable by or against Bothnia in the place of the relevant Transferor.
- 5.8 Bothnia shall indemnify each Transferor against any loss or expense incurred by that Transferor, whether before or after the Effective Date, that is attributable to the Transferring Business.

- 5.9 All costs and expenses incurred in connection with the preparation and carrying into effect of the Scheme, whether before or after the Effective Date, shall be paid by the Transferors and the Transferee (and not by the policyholders of the Transferring Business).
- 5.10 The terms of the Scheme are governed by English law.

## MOTIVATION FOR THE SCHEME

- 5.11 As explained in Section 4 above, QBE and Moorgate are both current members of RFP and, until February 2016, QBE also undertook the management of the pool on behalf of all members. As well as being a member of RFP, QBE also 100% reinsures the participations of some of the other members of RFP (including Moorgate).
- 5.12 In February 2016 QBE entered into a loss portfolio transfer agreement (LPT2016) under which Bothnia 100% assumed QBE's involvement in RFP, both the RFP business transferred to QBE and the RFP business retroceded to QBE. Bothnia assumed the administration of RFP in its entirety, which it then subcontracted to Compre Services. As the Transferring Business has been 100% retroceded into Bothnia, QBE's net liability in respect of the Transferring Business is nil; Bothnia ultimately carries the economic liability for the business.
- 5.13 The purpose of the proposed Scheme is to align the legal liability for the Transferring Business with the economic liability for the Transferring Business. This will also provide finality to both QBE (regarding the RFP business only) and Moorgate. I understand that it is intended that the Scheme will result in no policy liabilities remaining within Moorgate and that CHL intends that, post the Effective Date and subject to regulatory permissions, Moorgate will be wound up.
- 5.14 Although outside the scope of the Scheme, I note that the involvement in RFP of other insurers (HIR and Württ) have recently been transferred to Bothnia and that, at the time of drafting this Report, the process to obtain regulatory approval for the transfer of Allianz's involvement in RFP to Bothnia was ongoing.

## EFFECT OF THE SCHEME ON THE BALANCE SHEETS OF QBE, MOORGATE AND BOTHNIA

- 5.15 Table 5.1 below shows simplified balance sheets for QBE as at 31 December 2016<sup>21</sup> in two situations:
- 5.15.1 The "Actual" column shows the actual balance sheet as at 31 December 2016.
- 5.15.2 The "Post-Scheme" column shows what the balance sheet would have looked like as at 31 December 2016 had the Scheme been approved and become effective as at 31 December 2016. This would have reduced both the gross technical provisions and reinsurers' share of technical provisions by £14.6 million, the gross value of QBE's RFP-related liabilities as at 31 December 2016. This amount represents roughly 0.4% of the gross technical provisions and 1.4% of reinsurers' share of technical provisions. I have assumed that no further margins would be transferred as part of the Scheme. I have further assumed that the LOCs (\$0.343 million or £0.278 million), which formed part of the consideration for LPT2016 but which have yet to be transferred to Bothnia and therefore appear as a creditor within QBE's balance sheet as at 31 December 2016, would be transferred to Bothnia. Should the LOCs not be transferred to Bothnia then some other assets of an equivalent amount would need to be transferred to Bothnia instead. This would not result in a material difference to the Post-Scheme balance sheet shown in Table 5.1.

<sup>21</sup> Based on QIEL's Annual Report as at 31 December 2016 for the year ended 31 December 2016



**Table 5.1**  
**Simplified Balance Sheets for QBE as at 31 December 2016 (in £'000)**

	Actual	Impact of Scheme	Post-Scheme
<b>Assets</b>			
Investments	3,507,134		3,507,134
Reinsurers' share of technical provisions	1,074,368	-14,646	1,059,722
Debtors	933,657		933,657
Other assets	196,193	-278	195,915
Prepayments and Accrued Income	193,693		193,693
<b>Total Assets</b>	<b>5,905,045</b>	<b>-14,924</b>	<b>5,890,121</b>
<b>Liabilities</b>			
Capital and reserves	1,392,283		1,392,283
Gross technical provisions	3,893,060	-14,646	3,878,414
Other provisions	1,945		1,945
Creditors	607,617	-278	607,339
Accruals and deferred income	10,140		10,140
<b>Total Liabilities</b>	<b>5,905,045</b>	<b>-14,924</b>	<b>5,890,121</b>

5.16 Table 5.2 below shows simplified balance sheets for Moorgate pre and post Scheme (based on its statutory accounts as at 31 December 2016<sup>22</sup>).

**Table 5.2**  
**Simplified Balance Sheets for Moorgate as at 31 December 2016 (in £'000)**

	Actual	Impact of Scheme	Post-Scheme
<b>Assets</b>			
Investments	1,034		1,034
Reinsurers' share of technical provisions	1,449	-1,449	0
Debtors and salvage	0		0
Other Assets	2,202		2,202
Inadmissible Assets	0		0
<b>Total Assets</b>	<b>4,685</b>	<b>-1,449</b>	<b>3,236</b>
<b>Capital and Liabilities</b>			
Capital and reserves	3,118	21	3,139
Gross technical provisions	1,470	-1,470	0
Equalisation provision	0		0
Other provisions	12		12
Creditors	73		73
Accruals and deferred income	13		13
<b>Total Capital and Liabilities</b>	<b>4,685</b>	<b>-1,449</b>	<b>3,236</b>

5.17 Table 5.3 below shows simplified balance sheets for Bothnia (based on its statutory accounts as at 31 December 2016<sup>23</sup>) in four situations (note that the values are shown in Euros rather than Sterling):

5.17.1 The "Actual" column shows the actual balance sheet as at 31 December 2016.

<sup>22</sup> Based on Moorgate's Annual Report and Financial Statements for the year ended 31 December 2016.

<sup>23</sup> Based on Bothnia's Financial Statements 2016.

- 5.17.2 The “Post-ADC, Pre-Scheme, Pre-Allianz approval” column shows what the balance sheet would have looked like as at 31 December 2016 had the Bothnia ADC been in place as at 31 December 2016. The ITM section of the Bothnia ADC would have increased the reinsurers’ share of technical provisions by €16.8 million (the equivalent of £14.4 million). There would have been an equivalent charge to creditors, the premium being charged on a funds withheld basis. Bothnia would have paid a premium in respect of the OTM section, which would have resulted in a reduction of €0.4 million in both the Investments and the Capital & Reserves.
- 5.17.3 The “Post-ADC, Post-Scheme, Pre-Allianz approval” column shows what the balance sheet would have looked like as at 31 December 2016 had the Scheme been approved and become effective as at 31 December 2016 (with the Bothnia ADC already in place). This would have increased both the gross technical provisions and reinsurers’ share of technical provisions by €3.4 million (the equivalent of £2.9 million), which is the value of reinsurance recoveries related to QBE’s and Moorgate’s share of the 100% gross pool liability. This amount represents roughly 4.6% of gross technical provisions and 10.3% of reinsurers’ share of technical provisions. I have assumed that no further margins would be transferred as part of the Scheme. I have further assumed that the LOCs mentioned in paragraph 5.15.2 in respect of LPT2016 would be transferred to Bothnia, thus making equal and opposite changes to investment assets and debtors. Should the LOCs not be transferred to Bothnia then some other assets of an equivalent amount would need to be transferred from QBE to Bothnia instead. This would not result in a material difference to the “Post ADC, Post-Scheme, Pre-Allianz approval” balance sheet shown in Table 5.3.
- 5.17.4 The “Post-ADC, Post-Scheme, Post-Allianz approval” column shows what the balance sheet would have looked like as at 31 December 2016 had both the Scheme and the transfer to Bothnia of Allianz’s involvement in RFP been approved and become effective as at 31 December 2016 (with the Bothnia ADC already in place). This would have increased both the gross technical provisions and reinsurers’ share of technical provisions in the “Post ADC, Post-Scheme, Pre-Allianz approval” balance sheet by €0.7 million (the equivalent of £0.6 million), which is the value of reinsurance recoveries related to Allianz’s share of the 100% gross pool liability. This amount represents roughly 0.9% of gross technical provisions and 2.0% of reinsurers’ share of technical provisions, both “Post ADC, Post-Scheme, Pre-Allianz approval”. I have assumed that no further margins would be included as part of the Allianz transfer.

**Table 5.3**  
**Simplified Balance Sheets for Bothnia as at 31 December 2016 (in €’000)**

	Actual	Impact of Bothnia ADC	Post-ADC, Pre-Scheme, Pre-Allianz approval	Impact of Scheme	Post-ADC, Post-Scheme, Pre-Allianz approval	Impact of Allianz approval	Post-ADC, Post-Scheme, Post-Allianz approval
<b>Assets</b>							
Investments	56,149	-408	55,741		55,741		55,741
Reinsurers’ share of technical provisions	16,041	16,800	32,841	3,377	36,217	719	36,936
Debtors and salvage	19,795		19,795		19,795		19,795
Other Assets	29,143		29,143	278	29,421		29,421
Inadmissible Assets	0		0		0		0
<b>Total Assets</b>	<b>121,127</b>	<b>16,392</b>	<b>137,519</b>	<b>3,655</b>	<b>141,174</b>	<b>719</b>	<b>141,893</b>
<b>Capital and Liabilities</b>							
Capital and reserves	24,495	-408	24,087		24,087		24,087
Gross technical provisions	73,594		73,594	3,377	76,971	719	77,690
Equalisation provision	4,834		4,834		4,834		4,834
Other provisions	0		-0		-0		-0
Creditors	15,848	16,800	32,648	278	32,926		32,926
Accruals and deferred income	2,356		2,356		2,356		2,356
<b>Total Capital and Liabilities</b>	<b>121,127</b>	<b>16,392</b>	<b>137,519</b>	<b>3,655</b>	<b>141,174</b>	<b>719</b>	<b>141,893</b>

- 5.18 The reserving strength of QBE, Moorgate and Bothnia are discussed in more detail in Section 6 below. The figures shown in Table 5.3 above are on the basis that Bothnia maintains its current reserving strength in respect of the Transferring Business post Scheme.

## POLICYHOLDERS AFFECTED

- 5.19 I have considered the effects of the Scheme on the following groups of policyholders:
- Group A those holders of policies issued by RFP and covered in part by QBE – responsibility for those parts of their liabilities will be transferred by the Scheme from QBE to Bothnia;
  - Group B those members of RFP that have ceded their liabilities to QBE – those reinsurance contracts will be transferred by the Scheme from QBE to Bothnia;
  - Group C those holders of policies issued by RFP and covered in part by Moorgate – responsibility for those parts of their liabilities will be transferred by the Scheme from Moorgate to Bothnia;
  - Group D those members of RFP that have ceded their liabilities to Moorgate – those reinsurance contracts will be transferred by the Scheme from Moorgate to Bothnia;
  - Group E the current policyholders of QBE who have policies that are not being transferred; and
  - Group F the current policyholders of Bothnia.
- 5.20 I understand that it is intended that all of the outstanding (re)insurance liabilities of Moorgate will be transferred as part of the Scheme and that therefore there will be no policyholders of Moorgate whose policies are not within the Moorgate Transferring Business.
- 5.21 I do not consider that the policyholders of any other insurance companies are affected by the Scheme.
- 5.22 Group A comprises insurance entities who have ceded their RFP-related liabilities to QBE under reinsurance or retrocessional policies; Group B comprises insurance entities who have ceded their RFP-related liabilities to QBE under retrocessional policies. I do not believe that the Scheme will impact Group A any differently from how it will impact Group B so henceforth in this Report I have considered them together as the QBE Transferring Policyholders.
- 5.23 Similarly, Group C comprises insurance entities who have ceded their RFP-related liabilities to Moorgate under reinsurance or retrocessional policies; Group D comprises insurance entities who have ceded their RFP-related liabilities to Moorgate under retrocessional policies. I do not believe that the Scheme will impact Group C any differently from how it will impact Group D so henceforth in this Report I have considered them together as the Moorgate Transferring Policyholders.
- 5.24 It should be noted that there is not complete mutual exclusivity between Groups A-D and F. For example, the retroceded liabilities of Gothaer were shared between the other members of RFP and therefore Gothaer is a policyholder of Groups B, D and F. I do not believe that this lack of complete mutual exclusivity should cause me to adjust my approach when considering the effects of the Scheme on the various parties.

## COMPENSATION AND COMPLAINTS

- 5.25 The Transferring Business comprises solely reinsurance and retrocessional contracts. As such, the Transferring Policyholders are not private policyholders and would only be eligible for protection under the FSCS or able to lodge complaints with the FOS were they “small businesses” or “micro enterprises”, as described in paragraphs 3.9-3.10 above. While it is unlikely that any of the Transferring Policyholders would have been eligible to the services of either the FSCS or the FOS at the time that they became policyholders of RFP (had these services then been in place), it is possible that, due to changes in circumstances in the intervening years, some Transferring Policyholders might now be deemed “small businesses” or “micro enterprises” and therefore could avail themselves of these services.
- 5.26 As the Transferring Business will be transferred from a UK-regulated entity to a Finnish-regulated entity, post the Effective Date no Transferring Policyholder will be eligible for compensation under the FSCS, regardless of whether or not they were eligible pre-Scheme. Because Bothnia has subjected itself to the jurisdiction of the FOS (as explained in paragraph 3.11 above), Transferring Policyholders who were able to access the FOS pre-Scheme would remain able to access it post the Effective Date, for so long as Bothnia continues its voluntary submission to the FOS.

## ADMINISTRATION

5.27 As explained in paragraph 4.15 above, Bothnia assumed responsibility for the administration of all of the RFP business with effect from 12 February 2016 on an indefinite basis. This arrangement will be unaffected by the implementation of the Scheme and so, post the Effective Date, the Transferring Business will continue to be administered by Bothnia. There will also be no change to the administration of either the non-transferring business of QBE or the existing business of Bothnia.

