

**Report of the Independent Expert on
the Proposed Insurance Business
Transfer Scheme from QBE Insurance
(Europe) Limited to Reliance National
Insurance Company (Europe) Limited
under Part VII of the Financial
Services and Markets Act 2000**

4 July 2018

Prepared by John Charles, Independent Expert

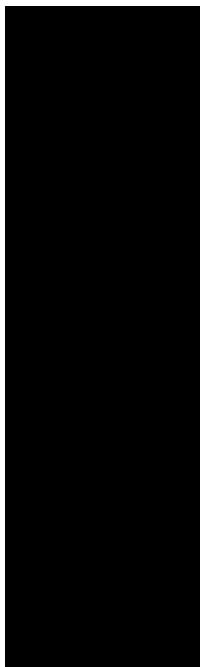
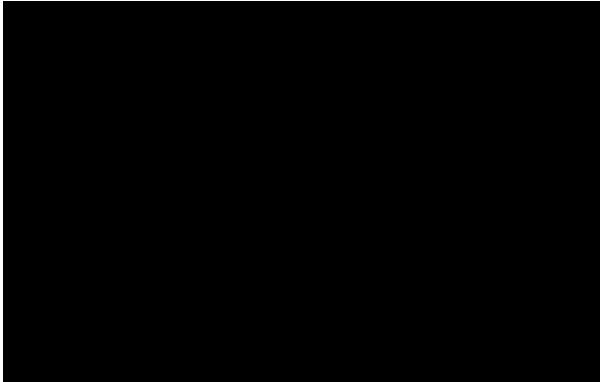


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Section 1: Introduction and scope

The Independent Expert

- 1.1 When a scheme for transferring insurance business from one company to another is put to the Court for approval it must be accompanied by a report on the terms of the scheme from an independent expert ("the Independent Expert"). This is a requirement under Part VII of the Financial Services and Markets Act 2000 ("FSMA").
- 1.2 I, John Charles, have been appointed jointly by QBE Insurance (Europe) Limited ("QIE") and Reliance National Insurance Company (Europe) Limited ("RNICE") to provide an Independent Expert report for the proposed Part VII transfer of a run-off portfolio of Italian and Spanish medical malpractice business ("the Transferring Portfolio") from QIE to RNICE. The proposed insurance business transfer from QIE to RNICE is defined in this report as the "Proposed Scheme".
- 1.3 It is intended that the effective date of the Proposed Scheme will be 31 October 2018 (the "Effective Date"). However, in this report the calculations were prepared using an intended date (the "Scheme Date") of 30 September 2018.
- 1.4 My appointment as the Independent Expert in connection with the Proposed Scheme was approved by the PRA, after consultation with the FCA, on 23 February 2018. In connection with this appointment there is an engagement letter dated 12 September 2016 in place between Towers Watson Limited ("Willis Towers Watson"), QIE and RNICE. In conducting this work, I have been supported by a number of other Willis Towers Watson personnel ("my team").
- 1.5 The costs and expenses relating to my appointment as the Independent Expert are shared equally by QIE and RNICE.
- 1.6 I am a Fellow of the Institute and Faculty of Actuaries ("IFoA"), having qualified in 1991. I am a Senior Director in the firm of Towers Watson Limited. I have experience of the types of business written by each of QIE and RNICE, and the types of business in the Transferring Portfolio. My curriculum vitae is enclosed as Appendix B.
- 1.7 I am required to comply with relevant technical actuarial standards ("TASs") issued or adopted by the Financial Reporting Council ("the FRC") in the UK, the Actuaries Code and relevant actuarial practice standards ("APSs") issued by the IFoA in the UK. This report complies with all applicable TASs and APSs. Specifically, this report has been prepared in accordance with:
 - TAS 100: Principles for Technical Actuarial Work, issued by the FRC
 - TAS 200: Insurance, issued by the FRC
 - The Actuaries' Code, issued by the IFoA
 - APS X2: Review of Actuarial Work, issued by the IFoA
 - Paragraphs 2.27 to 2.40 of "The Prudential Regulation Authority's approach to insurance business transfers".
- 1.8 This report and the underlying work have been peer reviewed by a suitably qualified member of Willis Towers Watson, who was not otherwise engaged with the work on the Proposed Scheme.

Proposed business to be transferred and brief introduction to QIE and RNICE

- 1.9 The proposed business to be transferred from QIE to RNICE is a portfolio of Italian and Spanish medical malpractice business, which was placed in run-off during 2013.
- 1.10 QIE is domiciled in the UK and is supervised by the Prudential Regulation Authority ("PRA") and the Financial Conduct Authority ("FCA"). QIE is part of the QBE group of companies, as described in Section 3 of this report.
- 1.11 RNICE is domiciled in the UK and is supervised by the PRA and the FCA. RNICE is part of the Armour Group of companies, as described in Section 3 of this report.

Scope of my report

- 1.12 This report considers the likely effects of the Proposed Scheme on the following three groups of policyholders:
 - The policyholders remaining with QIE;
 - The policyholders transferring from QIE to RNICE ("the Transferring Policyholders"); and
 - The current policyholders of RNICE.
- 1.13 For each group of policyholders, I have considered the likely effects of the Proposed Scheme on:
 - The security of policyholders' contractual rights; and
 - The levels of service provided to policyholders.

Statement of independence

- 1.14 Neither I, nor any member of my immediate family, hold any shares, have any contracts of insurance or have any other financial interest in the legal entities involved in the Proposed Scheme, or with any QBE or Armour group companies.
- 1.15 I have not carried out any consulting work for the legal entities involved in the Proposed Scheme, or for any QBE or Armour group companies, during the past three years.
- 1.16 Willis Towers Watson, globally, has relationships with QBE and Armour group companies; however, I consider that the nature of these relationships would not impact on my ability to act as Independent Expert for the Proposed Scheme. I have provided details of these relationships to the PRA and FCA.
- 1.17 With effect from 5 January 2016, the Towers Watson group of companies merged with the Willis group of companies. I understand that the broking teams within legacy Willis have relationships with the QBE and Armour groups of companies. However, the broking lines of business are maintained as separate lines of business to the Insurance Consulting and Technology ("ICT") business segment, of which I am part, within Willis Towers Watson, and Willis Towers Watson is committed to maintaining confidentiality, objectivity and independence in the services it provides to its insurance clients. Towers Watson Limited remains a separate legal entity within Willis Towers Watson.
- 1.18 I consider that the matters disclosed above do not affect my independence and suitability to act as the Independent Expert for the Proposed Scheme.

Terms of reference

- 1.19 The terms of reference for my review of the Proposed Scheme were agreed by QIE and RNICE, and have been seen by the PRA and FCA.
- 1.20 This report is intended to aid the Court's deliberations as to whether the Proposed Scheme should be approved. In reporting on the Proposed Scheme in accordance with Part VII of the FSMA, I owe a duty to the Court to help the Court on matters within my expertise. This duty overrides any obligation to any person or party from whom I have received instructions or by whom I am paid. I have complied, and continue to comply, with this duty.
- 1.21 In preparing this report I have taken account of the following:
 - Part 35 of the Civil Procedure Rules.
 - The Practice Direction supplement to Part 35 of the Civil Procedure Rules.
 - The protocol for the instruction of experts to give evidence in civil claims drafted by the Civil Justice Council.
 - Guidance in SUP18 of the FCA Handbook and the PRA's "Statement of Policy: The Prudential Regulation Authority's approach to insurance business transfers" which sets out guidance on the form of the scheme report. I have also had regard to the FCA guidance consultation entitled "GC17/5: proposed guidance on the FCA's approach to the review of Part VII insurance business transfers" which was issued on 15 May 2017.
- 1.22 This review does not comprise an audit of the financial resources and liabilities of QIE, RNICE or of any other QBE / Armour group companies.
- 1.23 I have not reviewed the systems and controls currently operated by QIE, RNICE or by any other QBE / Armour group companies.
- 1.24 I am required to comment on the Proposed Scheme; my report is not concerned with possible alternatives to the Scheme.

Reliances and limitations

- 1.25 In carrying out my review and producing this report I have relied without independent verification upon the accuracy and completeness of the data and information provided to me, both in written and oral form. My team and I have reviewed the information provided for general reasonableness and consistency. My team and I have also met with representatives of QIE and RNICE to discuss in detail the information which they have provided in relation to the Proposed Scheme. I consider it is reasonable to rely on these individuals because they are PRA and FCA approved persons or are senior professionals employed by QIE / RNICE. Reliance has been placed upon, but not limited to, the information detailed in Appendix C.
- 1.26 I have obtained confirmation from each of QIE and RNICE that, to the best of their knowledge and belief:
 - All the items of data and information which have been provided to me by QIE / RNICE for the purposes of this report are accurate and complete.
 - There are no significant errors or omissions in the descriptions in this report of the business of QIE / RNICE and of the Transferring Portfolio.
 - There are no other material items of data and information which have not been provided to me by QIE / RNICE and which are likely to be relevant to this report.

- 1.27 Based on my review, I am satisfied that the information detailed in Appendix C represents an appropriate basis for the conclusions set out in this report and I consider that it is reasonable for me to rely on this information.
- 1.28 I contacted the PRA and FCA at an early stage to establish whether there were matters or issues which they wanted me to consider in this report. A draft of this report has been made available to the PRA and FCA whose comments have been taken into account. The PRA, in consultation with the FCA, has approved the form of this report.
- 1.29 No unreasonable limitations have been imposed on the scope of my work and the opinions in this report about the Proposed Scheme are mine, based on the information provided to me and the answers given to any questions my team and I have raised. In my opinion, all significant matters that are relevant to policyholders' consideration of the Proposed Scheme have been considered in this report.
- 1.30 This report has been prepared on an agreed basis for the purposes of reporting on the Proposed Scheme to the High Court, and must not be relied upon for any other purpose. It must be considered in its entirety because individual sections, if considered in isolation, may be misleading. This report is subject to the terms and limitations, including a limitation of liability, set out in my firm's engagement letter.
- 1.31 This report must not be construed as investment advice.
- 1.32 This report has been prepared on the joint instruction of QIE and RNICE for the benefit of the High Court solely for the purposes of satisfying FSMA requirements for Part VII transfers. It has not been prepared for use by any third party. Accordingly, neither the Independent Expert nor Towers Watson Limited accepts any responsibility or duty of care to any third party in relation to this report. Any reliance placed by such third parties on the report is entirely at their own risk.
- 1.33 This Independent Expert report is based on financial information in respect of QIE, RNICE and the Transferring Portfolio as at 31 December 2016, and does not take into account any developments after that date unless stated explicitly to the contrary in this report.
- 1.34 I expect to produce a supplementary report in due course, based on the financial positions of QIE, RNICE and the Transferring Portfolio as at the latest quarter and/or year-end for which appropriate data is available given the proposed date of the transfer and the timing of the production of the supplementary report. This will include annual year-end updates as at 31 December 2017 that may form the basis for any subsequent quarterly assessments. The review is intended to take account of known significant developments between 1 January 2017 and the date of the intended transfer.
- 1.35 Figures in all tables in this report are subject to possible rounding differences.
- 1.36 Tables in this report show accounting information in various currencies, reflecting the different currencies which apply to different companies and groupings of business. In particular:
 - The current reporting currencies for QIE and RNICE are pounds sterling and US dollars respectively.
 - The contracts of insurance in the Transferring Portfolio are denominated in Euros.
- 1.37 Any currency conversions in this report are based on the following currency exchange rates which applied at 31 December 2016: £1 = €1.1651 = US\$1.2303. (Source: Bank of England)

Legal jurisdiction

1.38 This report is governed by and shall be construed in accordance with English law. Willis Towers Watson, QIE and RNICE submit to the exclusive jurisdiction of the English courts in respect of all disputes and differences arising out of, under or in connection with this report.

Structure of this report

1.39 The structure of this report is as follows:

- Section 1 summarises the scope of my work as the Independent Expert
- Section 2 summarises my overall conclusions
- Section 3 summarises:
 - The terms of the Proposed Scheme
 - The business of QIE, before and after the Proposed Scheme
 - The business of RNICE, before and after the Proposed Scheme
- Section 4 discusses my analysis of the reserves of QIE, RNICE and the Transferring Portfolio including the volatility of the reserves of the Transferring Portfolio in relation to the Standard Formula ("SF") SCR reserving risk factor
- Section 5 considers in detail the likely effects of the Proposed Scheme on the three affected groups of policyholders in respect of security considerations
- Section 6 considers the likely effects of the Proposed Scheme on the three affected groups of policyholders in respect of other considerations which can impact service levels
- Appendix A contains a glossary of various capitalised terms in this report
- Appendix B contains my curriculum vitae
- Appendix C contains details of information considered for the purposes of this report
- Appendix D contains details of proposed policyholder communication
- Appendix E contains various reliances and limitations.

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Section 2: Summary and opinion

Background

- 2.1 In 2014 QIE, Tokio Millennium Re AG, Bermuda Branch (“TMR”) and ILS Property and Casualty Re Limited (“ILS P&C Re”) entered into arrangements that effectively transfer QIE’s economic policyholder obligations relating to the Transferring Portfolio to ILS P&C Re. The arrangements included TMR acting as a fronting reinsurer, collateral, a claims handling agreement and a commitment by QIE and RNICE, an ILS P&C Re subsidiary, to pursue a Part VII transfer of the Transferring Portfolio. This proposed Part VII transfer is intended to give legal effect to the economic transfer implied by those arrangements by formally transferring QIE’s policyholder obligations to RNICE. The Scheme ends QIE’s policyholder obligations in respect of the Transferring Portfolio and eliminates TMR’s role as fronting reinsurer.
- 2.2 To give effect to the transactions referred to above, the following legal agreements were made in connection with the Transferring Portfolio:
- A Loss Portfolio Transfer Agreement (“LPTA”), with an effective date of 1 July 2014, between QIE, TMR and ILS P&C Re in respect of its segregated account A (“Cell A”), under which TMR and ILS P&C Re agreed to provide separate aggregate reinsurance contracts to QIE in respect of the Transferring Portfolio. ILS P&C Re provides aggregate reinsurance coverage in excess of the aggregate limit under the TMR reinsurance contract.
 - A Deed of Charge (“Security Deed”) between QIE and TMR creating a charge in favour of QIE over the custody account in which the premium paid to TMR under the LPTA (“Premium”) is held subject to the terms of the Custody Agreement referred to below. The Security Deed provides security to QIE for the performance of TMR’s obligations as reinsurer under the LPTA.
 - A Claims Handling Agreement (“Claims Handling Agreement”) between QIE and Armour Risk Management Limited (“ARM”) under which ARM assumes responsibility for providing various claims management services in respect of the Transferring Portfolio. ARM also employs a network of Third Party Administrators (“TPAs”) in Italy and Spain.
 - A Transfer Agreement (“Transfer Agreement”) between QIE and RNICE, a fully owned ILS P&C Re subsidiary, under which the parties agree to pursue a Part VII transfer of the Transferring Portfolio from QIE to RNICE.
 - A Custody Agreement (“Custody Agreement”) between QIE, TMR and The Bank of New York Mellon, London Branch (“BNY Mellon”) setting out the basis on which BNY Mellon acts as custodian of the premium and any other funds provided by TMR in accordance with the terms of the LPTA to ensure that the value of the funds in the account reaches the required level, as calculated from time to time under the terms of the LPTA.
 - A further agreement (“Retrocession Agreement”) between TMR and ILS P&C Re for and on behalf of its segregated account Cell A, under which ILS P&C Re agrees to provide retrocession coverage which corresponds to the obligations and liabilities of TMR towards QIE under the LPTA.
 - A Trust Agreement (“Trust Agreement”) between TMR, ILS P&C Re for and on behalf of its segregated account Cell A, and HSBC Bank USA, National Association (“HSBC”) under which various trust account arrangements are agreed in respect of funds supporting the Retrocession Agreement between TMR and ILS P&C Re.

2.3 I understand from QIE and RNICE that all of the above legal agreements will remain in force if the Proposed Scheme does not proceed. This is because the agreements do not contain termination rights contingent upon the Proposed Scheme not proceeding.

The Proposed Scheme

Purpose of the Proposed Scheme

2.4 I have been informed by QIE and RNICE ("the Parties") that:

- RNICE entered into an agreement with QIE on 15 August 2014 to acquire its Italian and Spanish medical malpractice portfolio (in run-off), with the Parties obliged to endeavour to transfer the portfolio from QIE to RNICE by an insurance portfolio transfer pursuant to Part VII of the FSMA.
- The staff managing the portfolio transferred from QIE to ARM with effect from 5 September 2014 pursuant to the LPTA. ARM entered into a Claims Handling Agreement with QIE to manage the run-off of the portfolio, and the portfolio was 100% reinsured by TMR and ILS P&C Re.
- The Proposed Scheme is therefore the final part of the acquisition process to transfer the portfolio from QIE to RNICE. The Proposed Scheme is intended to fulfil the Parties' contractual obligations. No further consideration will be paid between the Parties in respect of the Proposed Scheme.

Summary of the Proposed Scheme

2.5 The intended date of the Proposed Scheme is 31 October 2018 (the "Effective Date").

2.6 I understand from QIE and RNICE that the Proposed Scheme will involve transferring from QIE to RNICE:

- The entire liabilities of the Transferring Portfolio (i.e. the portfolio of Italian and Spanish medical malpractice policies, which were placed in run-off during 2013).
- Entitlement to a small number of facultative reinsurance ("Facultative Reinsurance") contracts which attach to the Transferring Portfolio.

2.7 I also understand that, in combination with the Proposed Scheme, the following further actions will all take place:

- The reinsurance contract, as part of the LPTA, between RNICE (transferred from QIE) and TMR, with an aggregate limit of €335,980,711 in respect of unpaid claims from the Transferring Portfolio from 1 July 2014 onwards, will terminate.
- The reinsurance contract, as part of the LPTA, between RNICE (transferred from QIE) and ILS P&C Re in respect of Cell A, in excess of an aggregate amount of €335,980,711, will terminate.
- The Custody Agreement will terminate.
- The Retrocession Agreement between TMR and ILS P&C Re in respect of Cell A will terminate.
- The Trust Agreement will terminate.

- The total amount of funds in the Secured Accounts (comprising the Cash Secured Account and the Securities Secured Account, which were established by the LPTA) will be transferred directly to RNICE before the Effective Date of the Proposed Scheme but following sanction of the Proposed Scheme.
 - The Claims Float Account, including the TPA Claims Float Accounts, (which was established by the Claims Handling Agreement) will continue to be held by ARM on trust for RNICE, instead of QIE.
 - A pre-defined amount of funds will be transferred from the Trust Account (which was established by the Trust Agreement) directly to RNICE before the Effective Date of the Proposed Scheme but following sanction of the Proposed Scheme. The amount of funds to be transferred from the Trust Account to RNICE is defined by the following process:
 - A capital amount ("Capital Amount") in respect of the Transferring Policies is to be calculated, which is equal to A less B plus C where:

A = 75% of the best estimate element ("Best Estimate") of the Solvency II Technical Provisions ("SII Technical Provisions") of RNICE.

B = the Risk Margin ("Risk Margin") component of RNICE's SII Technical Provisions.

C = Deductible asset balances in respect of amounts due for more than 6 months.