## EXCLUDED POLICIES

5.28 Any policy which is not capable of being transferred for legal reasons will be treated as an “Excluded Policy” and will remain fully reinsured by Bothnia. It is not expected that there will be any Excluded Policies.

## APPROACH TO COMMUNICATION WITH POLICYHOLDERS

5.29 QBE and CHL have set out the approach that they intend to take in communicating information about the proposed Scheme to the affected policyholders and other parties.

5.30 The main objectives of the communications are to:

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

5.31 CHL believes that the RFP database maintained by Bothnia includes details of all RFP policyholders and reinsurers of the RFP business, as well as relevant brokers. From this it has compiled an address list, using as additional information sources underwriting and claim files, brokers, third party service providers, the internet, reinsurance market bodies and databases, National Insurance Institutes of various countries and states, market contacts and contacts at ongoing active cedants and reinsurers.

5.32 CHL will be writing to all RFP policyholders (not just to the QBE Transferring Policyholders and the Moorgate Transferring Policyholders), and to the reinsurers of the RFP Pool business (or, where CHL does not have contact details for the reinsurer, to the broker authorised to act on behalf of that reinsurer). As such it will be writing to all Moorgate policyholders. It will seek alternate contact details for those to whom letters have been sent but then returned. CHL 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 CHL’s response.

5.33 QBE does not intend to notify directly any of its policyholders that are not transferring under the Scheme for the following reasons:

- gross of reinsurance, the liability to be transferred by the Scheme is not material in the context of the overall reserves of QBE;
- the gross liability is 100% reinsured and so, net of reinsurance, no liability will be transferred by the Scheme; and
- the cost of mailing all current QBE policyholders (roughly 905,000), as well as the QBE Transferring Policyholders, would be very high, for no obvious benefit.

- 5.34 CHL also proposes that no individual policyholder notifications are issued in respect of existing policyholders of Bothnia on the basis that the relevant liabilities are already with Bothnia through its reinsurance arrangement with QBE, that the Scheme will not cause any changes to the terms and conditions of the policies held by the existing Bothnia policyholders, and that the costs of publicity would be disproportionate to the likely benefits to the affected parties.
- 5.35 CHL and QBE will be applying to the Court for waivers in accordance with paragraphs 5.33 and 5.34.
- 5.36 All remaining Moorgate policies are part of the Moorgate Transferring Business and so all policyholders of Moorgate will be contacted within the mailing process.
- 5.37 In addition to direct, written correspondence, indirect notification is also planned via advertisements in appropriate periodicals, as well as *The Times*, *The Financial Times* and *Insurance Day*.
- 5.38 The letters, notices and advertisements will refer all queries to a postal address or a telephone number or a website address, all of which will be dedicated to responding promptly to any such queries. It is intended that both this Report and the Supplementary Report will be published on the QBE and Compre 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 (or as soon thereafter that the dedicated pages on the QBE and Compre websites have been set up) and the Supplementary Report will likewise be made available at least one week before the date of the Court hearing.
- 5.39 I comment on this proposed approach to communications with policyholders in Section 9.

## COSTS

- 5.40 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 the Transferors and the Transferee in accordance with the terms previously agreed between them.

## 6. THE IMPACT OF THE SCHEME ON THE TRANSFERRING POLICYHOLDERS

### INTRODUCTION

- 6.1 Under the Scheme, the QBE Transferring Business and the Moorgate Transferring Business will be transferred to Bothnia.
- 6.2 The main issues affecting the transferring policyholders of QBE and Moorgate as a result of the Scheme are likely to arise from relative differences in:
- The financial strength of Bothnia post-Scheme compared with that of QBE and of Moorgate. 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 Bothnia compared with those in QBE and Moorgate
  - The policy servicing levels provided by Bothnia post-Scheme compared with those currently enjoyed by the QBE Transferring Policyholders and the Moorgate Transferring Policyholders.
- 6.3 In this Section I deal with each of these in turn.
- 6.4 I note that the reserves held on a GAAP basis differ from the Technical Provisions that help determine the own funds available to meet the solvency capital requirements under Solvency II. However, the best estimate of the liabilities under GAAP is usually used as the base for the best estimate of the liabilities under Solvency II, which then forms a key part of the Solvency II Technical Provisions.
- 6.5 While key metrics under Solvency II, such as the SCR, MCR and Eligible Own Funds, are intended to be made public as part of each insurer's annual Solvency Financial Condition Report ("SFCR"), there are other relevant metrics (for example, projected values of own funds and of solvency capital requirements as set out in insurers' ORSAs) that are private matters between the entities and the relevant regulators. Therefore, I am not at liberty to disclose in the Report the actual values of those metrics, or figures by which those values could be calculated. In the Report I have considered the extent to which QBE, Moorgate and Bothnia each hold capital in excess of various solvency capital measures. I refer to the ratio of the actual capital that the entity under consideration holds to the regulatory solvency capital requirement as the "Capital Cover Ratio". Each entity will have different Capital Cover Ratios for different solvency measures. Where permitted I have expressed Capital Cover Ratios in numeric terms. In other instances, for comparative purposes in the Report, I have defined the following terms:
- "sufficiently capitalised" refers to a Capital Cover Ratio between 100% and 119%;
  - "more than sufficiently capitalised" refers to a Capital Cover Ratio between 120% and 149%;
  - "well-capitalised" refers to a Capital Cover Ratio between 150% and 199%, and
  - "very well-capitalised" refers to a Capital Cover Ratio in excess of 200%.

### RESERVE STRENGTH OF QBE (PRE AND POST SCHEME)

- 6.6 I have been provided with the following full reserving reports for QBE:
- "Actuarial Analysis of Provisions for Underwriting Years from 1964 to 2014 as at 31 October 2014", dated 1 March 2015;
  - "Actuarial Analysis of Provisions for Underwriting Years from 1964 to 2015 as at 30 September 2015", dated 19 February 2016; and

- “Actuarial Analysis of Provisions for Underwriting Years from 1964 to 2016 as at 30 September 2016”, dated 21 March 2017.
- 6.7 These reports detail the methodology, assumptions and IBNR selections, as well as claims and business developments since the previous year’s full review for each of the lines of business written by each of QBE’s business divisions.
- 6.8 I have also been provided with the following update reserving reports for QBE:
- “Actuarial Summary on QBE European Operations’ Reserves at 31 December 2014”, dated 19 March 2015; and
  - “Actuarial Summary on QBE European Operations’ Reserves at 31 December 2015”, dated 15 March 2016; and
  - (A redacted version of) “Actuarial Summary of QBE European Operations’ Reserves as at 31 December 2016”, dated 17 March 2017.
- 6.9 These update reports outline the additional work done to update the 31 October/30 September actuarial reserve estimates to the end of the year, and which form the basis of the reserves booked by QBE as at the respective year-ends. As such they take account of payments made, foreign exchange movements and actual versus expected claims movements (split between catastrophe, large and attritional claim movements) between the date of the full reviews and the end of December. They also present reserve estimates on an earned basis, suitable for inclusion in QBE’s accounts, whereas the actuarial estimates presented in the full reserving analysis reports are on an ultimate, underwriting year basis only.
- 6.10 The QBE actuaries have estimated ultimate claims amounts on a best estimate basis, i.e. with no deliberate bias upwards or downwards, and not including any margins. Their actuarial best estimates of outstanding claims net of reinsurance as at 31 December 2016 was £1,970 million. Subsequently, on 27 February 2017, the Lord Chancellor announced a change in the discount rate to be applied on settlement to certain lump sum bodily injury claims. QBE quantified the pre-tax impact of this post balance sheet event as £60.5 million, which implicitly increases the actuarial best estimate of outstanding claims net of reinsurance as at 31 December 2016 to £2,030 million. In booking reserves for outstanding claims liabilities in its accounts as at 31 December 2016, QBE continues to have a margin over and above the best estimate, as the booked reserve for outstanding claims net of reinsurance is £2,080 million.
- 6.11 I have reviewed the work carried out by those responsible for estimating reserves for QBE, as set out in the aforementioned reports, in order to satisfy myself that it is reasonable for me to rely on their work.
- 6.11.1 I have noted that those responsible for the reserve estimates were suitably qualified actuaries within QBE, and I have also noted that their results and conclusions have been reviewed and agreed by more senior actuaries within the QBE Group. As a result I have not attempted to review in detail the calculations performed by the QBE actuaries.
- 6.11.2 The reports have been in sufficient detail for me to understand the process by which reserves were set, the approach followed by QBE’s actuaries, the key areas of reserve uncertainty and the apparent strength of the reserves based on these reviews. This has enabled me to consider the appropriateness of the methodologies and major assumptions used. I have concluded that the methodologies, major assumptions and results as at 30 September 2016, and updated to 31 December 2016, appear reasonable.
- 6.11.3 As a result I have concluded that it is reasonable for me to rely on the reserving work of the QBE actuaries.



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- 6.12 As noted in paragraph 6.10 above, the reserves established by QBE as at 31 December 2016 include a margin over and above the actuarial best estimate (even allowing for the additional cost of the post balance sheet change announcement by the Lord Chancellor). I therefore consider QBE's booked reserves to be on a basis higher than a 50% confidence level (as the claim distribution is expected to be positively skewed<sup>24</sup>). I note that, as QBE does not generally discount its reserves, this gives rise to an off balance sheet asset (or margin) equivalent to the time value of money inherent in the undiscounted part of the reserves. Such a margin increases the security of the policyholders.
- 6.13 The QBE actuaries have analysed the business by 20 subdivisions across 5 major divisions which represent high level groupings of product types. As at 30 September 2016 the most significant subdivisions by estimated net reserves were Liability (31%), Property (11%), Financial and Specialty Markets (17%), and Motor (19%).
- 6.14 As at 30 September 2016, QBE's actuarial reserving report identifies the main sources of reserve uncertainty to be:
- uncertainties relating to long term disease claims, in particular those relating to noise induced hearing loss ("NIHL") and mesothelioma exposures;
  - exposure of the unearned business to future catastrophe events and large losses;
  - its exposure to a growing number of claims settling as Periodic Payment Orders ("PPOs") (these are structured settlements that can be awarded by UK courts in respect of injury claims); and
  - the external environment, including regulatory changes.
- 6.15 More generally, QBE has identified the following main areas of uncertainty inherent within its projections:
- the appropriateness of loss development tail factors;
  - the sensitivity of *a priori* selections of loss ratios and average claim amounts to rate change and claims inflation assumptions;
  - general levels of new claims notifications; and
  - new future, and as yet unknown and unquantifiable, large market loss events that could impact the business.
- 6.16 I would typically expect to see the above uncertainties in claims reserving for business of this nature.
- 6.17 The margins within QBE's booked reserves, both explicit and implicit (in particular the general non-allowance for the time value of money in the reserves), gives me some assurance that the total reserves held provide a reasonable allowance given the uncertainty around the final cost of these liabilities, the main sources of which I have noted above. I have derived further assurance from the results of the 30 September 2016 actuarial review showing that, overall, experience was favourable compared with the previous review as at 30 September 2015 (although the run-off was not positive in all sub-divisions). There was similarly favourable experience overall, relative to expectations, in the preceding 12 months and again two years earlier. Over the four years covered by the reserving reports listed in paragraph 6.6 the only period of unfavourable experience was that covered by the review as at 31 October 2014.

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<sup>24</sup> A claims distribution of potential losses is said to be positively skewed as the loss cannot be less than zero, but can be many times larger than the mean loss (alternatively, this may be viewed as a distribution of potential losses having a higher frequency of lower value losses, and a lower frequency of higher value losses, e.g. observed losses of: 1, 2, 3, 4, 100).

- 6.18 I note that this unfavourable experience was principally attributable to two causes: UK storm losses that impacted the unearned element of the 2013 underwriting year; and reserve strengthening related to the legacy business, in particular relating to NIHL and other long term disease claims. Both of these are already identified sources of uncertainty, and occurrences such as the UK storms losses can be expected from time to time. The uncertainty regarding long term disease claims relates to the changing legal and claims environment, as well as the long latency period prior to these claims being reported, in particular for mesothelioma claims for which latency periods of 40 years are common. There had been a spike in mesothelioma claims, a trend QBE projected to continue. A spike in NIHL claims has also been seen across the industry in recent years. These events led to the aforementioned reserve strengthening by QBE as at 31 October 2014.
- 6.19 The generally favourable reserve run-off experience and the general stability over time in the reserving approach and key assumptions gives me added comfort regarding the strength of QBE's reserves.
- 6.20 I note that, in June 2016, QBE entered into a retrospective quota share reinsurance agreement relating to its Employers' Liability and Public Liability exposures for underwriting years 2007 and prior. This provides ground-up cover up to 155% of reserves with a further layer (with a different reinsurer) providing unlimited cover above that. Through this deal, QBE has effectively mitigated the reserve risk relating to these liabilities, including its exposure to industrial disease claims for those underwriting years, although it retains some risk in the form of counterparty risk relating to its reinsurers under the reinsurance.
- 6.21 As noted in paragraph 4.24 above, the QBE Transferring Business represented less than 0.5% of the technical provisions of QBE, gross or net of reinsurance, as at 31 December 2016. With effect from 12 February 2016 this business has been 100% reinsured by Bothnia and so the net reserves for the Transferring Business are nil.
- 6.22 Estimated ultimate amounts for the RFP business are calculated by the run-off manager of RFP, which has been Bothnia with effect from 12 February 2016 and was previously QBE. The run-off manager provides the paid-to-date, incurred and estimated ultimate amounts to all members of RFP, both the total amounts and the individual amounts for each member.