A and B are calculated as at a fixed date of 31 March 2018 as if the transfer had taken place as at that date. Item C is calculated as at the date of the transfer.
 - The total amount of funds to be transferred to RNICE from the combination of the Secured Accounts, Claims Float Account and Trust Account before the Effective Date of the Proposed Scheme will have the effect that the available capital resources ("Available Capital Resources") of RNICE following the Proposed Scheme will be equal to the Capital Amount.
 - To the extent reasonably practicable:
 - The assets of RNICE which correspond to the best estimate component of the SII Technical Provisions of RNICE following the Proposed Scheme will be converted to Euro-denominated investments before the Effective Date of the Proposed Scheme to the extent that they are not already denominated in Euros.
 - The assets of RNICE which correspond to the Available Capital Resources of RNICE plus the Risk Margin component of the SII Technical Provisions following the Proposed Scheme will be converted to US dollar-denominated investments before the Effective Date of the Proposed Scheme to the extent that they are not already denominated in US dollars.
- 2.8 I understand that RNICE has changed its reporting currency to US dollars.
- 2.9 The actions in paragraph 2.7 are documented in the following legal agreement(s):
- The Insurance Business Transfer Scheme.
 - A letter entitled "Project Docklow: Termination of LPTA, amendment of Transfer Agreement, and release of collateral and security" ("the LPTA Amendment Agreement").
 - A letter entitled "Project Docklow: Trust Agreement – Withdrawal of Assets from the Trust Account" ("the TA Amendment Agreement").

2.10 The following provisions have been made to ensure that the Proposed Scheme and all of the actions in paragraph 2.7 will take place in combination with each other:

- It is specified in the Insurance Business Transfer Scheme that:
 - The Proposed Scheme will only be implemented on the Effective Date if the required transfers of funds from each of the Secured Accounts and Trust Account have been received by RNICE.
 - To the extent reasonably practicable, the funds transferred to RNICE will be converted before the Effective Date into Euros (in respect of funds corresponding to the Technical Provisions) and US dollars (in respect of funds corresponding to Available Capital Resources), to the extent that the transferred funds are not already denominated in these currencies.
- The LPTA Amendment Agreement requires the parties to that agreement to give instructions for the transfer directly to RNICE of funds held in the Secured Accounts, following the Sanction Hearing.
- The TA Amendment Agreement requires the parties to that agreement to give instructions for the transfer directly to RNICE of the pre-defined amount of funds held in the Trust Account, following the Sanction Hearing.

2.11 I have reviewed a copy of a letter dated 13 July 2017 from the Bermuda Monetary Authority that confirms that it does not object either to the required transfers of funds between ILS P&C Re entities, or to the Proposed Scheme and other related actions subject to the appropriate PRA, FCA and UK High Court approvals.

2.12 My conclusions are predicated on the assumption that the Parties will present evidence to the Sanction Hearing to confirm that the following important assumptions, on which this report is based, are true:

- The Proposed Scheme and all of the actions described in 2.7 will take place in combination with each other.
- RNICE's investment policy will remain consistent with that indicated by its SCR calculation.
- The LPTA has not been cancelled prior to the Sanction Hearing.
- That the Capital Amount remains appropriate and reasonable on the basis of the information available prior to the Sanction Hearing.

2.13 The Claims Handling Agreement, which is an outsourcing arrangement, will continue to apply between RNICE, in place of QIE, and ARM following the Proposed Scheme. The existing Claims Handling Agreement will be novated in its exact current form after the transfer so no change to claims handling is expected to arise because of the Proposed Scheme.

Scope of my review

2.14 In this report I consider the likely effects of the Proposed Scheme on three distinct groups of affected policyholders:

- The policyholders remaining with QIE;
- The policyholders transferring from QIE to RNICE ("the Transferring Policyholders"); and
- The current policyholders of RNICE.

2.15 In performing my review, I considered each of the following areas:

- Financial strength. The level of claims reserves together with the required, as well as any excess, capital that a company holds is a key measure of financial security for the policyholders as it indicates whether there is a reasonable expectation that the company will be able to absorb losses in both normal as well as adverse scenarios.
- Policyholder treatment. Whether the Proposed Scheme will have any effect on matters such as claims handling service levels, investment management, new business strategy, management, administration, governance arrangements and expense levels in so far as these will affect the security of policyholders' contractual rights or the levels of service provided to policyholders.

Summary of findings

Security of the policyholders remaining with QIE

- 2.16 The policyholders remaining with QIE have policies with a well-capitalised company, QIE, whose level of shareholders' funds provides a security level in excess of the Solvency II capital requirement. This means that QIE is estimated to have sufficient capital to meet its obligations over a one year period in more than 99.5% of cases. In other words, before the Proposed Scheme, the shareholders' funds of QIE are estimated to be more than sufficient to absorb the financial impact of a 1-in-200 year event.
- 2.17 The QIE Solvency Capital Requirement ("SCR") is calculated using a PRA approved Internal Model ("IM"). Under Solvency II, companies may, subject to the approval of the insurance supervisor determine the SCR using an IM. For the sake of clarity, I refer to the QIE SCR as the "IM SCR".
- 2.18 There are no guarantees protecting the policyholders of QIE.
- 2.19 The risk profile of the policyholders remaining with QIE will not change significantly following the Proposed Scheme as:
- The Transferring Portfolio, gross of reinsurance, is small relative to the total business of QIE being 3.5% of QIE's gross claims outstanding reserves as at 31 December 2016.
 - The net of reinsurance liabilities of QIE in relation to the Transferring Portfolio are zero, as the Transferring Portfolio is 100% reinsured by a combination of TMR and ILS P&C Re.
- 2.20 The Proposed Scheme is expected to slightly increase the QIE IM SCR Solvency Cover ratio for the policyholders remaining with QIE. This is because:
- The QIE Technical Provisions, net of reinsurance, in respect of the Transferring Portfolio are zero as at 31 December 2016 before the Proposed Scheme. This means that the QIE total Technical Provisions, net of reinsurance, and Available Capital Resources as at 31 December 2016 will not be changed by the Proposed Scheme.
 - The QIE SCR as at 31 December 2016 will reduce slightly following the Proposed Scheme as QIE will no longer be exposed to counterparty default risk in respect of the aggregate reinsurance contracts protecting the Transferring Portfolio.
- 2.21 This means that, following the Proposed Scheme, the policyholders remaining with QIE will continue to have policies with a well-capitalised company, whose level of shareholders' funds imply a security level in excess of the SCR. I consider that this is satisfactory.
- 2.22 In summary, in my opinion, the security of the policyholders remaining with QIE is not materially adversely impacted by the Proposed Scheme.

Security of the policyholders transferring from QIE to RNICE

- 2.23 The Transferring Policyholders currently have policies with a well-capitalised company, QIE, whose level of shareholders' funds provides a security level in excess of the SCR.
- 2.24 The risk profile of the Transferring Policyholders will change following the Proposed Scheme as follows:
- The Transferring Policyholders will move to a company, RNICE, which is expected to have a Solvency Cover ratio of 157% on the basis of my tailored assessment of the required capital. Under the Solvency II Standard Formula SCR ("SII SF SCR"), the transferring policyholders will have Solvency Cover ratio of 201%. My tailored assessment of the SCR for the Transferring Policyholders is based on SII SF SCR with an adjustment to reflect my view of the increased reserve risk volatility applicable to the portfolio instead of the assumption that would apply under the SII SF SCR.
 - Provided that the ultimate loss cost underlying the reserve estimates does not increase materially, the Solvency Cover ratio on both the tailored and regulatory bases is expected to increase significantly during the next three to five years as the Transferring Portfolio runs-off, before allowing for any dividend payments. As a UK run-off company, RNICE will only be permitted to pay dividends or extract capital if the PRA confirms that it does not object to such actions.
 - The Transferring Policyholders will move to a company, RNICE, with a significantly lower level of diversification of its business, and which is only protected by a small amount of Facultative Reinsurance. Against this, the Transferring Policyholders will no longer be exposed to underwriting risks from new business.
 - RNICE will not have the benefit of the following arrangements which were previously available to QIE in respect of the Transferring Portfolio:
 - The aggregate reinsurance contracts currently provided to QIE by TMR and ILS P&C Re.
 - The Custody Agreement and the Trust Agreement which currently provide collateral in respect of the aggregate reinsurance contracts underwritten by TMR and ILS P&C Re for the benefit of QIE.

However, in this context it should be understood that the above arrangements were put in place as part of the LPTA and there is no obligation for such arrangements to continue in the event that the LPTA were to be cancelled.

- 2.25 Subject to RNICE maintaining an appropriate investment policy that is consistent with that indicated by its Post-Scheme SCR calculations, based on the above analysis I consider that the security of the Transferring Policyholders is not materially adversely impacted by the Proposed Scheme.

Security of RNICE's current policyholders

- 2.26 As at 31 December 2016, the current policyholders of RNICE have policies with a small company whose level of shareholders' funds provides a security level in excess of the Solvency II required capital which in this case is the AMCR.

- 2.27 In light of the small size of RNICE's reserves, I consider that the SF SCR would understate the underlying capital requirement because the Standard Formula is calibrated in the context of larger more diversified entities. RNICE's SF SCR falls below the Absolute Minimum Capital Requirement ("AMCR") which is the lowest prescribed amount of the Minimum Capital Requirement ("MCR") under Solvency II. I consider the AMCR as a more appropriate, albeit prudent, indication of security because this capital level would allow for the emergence of material unanticipated losses that could arise under remote scenarios and I have adopted this measure as my tailored SCR.
- 2.28 The risk profile of the current policyholders of RNICE will change following the Proposed Scheme. The current policyholders of RNICE will be exposed to material additional risks in respect of the Transferring Portfolio, including:
- The risk that the Technical Provisions in respect of the Transferring Portfolio will not be sufficient to cover the run-off of outstanding claims.
 - The risk that RNICE will be unable to reclaim outstanding deductible amounts from policyholders in respect of the Transferring Portfolio.
 - The risk that there will be significant adverse movements in the value of assets, including any currency exchange rate risk, to be transferred to RNICE in connection with the Proposed Scheme.
- 2.29 Against the assumption of additional risk, the current policyholders of RNICE will potentially benefit from:
- A significant increase in the tailored SCR Solvency Cover ratio from 114% to 157%.
 - A significant increase in the scale of RNICE's operations which means that the volatility that could arise from RNICE's current policyholders would be far less material to RNICE in the context of its capital resources.
- 2.30 In the event of insolvency, current RNICE policyholders would have access to the Financial Services Compensation Scheme ("FSCS") which provides cover for 100% of losses for compulsory policies and 90% of losses for non-compulsory insurances with no upper limit. There are 16 non-compulsory policies and 4,336 compulsory policies. As of 31 December 2016, RNICE had been advised of potential claims on 10 of the 4,336 compulsory policies and no active claims on the 16 non-compulsory policies.
- 2.31 Subject to RNICE maintaining an appropriate investment policy that is consistent with that indicated by its Post-Scheme SCR calculations, I consider that the security of the current policyholders of RNICE is not materially adversely impacted by the Proposed Scheme for the following reasons:
- RNICE's Solvency Cover ratio on the basis of my tailored capital assessment will increase substantially post-transfer.
 - RNICE's business will be substantially more diversified and the scale of its capital resources in excess of regulatory requirements and my tailored capital assessment will have increased significantly beyond the extent of expected claims from RNICE's current policyholders.
 - Post-transfer there is a significant increase in the scale of RNICE's available capital resources in excess of regulatory requirements.
 - The policyholders will continue to have access to the FSCS in the event of a failure.

Brexit

- 2.32 QBE EO has established a newly incorporated (re)insurer, QBE Europe SA/NV domiciled in Belgium. This entity is scheduled to underwrite 2019 renewals of EEA business. In the event that QIE is no longer able to rely on passporting rights in respect of pre-Brexit EEA policies, QIE is also undertaking a portfolio transfer of the majority of its European branch business to this new entity ("the QIE Brexit Portfolio Transfer"). I understand that the Transferring Policyholders are excluded from the QIE Brexit Portfolio Transfer, in light of an expectation that both the Proposed Scheme and the QIE Brexit Portfolio Transfer are expected to be sanctioned in Q4 2018.
- 2.33 I understand that RNICE intends to obtain any authorisation which may be necessary from the Italian and Spanish regulators in order to permit it to continue to service the Transferring Policies following Brexit. There is currently a lack of clarity as to the approach that will be taken in relation to UK authorised insurers in run-off whose sole activity will be the payment of claims under pre-existing policies covering risks in Spain or Italy. RNICE is taking legal advice from local counsel with the intention of ensuring that when the position becomes clearer, it can address any requirements of local law and regulation, including applying for any authorisation that may be required on a timely basis.
- 2.34 QIE and RNICE are both UK authorised insurance companies and are therefore in similar positions regarding Brexit in needing to take steps to ensure that they can continue to service EEA policyholders after Brexit in the event that authorised UK insurance firms are no longer permitted to service EEA pre-Brexit run-off policies originally written on a passporting basis without fulfilling additional requirements.
- 2.35 In light of the uncertainties affecting Brexit and the potential implications for the ability of UK insurers to service EEA pre-Brexit run-off policies originally written on a passporting basis, it is not possible to draw definitive conclusions as to the effect of Brexit on the Transferring Policyholders at this time.
- 2.36 As QIE and RNICE are both UK authorised insurance companies and the Transferring Policyholders are excluded from the scope of the QIE Brexit Portfolio Transfer, the impact of Brexit on the Transferring Policyholders is expected to be similar, whether the Proposed Scheme proceeds or not under the assumption that each of QIE and RNICE takes appropriate steps to minimise potential disruption to policyholders that could arise from Brexit. On this basis I conclude that at the current time the Proposed Scheme can reasonably be expected not to have a material adverse effect on the Transferring Policyholders because of Brexit.

Effect of QIE Brexit Portfolio Transfer on policyholder security

- 2.37 The QIE Brexit Portfolio Transfer could affect the security of:
- Transferring Policyholders if the Proposed Scheme is not sanctioned.
 - Policyholders remaining with QIE.
- 2.38 The financial projections in this report do not explicitly consider the effect of the QIE Brexit Portfolio Transfer. However, on the basis that the QIE Brexit Portfolio Transfer takes place in a manner that does not materially disadvantage the main groups of the affected policyholders then I consider that it is reasonable to infer that the conclusions of this report will be unaffected with respect to policyholder security.

Other considerations

Other considerations: Overview

- 2.39 In the following paragraphs, I consider the potential effect of the Proposed Scheme on the arrangements for managing policies and claims, investment risk and expense levels in so far as these are expected to affect the security of policyholders' contractual rights and the levels of service provided to policyholders. My review of these matters is based on my consideration of the information provided to me and my team.
- 2.40 I understand from QIE that the Proposed Scheme will not cause any change in the management of policies and claims for policyholders remaining with QIE.
- 2.41 I understand from QIE and RNICE that the Proposed Scheme is not expected to cause any change in the management of policies and claims for Transferring Policyholders, as these policies will continue to be managed by ARM. The existing Claims Handling Agreement will be novated in its exact current form after the proposed transfer so no change to claims handling is expected to arise because of the Proposed Scheme.
- 2.42 I understand from RNICE that the Proposed Scheme is not expected to cause any change in the management of policies and claims for the current policyholders of RNICE.

Other considerations: Policyholders remaining with QIE

- 2.43 In respect of policyholders remaining with QIE, my view is that the Proposed Scheme is expected to have no effect on service levels, expense levels and the level of investment risk.

Other considerations: Transferring Policyholders

- 2.44 In respect of policyholders transferring from QIE to RNICE, my view is that the Proposed Scheme is expected to have no significant effect on service levels or expense levels.
- 2.45 There may be an increase in investment risk for the Transferring Policyholders, reflecting:
- The elimination of collateral arrangements related to the cancellation of the aggregate reinsurance contracts currently provided by TMR and ILS P&C Re to QIE in respect of the Transferring Portfolio.
 - The transfer of material funds to RNICE which will be exposed to potential future fluctuations in market value. This will depend on RNICE's prospective investment strategy.
- 2.46 Subject to RNICE maintaining an appropriate investment policy that is consistent with that indicated by its Post-Scheme SCR calculations, I consider that this possible increase in investment risk taken in the context of the expected capitalisation of RNICE after the Proposed Scheme does not change my conclusion that the security of this group of policyholders is not materially adversely impacted by the Proposed Scheme.

Other considerations: Current policyholders of RNICE

- 2.47 In respect of current policyholders of RNICE, my view is that the Proposed Scheme is expected to have no significant effect on service levels or expense levels.

- 2.48 As the Proposed Scheme envisages the elimination of collateral arrangements related to the aggregate reinsurance contracts currently provided by TMR and ILS P&C Re to QIE in respect of the Transferring Portfolio, there will be a transfer of material funds to RNICE. RNICE's asset portfolio will therefore be exposed to potential future fluctuations in market value to an increased extent, although this will depend on RNICE's prospective investment strategy. It is therefore reasonable to expect that there may be an increase in investment risk for the current policyholders of RNICE.
- 2.49 Subject to RNICE maintaining an appropriate investment policy that is consistent with that indicated by its Post-Scheme SCR calculations, I consider that this possible increase in investment risk taken in the context of the expected capitalisation of RNICE after the Proposed Scheme does not change my conclusion that the security of this group of policyholders is not materially adversely impacted by the Proposed Scheme.

Other considerations: Affected reinsurers

- 2.50 The Proposed Scheme includes the transfer from QIE to RNICE of entitlement to a small number of Facultative Reinsurance contracts which attach to the Transferring Portfolio. I am satisfied that the Proposed Scheme will not have any significant effect on the reinsurers whose contracts of reinsurance are to be transferred by the Proposed Scheme.
- 2.51 The Proposed Scheme includes the transfer from QIE to RNICE of entitlement to a small number of Facultative Reinsurance contracts which attach to the Transferring Portfolio. I am satisfied that the Proposed Scheme is not expected to have any financial effect on the single reinsurer whose contracts of reinsurance are to be transferred by the Proposed Scheme.

Proposed approach to communications with policyholders

- 2.52 The proposed approach to policyholder communication is described in Appendix D of this report. I have been asked to comment on the appropriateness of the proposed approach to policyholder communication. My comments are set out in the following paragraphs.

Communication: Content of circular to policyholders

- 2.53 I consider that the draft circular to policyholders contains an appropriate summary of:
- The Proposed Scheme, including appropriate references to the further actions which will take place in combination with the Proposed Scheme, described in paragraph 2.7 of this report
 - The conclusions of this Independent Expert report.

Communication: Policyholders remaining with QIE

- 2.54 It is proposed that policyholders remaining with QIE will not receive individual notification of the Proposed Scheme in view of QIE's limited exposure to the Transferring Portfolio which is currently 100% reinsured by a combination of TMR and ILS P&C Re, and the immaterial effect of the Proposed Scheme on the policyholders remaining with QIE. I understand that, given the large number of policyholders remaining with QIE, the cost of individual notification of each QIE policyholder would be substantial.

Communication: Transferring Policyholders

- 2.55 It is proposed that notification of the Proposed Scheme will only be sent to the Primary Named Insureds under each policy within the Transferring Portfolio, and that no notification will be sent to Named Additional Insureds and Unnamed Additional Insureds (these terms are defined in Appendix D).

- 2.56 I consider that this approach is appropriate, reasonable and proportionate, given that:
- The Primary Named Insured was responsible for purchasing the policies in each case.
 - All communications in relation to the policies are sent to the Primary Named Insured.
 - QIE does not have contact details for each Named Additional Insured or for any Unnamed Additional Insureds.
 - This approach is consistent with the basis under which the policies operate, with the central management of claims by the Primary Named Insured.
- 2.57 The Transferring Policyholders also include a small portfolio covering dentists and private practitioners in Italy that was written under a delegated authority through a coverholder. I understand that QIE has contact details for all insureds with open claims and is proposing to notify all such insureds and the coverholder. Contact details are unavailable for other policyholders without open claims. I consider that the proposed communication approach for these policies is appropriate, reasonable and proportionate.

Communication: Claimants in respect of the Transferring Portfolio

- 2.58 It is proposed that no notifications will be sent to claimants in respect of policies within the Transferring Portfolio.
- 2.59 I consider that this is reasonable because claimants are not policyholders and are therefore not entitled to payment under the terms of the policies. QIE has no contractual relationship with claimants. There are also difficulties in obtaining contact information for claimants, and there is a risk of increasing the liability of policyholders (who are liable for deductibles or SIRs) by making direct contact with claimants.

Communication: Current policyholders of RNICE

- 2.60 It is proposed that notification of the Proposed Scheme will be sent to all current policyholders of RNICE for whom RNICE has been able to obtain contact details. I consider that this approach is appropriate, reasonable and proportionate, based on my understanding that RNICE has undertaken a thorough review of its available records in order to identify its remaining policyholders. It is usually difficult to obtain up-to-date contact details for a run-off portfolio such as that represented by the current policyholders of RNICE.

Communication: Other interested parties

- 2.61 It is proposed that notification of the Proposed Scheme will be sent to:
- The co-insurers of two Italian policies
 - The single outwards reinsurer whose reinsurance policies are transferring.
- 2.62 Notifications of the scheme will not be sent to brokers who originally placed the business with QIE. I consider this reasonable because I understand that claims are handled directly through the Primary Named Assureds and the brokers are currently not involved in communications related to claims.

Change of Scheme Date

- 2.63 The financial projections of the effect of the Scheme were prepared on the basis of a planned Scheme Date of 30 September 2018. The Effective Date has since changed to 31 October 2018. If I were to update the calculations to the Effective Date, my conclusions related to the Proposed Scheme would remain unaltered. However, I note that the RNICE Post-Scheme Solvency Cover Ratios would be expected to increase because of the fixed date of 31 March 2018 used in the determination of the Capital Amount.

Change to QIE Internal Model

- 2.64 I have been informed that the QIE IM SCR as at 31 December 2016 was altered from £909 million, as stated in the analysis underlying this report, to £883 million. I understand that the change related to reinsurance credit risk. The difference is a 2.9% reduction in the IM SCR for QIE. If I were to incorporate the updated IM SCR into my analysis of the Proposed Scheme, the Solvency Cover Ratios for QIE would be expected to increase slightly. However, this change would not affect my conclusions related to the Proposed Scheme.

Supplementary report

- 2.65 This Independent Expert report is based on financial information in respect of QIE, RNICE and the Transferring Portfolio as at 31 December 2016.
- 2.66 I expect to produce a supplementary report in due course, based on the financial positions of QIE, RNICE and the Transferring Portfolio as at an appropriate date, which will take into account actual developments between 1 January 2017 and that date. The appropriate date will be the latest quarter-end for which data is available to allow preparation of the supplementary report in time for the Sanction Hearing ahead of the proposed date of the transfer of 31 October 2018.
- 2.67 In addition to updated financial information, the supplementary report will also consider, amongst other things, updates on Brexit developments and confirmation of RNICE's prospective investment policy.

Duty to the Court

- 2.68 As required by Part 35 of the Civil Procedure Rules, I hereby confirm that I understand my duty to the Court, I have complied with that duty and I will continue to do so.

Statement of truth

- 2.69 I confirm that insofar as the facts stated in my report are within my own knowledge I have made clear which they are and I believe them to be true, and that the opinions I have expressed represent my true and complete professional opinion.



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Section 3: Background

Companies

QBE Insurance (Europe) Limited (“QIE”)

- 3.1 QIE is a limited company registered in England and Wales. QIE is regulated by the PRA and FCA.
- 3.2 The principal activity of QIE is the transaction of insurance and reinsurance business on a worldwide basis.
- 3.3 QIE is an indirect subsidiary of QBE European Operations plc (“QBE EO”), which is incorporated in the UK. QBE EO is the holding company for the European Operations division of QBE Insurance Group Limited (“QBE Group”). QIE is managed at the QBE EO division level.
- 3.4 QIE’s ultimate parent undertaking and controlling entity is QBE Group, which is incorporated in Australia and is the largest group of undertakings into which QIE’s financial statements are consolidated.
- 3.5 The following table summarises the profit and loss accounts of QIE for each of the 2014, 2015 and 2016 financial years on a UK GAAP basis, for the combination of continuing and discontinued business:

Table 3.1: QIE year-end profit and loss accounts

£ million	2014	2015	2016
Net earned premiums	1,001	1,134	1,009
Net claim incurred	(598)	(732)	(546)
Net operating expenses	(440)	(419)	(400)
Change in equalisation provision	37	(7)	17
Investment income	159	70	64
Unrealised gains / (losses) on investments	(20)	(12)	30
Investment expenses and charges	(66)	(8)	(16)
Total profit / (loss) before tax	72	26	158
Taxation	(25)	(21)	(28)
Total profit / (loss) after tax	48	5	130
Currency translation differences	7	3	(24)
Movement in revaluation reserve	(24)	0	0
Total comprehensive income	31	8	107

3.6 The following table summarises the balance sheets of QIE as at each of 31 December 2014, 31 December 2015 and 31 December 2016 on a UK GAAP basis, before the Proposed Scheme. I understand that the Technical Provisions as at 31 December 2016 include allowance for the reduction in the Ogden discount rate underlying court awards for UK bodily injury claims, which was announced by the Lord Chancellor on 27 February 2017:

Table 3.2: Summary QIE UK GAAP Balance Sheets

£ million	31 December 2014	31 December 2015	31 December 2016
Assets			
Investments	3,279	3,295	3,507
Reinsurers' share of technical provisions			
Provision for unearned premiums	79	135	59
Claims outstanding	987	888	1,016
Debtors	899	1,098	934
Other assets	132	127	196
Prepayments and accrued income	179	182	194
Total assets	5,555	5,725	5,905
Liabilities			
Total shareholders' funds	1,404	1,392	1,392
Technical provisions			
Provision for unearned premiums	766	739	798
Claims outstanding	2,876	2,936	3,095
Equalisation provision	10	17	0
Other provisions	1	1	2
Deposits received from reinsurers	1	1	0
Creditors	487	628	608
Accruals and deferred income	11	10	10
Total liabilities	5,555	5,725	5,905

3.7 The following table summarises the Solvency II balance sheet of QIE as at 31 December 2016, before the Proposed Scheme:

Table 3.3: Summary QIE UK Solvency II Balance Sheet as at 31 December 2016

Amounts in £ million	31 December 2016
Total assets	5,178
Total liabilities	3,889
Adjustment for restricted own fund items	(12)
Available Capital Resources	1,277
Internal Model SCR	909
Available Capital Resources to meet SCR	1,277
SCR Solvency Cover ratio	140%

- 3.8 QIE is a large entity with net assets of the order of £1 billion. QIE's SCR is determined from EO's PRA-approved internal capital model ("IM"). The Available Capital Resources to meet the SCR are 140% of QIE's IM SCR.
- 3.9 QIE's available capital on a Solvency II basis of £1,277 million and total shareholders' funds on a UK GAAP basis of £1,392 million differ by £115 million as at 31 December 2016. This is due to different treatments under Solvency II and UK GAAP of various balance sheet items.

Reliance Insurance Company (Europe) Limited ("RNICE")

- 3.10 RNICE is a private company limited by shares and registered in England. RNICE is regulated by the PRA and FCA.
- 3.11 The ownership structure of RNICE may be summarised as follows:
- RNICE is 100% owned by segregated cell account Q ("Cell Q") of ILS P&C Re. Cell Q is a protected segregated account of ILS P&C Re, a company incorporated in Bermuda, licensed as an insurer and as such regulated by the Bermuda Monetary Authority (the "BMA"), and registered as a segregated accounts company.
 - The ultimate beneficial owner of ILS P&C Re is a fund complex (the "Fund Complex") consisting of the following entities:
 - ILS Property & Casualty Feeder Fund Ltd, a Cayman incorporated, limited liability, passive investment vehicle (the "Feeder Fund").
 - ILS Property & Casualty Master Fund Ltd, a Cayman incorporated, limited liability, passive investment vehicle (the "Master Fund" and together with the Feeder Fund, the "Funds").
 - ILS Property & Casualty Holding Company Ltd, a Cayman incorporated limited liability company (the "Holding Company") which acts as the holding company for ILS P&C Re.
 - The Fund Complex follows a common structure used by investors in order to pool passive investment capital raised by investors – both taxable and tax-exempt – and overseas investors into one central vehicle called the master fund, with separate investment vehicles or feeders created for each investor group. With respect to the Fund Complex, the Master Fund invests substantially all of its assets into the Holding Company which in turn invests its assets into the ILS P&C Re and/or segregated cell accounts of ILS P&C Re. The Funds are passive investment vehicles, have no substantial operations of their own and do not expect to have any significant operations or assets other than their direct ownership of the Holding Company and the indirect ownership of the ILS P&C Re and its segregated cell accounts.
 - Credit Suisse Asset Management ("CSAM") is the investment manager and has delegated the investment advisory functions to ILS Investment Management Limited ("ILS IM"). ILS IM is also the holder of the voting shares in the Master Fund. As a result, ILS IM should be considered to control ILS P&C Re, Cell Q and RNICE.
- 3.12 RNICE was incorporated on 29 August 1979 under the name San Francisco Insurance Company (U.K.) Limited. It traded from that time until and including 1987, when it ceased underwriting. In February 1989, its insurance business was transferred to St Paul Fire and Marine Insurance Company (U.K.) Limited. The transfer was approved by the Secretary of State for Trade and Industry. All claims in the name of San Francisco Insurance Company (U.K.) Limited then became liabilities of St Paul Fire and Marine Insurance Company (U.K.) Limited after the transfer. No liability in relation to this period remains with RNICE.

- 3.13 RNICE was not authorised to, and did not, trade in 1989 or 1990. It was reauthorised to trade on 27 February 1991. RNICE was purchased by Reliance National (UK) Limited on 15 February 1991 and changed its name to Reliance National Insurance Company (UK) Limited on 1 March 1991. It then recommenced underwriting insurance business. Its ultimate holding company was Reliance Group Holdings Inc. The company changed its name to Reliance National Insurance Company (Europe) Limited on 30 September 1996.
- 3.14 On 15 January 2001 RNICE informed the Financial Services Authority that it had resolved to cease underwriting. Reliance Group Holdings Inc. filed for Chapter 11 bankruptcy protection in the United States of America on 11 June 2001. RNICE voluntarily surrendered its licenses on 29 November 2001.
- 3.15 Following its US parent Reliance Insurance Company ("Reliance US") being placed into liquidation on 3 October 2001, RNICE was acquired in October 2003 by Whittington Investments (Guernsey) Limited, a company incorporated in Guernsey. RNICE was subsequently purchased by ILS P&C Re, following regulatory approval of the change in control on 2 October 2013.
- 3.16 RNICE implemented a Solvent Scheme of Arrangement in 2006 (Compromise or arrangement, Section 425 of the Companies Act 1985) which had the effect of finalising the vast majority of the company's claim liabilities with the final scheme claims being settled in August 2012.
- 3.17 There were 16 non-employers' liability policies that were excluded from the Solvent Scheme of Arrangement because they were unexpired at that time. Although the risk exposures in respect of these policies are expired as of 31 December 2016, it remains possible for claims to arise from them from past events during the periods of cover. RNICE is currently unaware of any active claims from these policies.
- 3.18 The remaining portfolio consists of 4,336 employers' liability policies originally underwritten by RNICE. As a compulsory class of insurance business these policies were not eligible for the solvent scheme which concluded in 2012. RNICE maintains a comprehensive list of employers' liability policies on the database of employers' liability policies maintained by the Employers' Liability Tracing Office ("ELTO"). ELTO is an independent body set up to provide claimants with access to a database of employers' liability policies through an online search facility, to assist them in locating their employer's insurer.
- 3.19 RNICE underwrote the majority of its policies on a single year basis as part of a subscription market. RNICE participated as a follow market subscriber and is not known to have led any policies. In most cases independent third party lawyers are appointed to protect the market interest. In cases where external lawyers have been instructed, the lawyers' reserve estimates are booked by RNICE and split by case, claimant and own costs.
- 3.20 There is no outwards reinsurance currently applicable.
- 3.21 As of 31 December 2016, RNICE had been advised of potential claims on 10 of the 4,336 policies and no claims on the non-employers' liability policies that were excluded from the scheme. Most of these advised employers' liability claims appertain to one policy (Baker Hughes) which was written for one year, being the 1998 year of account. These claims relate to hearing losses, occurring at one Northern Irish factory. There are 24 open claims as at 31 December 2016 with case reserves on 8 of these totalling £25,017. The internal Armour actuarial team has projected IBNR claims of £54,266, making total projected claims reserves of £79,283 on a best estimate basis. RNICE held significantly higher claims provisions than this of £206,204 as at 31 December 2016.

- 3.22 In 2014 and 2015 RNICE was advised of 3 potential mesothelioma cases relating to employers' liability policies written in 1992, 1993 and 1994 respectively. Since then no formal claims have been intimated. RNICE considers that its exposure in relation to these 3 cases is extremely limited. RNICE's potential exposure to mesothelioma claims is from its underwriting activity from 1991 to 2001. This period falls outside the most significant market exposures to these claims because of significant increases in awareness and the regulation of the use of asbestos in the UK.
- 3.23 I consider that RNICE's exposure to future mesothelioma claims would be expected to be very limited because:
- RNICE's employers' liability exposures are in the 1990's when asbestos use was strictly regulated in the UK and there was high awareness of the dangers of asbestos.
 - While RNICE may be exposed by periods of employment which overlapped with its coverage period, it would be reasonable to expect that RNICE would typically benefit from claims-sharing. In this context however, I note that in the unlikely event of all the other involved parties being insolvent, RNICE would have to assume sole responsibility for losses.
- 3.24 There was no separate provision held by RNICE as at 31 December 2016 in respect of unallocated loss adjustment expenses on a UK GAAP basis, although allowance has been made for such expenses in the Solvency II balance sheet as at 31 December 2016.
- 3.25 The following table summarises the profit and loss accounts of RNICE for each of the 2014 (restated), 2015 and 2016 financial years on a UK GAAP basis, before the Proposed Scheme:

Table 3.4: RNICE year-end profit and loss accounts

£ thousands	2014 restated	2015	2016
Net claims incurred	(62)	(36)	(8)
Net operating expenses	(138)	(185)	(150)
Movement in run-off provision	(111)	39	8
Investment income	13	1	1
Foreign exchange rate movement on assets	379	174	642
Taxation	0	0	0
Total profit / (loss) after tax	81	(7)	493

- 3.26 The following table summarises the balance sheets of RNICE as at each of 31 December 2014 (restated), 31 December 2015 and 31 December 2016 on a UK GAAP basis, before the Proposed Scheme:

Table 3.5: Summary RNICE UK GAAP Balance Sheets

£ thousands	31 December 2014 restated	31 December 2015	31 December 2016
Assets			
Debtors	42	0	3
Cash at bank and in hand	3,997	4,032	4,537
Total assets	4,039	4,032	4,540
Liabilities			
Outstanding claims provision	253	214	206
Other creditors	361	378	411
Accruals and deferred income	26	48	38
Total capital resources	3,399	3,392	3,885
Total liabilities	4,039	4,032	4,540

- 3.27 The following table summarises the Solvency II balance sheet of RNICE as at 31 December 2016, before the Proposed Scheme:

Table 3.6: Summary RNICE Solvency II Balance Sheet as at 31 December 2016

Amounts in £ thousands	31 December 2016
Total assets	4,540
Total liabilities	749
Available Capital Resources	3,790
SF SCR	1,078
Minimum Capital Requirement ("MCR")	3,332
MCR Solvency Cover ratio	114%

- 3.28 RNICE is a very small entity and its SCR is determined using the SF approach. Due to its small size, RNICE's SF SCR falls well below the MCR which in this case is the Absolute Minimum Capital Requirement ("AMCR"). The Available Capital Resources are 114% of the AMCR, which specifies RNICE's regulatory capital requirement instead of the SCR.
- 3.29 RNICE's available capital on a Solvency II basis of £3.8 million and total shareholders' funds on a UK GAAP basis of £3.9 million differ by £0.1 million as at 31 December 2016. This is due to different treatments under Solvency II and UK GAAP of various balance sheet items.

The Transferring Portfolio

- 3.30 The Transferring Portfolio comprises a portfolio of Italian and Spanish medical malpractice business, which was placed in run-off during 2013.
- 3.31 The Transferring Portfolio consists of the liabilities arising from several underwriting blocks of medical malpractice insurance. The business was written across Italy and Spain providing coverage to public hospitals, private hospitals and healthcare institutions. All policies in the Transferring Portfolio were issued to policyholders located in either Italy or Spain, and are governed by Italian law or Spanish law respectively.

Italian Portfolio

- 3.32 In Italy QIE wrote claims-made medical malpractice liability policies from 2002 until 2013 with the last risks expiring in 2014. Claims-made policies cover valid claims arising from potential loss circumstances notified to the insurer during the policy period subject to a retroactive date which is the earliest date of occurrence for which a claim will be covered by the policy. QIE took the decision to cease underwriting Italian medical malpractice business in 2013 as it was then classified as non-core business.
- 3.33 The Italian policies predominantly provided coverage to public hospitals, private hospitals and healthcare institutions based solely in Italy in a number of different regions. Apart from one assumed reinsurance cedant ("Carige"), which has now been commuted, all policies were written on a direct basis. With the exception of two policyholders, QIE wrote the business 100% without co-insurance. Policies were issued on a claims-made basis and often include a self-insured retention ("SIR") or a deductible on a single claim or aggregate basis. There are only three policies with unlimited retroactive dates. Further new claims are not anticipated by QIE and RNICE, given the expiry of the claims-made policies and the general lack of extended reporting periods. There is a small amount of high retention facultative excess-of-loss reinsurance in place in respect of some of the Italian business. This Facultative Reinsurance is placed with a single EEA reinsurer with an A+ financial strength rating from A.M. Best.
- 3.34 QIE underwrote 190 Italian policies of which approximately 142 had open claims pending as at 31 December 2016. There were approximately 2,069 open claims with a total carried gross indemnity case reserve of €95.2 million net of deductibles, SIRs and Facultative Reinsurance as at 31 December 2016, including the Carige commutation payment of €19.5 million which was made during February 2017.

Spanish Portfolio

- 3.35 In Spain, QIE wrote a smaller volume of claims-made medical malpractice liability business from 2005 until 2011 with the last risk expiring in 2012. The business was placed in two parts: the Madrid business written from 2005 to 2010; and the Valencia business written from 2009 to 2011. In both cases, the policyholders are Madrid and Valencia health authorities responsible for a small number of individual hospitals. The policies were all written on a direct basis with no reinsured cedants. The policies were all written on a 100% basis with no co-insurance. There are no policy deductibles nor is there inuring reinsurance. The policies were written on a claims-made basis and, unlike Italy, included defined, limited discovery periods which have all now expired.
- 3.36 QIE underwrote three Spanish polices with approximately 636 open claims with a total carried case indemnity reserve of €6.6 million as at 31 December 2016.