#### **Conclusion**

- 6.23 ***Based on my review as described above, I have concluded that the methodologies and major assumptions underlying the reserve analyses as performed by the QBE actuaries as at 31 December 2016 are reasonable, that their best estimate of unpaid claim amounts also appear reasonable and that the reserves booked by QBE as at 31 December 2016 include some margins, both implicit and explicit, over those best estimates. Moreover, the reserving methodology has been largely stable over the last three years and emerging results have not indicated either material under-reserving or excessive over-reserving.***
- 6.24 ***Therefore I conclude that QBE's reserves appear reasonable at present. Furthermore, I have no reason to think that the reserve strength of QBE will be impacted by the Scheme.***

#### **RESERVE STRENGTH OF MOORGATE (PRE AND POST SCHEME)**

- 6.25 As Moorgate has 100% ceded its RFP liabilities to QBE and as these liabilities comprise its only remaining insurance liabilities, its claims reserves, net of reinsurance are effectively nil (it holds a small provision against reinsurer default). The gross reserves are based on the calculations provided by the run-off manager of RFP.

#### **RESERVE STRENGTH OF BOTHNIA (PRE AND POST SCHEME)**

- 6.26 Each quarter, Bothnia's claims reserves have been based on the results of an internal actuarial review prepared by the Group Actuarial Director of the Compre Group. I have been provided with the following reports for Bothnia which cover these internal actuarial reviews:
- Actuarial valuation of undiscounted gross and net reserves as at Q4 15, undated;
  - Actuarial valuation of undiscounted gross and net reserves as at Q2 16, dated 22 August 2016;
  - Actuarial valuation of undiscounted gross and net reserves as at Q3 16, dated 2 November 2016; and
  - Actuarial valuation of undiscounted gross and net reserves as at Q4 16, dated 16 February 2017.

- 6.27 These reports detail the methodologies used, the assumptions adopted and the selected IBNR estimates, as well as claims and business developments since the previous quarter's review, for each of the reserving segments reviewed by Bothnia. For the 30 September 2016 valuation, I have also been provided with the underlying analysis files prepared by the Compre Group actuaries setting out the results of their review.
- 6.28 Bothnia's business and hence its reserves have changed significantly over the course of 2016.
- 6.28.1 The Transferring Business has been 100% reinsured by Bothnia via LPT2016 since 12 February 2016. By assuming this loss portfolio transfer, Bothnia increased its net claims reserve (and therefore its reserve risk) from its value as at 31 December 2015 by roughly 85%.
- 6.28.2 In November 2016, Bothnia assumed shares of the Gibbon Underwriting Pool via quota share reinsurance agreement from A G Belge d'Assurances and Swiss Re International SE for underwriting years 1950 up to 1972. In December 2016, all assets and liabilities relating to the insurance and reinsurance business of Stockholm Re were transferred into Bothnia via legal merger. Through these deals, Bothnia effectively increased its net reserves (and therefore its reserve risk) compared to the position as at 31 December 2015 by a further 100%.
- 6.29 I have noted that Group Actuarial Director of the Compre Group is a suitably qualified actuary, and I have also noted that the outstanding claims liabilities have been independently assessed and compared with the Bothnia booked reserves by external actuaries. This gives me confidence regarding the reliability of the calculations made by the Compre Group actuaries and, therefore, I have not attempted to re-perform those calculations. Instead I have reviewed the approach followed by the Compre Group actuaries, the process by which reserves are set, the methodologies implemented for each reserving segment, the key areas of reserve uncertainty and the apparent strength of the reserves based on this review.
- 6.30 The Compre Group actuaries have estimated reserves for Bothnia on a best estimate basis, i.e. not deliberately biased upwards or downwards, and not including any margins. The best estimates have been produced both gross of reinsurance and net of reinsurance, with the latter also including a bad debt provision.
- 6.31 The best estimate of outstanding claim amounts as at 31 December 2016, excluding a provision for ULAE, was €57.4 million gross of reinsurance and €41.9 million net of reinsurance. In booking reserves for outstanding claims liabilities in its accounts as at 31 December 2016, Bothnia included a margin over and above the best estimate, taking its claims reserves excluding a provision for ULAE to €69.5 million gross of reinsurance and €53.5 million net of reinsurance.
- 6.32 The Compre Group actuaries group claims data by the loss type, contract type and underwriting year period to produce a set of broadly homogenous cohorts on which to perform analysis. They exclude material individual losses from those cohorts and analyse them separately where their development profile is not typical of the rest of the cohort.
- 6.33 For each reserving cohort the Compre Group actuaries derive reserve estimates mainly using the following methods:
- Survival ratio analysis – application of an internal view regarding the number of future years over which recent levels of annual claims payments will continue.
  - Benchmark IBNR:OS – application of benchmark ratios of IBNR to case reserves, based on Bothnia's experience and broader market experience including, when relevant, findings of the Institute and Faculty of Actuaries' working party on UK Asbestos.
  - Redundancy analysis – for cohorts where no, or an immaterial level, of new claims are being reported, the average degree to which case reserves have tended to be overstated or understated is analysed by examining the ratio between the reduction in total outstanding amounts to the increase in paid amounts. The analysis of this ratio and its development over time helps form a view on the potential level of redundancy in the current outstanding reserves.

- 6.34 The proportions of outwards reinsurance recoveries to gross outstanding claims has been very small in the three reserve reviews noted above, and were estimated by applying a reinsurance to gross ratio based on the recoverability of the outstanding claims reserves. Where material individual losses have significant reinsurance protections, specific reinsurance recoveries have been modelled. Further, each of the significant reinsurance counterparties has been considered and a loss given default percentage based on the relevant credit rating and term of reinsurance recoveries is applied to the reinsurance reserves. The loss given default percentages were based on the 2015 Global Corporate Default study carried out by Standard & Poor's, adjusted to reflect a 40% recovery in insolvency situations.
- 6.35 Claims handling expenses, or ULAE, are estimated based on the levels incurred over the last few years with respect to those expenses that would be applicable if an entity was to minimise operations to the point where it were just running off its current liabilities and not, for example, also incurring costs in respect of acquiring new portfolios. Future annual costs are then projected in proportion to the projected run-off of claims reserves.
- 6.36 This approach and these methodologies and key assumptions are consistent with typical market practice for reserving for business of this type. Therefore I have concluded that they are reasonable and have further concluded that it is reasonable for me to rely on the results of the reserving work of the Compré Group actuaries.
- 6.37 As noted in paragraph 6.29 above, external actuaries have reviewed Bothnia's booked reserves, gross and net of reinsurance as at 31 December 2016. They grouped the data into similar reserving cohorts, appear to have used, independently, similar methods to those used by the Compré Group actuaries, and concluded that Bothnia's booked reserves were reasonable on both a gross and net of reinsurance basis.
- 6.38 As noted in paragraph 6.30 above, the reserves established by Bothnia as at 31 December 2016 include a margin over and above the actuarial best estimate. I therefore consider Bothnia's booked reserves to be on a basis higher than a 50% confidence level (as the claim distribution is expected to be positively skewed). I note that Bothnia does not generally discount its reserves and that this gives rise to an off balance sheet asset (or margin) equivalent to the time value of money inherent in the undiscounted part of the reserves. Such a margin increases the security of the policyholders.
- 6.39 Bothnia's reserve reports identify the main sources of reserve uncertainty to be:
- Longer tailed claims in general: such liabilities can produce claims deterioration many years after policy underwriting periods, in particular liability type exposures;
  - Asbestos claims specifically: uncertainty surrounding these claims is driven by uncertain future costs including the future legal environment and any limitations of the available data;
  - Australian motor claims: there is potential for claims to develop significantly due to deteriorating circumstances of underlying claimants leading to increased care requirements;
  - Future insureds: there is the potential for future new insureds to develop and significantly impact the portfolios;
  - Miscellaneous loss type reserves: the reserves in this cohort are subject to greater uncertainty given the largely unknown nature of the underlying loss types; and
  - The external environment, including regulatory changes.
- 6.40 I would typically expect to see the above uncertainties in claims reserving for business of this nature.
- 6.41 The margins within Bothnia's booked reserves, both explicit and implicit (in particular the general non-allowance for the time value of money in the reserves), gives me some assurance that the total reserves held provide a reasonable allowance given the uncertainty around the final cost of these liabilities, the main sources of which I have noted above. I have derived further assurance from the consecutive results observed as at 31 December 2015, 30 June 2016, 30 September 2016, and 31 December 2016, where, after adjusting for currency exchange rates and excluding new business written (i.e. portfolios assumed), the overall experience has been favourable compared with expectations. I have derived further assurance from the conclusions of the external actuarial review.

- 6.42 I have been provided with an internal Compre Group paper discussing the reserves of the RFP business as at 31 December 2014 including implicitly the Transferring Business. This paper was prepared by the Compre Group due diligence team prior to LPT2016. It set out the Compre Group's own evaluations of the likely outstanding claims amounts, gross of reinsurance, and compared those with the equivalent values produced by QBE (as the then run-off managers), an independent review carried out by third party actuaries, previous estimates made by the Compre Group, and the results of an internal review by the Value Creation Team ("VCT") within CHL. The VCT assessment included the classification of major losses into loss types such that indications could be produced based on benchmarks and methodologies used for the broader portfolio. Having considered this paper I conclude that there is a wide range of reasonable values for the best estimate of outstanding RFP claims, and there is likely to remain volatility from year-to-year in the values even so far into the run-off. I also conclude that the values estimated by QBE as at 31 December 2014 were within that reasonable range of such values. I have no reason to suspect that the relative strength of QBE's assessment of RFP's outstanding claims altered between year-ends 2014 and 2015, or that the strength of the assessment of RFP's outstanding claims as at 31 December 2016 is materially different.
- 6.43 As the Transferring Business on a net basis is already reinsured by Bothnia and the associated outwards reinsurance is small, its reserves will not materially change as a result of the Scheme, and therefore I have no reason to believe that the Scheme will have any effect on the reserve strength of Bothnia.

#### **Conclusion**

- 6.44 ***Based on my review as described above, I have concluded that the methodologies and major assumptions underlying the reserve analyses as performed on behalf of Bothnia by the Compre Group actuaries as at 31 December 2016 are reasonable, that their best estimate of unpaid claim amounts also appear reasonable and that the reserves booked by Bothnia as at 31 December 2016 include some margins, both implicit and explicit, over those best estimates. Moreover, the reserving methodology has been largely stable over the last three years and emerging results have not indicated either material under-reserving or excessive over-reserving.***
- 6.45 ***I am therefore satisfied that the reserves held by Bothnia as at 31 December 2016 appear reasonable. Furthermore, I do not believe that the reserve strength of Bothnia will be materially affected by the Scheme.***

#### **EXCESS ASSETS OF QBE**

- 6.46 As noted in paragraph 3.36 above, with effect from 1 January 2016 almost all EU insurers, including QBE, have been required to satisfy the newly-introduced Solvency II regime. As stated above, QBE has been approved to use the QEO Internal Model in order to calculate its SCR. I have been provided with a report entitled "*Pillar 3 Day 1 Solvency IISCR Report*" and dated 31 August 2016, which contains a description of the QEO Internal Model used to calculate the SCR. I have been informed that this is the same version of the QEO Internal Model as used for QEO's internal model approval application to the PRA, as described in the report "*2015 SCR Report*," with a few minor changes including a move to a consensus view of dependencies and a list of general parameter updates. The report sets out in detail the results of the internal model calculations for, among other entities, QBE, and shows the projected SCR for 2016, based on QBE's financial position as at 31 December 2015.
- 6.47 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.
  - In both cases the SCR is calculated to a one in 200 year confidence level.
- 6.48 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 QBE, 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.

- 6.49 The most significant component of QBE'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.
- 6.50 Other material risk classes are reinsurer credit risk (the risk of reinsurers not meeting their obligations); operational risk (which QEO has categorised into 7 sub-risks including internal and external fraud, improper business practice and business and transaction risks); and market risk (the risks around asset returns relative to the returns assumed in the discounting of reserves).
- 6.51 I have reviewed the work undertaken in estimating capital requirements for QBE, as documented in the *2015 SCR 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 QBE's modelling team, the key assumptions employed, and the resulting capital amounts based on this review. Based on my review, I consider the methodology and modelling techniques used by QBE 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 QBE, and that they have been reviewed and agreed by senior members of the QBE modelling team.
- 6.52 As a result, I believe it is reasonable for me to rely on the work of the QBE modelling team, and therefore I have not attempted to review in detail the calculations performed by QBE in order to estimate its SCR.
- 6.53 I have been provided with QBE's QRTs as at 31 December 2016, which indicate that QBE is more than sufficiently capitalised relative to its SCR with a Capital Cover Ratio of 147%.
- 6.54 I have also been provided with a report entitled "*QBE European Operations Annual ORSA Report*" and dated 30 January 2017 (the "2016 QBE ORSA Report"), which includes a forward looking assessment of QBE's SCR and own funds over the period 2017-2019 for QEO entities, including QBE. The SCRs have been produced on both the one year and to-ultimate bases, with the latter generating lower values. I have read the 2016 QBE ORSA Report, 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.
- 6.54.1 The Capital Cover Ratios for QBE derived from the one year capital values (they being more onerous than the to-ultimate values) and from the excess assets as reported in the financial statements as at 31 December 2016 indicate that, as at 31 December 2016, QBE should be considered more than sufficiently capitalised and possibly well-capitalised.
- 6.54.2 The 2016 QBE ORSA Report shows that the one year time horizon SCRs for QBE remain nearly constant over the next three years while eligible own funds increase by 2% to 3% each year, resulting in Capital Coverage Ratios which steadily increase, indicating that it is expected that, by the end of 2019, QBE would be well-capitalised.