Claims provisions as at 31 December 2016

- 3.37 Claims provisions of €106.6 million, net of deductibles, SIRs and Facultative Reinsurances but gross of other reinsurances, were held as at 31 December 2016 in respect of the Transferring Portfolio, comprising the following components:
- Case reserves of €95.2 million in respect of the Italian portfolio. This amount includes an agreed commutation amount of €19.5 million in respect of the Carige reinsurance portfolio, for which the commutation was agreed prior to 31 December 2016 and the commutation payment was made during February 2017.
 - Case reserves of €6.6 million in respect of the Spanish portfolio.
 - Incurred but not reported claim amounts ("IBNR"), comprising allowance for unreported claims and movements in existing case reserves to ultimate settlement, of €4.9 million.

3.38 Claims provisions as at 31 December 2016, net of all reinsurances including the LPTA, in respect of the Transferring Portfolio were zero.

Legal agreements governing the Transferring Portfolio

3.39 The following legal agreements were made in connection with the Transferring Portfolio:

- A Loss Portfolio Transfer Agreement ("LPTA"), with an effective date of 1 July 2014, between QIE, Tokio Millennium Re AG, Bermuda Branch ("TMR") and ILS P&C Re in respect of its segregated account A ("Cell A"), under which TMR and ILS P&C Re agreed to provide separate aggregate reinsurance contracts to QIE in respect of the Transferring Portfolio. ILS P&C Re provides aggregate reinsurance coverage in excess of the aggregate limit under the TMR reinsurance contract.
 - A Deed of Charge ("Security Deed") between QIE and TMR creating a charge in favour of QIE over the custody account in which the premium paid to TMR under the LPTA ("Premium") is held subject to the terms of the Custody Agreement referred to below. The Security Deed provides security to QIE for the performance of TMR's obligations as reinsurer under the LPTA.
 - A Claims Handling Agreement ("Claims Handling Agreement") between QIE and Armour Risk Management Limited ("ARM") under which ARM assumes responsibility for providing various claims management services in respect of the Transferring Portfolio. ARM also employs a network of Third Party Administrators ("TPAs") in Italy and Spain.
 - A Transfer Agreement ("Transfer Agreement") between QIE and RNICE, a fully owned ILS P&C Re subsidiary, under which the parties agree to pursue a Part VII transfer of the Transferring Portfolio from QIE to RNICE.
 - A Custody Agreement ("Custody Agreement") between QIE, TMR and The Bank of New York Mellon, London Branch ("BNY Mellon") setting out the basis on which BNY Mellon acts as custodian of the premium and any other funds provided by TMR in accordance with the terms of the LPTA to ensure that the value of the funds in the account reaches the required level, as calculated from time to time under the terms of the LPTA.
 - A further agreement ("Retrocession Agreement") between TMR and ILS P&C Re for and on behalf of its segregated account Cell A, under which ILS P&C Re agrees to provide retrocession coverage which corresponds to the obligations and liabilities of TMR towards QIE under the LPTA.
 - A Trust Agreement ("Trust Agreement") between TMR, ILS P&C Re for and on behalf of its segregated account Cell A, and HSBC Bank USA, National Association ("HSBC") under which various trust account arrangements are agreed in respect of funds supporting the Retrocession Agreement between TMR and ILS P&C Re.
- 3.40 I understand from QIE and RNICE that all of the above legal agreements will remain in force if the Proposed Scheme does not proceed. This is because the agreements do not contain termination rights contingent upon the Proposed Scheme not proceeding.

Purpose of the Proposed Scheme

3.41 I have been informed by QIE and RNICE ("the Parties") that:

- RNICE entered into an agreement with QIE on 15 August 2014 to acquire its Italian and Spanish medical malpractice portfolio (in run-off), with the Parties obliged to endeavour to transfer the portfolio from QIE to RNICE by an insurance portfolio transfer pursuant to Part VII of FSMA.
- The staff managing the portfolio transferred from QIE to ARM with effect from 5 September 2014 pursuant to the LPTA. ARM entered into a Claims Handling Agreement with QIE to manage the run-off of the portfolio, and the portfolio was 100% reinsured by TMR and ILS P&C Re.
- The Proposed Scheme is therefore the final part of the acquisition process to transfer the portfolio from QIE to RNICE. The Proposed Scheme is intended to fulfil the Parties' contractual obligations. No further consideration will be paid between the Parties in respect of the Proposed Scheme.

Summary of the Proposed Scheme

3.42 The intended date of the Proposed Scheme is 31 October 2018 (the "Effective Date").

3.43 I understand from QIE and RNICE that the Proposed Scheme will involve transferring from QIE to RNICE:

- The entire liabilities of the Transferring Portfolio (i.e. the portfolio of Italian and Spanish medical malpractice policies, which were placed in run-off during 2013)
- Entitlement to a small number of Facultative Reinsurance contracts which attach to the Transferring Portfolio.

3.44 I also understand that, in combination with the Proposed Scheme, the following further actions will all take place:

- The reinsurance contract, as part of the LPTA, between RNICE (transferred from QIE) and TMR, with an aggregate limit of €335,980,711 in respect of unpaid claims from the Transferring Portfolio from 1 July 2014 onwards, will terminate.
- The reinsurance contract, as part of the LPTA, between RNICE (transferred from QIE) and ILS P&C Re in respect of Cell A, in excess of an aggregate amount of €335,980,711, will terminate.
- The Custody Agreement will terminate.
- The Retrocession Agreement between TMR and ILS P&C Re in respect of Cell A will terminate.
- The Trust Agreement will terminate.
- The total amount of funds in the Secured Accounts (comprising the Cash Secured Account and the Securities Secured Account, which were established by the LPTA) will be transferred directly to RNICE before the Effective Date of the Proposed Scheme but following sanction of the Proposed Scheme.
- The Claims Float Account, including the TPA Claims Float Accounts, (which was established by the Claims Handling Agreement) will continue to be held by ARM on trust for RNICE, instead of QIE.

- A pre-defined amount of funds will be transferred from the Trust Account (which was established by the Trust Agreement) directly to RNICE before the Effective Date of the Proposed Scheme but following sanction of the Proposed Scheme. The amount of funds to be transferred from the Trust Account to RNICE is defined by the following calculation:
 - A capital amount (“Capital Amount”) in respect of the Transferring Policies is to be calculated, which is equal to A less B plus C where:
 - A = 75% of the best estimate element (“Best Estimate”) of the Solvency II Technical Provisions (“SII Technical Provisions”) of RNICE.
 - B = the Risk Margin (“Risk Margin”) component of RNICE’s SII Technical Provisions.
 - C = Deductible asset balances in respect of amounts due for more than 6 months.

A and B are calculated as at a fixed date of 31 March 2018 as if the transfer had taken place as at that date. Item C is calculated as at the date of the transfer.

 - The total amount of funds to be transferred to RNICE from the combination of the Secured Accounts, Claims Float Account and Trust Account before the Effective Date of the Proposed Scheme will have the effect that the Available Capital Resources of RNICE following the Proposed Scheme will be equal to the Capital Amount.
- To the extent reasonably practicable:
 - The assets of RNICE which correspond to the best estimate component of the SII Technical Provisions of RNICE following the Proposed Scheme will be converted to Euro-denominated investments before the Effective Date of the Proposed Scheme to the extent that they are not already denominated in Euros.
 - The assets of RNICE which correspond to the Available Capital Resources of RNICE plus the Risk Margin component of the SII Technical Provisions following the Proposed Scheme will be converted to US dollar-denominated investments before the Effective Date of the Proposed Scheme to the extent that they are not already denominated in US dollars.

3.45 The actions described in the preceding paragraph are documented in the following legal agreement(s):

- The Insurance Business Transfer Scheme.
- A letter entitled “Project Docklow: Termination of LPTA, amendment of Transfer Agreement, and release of collateral and security” (“the LPTA Amendment Agreement”).
- A letter entitled “Project Docklow: Trust Agreement – Withdrawal of Assets from the Trust Account” (“the TA Amendment Agreement”).

3.46 The following provisions have been made to ensure that the Proposed Scheme and all of the actions in paragraph 2.7 will take place in combination with each other:

- It is specified in the Insurance Business Transfer Scheme that:
 - The Proposed Scheme will only be implemented on the Effective Date if the required transfers of funds from each of the Secured Accounts and Trust Account have been received by RNICE.
 - To the extent reasonably practicable, the funds transferred to RNICE will be converted before the Effective Date into Euros (in respect of funds corresponding to the Technical Provisions) and US dollars (in respect of funds corresponding to Available Capital Resources), to the extent that the transferred funds are not already denominated in these currencies.
- The LPTA Amendment Agreement requires the parties to that agreement to give instructions for the transfer directly to RNICE of funds held in the Secured Accounts, following the Sanction Hearing.
- The TA Amendment Agreement requires the parties to that agreement to give instructions for the transfer directly to RNICE of the pre-defined amount of funds held in the Trust Account, following the Sanction Hearing.

3.47 I understand that RNICE has changed its reporting currency to US dollars.

3.48 I have reviewed a copy of a letter from the Bermuda Monetary Authority that confirms that it does not object either to the transfer of funds from Cell A to Cell Q of ILS P&C Re, or to the Proposed Scheme and related actions subject to the appropriate PRA, FCA and UK High Court approvals.

3.49 My conclusions are predicated on the assumption that the Parties will present evidence to the Sanction Hearing demonstrating that the following important assumptions, on which this report is based, are true:

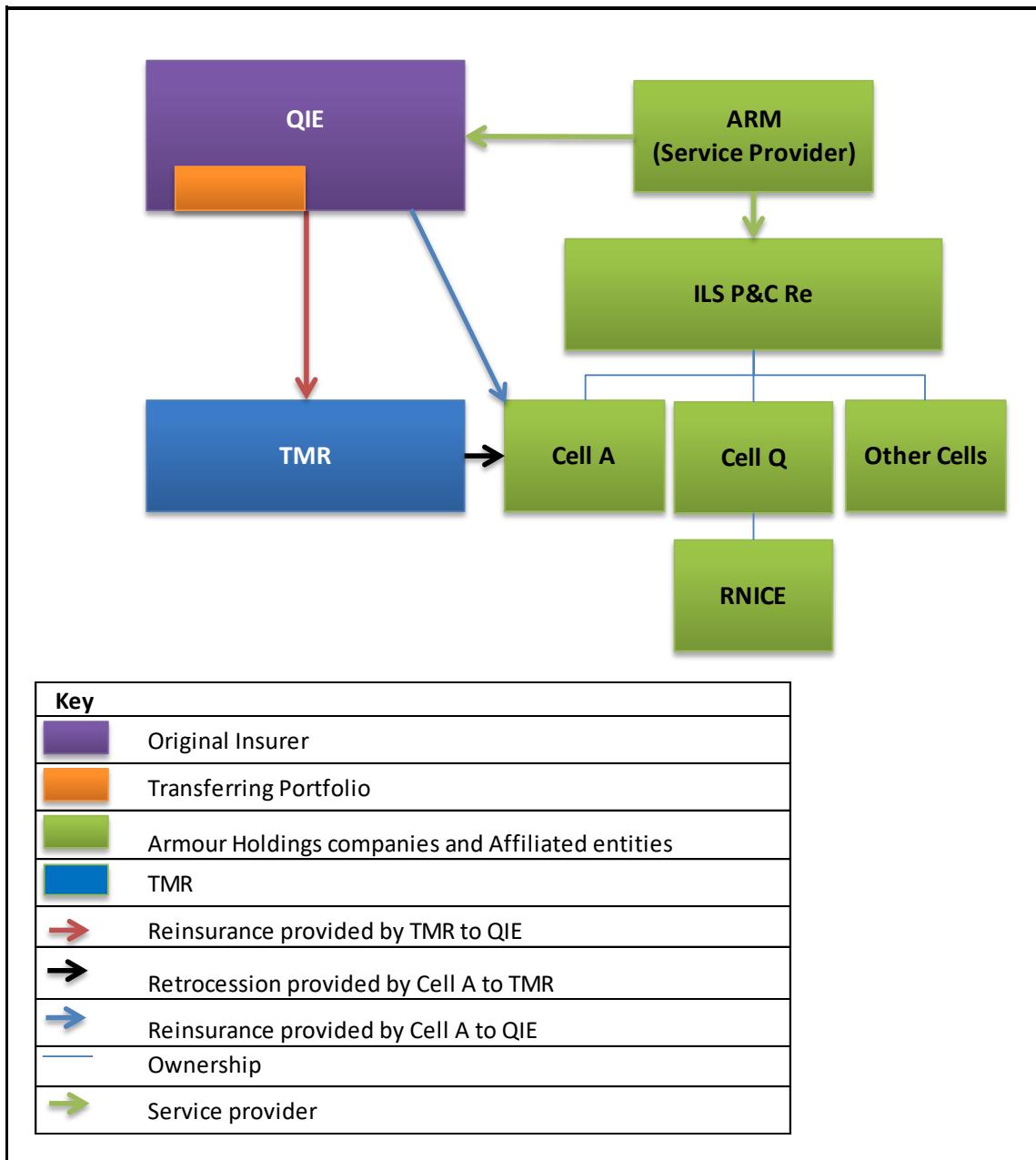
- The Proposed Scheme and all of the actions described in paragraph 2.7 will take place in combination with each other.
- RNICE's investment policy will remain consistent with that indicated by its SCR calculation.

3.50 The Claims Handling Agreement, which is an outsourcing arrangement, will continue to apply between RNICE, in place of QIE, and ARM following the Proposed Scheme. The existing Claims Handling Agreement will be novated in its exact current form after the proposed transfer so no change to claims handling is expected to arise because of the Proposed Scheme.

3.51 The following diagrams summarise the key aspects of the corporate structures before and after the Proposed Scheme.

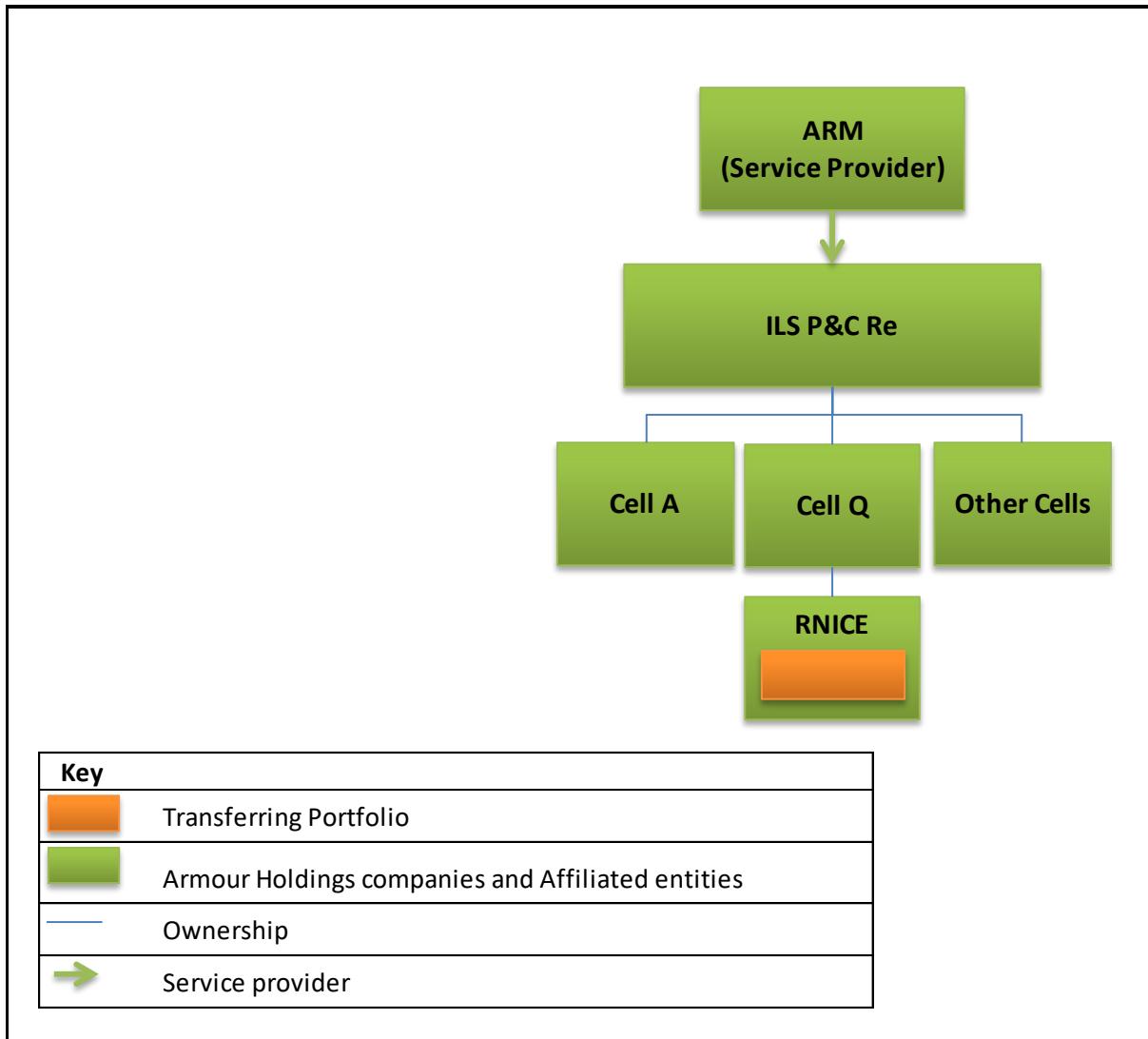
3.52 The diagram below provides an overview of the corporate structures before the Proposed Scheme. It does not show the related collateral arrangements.

Overview of Structure before the Proposed Scheme



3.53 The diagram below provides an overview of the corporate structures after the Proposed Scheme.

Overview of Structure after the Proposed Scheme



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Section 4: Reserving considerations

Overview

- 4.1 In this section I consider reserving issues relevant to QIE, the Transferring Portfolio and RNICE. I also consider the reserving volatility of the transferring portfolio in the context of the SF SCR Reserving risk factor.

Reserve Strength

- 4.2 One of the key questions for policyholders potentially affected by the Proposed Scheme is whether the financial security of their actual or potential claims is affected. This is primarily a question of how the available capital compares to the risks to which each company is exposed. However, when comparing financial strength between entities, a potential distorting factor is the strength of the reserves. If a company has stronger reserves this will result in its capital resources being lowered and weaker reserves will result in its capital resources being increased. It is also important for policyholders to understand any unusual uncertainties in the liabilities as they could affect the likely adequacy of the capital.

QIE Reserve Strength

- 4.3 For QIE, I have been provided with details of the reserves and documentation in respect of the internal management review which has been performed as at 31 December 2016, in respect of the following reserves held at that date, before the Proposed Scheme. The internal management review comprised a detailed internal reserve review as at 30 September 2016 and a less detailed roll-forward reserve review as at 31 December 2016. I have also had access to an independent reserve review undertaken by an external third party consulting firm as at 31 October 2016. Both the internal reserve review and the external third party independent reserve review indicate that held Technical Provisions as at 31 December 2016 are a little higher than a best estimate of future claims payments:

Table 4.1: QIE Technical Provisions as at 31 December 2016

£ million	Gross of reinsurance	Net of reinsurance
Technical Provisions		
Provision for unearned premiums	798	739
Outstanding claims provision	3,095	2,080
Total reserves	3,893	2,819

- 4.4 I have not attempted to review in detail the calculations performed. Instead, I have considered the process by which the reserves have been set, the approach followed by the internal actuaries, the key areas of reserve uncertainty and the apparent strength of the reserves, as discussed in their reports.
- 4.5 The internal reserving reports indicate that, as would be expected for this type of account, the claims provisions, gross of reinsurance, are subject to a substantial degree of uncertainty, which is concentrated in the following areas: long tail disease claims such as noise induced hearing loss ("NIHL") and mesothelioma claims, exposure to catastrophe and large loss events in respect of the 2014 to 2016 underwriting years, the exposure of UK bodily injury claims to changes in the UK discount rate for determining lump sum settlements and the possibility of changes in the proportion of settlements in the form of periodical payment orders ("PPOs"), and UK regulatory changes.

4.6 Based on the above review my conclusions concerning the reserves of QIE as at 31 December 2016, are as follows:

- A reasonable approach has been adopted to the assessment of the premium provisions and claims provisions.
- The premium provisions and claims provisions represent a reasonable estimate of future claims developments.
- The overall level of uncertainty surrounding the claims provisions is not unusual for an account of this type.

Reserve Strength of the Transferring Portfolio

4.7 For the Transferring Portfolio, I have been provided with details of the reserves and documentation in respect of the internal reserve assessment which has been performed as at 31 December 2016, relating to the following reserves held at that date, which are denominated in Euros. This internal reserve review as at 31 December 2016 was largely based on an independent reserve review undertaken by an external third party consulting firm as at 30 June 2016. The RNICE internal actuarial team then established the following claims provisions as at 31 December 2016 after making allowance for the development of gross incurred claims between 1 July 2016 and 31 December 2016. The internal actuarial team maintained the same allowance for IBNR claims, net of deductibles, SIRs and Facultative Reinsurances but gross of other reinsurances, as at 31 December 2016 as had been projected by the external third party consulting firm as at 30 June 2016:

Table 4.2: Transferring Portfolio Technical Provisions as at 31 December 2016

£ million	Gross of reinsurance	Net of reinsurance
Technical Provisions		
Provision for unearned premiums	0	0
Outstanding claims provision	91	0
Total reserves	91	0

4.8 I have not attempted to review in detail the calculations performed. Instead, I have considered the process by which the reserves have been set, the approaches followed by the internal and external actuaries, the key areas of reserve uncertainty and the apparent strength of the reserves based on this review, as discussed in the reports and analyses which have been provided to me.

4.9 In my opinion, the following matters are relevant to the assessment of the Technical Provisions in respect of the Transferring Portfolio as at 31 December 2016:

- The Transferring Portfolio has been written on a claims-made basis. There are only three policies with unlimited retroactive dates meaning that valid claims can be submitted irrespective of the occurrence date of the event which gave rise to the claim. With this exception, all other policyholders have limited retroactive dates with the earliest being 1997.
- The Transferring Portfolio was placed into run-off during 2013. For all policies, there is a contractual requirement, which I understand is enforced strictly by ARM, that any circumstances which might give rise to a claim must be notified to QIE within a maximum of two years of the event or action which could potentially give rise to a claim. This limits the potential for new claims to be notified in the future, and new claims should only arise from previously reported circumstances.

- The management of the Transferring Portfolio was moved during 2014 from QBE to ARM. ARM has adopted a much more proactive approach to the management of the run-off of the claims portfolio. This has included the appointment of new third party administrators, the establishment of new claims management procedures, new claims estimation methodologies and the proactive closure of claims which are considered very unlikely to experience any further claims activity.
- An effect of these ARM initiatives has been to distort claims development patterns and to potentially increase the risk that claims will be reopened in the future. My team has met with ARM to understand the nature of the Transferring Portfolio, changes in claims processes and issues relating to the management and settlement of claims. Based on my review of these discussions, I am satisfied that the approach adopted by ARM to the management of the Transferring Portfolio is reasonable and appropriate, and that there is only a small risk of a significant number of reopened claims emerging in the future.
- Most of the Italian contracts have either deductibles or self-insured retentions which need to be taken into account in the reserving process.
- Deductible arrangements tend to apply mainly to Italian medical malpractice contracts written prior to 2010. Under these arrangements, QIE is responsible for paying the whole of the claim and is then able to recover the deductible from the insured party. I understand from ARM that the recovery of outstanding deductibles is managed proactively by ARM, and that the recovery of deductibles has only been affected by limited delays and minor disputes.
- New schedules of legal fees and medical fees have been implemented, which are expected to have the effect of reducing significantly overall legal fees and medical fees. Furthermore, RNICE has reduced the number of principal third party administrators in Italy since 31 December 2016 from three to one, following a competitive tender.
- Self-insured retentions apply only to Italian medical malpractice contracts written from 2010 onwards, although deductibles continued to apply for some policyholders between 2010 and 2013. Self-insured retentions tend to be significantly larger than the deductibles which applied typically in earlier years. The insured is solely responsible for payment of amounts below the self-insured deductibles.

4.10 My conclusions, concerning the reserves of the Transferring Portfolio as at 31 December 2016 are set out in the following paragraphs.

4.11 Based on my review as summarised above, I consider that a reasonable approach has been adopted to the assessment of the best estimate claims provisions as at 31 December 2016. My opinion takes account of:

- The relatively benign development of Italian gross incurred claims for the period from 31 December 2014 to 30 June 2016 in respect of each of the 2002 to 2013 underwriting years inclusive.
- The favourable aggregate gross incurred claims development for Italian medical malpractice claims during the second half of 2016. Total gross incurred claims have reduced by €11.2 million during this six month period.
- An external claims audit in early 2017, based on the review of a sample of 190 claims files in respect of both closed and open claims, which concluded that the claims are being handled effectively, case estimates are appropriate in most cases, and there is limited scope for future reopening of closed claims.

4.12 In particular:

- I am satisfied that the claims provisions are a reasonable best estimate, having regard to the nature of the business which has been written, the changes in claims management processes and the allowance which has been made for deductibles and self-insured retentions.
- I am satisfied that it is reasonable to expect a relatively limited scope for either new claims or reopened claims to emerge after 31 December 2016.

4.13 The overall level of uncertainty surrounding the claims provisions is higher than I would normally expect for a portfolio of this type, in view of:

- The changes in claims management processes which are described above, which have had the effect of distorting claims development patterns in respect of the Transferring Portfolio.
- The significant projected amount of deductible amounts payable by policyholders to QIE (US\$6.9 million relating to gross claims payments and US\$28.5 million relating to gross case estimates) which remained outstanding as at 31 December 2016.
- Additional uncertainty which is caused by the relatively high level of self-insured retentions in respect of the most recent underwriting years. While I understand that there is no information to suggest that this will happen, it remains possible that there are current claims below the self-insured retentions which could develop above the self-insured retentions in due course and give rise to claims payments.

4.14 I consider that this uncertainty in absolute terms is likely to reduce significantly over the next few years as the Transferring Portfolio runs-off and the liabilities reduce over time.

4.15 I consider that the outstanding claims provision represents a reasonable estimate of future claims development, based on the wide range of possible outcomes which is implied by the various significant uncertainties which are described above. However, I consider that these uncertainties will be taken into account in the capital assessment for RNICE following the Proposed Scheme.

RNICE Reserve Strength

4.16 For RNICE, I have been provided with details of the reserves and documentation in respect of the internal management review which has been performed as at 31 December 2016, in respect of the following reserves held at that date, before the Proposed Scheme:

Table 4.3: RNICE Technical Provisions as at 31 December 2016

£ thousands	Gross of reinsurance	Net of reinsurance
Technical Provisions		
Provision for unearned premiums	0	0
Outstanding claims provision	206	206
Total reserves	206	206

4.17 I have not attempted to review in detail the calculations performed. Instead, I have considered the process by which the reserves have been set, the approach followed by the internal actuaries, the key areas of reserve uncertainty and the apparent strength of the reserves as discussed in their reports.

4.18 While there would be differences if I were to have performed these calculations myself, I do not consider these to be material in the context of my assessment of the Proposed Scheme. The conclusions from my review of RNICE's claims reserves as at 31 December 2016, are as follows:

- The UK GAAP claims provisions of £0.2 million represent a prudent estimate of future claims developments as at 31 December 2016, excluding allowance for future unallocated claims expenses. The RNICE internal actuary has estimated a comparable provision of £0.1 million which I consider to be reasonable.
- The Finance department of RNICE has estimated that future ULAE as at 31 December 2016 amounts to £0.2 million. This amount has not been included as a liability in the RNICE balance sheet as at 31 December 2016 on a UK GAAP basis, although allowance has been made for such expenses in the Solvency II balance sheet as at 31 December 2016.
- The SII Technical Provisions of £0.3 million, which includes the Risk Margin and allowance for future unallocated claims expenses, appears reasonable and is based on the £0.1 million best estimate, a £0.2 million allowance for ULAE and a Risk Margin consistent with Solvency II requirements.
- The overall level of uncertainty affecting the claims provisions is not unusual for an account of this type.

Reserving risk factor

4.19 I consider that the 11% factor underlying the reserving risk charge in the Standard Formula for the calculation of the SCR is too low in the context of RNICE following the Proposed Scheme, and that a higher factor of 15% would be more appropriate. To reflect this I have calculated an alternative view of the SII SF SCR based on my view of the increased reserve risk volatility. For the Transferring Policyholders, I refer to this alternative SII SF SCR as the tailored SII SF SCR.

4.20 The RNICE capital assessment prepared by the Armour actuarial team makes reference to an independent review of reserve volatility in respect of the Transferring Portfolio, prepared by an external third party consulting firm as at 30 June 2016. This external third party review contains an analysis of reserve variability, based on a variety of approaches. The resulting factors, based on these alternative approaches, vary widely from below 10% to more than 20%. My team and I have reviewed the principal assumptions underlying each of these alternative results in order to form my own view.

4.21 I have based my selected alternative reserving risk factor of 15% on the following principal considerations:

- The higher reserving risk factors of the order of 20% tend to be based on the experience of the Transferring Portfolio prior to 2013 and the variability to ultimate rather than variability over a one year time horizon (the Solvency II SCR reserve risk charge is based on reserve variability over a one year time horizon). I am satisfied, based on my investigations, that the management of the run-off of the Transferring Portfolio has improved significantly following the appointment of ARM in 2014, and that this is likely to have had the effect of reducing reserve variability. I have concluded therefore that a reserving risk factor of 20% would be too high.
- The lower reserving risk factors of the order of 10% tend to be based on the experience of benchmark portfolios, gross of reinsurance but net of deductibles. The benchmark portfolios are larger than, and significantly more diversified than, the Transferring Portfolio which mainly comprises Italian medical malpractice policies. I have concluded therefore that a reserving risk factor of 10% would be too low.

- I would expect that reserving risk factors applicable to Technical Provisions which are net of reinsurance, deductibles and SIRs would tend to be higher than the corresponding factors applicable to Technical Provisions which are gross of reinsurance, deductibles and SIRs. This reflects the likelihood that Technical Provisions which are net of reinsurance, deductibles and SIRs will be more highly geared than gross Technical Provisions to fluctuations in claims experience.
- I have had regard to:
 - Benchmark information which is available to me regarding the relationship between variability over a one year time horizon and variability to ultimate.
 - An analysis regarding the possible relationship between measures of variability, which are either net or gross of reinsurance, deductibles and SIRs.
- The run-off of the Transferring Portfolio has been favourable during the past three years with claims tending to settle for amounts which are lower than the corresponding case reserves. For example, total gross incurred claims have reduced by €11.2 million during the 6 month period from 1 July 2016 to 31 December 2016. There is significant uncertainty about the extent to which this favourable experience will be sustained in the future. The outstanding claims provisions held in respect of the Transferring Portfolio take little or no credit for a continuation in the future of this recent favourable claims experience. In my assessment, I have taken a small amount of further credit for the likelihood that there is an element of prudence in the current outstanding claims provisions for the Transferring Portfolio.
- I have undertaken an analysis to confirm that my selected alternative reserving risk factor of 15% can be shown to be reasonable, based on adjusting the various results arising from the independent review of reserve volatility to reflect the considerations which are outlined above.

Section 5: Security considerations

Overview

- 5.1 In this section, I discuss considerations arising from the effect of the Proposed Scheme on the security of policyholders' contractual rights. In other words, I have considered, whether and the extent to which, the Proposed Scheme is expected to affect the likelihood that policyholders' claims will be paid.
- 5.2 I have considered the likely effects of the Proposed Scheme on the security of policyholders' contractual rights for the following three groups of policyholders:
- The policyholders remaining with QIE.
 - The policyholders transferring from QIE to RNICE ("the Transferring Policyholders").
 - The current policyholders of RNICE.
- 5.3 In the case of each of the three groups of policyholders listed in paragraph above, I have considered the security of the policyholders on two bases:
- The current position which corresponds to the position should the Proposed Scheme not proceed (the "Pre-Scheme Position").
 - The position should the Proposed Scheme proceed (the "Post-Scheme Position").
- 5.4 I am not aware of any reasons why distinct sub-groups of these three groups of policyholders would be treated differently by the Proposed Scheme and would therefore merit separate consideration.
- 5.5 The Proposed Scheme provides for the possibility that certain liabilities or assets may not be, or may not be capable of being, transferred on the Effective Date ("Retained Business"). I understand from the witness statement of Mr Neil Christopher Sutton that it is not expected that there will be any Retained Business, and I assume therefore in this report that this is indeed the case.
- 5.6 Security for policyholders is provided by assets backing the technical reserves and by net shareholder assets. In considering policyholder security, it is also necessary to take account of the potential variability of future experience (including investment returns, claims experience, expense levels and wider operational risks), and potential future distributions to, or capital injections from, shareholders. Another factor is the nature of the reinsurance arrangements. Finally, security is affected by the nature and volume of future new business (if any).
- 5.7 When considering the likely effects of the Proposed Scheme, the solvency positions and assets of the following companies are relevant:
- The Pre-Scheme Position of QIE relative to the Post-Scheme Position of QIE (for the policyholders remaining with QIE).
 - The Pre-Scheme Position of QIE relative to the Post-Scheme Position of RNICE (for the Transferring Policyholders).
 - The Pre-Scheme Position of RNICE relative to the Post-Scheme Position of RNICE (for the current policyholders of RNICE).

- 5.8 In addition, in a large group, additional security may be provided as a result of the position of the company in the group and any applicable guarantees which are in place.
- 5.9 Under the Proposed Scheme the aggregate reinsurance protections provided by TMR and ILS P&C Re to QIE in respect of the Transferring Portfolio and the related collateral arrangements will be cancelled. However, it should be understood that these arrangements benefit QIE, and not the policyholders directly. Prior to the Proposed Transfer, the Transferring Policyholders are ultimately reliant on QIE's financial security.
- 5.10 It is important that the Proposed Scheme and all the actions described in paragraph 2.7 will take place in combination with each other on the Effective Date. My understanding is that the Proposed Transfer will take place on this basis.

Regulatory capital position

- 5.11 QIE and RNICE are both regulated by the PRA and FCA in the UK.
- 5.12 Summaries of the capital positions of QIE and RNICE, before and after the Proposed Scheme, are set out in Section 3.
- 5.13 A new Europe-wide regulatory regime, Solvency II, was implemented on 1 January 2016. It is appropriate therefore to consider the likely capital positions of QIE and RNICE under Solvency II.
- 5.14 Companies subject to Solvency II are required to hold available capital resources which are above 100% of the Solvency Capital Requirement ("SCR"). Under Solvency II, the SCR may be calculated using an approved Internal Model or the Standard Formula. QIE's SCR is calculated using an approved Internal Model. RNICE's SCR is calculated using the SF SCR.
- 5.15 Although the regulatory capital requirement is based on the SCR, this is subject to not being less than the minimum capital requirement ("MCR") which is subject to an absolute minimum amount ("AMCR"). Pre-transfer, RNICE's regulatory capital requirement is based on the AMCR because its small size results in an SCR which is lower than the AMCR.

Internal capital assessments

- 5.16 In order to assess the Pre-Scheme and Post-Scheme Position of:
 - The policyholders remaining with QIE;
 - The policyholders transferring from QIE to RNICE ("the Transferring Policyholders"); and
 - The current policyholders of RNICE.

I have placed reliance on the results of the existing capital modelling work and reserving work which have been undertaken by each of QIE and RNICE, and which I have reviewed (and adjusted in some cases) as described below.
- 5.17 I have been provided with the following information:
 - The 2014, 2015 and 2016 Own Risk and Solvency Assessment ("ORSA") reports of the QBE European operations, including QIE.
 - Assessments of the SCR for QIE as at 31 December 2016, both before and after the Proposed Scheme.
 - Solvency II quantitative reporting templates ("QRTs") for QIE as at 31 December 2016.

- The 2015 and 2016 ORSA reports of RNICE.
 - Assessments of the SCR for RNICE as at 31 December 2016, both before and after the Proposed Scheme.
 - Projections of the future SCR for RNICE as at 30 September 2017, 31 March 2018 and 30 September 2018.
 - Solvency II QRTs for RNICE as at 31 December 2016.
- 5.18 The SCR and ORSA capital assessments aim to quantify the capital required by each company to reflect the risks to which it is exposed. The risks include not only the traditional insurance risk and investment risk, but also other areas of risk such as credit risk and operational risk.
- 5.19 My team and I have reviewed the documentation provided of the internal capital assessment models and the estimated Solvency II capital requirements, and have had follow-up discussions with the staff responsible for these assessments.

QIE

UK GAAP balance sheets

- 5.20 The following table shows the balance sheets of QIE, on a UK GAAP basis as at 31 December 2016, before and after the Proposed Scheme:

Table 5.1: QIE UK GAAP Balance Sheets as at 31 December 2016 showing effect of Scheme

£ million	31 December 2016 before Proposed Scheme	Transferring Business	31 December 2016 after Proposed Scheme
Assets			
Investments	3,507	0	3,507
Reinsurers' share of Technical Provisions			
Provision for unearned premiums	59	0	59
Claims outstanding	1,016	91	924
Debtors	934	0	934
Other assets	196	0	196
Prepayments and accrued income	194	0	194
Total assets	5,905	91	5,814
Liabilities			
Total shareholders' funds	1,392	0	1,392
Technical provisions			
Provision for unearned premiums	798	0	798
Claims outstanding	3,095	91	3,004
Equalisation provision	0	0	0
Other provisions	2	0	2
Creditors	608	0	608
Accruals and deferred income	10	0	10
Total liabilities	5,905	91	5,814

- 5.21 On a UK GAAP basis, the Proposed Transfer would have no effect on QIE's total shareholders' funds. On a Solvency II basis QIE's balance sheet would be also affected to an immaterial extent.

Capital considerations

- 5.22 The following table shows the Available Capital Resources, SCR and the Solvency Cover ratio of QIE on a Solvency II basis as at 31 December 2016, before and after the Proposed Scheme. QIE's SCR is calculated using an Internal Model approved by the PRA. Under the SF, QIE's SCR would be a larger amount which would reduce the pre-Scheme Solvency Cover ratio from 140% to 130%.