### Conclusion

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

### EXCESS ASSETS OF MOORGATE

- 6.56 As Moorgate is in the process of implementing its exit strategy, it is outside the scope of Solvency II and therefore it has not produced an SCR. Its solvency capital requirements are therefore equal to the MCR which, in the case of Moorgate, are equal to the base capital resources requirement of £2.0 million.



- 6.57 As at 31 December 2016, on a UK GAAP basis, the policyholders of Moorgate enjoyed the security of capital resources (i.e. assets available to meet regulatory capital requirements) as measured in Moorgate’s audited annual report and financial statements as at 31 December 2016 of £3.1 million compared with the base capital resources requirement of £2.0 million. As at 31 December 2016, the Capital Cover Ratio for the base capital resources requirement would be 156% and the free assets equal to £1.1 million (i.e. capital resources less base capital resources requirement).

**Conclusion**

- 6.58 ***Overall, based on my review as described above concerning the excess assets of Moorgate, I believe the policyholders of Moorgate, all of whom are expected to transfer under the proposed Scheme, currently benefit from the strength provided by a well-capitalised company.***

**EXCESS ASSETS OF BOTHNIA**

- 6.59 I have been provided with the ORSA report for Bothnia dated 28 December 2016 (“the “2016 Bothnia ORSA Report”), and also with internal reports to the Board of Bothnia setting out the calculations supporting the eligible own funds and the SCR, as performed by the Group Actuarial Director of the Compre Group, as at each quarter end from 31 December 2015 through to 31 December 2016. As noted above, in paragraph 6.28, Bothnia’s business expanded materially during 2016 through a series of portfolio transactions, which means that the quarterly reports are rarely directly comparable with one another. Although the 2016 Bothnia ORSA Report was prepared based on data up to 30 June 2016, its forward looking assessment of own risks made allowance for anticipated transactions, including those involving Gibbon and Stockholm Re. I have also been provided with a spreadsheet prepared by the Group Actuarial Director of the Compre Group that shows his assessment of the impact that the Bothnia ADC would have had upon the eligible own funds and the SCR, had it been effective as at 31 December 2016.
- 6.60 I have reviewed these reports in order to satisfy myself that it is reasonable for me to rely on the estimates of the SCR and of the eligible own funds contained therein. This included reviewing the development of the technical provisions and hence the estimation of available own funds, the process by which capital estimates have been made, the approach taken to their calculation, the key assumptions employed, and the resulting capital amounts based on this review. I note that the capital estimates have been produced by suitably qualified actuaries (and other individuals) within Compre Group, and have been reviewed and agreed by senior members of the Compre Group modelling team.
- 6.61 Bothnia is using, and intends to continue using, the standard formula to calculate its SCR under Solvency II.
- 6.62 In assessing the technical provisions for Solvency II purposes, the Compre Group actuaries calculated the risk margin using a cost of capital approach, i.e. the discounted sum of future SCRs for the existing liabilities (excluding market risk and counterparty risk not related to the technical provisions) multiplied by the cost of capital. The cost of capital was assumed to be 6%, in line with EU regulation<sup>25</sup>. Two methods were assessed to project future SCRs and a weighted average of the results was selected. The first method projected future SCRs in proportion to the run-off of reserves and the second projected future SCRs in proportion to the square root of the run-off of reserves, recognising that there is less capital diversification in the tail of the run-off.
- 6.63 I consider this and the other adjustments made by the Compre Group actuaries to convert Bothnia’s GAAP claims reserves to Solvency II technical provisions to be reasonable and in line with typical market practice.
- 6.64 The key components of Bothnia’s SCR standard formula calculation, in addition to deferred taxes and diversification, are the charges for non-life underwriting risk (i.e. reserving risk), market risk, and counterparty default risk. Operational risk is also considered, but the charge for this risk class is less significant.
- 6.65 Based on my review, I consider the methodology and modelling techniques used by the Compre Group in assessing the capital requirements and the assets available to meet them to be in line with industry practice and generally appropriate.

<sup>25</sup> Commission Delegated Regulation (EU) 2015/35 dated 10 October 2014



- 6.66 I note that, in 2015, external consultants performed a review of the appropriateness of using the standard formula to assess Bothnia's capital requirements and concluded that the assumptions underlying the standard formula in the assessment of risk over a 1-year time horizon were broadly appropriate to the then risk profile of Bothnia. The Compre Group accepted these conclusions although it considered that the calibration of the standard formula for reserve risk resulted in an excessive capital charge for Bothnia's insurance liabilities. The Compre Group believed there was evidence that the volatility of Bothnia's liabilities was significantly less than implied by the standard parameters given that the majority of Bothnia's liabilities were non-proportional reinsurance for which the standard parameters applies the greatest capital charge. I have noted this view but have not made any allowance for it in my deliberations.
- 6.67 That review was conducted before the major expansion of the Bothnia portfolio during 2016. However, the risk profile of its underlying business has not been greatly altered as it continues to comprise mostly non-proportional reinsurance with heavy exposure to asbestos-related claims. Indeed, the increase in the size of the portfolio will have increased the risk diversification benefit within the portfolio and thus is likely to have reduced the underlying riskiness of the portfolio. I therefore accept that Bothnia's SCR values as set out in its Solvency II returns as at 31 December 2016 and in the 2016 Bothnia ORSA Report reasonably reflect the underlying riskiness of the business.
- 6.68 I note that the Solvency II assessment as at 31 December 2016, which includes allowance for all transactions involving, and investments into, Bothnia up to the 2016 year-end, indicates Own Funds totalling €34.0 million and an SCR of €22.5 million, resulting in a Capital Cover Ratio of 151%. The MCR as at 31 December 2016 was €6.2 million. On that basis I would consider Bothnia to be a well-capitalised company as at 31 December 2016. I also note that the 2016 Bothnia ORSA Report indicates that that the SCRs for Bothnia are expected to remain nearly constant over the next three years while eligible own funds are expected to increase each year, due to emerging retained run-off profit, resulting in Capital Coverage Ratios which grow steadily over time.
- 6.69 I have reviewed the spreadsheet that shows the assessment of the Group Actuarial Director of the Compre Group regarding the impact that the Bothnia ADC would have had upon the eligible own funds and the SCR, had it been effective as at 31 December 2016. Although I have not seen the detailed calculations underlying the spreadsheet, the overall findings appear to me to be reasonable. The impact has been both to increase the amount of Own Funds and to reduce the SCR. This increases the Capital Cover Ratio, moving Bothnia from being a well-capitalised company to being a very well-capitalised company.

#### **Conclusion**

- 6.70 ***Based on my review of the excess assets of Bothnia as at 31 December 2016, as described above, I believe that Bothnia is a very well-capitalised company and will continue to be so whether or not the Scheme is sanctioned.***

#### **RELATIVE FINANCIAL STRENGTH OF TRANSFERRING POLICYHOLDERS PRE AND POST SCHEME**

- 6.71 I have concluded above, based on my review of excess assets held relative to various capital requirements, that QBE was, as at 31 December 2016, a more than sufficiently capitalised company, and that Bothnia was, as at 31 December 2016, a very well-capitalised company. This would suggest that, in terms of excess assets and the security that they afford policyholders, the position of the QBE Transferring Policyholders would be enhanced by the Scheme being sanctioned. It should be borne in mind, however, that, while the excess assets in QBE are, in relative terms, less than those in Bothnia, in absolute terms the amount of excess assets is far greater in QBE, and policyholders of QBE also benefit from being part of a larger and more diversified insurance company, compared to Bothnia. These different aspects are not wholly quantifiable and hence are not directly comparable with one another. However, taking them all into account, I conclude that, on an ongoing basis, the QBE Transferring Policyholders will not be materially disadvantaged by differences in the financial strength between QBE and Bothnia.

- 6.72 I have also concluded above that Moorgate was, as at 31 December 2016, a well-capitalised company. This would suggest that, in terms of excess assets and the security that they afford policyholders, the position of the Moorgate Transferring Policyholders would be enhanced as a result of the Scheme being sanctioned. It also should be borne in mind that in absolute terms the amount of excess assets is far greater in Bothnia, and policyholders of Bothnia also benefit from being part of a larger and more diversified insurance company, compared to Moorgate. As noted above, these different aspects are not wholly quantifiable and hence are not directly comparable with one another, but, taking them all into account, I conclude that, on an ongoing basis, the Moorgate Transferring Policyholders will not be materially disadvantaged by differences in financial strength between Moorgate and Bothnia.
- 6.73 Pre-Scheme, were Bothnia to become insolvent, the Transferring Policyholders would continue to have their claims paid by QBE or by Moorgate. Furthermore, given the small size of the Transferring Business relative to QBE's entire portfolio, a default on its reinsurance contract by Bothnia would be very unlikely to have a significant financial effect on QBE or Moorgate. Post-Scheme, were Bothnia to become insolvent, the policyholders of the Transferring Business would not have any recourse to QBE or to Moorgate. This would appear to be a disadvantage of the Scheme from the point of view of the Transferring Policyholders. However, given the level of excess assets within Bothnia, the insolvency of Bothnia would presently appear to be a remote possibility, and one that would not be materially affected by the Scheme.
- 6.74 I note that Bothnia's current business contains some direct business. Therefore, in the event of Bothnia becoming insolvent post-Scheme, the Transferring Policyholders would rank behind those existing Bothnia policyholders of direct business, and alongside those existing Bothnia policyholders of indirect business. The claims reserves relating to the direct policyholders of Bothnia are relatively small (less than 2% of the total claims reserves) and therefore any disadvantage caused to the Transferring Policyholders through their lower ranking would be small. I also note that the QBE Transferring Policyholders would be transferring from a company with a high proportion of its claims reserves relating to direct policyholders to one with a low proportion of its claims reserves relating to direct policyholders.

#### **Conclusion**

- 6.75 ***I am therefore satisfied that the policyholders of the Transferring Business will not be materially adversely affected due to relative differences in the financial strength of Bothnia post Scheme to those of QBE and Moorgate pre-Scheme.***

#### **CHANGES IN RISK EXPOSURES**

- 6.76 If the Scheme is sanctioned, the policyholders of the Transferring Business will no longer be exposed to the risks within QBE or Moorgate, but will be exposed to those of Bothnia. While these policyholders are already indirectly exposed, to some extent, to the risk exposures of Bothnia through its reinsurance of the QBE Transferring Business, the reinsurance asset held with Bothnia is not significant relative to QBE's assets as a whole, and therefore a failure of Bothnia would be very unlikely to have a significant effect on QBE or on its ability to pay meet the liability payments in respect of the QBE Transferring Business (including the reinsurance of the Moorgate Transferring Business).
- 6.77 There are significant differences between the risk exposures in Bothnia relative to those in QBE, in particular relating to the types of business written. Bothnia is a relatively small insurer, specializing in the management of run-off portfolios whose liabilities include a significant amount of APH exposures. On the other hand, QBE is a large on-going insurer writing large amounts of new business, including UK personal and commercial lines. Within this, QBE does have a large and uncertain legacy portfolio, although, as noted in paragraph 6.19 above, it mitigated some of the risks posed by this portfolio via a retrospective quota share reinsurance agreement relating to its Employers' Liability and Public Liability exposures for underwriting years 2007 and prior.

- 6.78 QBE Transferring Policyholders will lose the benefit afforded by being part of a large and diverse insurance company but instead will move to a smaller and less diverse insurance company. However, different risk profiles, insofar as they might affect the future financial security of policyholders, are reflected in the capital requirements of QBE and Bothnia. As I have already concluded (see paragraphs 6.55 and 6.70 above), QBE is currently a more than adequately capitalised company whereas Bothnia is currently a very well-capitalised company, i.e. Bothnia is, currently and in relative terms, more strongly capitalised than QBE. So I am satisfied that the change of the QBE Transferring Policyholders' risk exposures resulting from the Scheme will be at least balanced by the improved capital position that they will find themselves in. Therefore, I conclude that this change in their risk exposure will not have a materially adverse impact on the security of QBE Transferring Policyholders.
- 6.79 The underlying risk exposures in Moorgate are similar to those in Bothnia, although Bothnia benefits from being a larger and more diversified entity. On the other hand, Moorgate has wholly mitigated its insurance risk by reinsuring it with QBE, albeit therefore increasing its exposure to counterparty risk. Moorgate Transferring Policyholders will lose the benefit afforded by that reinsurance arrangement but, given that I consider Bothnia currently to be a very well-capitalised company and QBE to be a more than adequately capitalised company, I consider the likelihood of Bothnia failing post-Effective Date to be no more than the likelihood of QBE defaulting on the reinsurance arrangement pre-Effective Date, so I do not consider this loss of benefit afforded by the reinsurance arrangement to be material.
- 6.80 There is also a potential benefit to the Transferring Policyholders in that Bothnia specialises in managing businesses similar to the Transferring Business and thus it is likely to receive more attention, especially as Bothnia increasingly consolidates the RFP business. Indeed, as the ownership of the RFP business becomes less diverse this will enable a wider range of claims management and finality options to be offered to the Transferring Policyholders.

**Conclusion**

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

**POLICY SERVICING**

- 6.82 There will be no change to the policy administration arrangements of the Transferring Business as a result of the Scheme. The business of RFP (of which the Transferring Business is a part) is currently administered by the Compre Group and this will not change as a result of the Scheme. There are no changes planned to the service standards or to the cedants' access to the policy administration resources (in terms of access methods or availability) and no transitional arrangements will be necessary as the current arrangements will remain in place for the foreseeable future.
- 6.83 I therefore have no reason to believe that there will be any change to policy servicing resulting from the Scheme.