Table 5.2: Summary of QIE Solvency Cover as at 31 December 2016

Amounts in £ million	31 December 2016 before Proposed Scheme	31 December 2016 after Proposed Scheme
Available Capital Resources	1,277	1,277
Internal Model SCR	909	894
Solvency Cover ratio	140%	143%

- 5.23 The results indicate that, following the Proposed Scheme, the policyholders remaining with QIE will continue to have policies with a well-capitalised company, whose level of shareholders' funds provides a security level in excess of the SCR.
- 5.24 QIE's IM SCR Solvency Cover Ratio is expected to increase slightly from 140% to 143%. This means that the security of the policyholders remaining with QIE is likely to be slightly improved by the Proposed Scheme.
- 5.25 A summary of QIE's SCR by risk type is set out in the table below. The largest risk is Insurance risk which arises from Premium risk due to underwriting activity and Reserve risk due to potential variability in the claim reserves. Credit risk is the next largest and reflects the significant scale of QIE's reinsurance cessions. The Market risk is dominated by Currency, Spread and Equity risk. As would be expected, diversification is significant at an overall level.

Table 5.3: QIE Regulatory Capital Requirement as at 31 December 2016

Amounts in £ million	Internal Model SCR	% of Diversified
Insurance Risk	839	92%
Market risk	112	12%
Credit Risk	216	24%
Operational Risk	160	18%
Other risks	15	2%
Diversification	(433)	(48%)
Internal Model SCR	909	100%

- 5.26 My team and I have reviewed the documentation provided for the estimation of the SCR prepared by QIE as at 31 December 2016. The SCR has been assessed by QIE using a detailed QBE EO approved internal capital model. In my opinion, the QIE IM SCR forms a reasonable basis for assessing its capital requirements.

- 5.27 QIE's governance structure is built around QBE EO's governance framework. QBE EO's ORSA process covers all of its operating entities including QIE. The 2016 ORSA report for QBE EO contains a detailed set of risk appetites for each of the above key risks, and evidences a rigorous approach to:
- The management and modelling of risk by QBE EO.
 - Governance and accountability for individual risks.
 - Governance, accountability and validation of the various components of the internal model which underlie the calculated SCR for QBE EO.
 - Stress and scenario testing to assess the robustness of the QIE internal capital model and the QBE EO capital position to a wide variety of stress and scenario tests.
- 5.28 QIE has an internal objective for the SCR coverage ratio to remain in excess of 130%. If the SCR coverage ratio were to fall below a lower level of 120% for any reason, QIE would undertake a range of remedial measures, which would be likely to include some or all of:
- A reassessment of the capital plan and risk position
 - The reduction or suspension of remittances to the parent company
 - The possible draw-down from a contingent capital facility.
- 5.29 There are no guarantees protecting the policyholders of QIE.
- 5.30 I understand that QIE has no defined benefit pensions obligations on its balance sheet. Pensions risk is therefore not considered in my analysis of QIE's capital position.

QIE conclusions

- 5.31 I have considered the likely effect of the Proposed Scheme on the capital position of QIE. The risk profile of QIE will not change significantly following the Proposed Scheme as:
- The Transferring Portfolio, gross of reinsurance, is a small component of QIE's portfolio which accounts for 3.5% of the claims outstanding at 31 December 2016
 - The net of reinsurance liabilities of QIE in relation to the Transferring Portfolio are zero, as the Transferring Portfolio is 100% reinsured by a combination of TMR and ILS P&C Re.
- 5.32 The Proposed Scheme is expected to slightly increase the QIE IM SCR Solvency Cover ratio as:
- The QIE Technical Provisions, net of reinsurance, in respect of the Transferring Portfolio are zero before the Proposed Scheme. This means that the QIE total Technical Provisions, net of reinsurance, and the Available Capital Resources as at 31 December 2016 will not be changed by the Proposed Scheme.
 - The QIE SCR as at 31 December 2016 will reduce slightly following the Proposed Scheme as QIE will no longer be exposed to counterparty default risk in respect of the aggregate reinsurance contracts protecting the Transferring Portfolio. I have received and reviewed a QIE analysis showing that the QIE SCR as at 31 December 2016 would be expected to reduce by approximately £15 million following the Proposed Scheme.

RNICE

UK GAAP balance sheets

- 5.33 The following table shows the balance sheets of RNICE, on a Solvency II basis as at 31 December 2016, before the Proposed Scheme, and an approximate projection as at 30 September 2018, after the Proposed Scheme.
- 5.34 The balance sheet before the Proposed Scheme is shown in sterling as at 31 December 2016 as this was the reporting currency of RNICE at that time. The balance sheet after the Proposed Scheme is shown in both sterling and US dollars because the reporting currency of RNICE has now changed to US dollars. The 31 December 2016 currency exchange rate of £1 = US\$1.2303 is used for currency conversion.

Table 5.4: RNICE Balance Sheets before and after the scheme

	31 December 2016 before Proposed Scheme	30 September 2018 (projected) after Proposed Scheme	
	£ million	£ million	US\$ million
Assets			
Debtors	0.0	4.2	5.2
Cash at bank and in hand	4.5	55.0	67.7
Investments	0.0	51.7	63.6
Total assets	4.5	110.9	136.5
Liabilities			
Technical Provisions			
Best Estimate	0.3	58.3	71.7
Risk Margin	0.0	3.9	4.7
Other creditors	0.4	0.0	0.0
Accruals and deferred income	0.0	0.0	0.0
Total capital resources	3.8	48.8	60.0
Total liabilities	4.5	110.9	136.5

Capital considerations

- 5.35 The following table shows the Available Capital Resources and SCR of RNICE on a Solvency II basis as at 31 December 2016, before the Proposed Scheme, and as at 30 September 2018 (projected), after the Proposed Scheme. The figures before the Proposed Scheme are shown in pound sterling million as the reporting currency of RNICE was pounds sterling at that time. RNICE has changed its reporting currency to US dollars. The figures after the Proposed Scheme are therefore shown in pound sterling and US\$ million as the reporting currency of before the Effective Date. The figures shown are converted using a currency exchange rate of £1 = US\$1.2303.

Table 5.5: Summary of RNICE Solvency Cover before and after the scheme

	Pre-Scheme 31 December 2016	Post-Scheme 30 September 2018	
	£ million	£ million	US\$ million
Available Capital Resources	3.8	48.8	60.0
SF SCR	1.1	24.2	29.8
Regulatory Capital Requirement	3.3	24.2	29.8
Tailored Capital Requirement	3.3	31.1	38.3
Solvency Cover ratio – Regulatory basis	114%	201%	201%
Solvency Cover ratio – Tailored basis	114%	157%	157%

- 5.36 I consider that the relationship between Available Capital Resources and the regulatory capital requirement for RNICE, before the Proposed Scheme, would be broadly similar at each of 31 December 2016 and 30 September 2018. This is because RNICE's SII Technical Provisions are very small and the Regulatory Capital Requirement is based on the Absolute Minimum Capital Requirement which is a prescribed fixed Euro amount. On this basis, notwithstanding the different effective dates, the above table provides a reasonable indication of the relative capital positions of RNICE, before and after the Proposed Scheme.
- 5.37 The projected ratio of the available capital resources to the tailored SCR as at 30 September 2018, based on my assessment of the required SCR, after the Proposed Scheme, is equal to approximately 157%; on this basis the SF SCR ratio increases to 201%.
- 5.38 The following table shows RNICE's SCR breakdown based on both Standard Formula and tailored bases immediately after the Proposed Scheme. The largest risk is Insurance risk which arises from Reserve risk due to potential variability in the claim reserves. Credit risk is the next largest and reflects the expected collections of Deductible payments from policyholders.
- 5.39 Market risk is relatively low in relation to the SCR because immediately after execution of the Proposed Scheme RNICE's Best Estimate Technical Provisions will be currency matched because:
- Assets corresponding to the Best Estimate SII Technical Provisions following the Proposed Scheme will be converted to Euro-denominated investments before the Effective date of the Proposed Scheme if they are not already denominated in Euros.
 - Assets corresponding to the capital resources and the Risk Margin of the SII Technical Provisions following the Proposed Scheme will be converted to US dollar-denominated investments before the Effective date of the Proposed Scheme if they are not already denominated in US dollars.

Table 5.6: Regulatory Capital Requirement after Proposed Scheme as at 30 September 2018

£ million	Standard SF SCR	% of Diversified	Tailored SCR	% of Diversified
Insurance Risk	19.2	79%	26.2	84%
Market risk	0.7	3%	0.7	2%
Credit Risk	5.2	21%	5.2	17%
Operational Risk	1.7	7%	1.7	6%
Diversification	(2.6)	(11%)	(2.7)	(9%)
Diversified SCR Capital Requirement	24.2	100%	31.1	100%

5.40 I understand that RNICE has no defined benefit pensions obligations on its balance sheet. Pensions risk is therefore not considered in my analysis of RNICE's capital position.

SCR Projection Simplifications

5.41 The following simplifications have been made in the RNICE projections of the Proposed Scheme:

- The Capital Amount Calculation excludes Deductible amount in respect of balances that are due for more than 6 months. This approximation is prudent in the sense that the projections are on a basis that will understate the actual amounts to be transferred under the scheme.
- The SCR was calculated in full by RNICE as at 30 September 2017 and has been projected forward on an approximate basis at future dates by pro-rating the SCR component risks using the key balance sheet risk drivers. For example, Insurance Risk is scaled using the SII Best Estimate Technical Provisions.

Stress Test scenarios

5.42 We have considered RNICE's Post-Scheme capital adequacy under the following stress test scenarios that emerge over 1 year as follows:

- Reserve Risk scenarios:
 - A 40% increase in the SII Technical Provisions that emerges after 1 year (as at 30 September 2019) following the execution of the Proposed Scheme. This is equivalent to a 25% increase in the SII Technical Provisions as at 30 September 2018
 - A 60% increase in the SII Technical Provisions that emerges after 1 year (as at 30 September 2019) following the execution of the Proposed Scheme. This is equivalent to a 38% increase in the SII Technical Provisions as at 30 September 2018
- Credit Risk scenario: We have assumed that 25% of the projected deductible recoveries on execution of the Proposed Scheme are not recoverable and this is fully recognised after 1 year.
- Market Risk scenario: An assumption that RNICE's asset distribution becomes mismatched by currency with the liabilities by assuming that payments during the year ended 30 September 2019 are made in US dollars instead of matching currencies.

5.43 The following table summarises the results. The base scenario is based on the best estimate projected balance sheet as at 30 September 2019. The results suggest that RNICE is robustly capitalised under the Proposed Scheme.

Table 5.7: Stress Test projections as at 30 September 2019

Amounts in US\$ million	Proposed Scheme	Reserve risk scenarios			Credit risk scenario	Market risk scenario
		40% increase in 2019 TPs	60% increase in 2019 TPs			
Available Capital Resources	61.5	42.1	32.4		53.9	61.5
Reduction in Capital Resources	0.0	19.3	29.0		7.6	0.0
SF SCR	20.3	26.7	29.9		19.8	23.0
Solvency Cover Ratio – SF SCR	303%	158%	109%		272%	267%
Tailored SCR	25.6	34.2	38.5		25.2	28.1
Solvency Cover Ratio – Tailored SCR	240%	123%	84%		214%	219%

RNICE Dividend Policy

5.44 I understand that the dividend policy of RNICE, following the Proposed Scheme, may be summarised as follows:

- The Directors will assess the capital of RNICE relative to the regulatory requirements. They will determine a margin above this level that, in their discretion, provides adequate allowance for fluctuations in experience to be absorbed without the regulatory requirement being challenged.
- From time to time the Directors will consider payment of dividends. Such payments will only be considered to the extent permitted under the Solvency II Framework Directive, and only to a level such that RNICE continues to comply with the SCR applicable to RNICE under Solvency II plus a margin the Directors consider appropriate.

5.45 As a UK-domiciled run-off company, RNICE will only be permitted to pay dividends or extract capital if the PRA confirms that it has no objection to such actions.

RNICE Investment Policy

5.46 I understand from RNICE that it intends to maintain an asset allocation approach that is consistent with that indicated by its SF SCR calculation assumptions, although RNICE's current Investment Guidelines permit a high degree of flexibility with 0% to 25% Equity allocation. In accordance with its financial projections, I understand from RNICE that it does not envisage making equity investments and is reviewing its investment management framework in order to more accurately reflect its intended investment stance.

5.47 In light of the asset allocation basis used for the SF SCR calculations, my conclusions are conditional on the assumption that the asset portfolio indicated by the SCR calculation reflects the core positioning of the Investment Strategy envisaged for RNICE Post-Scheme subject to matching the liabilities by duration and currency appropriately.

5.48 I intend to comment on RNICE's updated investment management framework in my supplementary report.

RNICE conclusions

- 5.49 The total amount of funds to be transferred to RNICE from the combination of the Secured Accounts, Claims Float Account and Trust Account before the Effective Date of the Proposed Scheme will have the effect that the Available Capital Resources of RNICE following the Proposed Scheme will be equal to the Capital Amount.
- 5.50 The principal conclusions of my review of the RNICE capital assessment, following the Proposed Scheme, which has been undertaken by the Armour actuarial team, are summarised below:
- The tailored SCR Solvency Cover ratio is 157% if the Effective Date of the Proposed Scheme is 30 September 2018 and experience emerges in line with expectations; on this basis the SF SCR increases to 201%.
 - Provided that the ultimate loss cost underlying the reserve estimates does not increase materially, the tailored SCR Solvency Cover ratio is expected to progressively increase over the next 3 to 5 years as the Transferring Portfolio runs off, assuming that no dividends are extracted. This is because there will be reductions in capital requirements as the unpaid liabilities reduce over time.

Solvency Cover ratio commentary

- 5.51 I consider that initial Solvency Cover ratio of 157% on the basis of the tailored SCR, under the Proposed Scheme, would be satisfactory as the Available Capital Resources, following the Proposed Scheme, would be substantially in excess of the required SCR under Solvency II regulations.
- 5.52 I have based this view on the following principal considerations:
- While good practice is still emerging following the introduction of Solvency II at the start of 2016, it appears to be normal for companies which are subject to Solvency II regulation to seek to maintain their Available Capital Resources at a level which is at least 120% of the required SCR.
 - I consider that RNICE should hold a significantly higher margin than 120%, at the Effective Date of the Proposed Scheme, because:
 - The Transferring Portfolio is relatively undiversified with most policies being in respect of Italian medical malpractice business.
 - The changes in claims management processes, including the appointment of ARM during 2014, have had the effect of distorting claims development patterns. This has increased the degree of uncertainty surrounding analyses of reserve variability for the Transferring Portfolio.
 - Provided that the ultimate loss cost underlying the reserve estimates does not increase materially, the Solvency Cover ratio on both the tailored and regulatory bases is expected to increase significantly during the next three to five years as the Transferring Portfolio runs-off, before allowing for any dividend payments. As a UK run-off company, RNICE will only be permitted to pay dividends or extract capital if the PRA confirms that it does not object to such actions.

Security of the policyholders remaining with QIE

- 5.53 The policyholders remaining with QIE have policies with a well-capitalised company, QIE, whose level of shareholders' funds provides a security level in excess of the SCR. This means that QIE is estimated to have sufficient capital to meet its obligations over a one year period in more than 99.5% of cases. In other words, before the Proposed Scheme, the shareholders' funds of QIE are estimated to be more than sufficient to absorb the financial impact of a 1-in-200 year event.
- 5.54 The QIE Solvency Capital Requirement ("SCR") is calculated using a PRA approved Internal Model ("IM"). Under Solvency II, companies may, subject to the approval of the insurance supervisor determine the SCR using an IM. For the sake of clarity, I refer to the QIE SCR as the "IM SCR".
- 5.55 There are no guarantees protecting the policyholders of QIE.
- 5.56 The risk profile of the policyholders remaining with QIE will not change significantly following the Proposed Scheme as:
- The Transferring Portfolio, gross of reinsurance, is small relative to the total business of QIE being 3.5% of QIE's gross claims outstanding reserves as at 31 December 2016.
 - The net of reinsurance liabilities of QIE in relation to the Transferring Portfolio are zero, as the Transferring Portfolio is 100% reinsured by a combination of TMR and ILS P&C Re.
- 5.57 The Proposed Scheme is expected to slightly increase the QIE IM SCR Solvency Cover ratio for the policyholders remaining with QIE. This is because:
- The QIE Technical Provisions, net of reinsurance, in respect of the Transferring Portfolio are zero as at 31 December 2016 before the Proposed Scheme. This means that the QIE total Technical Provisions, net of reinsurance, and Available Capital Resources as at 31 December 2016 will not be changed by the Proposed Scheme.
 - The QIE SCR as at 31 December 2016 will reduce slightly following the Proposed Scheme as QIE will no longer be exposed to counterparty default risk in respect of the aggregate reinsurance contracts protecting the Transferring Portfolio.
- 5.58 This means that, following the Proposed Scheme, the policyholders remaining with QIE will continue to have policies with a well-capitalised company, whose level of shareholders' funds imply a security level in excess of the SCR. I consider that this is satisfactory.
- 5.59 In summary, in my opinion, the security of the policyholders remaining with QIE is not materially adversely impacted by the Proposed Scheme.

Security of the policyholders transferring from QIE to RNICE

- 5.60 The Transferring Policyholders currently have policies with a well-capitalised company, QIE, whose level of shareholders' funds provides a security level in excess of the SCR.

5.61 The risk profile of the Transferring Policyholders will change following the Proposed Scheme as follows:

- The Transferring Policyholders will move to a company, RNICE, which is expected to have a Solvency Cover ratio of 157% on the basis of my tailored assessment of the required capital. Under the SII SF SCR, the transferring policyholders will have Solvency Cover ratio of 201%. My tailored assessment of the SCR for the Transferring Policyholders is based on SII SF SCR with an adjustment to reflect my view of the increased reserve risk volatility applicable to the portfolio instead of the assumption that would apply under the SII SF SCR.
- Provided that the ultimate loss cost underlying the reserve estimates does not increase materially, the Solvency Cover ratio on both the tailored and regulatory bases is expected to increase significantly during the next three to five years as the Transferring Portfolio runs-off, before allowing for any dividend payments. As a UK run-off company, RNICE will only be permitted to pay dividends or extract capital if the PRA confirms that it does not object to such actions.
- The Transferring Policyholders will move to a company, RNICE, with a significantly lower level of diversification and which is only protected by a small amount of Facultative Reinsurance. Against this, the Transferring Policyholders will no longer be exposed to underwriting risks from new business.
- RNICE will not have the benefit of the following arrangements which were previously available to QIE in respect of the Transferring Portfolio:
 - The aggregate reinsurance contracts currently provided to QIE by TMR and ILS P&C Re.
 - The Custody Agreement and the Trust Agreement which currently provide collateral in respect of the aggregate reinsurance contracts which are underwritten by TMR and ILS P&C Re for the benefit of QIE.

However, in this context it should be understood that the above arrangements were put in place as part of the LPTA and there is no obligation for such arrangements to continue in the event that the LPTA were to be cancelled.

5.62 In summary, the Proposed Scheme is projected to result in Solvency Cover ratios of 157% and 201% on the basis of the tailored and SF SCR respectively.

5.63 Subject to RNICE maintaining an appropriate investment policy that is consistent with that indicated by its Post-Scheme SCR calculations, based on the above analysis I consider that the security of the Transferring Policyholders is not materially adversely impacted by the Proposed Scheme.

Security of RNICE's current policyholders

- 5.64 As at 31 December 2016, the current policyholders of RNICE have policies with a small company whose level of shareholders' funds provides a security level in excess of the Solvency II required capital which in this case is the AMCR.
- 5.65 In light of the small size of RNICE's reserves, I consider that the SF SCR would underestimate the underlying capital requirement because the Standard Formula is calibrated in the context of larger more diversified entities. I consider the AMCR is a more appropriate, albeit prudent, indication of security because this capital level would allow for the emergence of material unanticipated losses that could arise under remote scenarios and I have adopted this measure as my tailored SCR.