**Conclusion**

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

**COMPENSATION AND COMPLAINTS**

- 6.85 I have noted above in paragraph 5.25-5.26 above that, post the Effective Date, no Transferring Policyholder will be eligible for compensation under the FSCS. I also noted that, because Bothnia has submitted itself to the jurisdiction of the FOS since October 2015, Transferring Policyholders who were able to access the FOS pre-Scheme will remain able to access the FOS post the Effective Date. However, Bothnia's submission to the jurisdiction of the FOS is voluntary and not safeguarded by law. Therefore, it is possible that, at some future date, Bothnia would cease its involvement with the FOS, at which point any Transferring Policyholder who had been able to access the FOS would no longer be able to do so.
- 6.86 The Transferring Policyholders are not private policyholders and, pre-Scheme, only those Transferring Policyholders that were "small businesses" or "micro enterprises", as described in paragraphs 3.9-3.10 above, would be eligible for protection under the FSCS or able to lodge complaints with the FOS. In this way, those Transferring Policyholders that are currently "small businesses" or "micro enterprises" (or which will become so before their interest of the Transferring Business is exhausted), and only those Transferring Policyholders, will be disadvantaged by the proposed Scheme.

6.87 I have been shown the results of an analysis that sought to identify those Transferring Policyholders that might possibly be a “small business” or “micro enterprise”. Only 3% of Transferring Policyholders were considered to be potential “small businesses” or “micro enterprises” and together these account for just over 1% of the RFP policies issued. Moreover, 75% of the policies issued to these potential “small businesses” or “micro enterprises” have since been commuted. I therefore consider it likely that very few, if any, Transferring Policyholders are currently eligible to access either the FSCS or the FOS.

#### **Conclusion**

6.88 ***I believe that the proposed Scheme will have an adverse impact on the ability of the Transferring Policyholders that are either “small businesses” or “micro enterprises” to make complaints or to seek compensation regarding the policy servicing that they experience or benefits that they receive. However, I believe that the number of Transferring Policyholders who would be affected in this way would be small, if indeed there are any at all. Moreover, because of the nature of the cover provided and the policy servicing standards required according to the ROMA, I do not consider this adverse impact to be material. I believe that the proposed Scheme will have no impact in this respect on the remainder of the Transferring Policyholders.***

## **BREXIT**

6.89 As noted in paragraph 3.47 above, the process by which the UK exits the EU has begun and, unless otherwise agreed by the UK and all of the remaining EU member states, will have concluded on or before 29 March 2019.

6.90 The terms of Brexit are subject to negotiation and it is unlikely that those terms will be known publicly until shortly before the exit. Therefore, it is difficult to anticipate the effects of Brexit without resorting to speculation. However, in the context of the Scheme there are some themes that should be considered. In particular, I need to consider whether Brexit will reinforce or mitigate the effects of the Scheme on the Transferring Policyholders. I note that the Transferring Business will be transferred from companies that it is expected will, from 29 March 2019, no longer reside within the EU (and which might also then reside outside the EEA) to a company that is and will remain within the EU. I also note that the policy servicing is being provided by related companies, of which it is expected that one (CSUK) will, from 29 March 2019, no longer reside within the EU (and possibly the EEA).

6.91 As the Transferring Business is all in run-off, there would be no issues created by Brexit regarding cross-border selling. I am unaware of any reason why the enforceability of any existing contract within or that relates to the Transferring Business would be affected by Brexit.

6.92 Post Brexit, QBE and Moorgate (assuming that it then still exists) would continue to be regulated by the PRA and FCA; and Bothnia would continue to be regulated by the FIN-FSA.

6.93 As discussed above in paragraph 4.97, although Compre Services considers and adjusts claims on behalf of Bothnia, its role is advisory. Bothnia management ultimately decides whether liability should be accepted, claims should be settled and the level of appropriate reserves to maintain. The authority to conclude commutations rests wholly with Bothnia. Therefore, Compre Services provides no services that are subject to regulation. Bothnia intends that, if the Scheme is sanctioned by the Court, the management of, and decision-making relating to, claims will continue to take place at its head office in Finland and, notwithstanding any future departure of the UK from the EU, the administration of the Transferring Business to continue to be sub-contracted to one or more of the companies that comprise Compre Services, post Scheme. I therefore believe that Brexit will have no material impact on the servicing of the Transferring Business.

## **Effect on balance sheets**

6.94 Immediately following the referendum, the value of Sterling on the currency exchange market dropped sharply and continued to fall throughout the summer. This was largely balanced by rises in the UK equity market, partially fuelled by higher expected levels of exports due to the weaker value of Sterling.

6.95 It is unclear what will happen to Sterling and to UK asset values over the period of the Brexit negotiation and following Brexit itself. However, it is likely that there will be instability, especially as rumours and speculation emerge regarding the progress of those negotiations. Any such instability would affect the balance sheets of companies with assets and/or liabilities in multiple currencies including Sterling, although the impact could be mitigated by the matching of assets and liabilities by currency. I note that Bothnia matches its assets and liabilities by currency and so its balance sheet should be largely immunised against the effects of currency exchange rate movements. I have been told that the same applies to all companies in the Compré Group, including Moorgate.

**Conclusion**

6.96 ***I do not believe that Brexit will materially alter the expected effects (if any) of the proposed Scheme on the security of the benefits or the standards of policy servicing experienced by the Transferring Policyholders.***

**CONCLUSION FOR THE POLICYHOLDERS OF QBE AND MOORGATE TRANSFERRING UNDER THE SCHEME**

6.97 ***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 QBE Transferring Policyholders or the Moorgate Transferring Policyholders.***

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

- 7.1 In this Section of the Report I consider the impact of the Scheme on those policyholders whose policies will not be transferred to Bothnia but which will remain within either of the Transferors after the Effective Date.
- 7.1.1 Within QBE this will be a large proportion of the policyholders.
- 7.1.2 Within Moorgate it is intended that all policies will be transferred to Bothnia and that none will remain within Moorgate. However, as noted above in paragraph 5.28 above, it might not be possible legally to transfer all policies within the Transferring Business and any policies that cannot be transferred would be deemed Excluded Policies. When discussing the impact of the Scheme on the policyholders of Moorgate who will not transfer under the Scheme I am referring only to Moorgate Transferring Policyholders who hold Excluded Policies (the “Moorgate Excluded Policies”).

### QBE

- 7.2 As the QBE Transferring Business is currently a very small part of QBE’s portfolio, and is already 100% reinsured into Bothnia, the non-transferring policyholders will be, to all intents and purposes, unaffected by the Scheme.
- 7.3 I have already illustrated, in Table 5.1 above, that QBE’s pre- and post-Scheme balance sheet would be largely unchanged, save for the gross technical provisions and the reinsurers’ share of technical provisions both being reduced by an amount equal to the gross reserves relating to the QBE Transferring Business. As explained in paragraph 4.24 above, the gross provisions relating to the QBE Transferring Business were very small relative to the total gross provisions of QBE.
- 7.4 The Scheme should have no impact on QBE’s eligible own funds. The only component of the SCR that would be impacted would be reinsurance credit risk, which would reduce slightly as a result of the Scheme. Therefore, the effect of the Scheme would be to reduce the SCR slightly and thus to increase, also slightly, the Capital Cover Ratio enjoyed by the remaining QBE policyholders.
- 7.5 Currently, if Bothnia were to fail, the gross liabilities of the QBE Transferring Business would fall back on QBE. Given the size of the QBE Transferring Business, this is unlikely to affect materially the other policyholders of QBE. If the Scheme were sanctioned this risk would be removed, and therefore the remaining QBE policyholders would benefit from the Scheme in this way. Similarly, were QBE to be wound-up (a possibility which also appears to be remote based on QBE’s current assets, as described in Section 6 above), those remaining QBE policyholders that were reinsured by QBE would be marginally better off had the Scheme been sanctioned as there would be fewer policies with which to share the remaining assets of QBE (direct policyholders of QBE would gain no such advantage from the Scheme as, in the event of QBE being wound-up, they already rank ahead of all reinsurance business which includes all of the QBE Transferring Business).
- 7.6 As noted above in paragraph 5.28, it is possible that, after the Effective Date, there might remain in QBE some RFP policies that could not be transferred under the Scheme (“the QBE Excluded Policies”). The gross liability for these will remain with QBE but they will continue to be 100% reinsured by Bothnia. In this respect the situation of the holders of the QBE Excluded Policies would be identical to that prior to the Effective Date. There would also be no changes to the policy servicing or administration of the QBE Excluded Policies.
- 7.7 While Brexit might affect the non-transferring policyholders of QBE (see paragraph 4.51 above), I do not believe that it would exacerbate, to any material degree, the impact on them of the Scheme.

### ***Conclusion for the policyholders of QBE not transferring under the Scheme***

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

## MOORGATE

- 7.9 The Moorgate Transferring Business comprises the whole of Moorgate's portfolio. Therefore, it is expected that there will be no Moorgate policyholders who do not transfer under the Scheme. However, as noted above in paragraph 5.28, it is possible that, after the Effective Date, there might remain in Moorgate some RFP policies that could not be transferred under the Scheme (i.e. the Moorgate Excluded Policies). The gross liability for these will remain with Moorgate but they will now be 100% reinsured by Bothnia, following the transfer under the Scheme of the QBE Transferring Business, including QBE's 100% reinsurance of Moorgate. In this respect the situation of the holders of the Moorgate Excluded Policies would be identical to that prior to the Effective Date. There would also be no changes to the policy servicing or administration of the Moorgate Excluded Policies.
- 7.10 Were there to remain policies within Moorgate, Moorgate would need to maintain capital equal to at least the base capital resources requirement of £2.0 million. As at 31 December 2016 the reserves for the whole of the Moorgate Transferring Business, net of the reinsurance arranged by RFPUM but gross of the retrocession to QBE, was £1.5 million and the capital held was £3.1 million. Even if all of the Moorgate Transferring Business became Moorgate Excluded Policies, the Moorgate Excluded Policies would continue to enjoy a very high level of security through the solvency capital within Moorgate, as well as through the retrocession of the liabilities to QBE, that policy being transferred by the Scheme to Bothnia. The relative level of security would increase as the number of Moorgate Excluded Policies decreases.
- 7.11 While Brexit might affect the holders of Moorgate Excluded Policies (should there be any), I do not believe that it would exacerbate, to any material degree, the impact on them of the Scheme.

### ***Conclusion for the policyholders of Moorgate not transferring under the scheme***

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



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## 8. THE IMPACT OF THE SCHEME ON THE CURRENT BOTHNIA POLICYHOLDERS

- 8.1 Under the Scheme, the policyholders within QBE and the policyholders within Moorgate whom Bothnia currently reinsures indirectly, will become policyholders of Bothnia. The Scheme does not provide for any transfer of assets from or to Bothnia, other than the outwards reinsurance contracts that relate to the Transferring Business. As the liabilities of the Transferring Business are already reinsured into Bothnia, there will be no change to the reserves or risk exposures in Bothnia as a result of the Scheme. No other changes in policy servicing or administration will result from the Scheme. I concluded in Section 6 above that the policyholders of Bothnia currently enjoy a degree of financial security in terms of reserve strength and excess assets as afforded by a well capitalised company, and will continue to do so if the Scheme is sanctioned.
- 8.2 If the Scheme is sanctioned, the only change to Bothnia's balance sheet would be corresponding increases to the gross technical provisions (a liability) and the ceded technical provisions (an asset). This would not lead to any change in the excess assets of Bothnia as at 31 December 2016, but would lead to an increase in counterparty default risk and therefore an increase in the standard formula SCR. An increase in the SCR of this magnitude, however, will not materially alter the Capital Cover Ratios of Bothnia, as described above, and I believe will not represent a material reduction in the security afforded to the policyholders of Bothnia.
- 8.3 The business written or accepted to date by Bothnia mostly comprises reinsurance or retrocessional contracts but includes some direct business. The business to be added by the Scheme is wholly reinsurance or retrocessional contracts. Therefore, in the event of an insolvency of Bothnia, those policyholders of Bothnia with direct policies will continue to rank ahead of all other policyholders, and those current Bothnia policyholders with reinsurance or retrocessional contracts will rank alongside the Transferring Policyholders. As such these Bothnia policyholders with reinsurance or retrocessional contracts will not be disadvantaged by the Scheme, even though, in the event of an insolvency of Bothnia, there would be a bigger group of policyholders with such contracts to share in the remaining assets of Bothnia.
- 8.4 While Brexit might affect some of the current Bothnia policyholders (see paragraphs 4.964.99 above), I do not believe that it would exacerbate, to any material degree, the impact on them of the Scheme.

### ***Conclusion for the Bothnia policyholders***

- 8.5 ***For the reasons discussed above, I am satisfied that the Scheme will not have a materially adverse effect on the security of existing Bothnia policyholders. Further, the service levels provided to the policyholders of Bothnia will not be adversely affected by the Scheme.***

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## 9. OTHER CONSIDERATIONS

### ASSETS AND LIABILITIES OF QBE, MOORGATE AND BOTHNIA

- 9.1 Since the Transferring Business is entirely reinsured by the Transferee, the only transferring assets are expected to be the benefit of those reinsurance contracts and other third party contracts, reinsurance recoveries, salvage and subrogation rights and the books and records, all as pertaining to the Transferring Business.
- 9.2 The Court has the power to order (and the Scheme provides for) the transfer to Bothnia of QBE's and Moorgate's shares of the relevant outwards reinsurance contracts secured by RFPUM in respect of the RFP business. On the basis that QBE's and Moorgate's shares of the relevant outwards reinsurance contracts are transferred as part of the Scheme, the net (of reinsurance) position of Bothnia should not be adversely impacted as a result of the Scheme.