5.66 The risk profile of the current policyholders of RNICE will change significantly following the Proposed Scheme. The current policyholders of RNICE will be exposed to additional risks in respect of the Transferring Portfolio, including:

- The risk that the Technical Provisions in respect of the Transferring Portfolio will not be sufficient to cover the run-off of outstanding claims.
- The risk that RNICE will be unable to reclaim outstanding deductible amounts from policyholders in respect of the Transferring Portfolio.
- The risk that there will be significant adverse movements in the value of assets, including any currency exchange rate risk, to be transferred to RNICE in connection with the Proposed Scheme.

5.67 Against the assumption of additional risk, the current policyholders of RNICE will potentially benefit from:

- A significant increase in the tailored SCR Solvency Cover ratio from 114% to 157%.
- A significant increase in the scale of RNICE's operations which means that the volatility that could arise from RNICE's current policyholders would be far less material to RNICE in the context of its capital resources.

5.68 In the event of insolvency, current RNICE policyholders would have access to the Financial Services Compensation Scheme ("FSCS") which provides cover for 100% of losses for compulsory policies and 90% of losses for non-compulsory insurances with no upper limit. There are 16 non-compulsory policies and 4,336 compulsory policies. As of 31 December 2016, RNICE had been advised of potential claims on 10 of the 4,336 compulsory policies and no active claims on the 16 non-compulsory policies.

5.69 Subject to RNICE maintaining an appropriate investment policy that is consistent with that indicated by its Post-Scheme SCR calculations, I consider that the security of the current policyholders of RNICE is not materially adversely impacted by the Proposed Scheme for the following reasons:

- RNICE's Solvency Cover ratio on the basis of my tailored capital assessment will increase substantially post-transfer.
- RNICE's business will be substantially more diversified and the scale of its capital resources in excess of regulatory requirements and my tailored capital assessment will have increased significantly beyond the extent of expected claims from RNICE's current policyholders.
- Post-transfer there is a significant increase in the scale of RNICE's available capital resources in excess of regulatory requirements.
- The policyholders will continue to have access to the FSCS in the event of a failure.

Other comments relating to security

5.70 The following highlights the other key areas I have considered which relate to the security of the three groups of policyholders which are listed in paragraph 5.2.

Accounting and reserving approach

5.71 I understand from QIE that the Proposed Scheme will not affect the approach adopted to accounting and reserving by QIE.

5.72 I understand from RNICE that:

- The Proposed Scheme will not affect the accounting approach for either the Transferring Policyholders or the current policyholders of RNICE
- The Proposed Scheme will not affect the reserving approach for the claims of both the Transferring Policyholders and the current policyholders of RNICE.

Insolvency

5.73 I am required to consider the effects of the insolvency of both QIE and RNICE, both before and after the Proposed Scheme. As I have explained above, the likelihood of QIE and RNICE being able to pay all future claims either before or after the Proposed Scheme will remain in excess of the level implied by the SCR. This means that the possibility of the insolvency of either QIE or RNICE (before or after the Proposed Scheme) is remote.

Ranking of policyholders in a winding-up

5.74 The following considerations are relevant:

- In the event of the insolvency of an insurer or reinsurer in the UK such as QIE and RNICE, the direct policyholders rank ahead of the reinsurance policyholders when the assets of the insolvent company are allocated to its creditors
- All of the Transferring Policyholders are direct policyholders. This implies that the ranking of the remaining policyholders of QIE in the event of the insolvency of QIE will improve marginally. However, the effect of this would be very small in view of the small size of the Transferring Portfolio in the context of the overall business of QIE
- In contrast, the current policyholders of RNICE would rank alongside the Transferring Policyholders in the event of the insolvency of RNICE following the Proposed Scheme. While this may represent a reduction in security for the current policyholders of RNICE, as noted above the possibility of the insolvency of RNICE after the Proposed Scheme is considered to be remote.

Policyholder compensation schemes

5.75 The following considerations are relevant:

- Certain UK policyholders of both QIE and RNICE currently have access to the UK Financial Services Compensation Scheme (“FSCS”), and their access to the FSCS would not be changed by the Proposed Scheme
- The Transferring Policyholders are all domiciled in either Italy or Spain. The Proposed Scheme does not affect the position on the availability (if any) of compensation for the Transferring Policyholders under the FSCS, so if any party has protection (or no protection) before the Proposed Scheme, that party would continue to have protection (or no protection) following the Proposed Scheme.

Tax implications of the Proposed Scheme

5.76 I understand from QIE that the Proposed Scheme is expected to have no material tax implications for QIE.

5.77 I understand from RNICE that the Proposed Scheme is expected to have no material tax implications for RNICE.

Trust funds

- 5.78 I understand from QIE and RNICE that there are no trust funds within either the Transferring Portfolio or RNICE.

Liquidity

- 5.79 The Proposed Scheme will not have any significant effect on the liquidity of QIE policyholders as no investments are being transferred from QIE to RNICE.
- 5.80 The Proposed Scheme will increase the liquidity of RNICE as most of the assets being transferred to RNICE in connection with the Proposed Scheme (and related actions) are liquid assets such as cash, cash equivalents and bonds.

Brexit

- 5.81 In June 2016, the UK voted to leave the European Union (“EU”) (“Brexit”). Brexit could have a potential effect on the Proposed Scheme because both QIE and RNICE are UK authorised insurance companies and the Transferring Policyholders are all domiciled in either Italy or Spain.
- 5.82 The EU and the UK government have agreed that there should be a transitional period until the end of 2020 as part of the Withdrawal Agreement between the EU and the UK. However, this transitional period is conditional on the Withdrawal Agreement between the EU and the UK being approved. If this were not the case then the transitional period until the end of 2020 would not take effect.
- 5.83 Solvency II passporting rights effectively enable insurers authorised in one EEA state to carry out insurance business in other EEA states on the basis of home state authorisation. An opinion paper published by the European Insurance and Occupational Pensions Authority (“EIOPA”) on 21 December 2017 indicates that, if the UK were to withdraw from the EEA without an agreed Withdrawal Agreement, UK firms would not be able to rely on passporting rights granted under Solvency II to service the run-off of pre-Brexit policies that had been written on a passporting basis in other EEA countries. The paper mandates that firms prepare appropriate contingency plans to ensure continuity of service to policyholders.
- 5.84 QBE EO has established a newly incorporated (re)insurer, QBE Europe SA/NV domiciled in Belgium. This entity is scheduled to underwrite 2019 renewals of EEA business. In the event that QIE is no longer able to rely on passporting rights in respect of pre-Brexit EEA policies, QIE is also undertaking a portfolio transfer of the majority of its European branch business to this new entity (“the QIE Brexit Portfolio Transfer”). I understand that the Transferring Policyholders are excluded from the QIE Brexit Portfolio Transfer, in light of an expectation that both the Proposed Scheme and the QIE Brexit Portfolio Transfer are expected to be sanctioned in Q4 2018.
- 5.85 I understand that RNICE intends to obtain any authorisation which may be necessary from the Italian and Spanish regulators to permit it to continue to service the Transferring Policies following Brexit. There is currently a lack of clarity as to the approach that will be taken in relation to UK authorised insurers in run-off whose sole activity will be the payment of claims under pre-existing policies covering risks in Spain or Italy. RNICE is taking legal advice from local counsel with the intention of ensuring that when the position becomes clearer, it can address any requirements of local law and regulation, including applying for any authorisation that may be required on a timely basis.

- 5.86 QIE and RNICE are both UK authorised insurance companies and are therefore in similar positions regarding Brexit in needing to take steps to ensure that they can continue to service EEA policyholders after Brexit in the event that authorised UK insurance firms are no longer permitted to service EEA pre-Brexit run-off policies originally written on a passporting basis without fulfilling additional requirements.
- 5.87 In light of the uncertainties affecting Brexit and the potential implications for the ability of UK insurers to service EEA pre-Brexit run-off policies originally written on a passporting basis, it is not possible to draw definitive conclusions as to the effect of Brexit on the Transferring Policyholders at this time.
- 5.88 As QIE and RNICE are both UK authorised insurance companies and the Transferring Policyholders are excluded from the scope of the QIE Brexit Portfolio Transfer, the impact of Brexit on the Transferring Policyholders is expected to be similar, whether the Proposed Scheme proceeds or not under the assumption that each of QIE and RNICE takes appropriate steps to minimise potential disruption to policyholders that could arise from Brexit. On this basis I conclude that at the current time the Proposed Scheme can reasonably be expected not to have a material adverse effect on the Transferring Policyholders because of Brexit.

Effect of QIE Brexit Portfolio Transfer on policyholder security

- 5.89 The QIE Brexit Portfolio Transfer could affect the security of:
- Transferring Policyholders if the Proposed Scheme is not sanctioned
 - Policyholders remaining with QIE
- 5.90 The financial projections in this report do not explicitly consider the effect of the QIE Brexit Portfolio Transfer. However, on the basis that the QIE Brexit Portfolio Transfer takes place in a manner that does not materially disadvantage the main groups of the affected policyholders then I consider that it is reasonable to infer that the conclusions of this report will be unaffected with respect to policyholder security.

Change of Scheme Date

- 5.91 The financial projections of the effect of the Scheme were prepared on the basis of a planned Scheme Date of 30 September 2018. The Effective Date has since changed to 31 October 2018. If I were update to the calculations to the Effective Date, my conclusions related to the Proposed Scheme would remain unaltered. However, I note that the RNICE Post-Scheme Solvency Cover Ratios would be expected to increase because of the fixed date of 31 March 2018 used in the determination of the Capital Amount.

Change to QIE Internal Model

- 5.92 I have been informed that the QIE IM SCR as at 31 December 2016 was altered from £909 million, as stated in the analysis underlying this report, to £883 million. I understand that the change related to reinsurance credit risk. The difference is a 2.9% reduction in the IM SCR for QIE. If I were to incorporate the updated IM SCR into my analysis of the Proposed Scheme, the Solvency Cover Ratios for QIE would be expected to increase slightly. However, this change would not affect my conclusions related to the Proposed Scheme.

Supplementary report

- 5.93 This Independent Expert report is based on financial information in respect of QIE, RNICE and the Transferring Portfolio as at 31 December 2016.
- 5.94 I expect to produce a supplementary report in due course, based on the financial positions of QIE, RNICE and the Transferring Portfolio as at an appropriate date, which will take into account actual developments between 1 January 2017 and that date. The appropriate date will be the latest quarter-end for which data is available to allow preparation of the supplementary report in time for the Sanction Hearing ahead of the proposed date of the transfer of 31 October 2018.
- 5.95 In addition to updated financial information, the supplementary report will also consider, amongst other things, updates on Brexit developments and confirmation of RNICE's prospective investment policy.

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Section 6: Other considerations

Other considerations: Overview

- 6.1 In this section, I consider the potential effect of the Proposed Scheme on the arrangements for managing policies and claims, investment risk and expense levels in so far as these are expected to affect the security of policyholders' contractual rights and the levels of service provided to policyholders. My review of these matters is based on my consideration of the information provided to me and my team. I also consider the proposed approach to policyholder communication.
- 6.2 I have considered the likely effects of the Proposed Scheme on service levels for:
 - Policyholders remaining with QIE;
 - The policyholders transferring from QIE to RNICE ("the Transferring Policyholders"); and
 - The current policyholders of RNICE.
- 6.3 I understand from QIE that the Proposed Scheme will not cause any change in the management of policies and claims for policyholders remaining with QIE.
- 6.4 I understand from QIE and RNICE that the Proposed Scheme will not cause any significant change in the management of policies and claims for Transferring Policyholders, as these policies will continue to be managed by ARM. The existing Claims Handling Agreement will be novated in its exact current form after the proposed transfer so no change to claims handling is expected to arise because of the Proposed Scheme.
- 6.5 I understand from RNICE that the Proposed Scheme will not cause any significant change in the management of policies and claims for the current policyholders of RNICE.

Other considerations: Policyholders remaining with QIE

- 6.6 In respect of policyholders remaining with QIE, my view is that the Proposed Scheme is expected to have no effect on service levels, expense levels and the level of investment risk.

Other considerations: Transferring Policyholders

- 6.7 In respect of policyholders transferring from QIE to RNICE, my view is that the Proposed Scheme is expected to have no significant effect on service levels or expense levels.
- 6.8 There may be an increase in investment risk for the Transferring Policyholders, reflecting:
 - The elimination of collateral arrangements related to the cancellation of the aggregate reinsurance contracts currently provided by TMR and ILS P&C Re to QIE in respect of the Transferring Portfolio.
 - The transfer of material funds to RNICE which will be exposed to potential future fluctuations in market value. This will depend on RNICE's prospective investment strategy.
- 6.9 Subject to RNICE maintaining an appropriate investment policy that is consistent with that indicated by its Post-Scheme SCR calculations, I consider that this possible increase in investment risk taken in the context of the expected capitalisation of RNICE after the Proposed Scheme does not change my conclusion that the security of this group of policyholders is not materially adversely impacted by the Proposed Scheme.

Other considerations: Current policyholders of RNICE

- 6.10 In respect of current policyholders of RNICE, my view is that the Proposed Scheme is expected to have no significant effect on service levels or expense levels.
- 6.11 As the Proposed Scheme envisages the elimination of collateral arrangements related to the aggregate reinsurance contracts currently provided by TMR and ILS P&C Re to QIE in respect of the Transferring Portfolio, there will be a transfer of material funds to RNICE. RNICE's asset portfolio will therefore be exposed to potential future fluctuations in market value to an increased extent, although this will depend on RNICE's prospective investment strategy. It is therefore reasonable to expect that there may be an increase in investment risk for the current policyholders of RNICE as a result of the Proposed Scheme.
- 6.12 Subject to RNICE maintaining an appropriate investment policy that is consistent with that indicated by its Post-Scheme SCR calculations, I consider that this possible increase in investment risk taken in the context of the expected capitalisation of RNICE after the Proposed Scheme does not change my conclusion that the security of this group of policyholders is not materially adversely impacted by the Proposed Scheme.

Other considerations: Affected reinsurers

- 6.13 The Proposed Scheme includes the transfer from QIE to RNICE of entitlement to a small number of Facultative Reinsurance contracts which attach to the Transferring Portfolio. I am satisfied that the Proposed Scheme will not have any significant effect on the reinsurers whose contracts of reinsurance are to be transferred by the Proposed Scheme.

Proposed approach to communications with policyholders

- 6.14 The proposed approach to policyholder communication is described in Appendix D to this report. I have been asked to comment on the appropriateness of the proposed approach to policyholder communication. My comments are set out in the following paragraphs.

Communication: Content of circular to policyholders

- 6.15 I consider that the draft circular to policyholders contains an appropriate summary of:
 - The Proposed Scheme, including appropriate references to the further actions which will take place in combination with the Proposed Scheme, described in paragraph 2.7 of this report
 - The conclusions of this Independent Expert report.

Communication: Policyholders remaining with QIE

- 6.16 It is proposed that policyholders remaining with QIE will not receive individual notification of the Proposed Scheme in view of QIE's limited exposure to the Transferring Portfolio which is currently 100% reinsured by a combination of TMR and ILS P&C Re, and the immaterial effect of the Proposed Scheme on the policyholders remaining with QIE. I understand that, given the large number of policyholders remaining with QIE, the cost of individual notification of each QIE policyholder would be substantial.

6.17 I consider that this proposed approach is appropriate, reasonable and proportionate, based on my conclusions that:

- The Proposed Scheme is expected to slightly increase the tailored SCR Solvency Cover ratio on a Solvency II basis for the policyholders remaining with QIE.
- The Proposed Scheme should have no effect on service levels, expense levels or the level of investment risk for the policyholders remaining with QIE.

Communication: Transferring Policyholders

6.18 It is proposed that notification of the Proposed Scheme will only be sent to the Primary Named Insureds under each policy within the Transferring Portfolio, and that no notification will be sent to Named Additional Insureds and Unnamed Additional Insureds (these terms are defined in Appendix D).

6.19 I consider that this approach is appropriate, reasonable and proportionate, given that:

- The Primary Named Insured was responsible for purchasing the policies in each case.
- All communications in relation to the policies are sent to the Primary Named Insured.
- QIE does not have contact details for each Named Additional Insured or for any Unnamed Additional Insureds.
- This approach is consistent with the basis under which the policies operate, with the central management of claims by the Primary Named Insured.

6.20 The Transferring Policyholders also include a small portfolio covering dentists and private practitioners in Italy that was written under a delegated authority through a coverholder. I understand that QIE has contact details for all insureds with open claims and is proposing to notify all such insureds and the coverholder. Contact details are unavailable for other policyholders without open claims.

6.21 These policies were written on a claims-made basis and all coverage expired in 2014. Consistent with this, I have been informed by RNICE that no new claims have been received and no claims have been reopened since 2014. It is reasonable to expect that there should be no unreported claims that are valid under the coverage provided. While there is a theoretical possibility that previously closed claims could re-open, at this stage of maturity, the number of such claims can reasonably be expected to be very small. I therefore consider that the proposed communication approach for these policies is appropriate, reasonable and proportionate.

Communication: Claimants in respect of the Transferring Portfolio

6.22 It is proposed that no notifications will be sent to claimants in respect of policies within the Transferring Portfolio.

6.23 I consider that this is reasonable because claimants are not policyholders and are therefore not entitled to payment under the terms of the policies. QIE has no contractual relationship with claimants. There are also difficulties in obtaining contact information for claimants, and there is a risk of increasing the liability of policyholders (who are liable for deductibles or SIRs) by making direct contact with claimants.

Communication: Current policyholders of RNICE

6.24 It is proposed that notification of the Proposed Scheme will be sent to all current policyholders of RNICE for whom RNICE has been able to obtain contact details. I consider that this approach is appropriate, reasonable and proportionate, based on my understanding that RNICE has undertaken a thorough review of its available records in order to identify its remaining policyholders. It is usually difficult to obtain up-to-date contact details for a run-off portfolio such as that represented by the current policyholders of RNICE.

Communication: Other interested parties

- 6.25 It is proposed that notification of the Proposed Scheme will be sent to:
- The co-insurers of two Italian policies
 - The single outwards reinsurer whose reinsurance policies are transferring.
- 6.26 Notifications of the scheme will not be sent to brokers who originally placed the business with QIE. I consider this reasonable because I understand that claims are handled directly through the Primary Named Assureds and the brokers are currently not involved in communications related to claims.

Appendix A: Glossary of terms

Absolute Minimum Capital Requirement ("AMCR")	This is the absolute minimum amount of the MCR.
APH	Liabilities in respect of asbestos, pollution and health hazard from USA sources.
Armour group	The Armour group of companies.
ARM	Armour Risk Management Limited.
Available Capital Resources	The Own Funds held by a company.
Best Estimate	The best estimate of future cash-flows.
BMA	Bermuda Monetary Authority.
BNY Mellon	The Bank of New York Mellon, London Branch.
Capital Amount	The calculated capital amount which is to be used to define the amount of funds to be transferred from the Trust Account directly to RNICE before the Effective Date.
Claims Handling Agreement	Claims Handling Agreement between QIE and ARM.
Claims-made cover	Claims-made cover provides indemnity for claims notified to the insurer during the policy period irrespective of when the loss occurred. This cover can be subject to a retroactive date, which is the earliest date of occurrence for which a claim will be covered by the policy.
CSAM	Credit Suisse Asset Management.
Custody Agreement	The Custody Agreement between QIE, TMR and BNY Mellon.
Effective Date	The intended effective date of the Proposed Scheme, 31 October 2018.
QBE EO	QBE European Operations plc.
EU	European Union.
EEA	European Economic Area.