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

- 9.3 The balance sheets I have reviewed for QBE, Moorgate and Bothnia show amounts as at 31 December 2016. I have chosen this date because it is the latest date for which audited financial information is available.
- 9.4 I expect that the current activities of QBE and Moorgate have continued, and will continue, between 31 December 2016 and the Effective Date (and, as appropriate, after the Effective Date). QBE has continued, and will continue, to write new business, and has continued, and will continue, to settle claims and reassess reserves in the light of experience; Moorgate has remained, and will continue to be, closed to new business. I do not consider that any material additional risk to any group of affected policyholders will emerge as a result of the continuation of normal business.
- 9.5 Similarly, Bothnia has continued to settle claims and reassess reserves in the light of experience. The Compré Group continues to consider other portfolios of run-off business to take on and may use Bothnia as a vehicle for taking on such portfolios if it is deemed appropriate. Since 31 December 2016, no new deals have been signed. I have been notified of two further acquisitions that are anticipated to be undertaken later in 2017. Together, were these to take place, they would increase Bothnia's gross technical reserves (as at 31 December 2016) by roughly a third. These transactions would be subject to proper review and regulatory scrutiny prior to approval. Such review and scrutiny should ensure that the interests of the existing policyholders of Bothnia (which by then would include the Transferring Policyholders, assuming that the Court approves of the Scheme) would not be adversely affected to a material degree by the transactions.
- 9.6 I believe that it is unlikely that any events occurring between 31 December 2016 and the Effective Date would affect any conclusion that I have reached based on my review as at 31 December 2016.
- 9.7 A short time before the final Court hearing, I will consider the extent to which actual changes in assets and liabilities have been in line with expectations (relative to the position as at 31 December 2016) and hence whether there have been any changes (including those associated with current economic conditions) that would affect my overall opinion, and, if necessary, I will report on these separately.

## MIS-SELLING LIABILITIES

9.8 In her judgement regarding the recent case of PA(GI) Limited v (1) GICL 2013 Limited (2) Cigna Insurance Services (Europe) Limited (2015), Mrs Justice Andrews DBE said that “..an intention to make provision for the transfer of mis-selling liabilities would quantify as an unusual feature which might have a material financial impact on the scheme, and which one would therefore expect to be expressly disclosed in the context of an application for a transfer under a Part VII scheme.” Neither QBE nor Moorgate is aware of any actual or potential mis-selling liabilities within its business. As stated in paragraph 1.9 above and paragraph 4.12 below, RFP wrote only inwards reinsurance business and no direct business. Therefore, the Transferring Business likewise comprises only reinsurance business and no direct business. While it is possible for reinsurance to be mis-sold, it is in general considered less likely to occur than in respect of direct policies in that the buyer is in all cases another insurer which should be able to evaluate what it is being sold. For that reason there is also much less likelihood that such mis-selling of reinsurance would have occurred on a systemic basis. Therefore, I think that the likelihood of any mis-selling liabilities emerging in relation to the Transferring Business is very small and therefore it would be reasonable to assume the expected cost of such liabilities to be at most negligible. In any event, it is intended that the Scheme will transfer any such liabilities, should they arise in relation to the Transferring Business, from QBE and Moorgate to Bothnia. Any mis-selling liability that arises within QBE or Moorgate that is not related to the Transferring Business would not be transferred from QBE or Moorgate to Bothnia as part of the Scheme. I have not considered it necessary to comment further on this matter in the Report.

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

- 9.9 In accordance with the PRA Statement of Policy and SUP18, I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts cover those parts of the RFP business to be transferred by the Scheme from QBE and Moorgate to Bothnia.
- 9.10 Leaving aside the 100% reinsurance of the Moorgate Transferring Business by QBE, the relevant shares of all reinsurance contracts benefiting the Transferring Business will transfer under the Scheme. As at 31 December 2016, the reinsurers' share of outstanding claims and IBNR claims amounted to approximately
- £2.5 million in respect of the QBE Transferring Business; and
  - £0.4 million in respect of the Moorgate Transferring Business.
- 9.11 The amount of the liabilities of each external reinsurer of the Transferring Business will not change as a result of the Scheme.
- 9.12 As noted in paragraph 1.14 above, the administration of the RFP business, including handling of claims, is currently the responsibility of Bothnia. This will remain the case post the Effective Date of the Scheme. I have no reason to expect any change in the standards of claims handling or management. Therefore, the magnitude and timing of recoveries claimed against reinsurance contracts relating to the business to be transferred by the Scheme from QBE and Moorgate to Bothnia will be unaffected by the Scheme.
- 9.13 Similarly, all matters between RFP and the reinsurers whose reinsurance contracts are to be transferred by the Scheme are currently dealt with by Bothnia. This will remain the case post the Effective Date of the Scheme.

- 9.14 I have considered whether the Scheme is likely to lead to any changes in the rights of “set-off”<sup>26</sup> for creditors or debtors of QBE, Moorgate or Bothnia. The existing business of Bothnia and the Transferring Business comprises (mostly in the case of Bothnia) inwards reinsurance contracts with liability mitigated by outwards reinsurance contracts. Any mutual debits or mutual credits would be available, post-Scheme, to be set off, *ab initio*, as if the mutual relationship always existed (this also means that any offsets that previously existed within QBE and within Moorgate would be lost). While Bothnia remains a solvent company, paying and receiving recoveries in respect of valid claims, this would not be an issue but there is a possibility of changes in the right of set-off on the insolvency of Bothnia post-Scheme. The chances of insolvency of Bothnia are, however, remote (particularly in the short-term). As such I do not believe the right of set-off affects my conclusions on the impact of the Scheme on reinsurers.

***Conclusion for the reinsurers of the Transferors whose contracts of reinsurance are to be transferred by the Scheme***

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

## THE APPROACH TO COMMUNICATION WITH POLICYHOLDERS

- 9.16 Regulations made under the FSMA require a communication regarding the proposed Scheme to be sent to every policyholder of the Companies. However, consideration may be given to the practicality and costs of sending notices against the likely benefits for policyholders of receiving such communications. In order to comply with both paragraph 2.53 of the Policy Statement and paragraph 2.46G of SUP18, the companies would be expected to notify the policyholders, or interested persons, at least six weeks before the date of the Court hearing at which the application to sanction the Scheme will be heard.
- 9.17 The Companies’ approach to communicating the Scheme to affected policyholders is outlined in Section 5 above.
- 9.18 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, and to contain all of the information that I would expect them to contain.
- 9.19 I am satisfied that the proposed approach to communication with policyholders in respect of the Scheme is both proportionate and reasonable.

## WHAT WOULD HAPPEN WERE THE SCHEME NOT TO PROCEED?

- 9.20 If the Scheme were not to proceed then
- 9.20.1 The QBE Transferring Business would remain with QBE, and would remain 100% reinsured by Bothnia. It would not be transferred to the new (re)insurance entity which will be established in Belgium (see paragraph 4.51 above). There would in effect be no change from the current situation, although the parties to the Scheme would revisit the contractual arrangements that are in place in relation to the QBE Transferring Business to ensure they remain appropriate, in particular post-Brexit. This would not provide the finality that QBE seeks in respect of this business.

<sup>26</sup> “Set-off” allows parties to cancel or offset mutual debts with each other by subtracting one from the other, and paying only the balance.

- 9.20.2 The Moorgate Transferring Business would remain with Moorgate, and would remain 100% reinsured by QBE. However, as its business plans would have to be changed, Moorgate is unlikely to continue to be granted exemption from Solvency II and would therefore need to comply with the full Solvency II requirements. CHL, the owners of Moorgate, consider that the costs that Moorgate would incur in making itself fully Solvency II compliant would be high and, aside from making Moorgate compliant with the prevailing regulations, would confer on Moorgate very little additional benefit. I have been told that CHL would still seek finality for Moorgate and to that end would consider other ways to transfer the gross business out of Moorgate. Any such restructuring would be subject to separate regulatory scrutiny. Moorgate has outsourced the management of its run-off to QBE which, in turn, has outsourced the management of the run-off of this business (as well as of its own RFP-related liabilities) to Bothnia. Moorgate's run-off arrangement with QBE would be unaffected were the Scheme not to proceed and would not be directly impacted by Brexit. However, were the Scheme not to proceed, CHL would review and, if necessary, revise the various contractual arrangements in respect of the Moorgate Transferring Business to ensure that they remain effective post-Brexit. This would include consideration, in conjunction with QBE, of QBE's outsourcing of the run-off management.
- 9.20.3 Bothnia would continue to operate as it currently does and would remain a vehicle for the strategy of the Compre Group to acquire portfolios of reinsurance business in run-off. However, it would find it administratively easier for there to be fewer remaining RFP members. Moreover, it is Bothnia's aim to hold 100% of the gross liability of the RFP business which would present various strategic advantages to Bothnia (e.g. negotiating commutations, flexibility in terms of claims settlement, etc.), advantages that would be lost were the Scheme not to proceed.

## LEGAL JURISDICTION

- 9.21 I understand an insurance business transfer scheme as defined in Section 105 of FSMA would be effective as a result of the Court Order sanctioning the business transfers for all policies governed by the law of an EEA member state. However, there is no obligation on the courts of non-EEA states to recognise automatically the ability of the Court to transfer a policy governed by non-EEA state laws. Thus it may be possible for one or more transferring policyholders with non-EEA policies to challenge the validity of the sanctions transfer subsequent to its effective date.
- 9.22 As set out in paragraph 4.14 above, 11.0% of the policies comprising the Transferring Business are governed by US law and 17.7% by laws other than those of one of the US or EEA states (with the number of policies governed by the laws of any one non-US or non-EEA country not exceeding 5% of the total). Net of commuted business, the equivalent percentages were 21.9% and 34.7% respectively. There is therefore a risk that such a challenge might be made.
- 9.23 I note that 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. I have seen legal opinion, obtained by QBE and Moorgate, that, were such a claim to be brought before a US court, the US court is very likely to consider it appropriate to apply the principle of comity and thus recognise the order of the Court. I am not a legal expert and cannot comment on the detail of the advice provided but, based on the arguments put forward, the conclusions and the opinion appear to me to be reasonable. Because the legal advice has been provided by a reputable firm with suitable experience, because the advice provided appears to me to be well presented and has not raised any questions or concerns, and because it is consistent with my understanding of similar advice offered in respect of previous Part VII transfers, I have decided that there is no need for me to seek further legal advice on the matter from lawyers otherwise unconnected with the proposed transfer.
- 9.24 I am unaware of any further legal opinion having been obtained in respect of the application of the principle of comity in any of the other states whose laws govern policies within the Transferring Business. Therefore, I cannot comment further on the likelihood of non-EEA, or non-US policyholders successfully challenging the Scheme post-Effective Date through their local courts.

## TAX

- 9.25 I am informed that the Scheme is not expected to have tax implications that would affect any of the Companies or any of the groups of policyholders identified in paragraph 2.7 above.

## COSTS OF THE SCHEME

- 9.26 The external costs of the Scheme (estimated to be about £300,000, based on the Scheme and planned communication with policyholders as outlined above, i.e. assuming that CHL and QBE are successful in their application to the Court for waivers as explained in paragraph 5.35 above) will be met by QBE and Bothnia in equal proportions. While these costs are not insubstantial, they are one-off in nature and not material in the context of the surplus capital as at 31 December 2016 of either organisation.

## 10. CONCLUSIONS

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

- The security of benefits to policyholders of QBE, Moorgate and Bothnia will not be materially adversely affected by the implementation of the Scheme on the Effective Date; and
- The Scheme will have no impact on service standards (operated in accordance with TCF criteria) experienced by the policyholders of QBE, Moorgate and Bothnia.

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

- I have considered which parties might be affected by the Scheme and in what way. I have documented my findings.
- Although I have not performed my own modelling, rather I have relied on the results of models developed and operated within QBE, Moorgate and Bothnia. 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 QBE, Moorgate and Bothnia having adopted alternative plausible assumptions.



Derek Newton / 27 July 2017

Fellow of the Institute and Faculty of Actuaries



## APPENDIX A DEFINITIONS

2016 Bothnia ORSA Report	The ORSA Report prepared in respect of Bothnia and dated 28 December 2016.
2016 QBE ORSA Report	The ORSA Report prepared in respect of QBE and dated 30 January 2017.
ACPR	The Autorité de Contrôle Prudentiel et de Résolution (“ACPR”) is responsible for supervising the banking and insurance sectors in France. The ACPR is an independent administrative authority attached to the Banque de France.
AGF	Assurances Generales de France, a member of RFP. AGF was bought by Allianz in 1998 and its RFP business was subsequently organised into Allianz.
Allianz	Allianz IARD. It is currently the subject of an application to the ACPR to transfer its RFP business, which was originally AGF’s RFP business, to Bothnia.
APH	Asbestos, pollution and health hazard
ARCO	Allstate Reinsurance Company (UK) Limited, a member of RFP which subsequently became part of the QBE Group and was renamed. Its RFP-related business has been wholly transferred to QBE.
Aviva Group	The group of companies comprising Aviva plc and all of its direct and indirect subsidiaries.
BaFin	The Federal Financial Supervisory Authority (in German, Bundesanstalt für Finanzdienstleistungsaufsicht or “BaFin”) is the authority for supervision of Germany’s financial and insurance sectors. The entities supervised by the authority include banks and financial services providers, insurance companies and pension funds, stock exchanges and markets, asset management companies and investment funds; and company start-ups and fintech companies. BaFin is funded solely out of fees and contributions from the institutions and businesses that it supervises and is thus independent of the Federal budget.
Best estimate	This term is used in this Report in reference to outstanding claim reserves and is intended to represent an expected value over a reasonable range of estimates. As such they are not deliberately biased upwards or downwards, and do not include any margins. However, the limitations of actuarial projection methods mean that “best estimates” are not statistically rigorous estimates of the means of the underlying distributions of all possible outcomes.
Bothnia	Bothnia International Insurance Company Limited, a subsidiary of CHL.
Bothnia ADC	An Adverse Development Reinsurance Cover secured by Bothnia in respect of its whole account with effect from 1 January 2017.
Brexit	“Brexit” is an abbreviation of “British Exit” which refers to the impending exit of the UK from the European Union, following the referendum on continuing membership held in the UK in June 2016. As at the time of drafting this Report, the terms of Brexit were unknown.
Capital Cover Ratio	The ratio of Available Capital to Requirement Capital. This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the company.

CHL	Compre Holdings Limited
The Companies	The collective term for QBE, Moorgate and Bothnia.
Compre Group	A collective term for CHL and its direct and indirect subsidiaries.
Compre Services	Compre Services (UK) Limited, Compre Services (Finland) Oy, Compre Services (Germany) GmbH and Compre Services (Sweden) Ab.
Correlation	Correlation (in the context of the Report) is a number that describes the statistical relationship between two variables (e.g. equity prices and interest rates).
The Court	The High Court of Justice of England and Wales
CS	A collective term for various service companies that are members of the Compre Group.
CSUK	Compre Services (UK) Limited, the UK-based CS company.
Effective Date	The date on which the Scheme shall become operative.
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.
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.
EEA	The European Economic Area (“EEA”) was established by the EEA Agreement on 1 January 1994. The EEA unites the 28 EU member states with Iceland, Liechtenstein, and Norway into an internal market governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely about the EEA in an open and competitive environment, a concept referred to as the four freedoms.
Excluded Policy	A contract of insurance or reinsurance (if any) written or assumed by QBE or by Moorgate under which any liability remains unsatisfied or outstanding as at the Transfer Effective Date and which, for any reason, is not transferred by order of the Court pursuant to Part VII of FSMA on the Effective Date. I have referred separately to such a policy as a QBE Excluded Policy if it emanates from QBE and as a Moorgate Excluded Policy if it emanates from Moorgate.
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.
FINE	The Finnish Financial Ombudsman Service (“FINE”) is a collaborative arrangement with the purpose of promoting the interests of customers and enhance their trust in the financial operations, to improve financial literacy among consumers, and otherwise to develop everyday practices in the financial sector in line with sound development principles.
FIN-FSA	The Financial Supervisory Authority of Finland (“FIN-FSA”) is the authority for supervision of Finland’s financial and insurance sectors. The entities supervised by the authority include banks,

	insurance and pension companies as well as other companies operating in the insurance sector, investment firms, fund management companies and the Helsinki Stock Exchange. It operates administratively in connection with the Bank of Finland, but is independent in its decision-making.
FSA	The Financial Services Authority was the UK regulator for financial services until 2012. Its responsibilities were then taken over by and divided between the PRA and the FCA.
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
GAN	Groupe des Assurances Nationales and GAN Incendie Accidents (collectively, “GAN“), a member of RFP, which was bought by Groupama in 1999 and its share of the RFP business was transferred via a portfolio transfer to HIR. This RFP involvement has been transferred to Bothnia under European transfer rules authorised by BaFin.
Gibbon	The Gibbon Underwriting Pools, business underwritten by RW Gibbon (Underwriting Agencies) Limited and RW Gibbon & Son Limited in the years 1950-1972.
Gothaer	Gothaer Versicherungsbank VVaG (“Gothaer”) was an original member of RFP that ceased being a member in 1991, with its share of the RFP business being transferred via a portfolio transfer to the other surviving members of RFP.
Groupama	Groupe des Assurances Mutuelles Agricoles (“Groupama”), which bought GAN and Minster Insurance Company Limited and was subsequently transferred to HIR. This RFP involvement has been transferred to Bothnia under European transfer rules authorised by BaFin.
HIR	Hamburger Internationale Rückversicherung AG (“HIR”), to which the RFP business of Groupama was transferred. This RFP involvement has been transferred to Bothnia under European transfer rules authorised by BaFin.
IBNR reserves	These are reserves in respect of claims which relate to claim events that have occurred before the valuation date but which were still to be reported to the insurer as at that date. For the purposes of this Report they also include reserves in respect of any perceived shortfall between the projected ultimate costs and the case estimates for claims already notified.
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.
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.
LPT2016	A reinsurance agreement under which QBE’s net RFP-related liabilities were 100% reinsured with effect from 12 February 2016 by Bothnia.
LMX	Excess of Loss reinsurance business written in the London Market
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).
Moorgate	Moorgate Insurance Company Limited, a member of the Compre Group
The New Zealand Companies	The collective term for The New Zealand Insurance Company (UK) Limited, The New Zealand South British Insurance plc and The New Zealand Reinsurance Company (UK) Limited. These companies have undergone several names changes and are now part of IAG but were members of RFP. The New Zealand companies are all now part of Ocean, transferred from Aviva, through the various Part VII transfers in Scotland and in the English Court.
NIHL	Noise induced hearing loss, a type of industrial disease.
Own Funds	In Solvency II terminology, the amount of capital or excess assets of an insurance company. Own funds are divided into basic own funds and ancillary own funds (e.g. unpaid share capital), which require regulatory approval.
Ocean	Ocean Marine Insurance Company Limited (“Ocean”), the insurer to which the New Zealand Companies transferred their RFP business.
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.
The Policy Statement	The Statement of Policy issued by the PRA entitled The Prudential Regulation Authority’s approach to insurance business transfers, issued in April 2015
PPO	Periodical Payment Order, a form of structured settlement that can be imposed on the parties to a personal injury claim by UK courts.
PRA	The Prudential Regulation Authority (“PRA”) is part of the Bank of England and carries out the prudential regulation of financial firms in the UK, including banks, investment banks, building societies and insurance companies. The PRA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
PRA Returns	Accounts, balance sheets, abstracts and statements relating to the business of an insurance company required under PRA rules to be submitted periodically to the PRA. Prior to May 2013, companies were required to submit this information to the FSA.

QBE	QBE Insurance (Europe) Limited, an indirect subsidiary of QEO.
QBE Group	A collective term for QIGL and its direct and indirect subsidiaries.
QEO	QBE European Operations plc ("QEO"), the indirect parent of QBE and a member of the QBE Group
QEO Internal Model	The internal model developed, maintained and used by QEO and its subsidiaries for business planning and solvency capital estimation purposes.
QIGL	QBE Insurance Group Limited ("QIGL"), the ultimate parent company of the QBE Group.
Quantitative Reporting Templates (QRTs)	Reporting templates that must be completed by insurers and submitted to the regulator on a regular basis in accordance with Solvency II. The QRTs cover a wide range of quantitative financial information about the insurer including details of its balance sheet, capital requirements and reserves.
Required Capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (for example the SCR).
Reinsurance	An arrangement with another insurer whereby risks are shared (or passed on). If reinsurance is termed as being "inwards" then the reinsurer in question has accepted risk from an(other) (re)insurer; if reinsurance is termed as being "outwards" then the (re)insurer in question has passed risk to a(nother) reinsurer.
The Report	References to "the Report" refer to this report.
RFP	The Ridgwell, Fox & Partners Pool ("RFP"), on behalf of which RFPUM underwrote reinsurance business.
RFPUM	Ridgwell, Fox & Partners (Underwriting Management) Limited
ROMA	The run-off management agreement dated 12 February 2016 by which responsibility for the administration of the RFP business, including handling of claims, was assumed with effect from that date by Bothnia from QBE.
The Scheme	In the context of this Report, the proposal that the RFP-related business of QBE and of Moorgate be transferred to Bothnia under the provisions of Part VII of FSMA.
SFCR	Each insurer is expected to publish a Solvency Financial Condition Report ("SFCR") annually which will contain certain qualitative and quantitative information, the quantitative information being in the format of certain prescribed QRTs.
SLA	Service level agreement
Solvency I	The system for establishing minimum capital requirements for EU (re)insurers under relevant EU Directives prior to the introduction of Solvency II on 1 January 2016.
Solvency II	The system for establishing (among other things) minimum capital requirements for EU (re)insurers under the Solvency II Directive 2009/138/EC.
SCR	The Solvency Capital Requirement ("SCR") under Solvency II is the amount of capital required to ensure continued solvency over a one-year trading time frame with a likelihood of 99.5%.
SUP18	Section 18 of the FCA Supervision Manual

Supplementary Report	A report I will prepare in advance of the Court hearing to sanction the Scheme covering any relevant matters which might have arisen since the date of the Report.
TCF	The TCF ('treating customer fairly') principle aims to raise standards in the way firms carry on their business by introducing changes that will benefit consumers and increase their confidence in the financial services industry. Specifically, TCF aims to: help customers fully understand the features, benefits, risks and costs of the financial products they buy; and minimise the sale of unsuitable products by encouraging best practice before, during and after a sale
Technical Provisions	Liabilities determined for regulatory purposes. In particular, the provisions for the ultimate costs of settling all claims arising from events which have occurred up to the balance sheet date, including provision for claims incurred but not yet reported, less any amounts paid in respect of these claims; plus the provisions for future claims (and premiums) arising on unexpired periods of risk (see Appendix F for further details).
Transfer Document	This document sets out the terms of the Scheme.
Transferee	The insurer to which business is being transferred – in the case of the Scheme this is Bothnia.
Transferors	The insurers from which business is being transferred – in the case of the Scheme these are QBE and Moorgate.
Transferring Business	The RFP business of QBE and Moorgate, which is to be transferred to Bothnia under the Scheme. I have referred separately to such a policy as a QBE Excluded Policy if it emanates from QBE and as a Moorgate Excluded Policy if it emanates from Moorgate.
Transferring Assets	The assets to be transferred to Bothnia under the Scheme
Transferring Policyholders	The policyholders of the Transferring Business. I have referred separately to such policyholders as QBE Transferring Policyholders if they are currently covered by QBE and as Moorgate Transferring Policyholders if they are currently covered by Moorgate.
ULAE	Unallocated loss adjustment expenses, i.e. claim-related costs that cannot be allocated specifically to individual claims, such as the costs of running a claims team.
Underwriting Year	The year to which a claim is allocated based on the date the policy was written.
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.
Württ	Württembergische Feuer was reorganized into Württembergische Versicherung AG in 1991 and Wüstenrot und Württembergische AG in 1999. Wüstenrot und Württembergische AG ("Württ") is a member of RFP. It was announced in January 2017 that an agreement had been reached to transfer the remaining RFP liabilities from Württ to Bothnia.

## APPENDIX B CV FOR DEREK NEWTON

- B.1. Derek Newton is a principal and actuarial consultant in Milliman's London office. He is co-leader of Milliman's UK General Insurance practice. He joined the firm in 2003.
- B.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 non-traditional risk transfer mechanisms, capital modelling and evaluation, and the design and construction of model office software. His experience includes:
- 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.
  - Assisting insurers with the preparation of solvency capital assessments, both internal and in accordance with prevailing regulatory requirements.
  - Acting as Actuarial Function for several insurers.
  - 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.
  - Providing expert-witness support to lawyers involved in legal action concerning insurance companies and insurance claims both in the UK and elsewhere.
  - Leading the evaluation of the reinsurance strategy and reinsurance programme for a major insurer.
  - Leading the review of various Europe insurers as part of due diligence assignments.
  - Advising a national insurance association in developing a pragmatic approach for its members to adopt in meeting new reserving regulations.
- B.3. Of particular relevance in this context, Derek acted as the independent expert in respect of the following Part VII transfers:
- The transfer of the general insurance business of RL(CIS) Limited to CIS General Insurance Limited, a transfer which was sanctioned in 2014.
  - The transfer of general insurance business relating to the Tower pool from Royal & Sun Alliance Insurance plc to Knapton Insurance Limited, a transfer which was sanctioned in 2015.
  - The transfer of the general insurance business of Dowa Insurance Company (Europe) Limited to Aioi Nissay Dowa Insurance Company of Europe Limited, a transfer which was sanctioned in 2016.



- B.4. In addition, Derek has been involved over the last five years (mostly as peer reviewer to the Independent Expert) in the following transfers (some of which were cross border).
- the business of various UK-regulated subsidiaries of QIGL to a smaller number of UK-regulated subsidiaries of QIGL. The transfers were approved by the Court on 12 December 2011
  - the business of PA(GI) Limited to QBE and to Marine Insurance Company. The transfers were approved by the Court on 12 December 2011
  - certain business of the Italian branch of Sampo Japan Insurance Company of Europe Limited to Berkshire Hathaway International Insurance Limited. The transfer was effective 31 March 2013
  - the business of Chevanstell Limited to R&Q Insurance (Malta) Limited. The transfer was effective 31 December 2013
  - the European branch business of Mitsui Sumitomo Insurance Company (Europe) Limited to MSIG Insurance Europe AG. The transfer was effective 31 December 2013.
- B.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.
- B.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 C SCOPE OF THE WORK OF THE INDEPENDENT EXPERT IN RELATION TO THE SCHEME

C.1. The following was included within the letter of engagement that was agreed between the Companies, Milliman and me, and which was shown to the PRA prior to the approval by the PRA and FCA of my appointment as the Independent Expert in respect of the Transfer. As such the following constitutes my terms of reference in respect of this assignment.

*“My report(s) will consider the terms of the Scheme generally and the effect which the Scheme will have on the holders of (re)insurance policies of the Companies.*

*My review and report(s) will address generally the way in which the Companies have conducted their (re)insurance business but taking into account the particular circumstances of each of the different groups of policyholders of the Companies involved in the Scheme. It will deal inter alia with the following aspects:*

- *The likely scope for deteriorations in each of the Companies’ claims reserves (i.e. the likelihood and extent to which each of the Companies’ reserves may prove inadequate);*
- *The impact of the Scheme on the security/financial strength afforded the different groups of policyholders of the Companies involved in the Scheme;*
- *The corporate governance structures operating in the Companies involved in the Scheme and the impact on the different groups of policyholders in the Companies involved in the Scheme;*
- *The impact of the Scheme on the levels of service provided to the different groups of policyholders of the Companies involved in the Scheme;*
- *The existing and proposed agreements between the Companies and their reinsurers;*
- *Guarantees and/or agreements (if any) between the Companies;*
- *Guarantees and/or agreements (if any) between each of the Companies and their respective parent company;*
- *Transactions (outside the Scheme) that impact upon one or both of the Companies;*
- *The terms and conditions (if any) expected to be imposed by the Scheme to be presented to the Court;*
- *The matters required by applicable provisions of the PRA’s Policy Statement PS7/15 and Chapter 18 of the supervision manual in the FCA’s Handbook;*
- *A review of the communications made to policyholders;*
- *Any other matters drawn to my attention by the Regulators or which are required by the Regulators to be addressed within the report(s).*

*The above list is not intended to be exclusive to any other aspects which may be identified during the completion of the project and which are considered to be relevant.*

*I shall not be directly involved in the formulation of the proposed transfers although I should expect to give guidance during the evolution of the detailed proposals on those issues which concern me, or which I consider unsatisfactory.*

*I will meet with the Companies at an early stage to identify key issues.*

*I will support the Companies in their liaison with and provision of information to the Regulators and share the Part VII Report(s) (and drafts) and any supplemental report with those noted at paragraph 6(b) of the engagement letter.*

*I will not provide any advice with respect to the merits of the proposed Scheme.”*

## APPENDIX D GENERAL CONSIDERATIONS OF THE INDEPENDENT EXPERT

### INTRODUCTION

- D.1. I have compiled my Report in accordance with the Policy Statement and with SUP18.
- D.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.
- D.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

- D.4. After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 5.19 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.
- D.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.
- D.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 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

- D.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.
- D.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.
- D.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.

D.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

D.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 and expense levels.

D.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

D.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.

D.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 E KEY SOURCES OF DATA

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

- RFP Pool - Members Trial Balance Index as at 30 September 2015, 31 December 2015, and 31 August 2016
- Agency agreements between RFPUM and for AGF, GAN, Moorgate, and Württ
- Summary of RFP Pool stamps split by underwriting year and separately for Marine and Non-Marine.
- Various reinsurance agreements between participants in the RFP pool supporting the current gross shares
- Scheme Transfer Document
- Draft witness statements from QBE and from Moorgate and Bothnia
- Draft letter to recipients of the Communications Pack
- Legal opinion, dated 8 June 2017, provided by Chadbourne & Parke LLP.

### QBE

- PRA Return for QBE Insurance (Europe) Limited for the year-ended 31 December 2015
- Audited report and accounts for QBE Insurance (Europe) Limited as at 31 December 2015 and 31 December 2016
- QEO 2015 SCR Report dated 28 May 2015
- QEO Annual ORSA report dated 18 November 2015 and 2016 Annual ORSA report dated 30 January 2017
- QEO November 2015 ORSA SCR Report dated 26 November 2015
- QEO Pillar 3 Day 1 Solvency II SCR Report dated 31 August 2016
- QEO QRTs as at 31 December 2016
- QBE Insurance (Europe) Limited Day-1 QRTs as at 31 December 2015
- QBE Insurance (Europe) Limited QRTs as at 30 June 2016 and 31 December 2016
- QBE Insurance (Europe) Limited actuarial report as at 31 October 2014, 30 September 2015, and 30 September 2016; dated 1 March 2015, 19 February 2016, and 24 March 2017
- Actuarial memo dated 19 March 2015 bridging the reserves between 31 October 2014 and 31 December 2014
- Actuarial memo dated 15 March 2016 bridging the reserves between 30 September 2015 and 31 December 2015
- A redacted version of an actuarial memo dated 17 March 2017 bridging the reserves between 30 September 2016 and 31 December 2016
- QBE Insurance (Europe) Limited proforma balance sheet and income statement as at 31 March 2017
- Documents summarising QEO's 2016 and 2017 outwards reinsurance programmes.

### Bothnia

- The 2015 and 2016 audited financial statements.
- The 2015 full regulatory returns and the 2016 regulatory returns for assets.
- Solvency II standard formula calculations as at 31 December 2015 and every quarter of 2016.
- A copy of Compre's Capital Management Policy

- A copy of Compre's Treating Customers Fairly (TCF) Policy
- Actuarial valuation of undiscounted gross and net reserves, authored by Compre Group actuaries, for Bothnia as at 31 December 2015 and every quarter of 2016.
- Project Triton Claims Due Diligence report
- The 2015 audited financial statements for Stockholm Re.
- Solvency II standard formula calculations as at 31 December 2015 and 30 September 2016 for Stockholm Re.
- Loss Portfolio Transfer Agreement, Run-off Management Services Agreement, and Framework Agreement between QBE and Bothnia
- Document summarising the deals pipeline as of 2 December 2016 and 8 May 2017.
- Deed of Novation with Allianz IARD
- Confirmations of approval ("Zustellungsurkunde") from BaFin for the transfer of HIR and Württ which are effective 7 November 2016 and 14 December 2016, respectively.
- Documents summarising Bothnia's FOS application and acceptance.
- Compre Reserve Review as at 31 December 2014 and 31 December 2016, authored by PwC.
- ORSA report (based on the balance sheet as at 30 June 2016), dated December 2016.

#### Moorgate

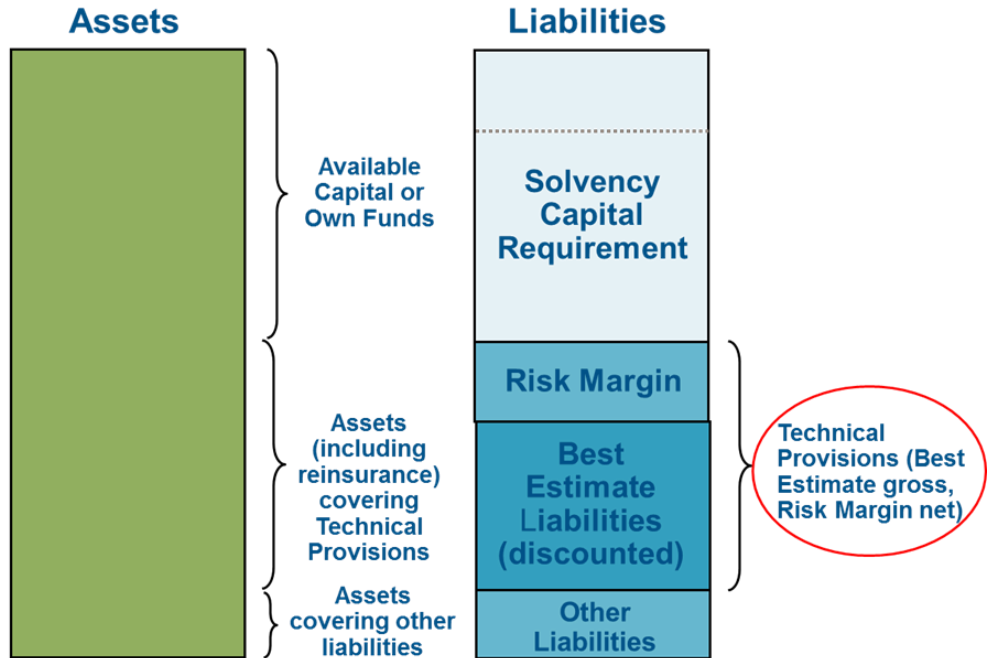
- The 2015 and 2016 audited financial statements.
- Run-off Reinsurance Agreement and Addendum between Moorgate and QBE
- Correspondence with the PRA regarding Moorgate's MCR and run-off strategy dated 16 February 2017.

E.2. Information relating to the items listed above was also gathered during discussions with staff of QBE and CHL.

## APPENDIX F SOLVENCY II BALANCE SHEET

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

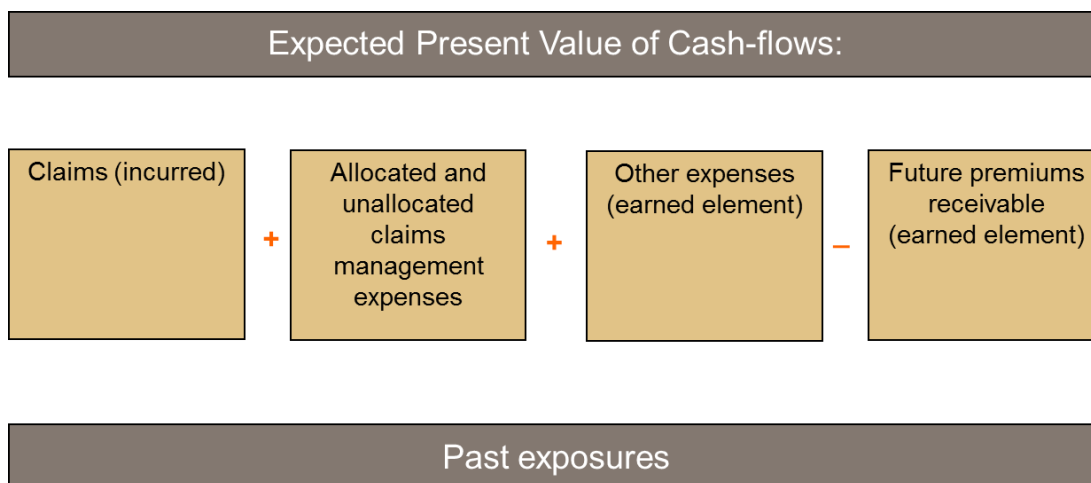
**Figure F.1**  
Solvency II balance sheet





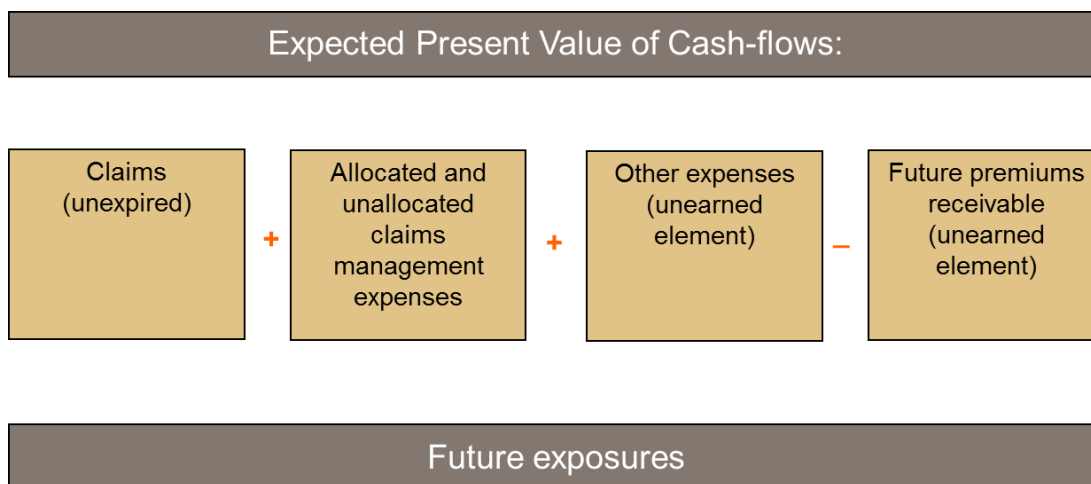
- F.2. The Solvency II balance sheet is intended to be a tool for management to assess an entity’s solvency and hence an important consideration for significant decisions. It is also a tool for regulators to assess the solvency of an insurer.
- F.3. A key consideration for management in making significant decisions will be the excess of assets over Technical Provisions, other liabilities and the Solvency Capital Requirement (SCR). This excess of Own Funds over the SCR will determine whether the entity can expand existing business, move in to new areas, undertake mergers/acquisitions (with less capital rich entities) etc. or whether they need to consider reducing business volumes, moving out of capital intensive lines of business, purchasing additional reinsurance and so on. The level of Own Funds will also likely impact the credit rating of an entity.
- F.4. The Technical Provisions are a direct input to the balance sheet, and are therefore a fundamental input in to the SCR calculation that models the potential movement in the balance sheet over a one year time horizon.
- F.5. Solvency II requires the Technical Provisions (as at the valuation date) to be determined using a market consistent valuation of the liabilities relating to insurance contract. In practice, a market consistent liability valuation cannot be calculated by reference to market prices, because such prices are not (for practical purposes) available. Therefore Technical Provisions are presently estimated on a proxy to a market value basis, i.e. a ‘best estimate’ of the liabilities relating to insurance contracts allowing (i.e. discounting) for the time value of money supplemented by a risk margin. More specifically the Technical Provisions are made up as follows:  
  
Claims provision + Premium provision + Risk margin
- F.6. The claims provision is the expected present value/discounted ‘best estimate’ of all future cash-flows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date. Figure F.2 below illustrates the components of the claims provision calculation.

**Figure F.2**  
**Claim Provision**



F.7. The premium provision is the expected present value/discounted ‘best estimate’ of all future cash-flows (claim payments, expenses and future premiums due) relating to future exposures arising from policies that the insurer is obligated to at the valuation date. Figure C.3 below illustrates the components of the premium provision calculation.

**Figure E.2  
Premium Provision**



F.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.