Facultative Reinsurance	Facultative Reinsurance is reinsurance for a single risk or a defined package of risks. The ceding company (the primary insurer) is not compelled to submit these risks to the reinsurer, and the reinsurer is not compelled to provide reinsurance protection.
FCA	The Financial Conduct Authority, one of the insurance industry regulatory supervisory authorities in the UK (the other being the PRA).
FSA	The Financial Services Authority, regulatory supervisory authorities of the financial services industry in the UK prior to 1 April 2013, which was replaced by the FCA and PRA.
FSCS	The Financial Services Compensation Scheme, the UK's statutory compensation scheme, which compensates customers of authorised financial services firms in the event that the company is unable pay claims against it.
FSMA 2000	The Financial Services and Markets Act 2000, an Act of Parliament to make provision for the regulation of financial services which details the legal basis for the transfer of an insurance business in the UK.
FRC	The Financial Reporting Council, the UK's independent regulator responsible for promoting high quality corporate governance and reporting. The FRC set standards for corporate reporting, audit and actuarial practice and monitor and enforce accounting and auditing standards.
HSBC	HSBC Bank USA, National Association.
IBNR claims	Incurred but not reported claims, in the context of claims provisions.
ICA	Individual Capital Assessment, an insurance company's own assessment of the capital that they needed to hold for regulatory purposes, based on the Individual Capital Adequacy Standards ("ICAS") regime which applied prior to the implementation of Solvency II on 1 January 2016.
ICG	Prior to the implementation of Solvency II on 1 January 2016, the PRA granted Individual Capital Guidance to all live firms and some run-off firms above a certain size. If the insurance company's ICA was regarded as adequate, the ICG was set equal to the ICA; however, if the PRA believed that the insurance company had not adequately assessed the risk they are exposed to, an additional load would be applied.
ILS IM	ILS Investment Management Limited.
ILS P&C Re	ILS Property & Casualty Re Limited (Bermuda), a company incorporated in Bermuda, licensed as an insurer and as such regulated by the BMA, and registered as a segregated accounts company.
LPTA	The Loss Portfolio Transfer Agreement between QIE, TMR and ILS P&C Re.

Minimum Capital Requirement (“MCR”)	This is the minimum level of capital insurers can hold to remain technically solvent. Any less, and the company would be insolvent for regulatory purposes.
ORSA	Own risk and solvency assessment.
Own Funds	The excess of assets over liabilities.
Parties	QIE and RNICE.
PRA	The Prudential Regulation Authority, one of the insurance industry regulatory supervisory authorities in the UK (the other being the FCA).
Proposed Scheme	The proposed transfer of the Transferring Portfolio from QIE to RNICE.
QBE group	The QBE group of companies.
QIE	QBE Insurance (Europe) Limited, a company within the QBE group.
Reinsurance	This is where an insurance company purchases insurance from a reinsurer in order to lay off some of the risk underwritten by the insurance company.
Report	Independent Expert’s report on the Proposed Scheme.
Retrocession Agreement	The Retrocession Agreement between TMR and ILS P&C Re in respect of its segregated account Cell A.
Risk Margin	Conceptually, a theoretical amount that an insurer would have to pay third party to take on an insurers’ assets and Best Estimate liabilities. Under Solvency II the Risk Margin is calculated using a cost of capital approach.
RNICE	Reliance National Insurance Company (Europe) Limited, a company within the Armour group.
Run-off	Describes the status of an insurance or reinsurance business when it does not accept new business (including policy renewals). The liabilities will gradually reduce over time, or run-off, as the company settles and pays the claims to the policyholders.
Sanction Hearing	The court hearing to consider the sanction of the Proposed Scheme.
Solvency Capital Requirement (“SCR”)	This is conceptually the capital required to ensure that an undertaking can meet all insurance obligations at a 99.5 th percentile value-at-risk over a one year time horizon. This means that a company holding a level of capital equal to the SCR is expected to have sufficient capital to meet its obligations over a one year period in more than 99.5% of cases. In other words, the shareholders’ funds are estimated to be sufficient to absorb the financial impact of a 1-in-200 year loss event.

It is required by EU insurance supervisors that firms will hold at least this level of capital at all times. Insurance supervisors can be expected to get closely involved in the operation of the undertaking if the capital level gets too close to this level.

Security Deed	The Security Deed between QIE and TMR.
Standard Formula ("SF")	The Standard Formula is a non-entity-specific, risk-based mathematical formula used by insurers to calculate their SCR under Solvency II.
SIRs	Self-insured retentions.
Solvency II	An EU directive aimed at harmonising the EU insurance regulation and enhancing consumer protection. The directive applies to all EU-domiciled insurance and reinsurance companies and was implemented on 1 January 2016.
Solvency Cover	The ratio of Available Capital Resources to minimum capital requirements on a defined basis.
SUP 18	Chapter 18, in relation to Transfers of Business, of the Supervision manual in the FCA Handbook.
Technical Provisions	Provisions held by an insurance company (sometimes referred to as reserves) to pay future claims. Technical Provisions usually comprise claims provisions (future payments in respect of claims which have already occurred) and premium provisions (future payments in respect of the unexpired component of premiums received to date). In the context of Solvency II, Technical Provisions are equal to the sum of the best estimate and the risk margin.
Transfer Agreement	The Transfer Agreement between QIE and RNICE.
TMR	Tokio Millennium Re AG, Bermuda Branch. Tokio Millennium Re AG is a reinsurance company, incorporated in Switzerland.
TPAs	Third Party Administrators employed by ARM in Italy and Spain.
Transferring Portfolio	The assets and liabilities of the portfolio of Italian and Spanish medical malpractice business which it is proposed will be transferred from QIE to RNICE.
Trust Agreement	The Trust Agreement between TMR, ILS P&C Re in respect of its segregated account Cell A and HSBC.
UK GAAP	Generally Accepted Accounting Practice in the UK, is the body of accounting standards and other guidance published by the UK Accounting Standards Board (ASB).
ULAE	Unallocated Loss Adjustment Expenses, expenses which are not attributable to a specific insurance claim. ULAE reserves form part of an insurer's expense reserve and can be one of the largest expenses that an insurer has to set aside funds for.
Willis Towers Watson	Towers Watson Limited, authorised and regulated by the FCA.

Appendix B: Curriculum vitae

Role at Willis Towers Watson

John Charles is a Senior Director in the Willis Towers Watson London office with more than 25 years of general insurance experience. John's has extensive claims reserving experience and advises clients on capital management, Solvency II and international accounting standards.

John is also the EMEA Professional Excellence leader for the ICT business of Willis Towers Watson. In this role, John supports the business in managing risk and professional issues.

Relevant Experience/Specialization

John's experience includes reserving projects for a number of insurers and reinsurers including provision of Lloyd's Statements of Actuarial Opinion ("SAOs") and Solvency II Technical provision calculations. He has experience of a diverse range of business classes. John has led and participated in several UK and International M&A due diligence exercises covering reserves, actuarial appraisal values and capital adequacy.

John acts as Head of Actuarial Function for two captive insurers in Ireland. He recently led a project supporting an international client to establish a UK branch with a view to undertaking a Part VII transfer of run-off liabilities. He has previously been a company actuary responsible for the development of actuarial support systems including reserving, personal and commercial pricing, reinsurance, asset allocation and business planning.

John has acted as peer reviewer for work related to Part VII transfer statements, an expert witness statement related to a Scheme of Arrangement, reports related to transfers of policyholders in Ireland and references to Towers Watson in IPO and rights issue prospectuses and investor day presentations.

John is a Fellow of the Institute of Actuaries. John is currently a member of the Professional Standards Committee of the Institute and Faculty of Actuaries. He has also chaired and participated in a number of working parties of the General Insurance Study Group covering subjects such as motor insurance, periodical payment orders, captives and international accounting standards. He has led several workshops on topics such as Capital Modelling, Solvency II, Internal Accounting Standards, reserving, motor insurance, financial institutions insurance and reinsurance.

Education and Credentials

John is a fellow of the Institute of Actuaries and has a First Class honours degree (BSc) in actuarial science from City University, London.

John currently holds IFOA Chief Actuary and Lloyd's SAO and Practising Certificates.

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Appendix C: Information considered

Items applicable to both QIE and RNICE

- The draft Scheme Document (“Insurance Business Transfer Scheme”)
- Details of the additional actions which it is proposed will take place in combination with the Proposed Scheme, together with relevant legal documents
- A statement of the purpose of the Proposed Scheme
- Background information on the Proposed Scheme
- Details of the proposed approach to policyholder communication
- The Loss Portfolio Transfer Agreement (“LPTA”) between QIE, TMR and ILS P&C Re
- The Claims Handling Agreement between QIE and ARM
- The Transfer Agreement between QIE and RNICE
- The Custody Agreement between QIE, TMR and BNY Mellon
- A Deed of Charge (“Security Deed”) between QIE and TMR
- The Retrocession Agreement between TMR and ILS P&C Re
- The Trust Agreement between TMR, ILS P&C Re in respect of its segregated account Cell A and HSBC
- The draft LPTA Amendment Agreement
- The draft TA Amendment Agreement
- Details of the assets to be transferred to RNICE under the Proposed Scheme

Transferring Portfolio

- Details of the business written within the Transferring Portfolio
- Details of Facultative Reinsurance policies protecting the Transferring Portfolio
- Details of performance bonds protecting the Transferring Portfolio
- Details of deductibles and self-insured retentions in respect of the Transferring Portfolio
- Details of a small number of minor disputes in relation to the Transferring Portfolio
- Technical and cash reports as at 31 December 2014, 2015 and 2016
- Reports prepared by a third party consulting firm (the “third party reports”) documenting actuarial reviews of the Italian and Spanish Medical Liability portfolios as at each of 31 July 2013 and 30 June 2016
- The complete set of the data underlying the third party report as at 30 June 2016, which was provided by ARM to the third party consulting firm

- A further report prepared by a third party consulting firm documenting the results of an analysis of reserve volatility for the Transferring Portfolio as at 30 June 2016
- A summary of the run-off of the Transferring Portfolio between 1 July 2016 and 31 December 2016
- A schedule of assets as at 31 December 2016
- An external claims audit report as at early 2017
- An analysis of the experience of ARM in recovering outstanding deductibles from policyholders
- New schedules of legal fees and medical fees

QIE

- A profit and loss account and balance sheet for QIE as at 31 March 2017
- Details of QBE group credit ratings
- ORSA reports prepared during 2014, 2015 and 2016
- Details of the internal reserve review undertaken by the QIE internal actuarial team as at 30 September 2016
- A reserve bridge report prepared by the QIE internal actuarial team which provides a bridge from the internal reserve review as at 30 September 2016 and the earned reserves as at 31 December 2016
- An external independent reserve review for QIE as at 31 October 2016
- Financial projections showing the projected SCR and eligible capital of QIE as at 31 December 2017, 2018 and 2019 (as evidenced in the QIE ORSA documents)
- A schedule showing the estimated effect of the Proposed Scheme on the Solvency II capital position of QIE as at 31 December 2016
- Details of the current and future capital and dividend policy of QIE (as evidenced in the QIE ORSA documents)

RNICE

- The quantitative reporting templates ("QRTs") under Solvency II regulation as at 1 January 2016 and 31 December 2016
- The annual report and accounts for the years ending 31 December 2012, 2013, 2014, 2015 and 2016
- Relevant correspondence with the UK's supervisory authorities
- ORSA reports prepared during 2015 and 2016
- Projections of Available Capital Resources and the SF SCR for RNICE for the next 5 years, following the Proposed Scheme, based on alternative starting points of 31 December 2016 and 31 December 2017

- Projections of Available Capital Resources and the SF SCR for RNICE for the next 5 years, following the Proposed Scheme, based on a starting point of 30 September 2017 for the SCR; the underlying projections are based on data as at 31 December 2016
- A copy of a letter dated 13 July 2017 from the Bermuda Monetary Authority that confirms that it does not object either to the transfer of funds from Cell A to Cell Q of ILS P&C Re, or to the Proposed Scheme and related actions subject to the appropriate PRA, FCA and UK High Court approvals
- Details of the current and future dividend policy of RNICE
- Details of RNICE's proposed investment strategy

Policyholder communication

- Draft witness statement of Mr Neil Christopher Sutton
- Draft witness statement of Mr John Caldicott Williams
- Draft circular to policyholders and other interested parties, and corresponding draft covering letters

Other

- Details of the effect (if any) of the effect of the Proposed Scheme in each of the following general areas: accounting and reserve approach, ranking of policyholders in a winding-up, policyholder compensation schemes, tax implications, trust funds and liquidity
- Other miscellaneous schedules.

Additional comments

This information and various oral supplementary information has been provided by a combination of the management teams of QIE and RNICE.

My team and I have a number of meetings and conference calls with representatives of QIE and RNICE to discuss in detail the information which they have provided in relation to the Proposed Scheme.

I have relied upon the accuracy and completeness of the above data and information without independent verification. However, my team and I have reviewed the data and information for general consistency and overall reasonableness.

There is no significant information which I requested from QIE and/or RNICE, which has not been provided to me.

I have obtained confirmation from each of QIE and RNICE that, to the best of their knowledge and belief:

- All of the items of data and information which have been provided to me by QIE / RNICE for the purposes of this report are accurate and complete.
- There are no significant errors or omissions in the descriptions in this report of the business of QIE / RNICE and of the Transferring Portfolio.
- There are no other material items of data and information which have not been provided to me by QIE / RNICE and which are likely to be relevant to this report.

Appendix D: Details of proposed policyholder communication

Content of circular to policyholders

The draft circular summarises the principal provisions of the Proposed Scheme, including appropriate references to the further actions which will take place in combination with the Proposed Scheme, described in paragraph 2.7 of this report.

The draft circular summarises the conclusions of this Independent Expert report in the following terms:

- The Proposed Scheme does not materially adversely affect the security of any of the groups of policyholders affected by it
- The Proposed Scheme is expected to have no significant impact on service levels experienced by any of the groups of policyholders affected by it
- The Proposed Scheme is expected to have no significant effect on expense levels
- The Proposed Scheme is expected to have no significant effect on the level of investment risk (which is the risk that policyholder security could be adversely affected by fluctuations in the market value of investments) for policyholders remaining with QIE
- There may be an increase in investment risk for the Transferring Policyholders and the current policyholders of RNICE but notwithstanding this the Independent Expert remains of the view that the Proposed Scheme does not materially adversely affect the security of these policyholders
- The Proposed Scheme has no significant effect on the reinsurers whose contracts of reinsurance are to be transferred under the Proposed Scheme.

Policyholders remaining with QIE

It is proposed that policyholders remaining with QIE will not receive individual notification of the Proposed Scheme in view of QIE's limited exposure to the Transferring Portfolio which is currently 100% reinsured by a combination of TMR and ILS P&C Re, and the immaterial effect of the Proposed Scheme on the policyholders remaining with QIE. This means that the limited utility to those policyholders of receiving individual notifications does not justify the substantial cost of notifying these policyholders.

Transferring Policyholders

Separate approaches to policyholder communication are proposed in respect of each of the following parties:

Policyholders excluding those subject to coverholder delegated authorities

It is proposed that:

- Notification of the Proposed Scheme will only be sent to the Primary Named Insureds under each policy in the Transferring Portfolio. A Primary Named Insured is generally the lead entity for a particular region or is a large central hospital with a number of associated or branch hospitals
- Notifications of the Proposed Scheme will not be sent to Named Additional Insureds, which are additional insured parties. Such Named Additional Insureds are generally other hospitals or medical facilities associated with the Primary Named Insured. While Named Additional Insureds are specifically referred to in some policies in the Transferring Portfolio, all communications in relation to the policies are sent to the Primary Named Insured, which was responsible for purchasing the policy, which will pass on these communications to the Named Additional Insureds as it considers appropriate. The policies are deliberately structured in this way to provide for the central management of claims by the Primary Named Insured. As the Primary Named Insured is responsible for communication with its Named Additional Insureds, QIE does not hold contact details for each Named Additional Insured
- Notifications of the Proposed Scheme will not be sent to Unnamed Additional Insureds. Policies may also provide cover to certain persons or entities that are not specifically named, but rather are indicated by category or class. These Unnamed Additional Insureds could be, for example, individual doctors or consultants employed from time to time by a given Primary Named Insured or Named Additional Insured
- Notification of the Proposed Scheme will not be sent to actual or potential claimants, on the basis that claimants are not policyholders. QIE has no contractual relationship with claimants. There are also difficulties in obtaining contact information for claimants, and there is a risk of increasing the liability of policyholders (who are liable for deductibles or SIRs) by making direct contact with claimants and thereby encouraging the submission of more claims.

Policyholders subject to a delegated authority through a coverholder

A small portfolio covering dentists and private practitioners in Italy was written under a delegated authority through a coverholder. QIE believes it has contact details for all such insureds, and is proposing to notify all such insureds and the coverholder.

Other interested parties

It is proposed that notification of the Proposed Scheme will be sent to:

- The co-insurers of two Italian policies
- The single outwards reinsurer whose reinsurance policies are transferring.

Notifications of the scheme will not be sent to brokers who originally placed the business with QIE. I consider this reasonable because I understand that claims are handled directly through the Primary Named Assureds and these brokers are currently not involved in communications related to claims.

Current policyholders of RNICE

It is proposed that notification of the Proposed Scheme will be sent to all current policyholders of RNICE for whom RNICE has been able to obtain contact details. I understand that RNICE has undertaken a thorough review of its available records in order to identify its remaining policyholders.

Wider communication

The Proposed Scheme contains provisions for notices of the Proposed Scheme to be advertised in:

- The London, Edinburgh and Belfast Gazettes
- Two national newspapers in the UK (the Times and The Daily Mail)
- Two national newspapers in Italy (Corriere della Sera and La Repubblica)
- Two national newspapers in Spain (El País and El Mundo)
- La Rivista Medica Italiana and Revista Clinica Española, which are specialist publications in Italy and Spain respectively which are aimed at the medical profession.

A website (with links from QIE's and RNICE's own homepages) will also be operated on which the letter to policyholders and a full copy of this report will be posted.

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Appendix E: Reliances and limitations

Reliances

In carrying out my review and producing this report I have relied without independent verification upon the accuracy and completeness of the data and information provided to me, both in written and oral form. Where possible, I have reviewed the information provided for reasonableness and consistency with my knowledge of the insurance and reinsurance industry and this gives me no cause for concern. My team and I have also met with representatives of QIE and RNICE to discuss in detail the information which they have provided in relation to the Proposed Scheme. I consider it is reasonable for me to rely on these individuals because they are PRA and FCA approved persons or are senior professionals employed by QIE / RNICE. Reliance has been placed upon, but not limited to, the information detailed in Appendix C.

Based on my review, I am satisfied that the information detailed in Appendix C represents an appropriate basis for the conclusions set out in this report and I consider that it is reasonable for me to rely on this information. There is no information which my team and I requested from QIE and / or RNICE, which has not been provided to us.

I contacted the PRA and FCA at an early stage to establish whether there were matters or issues which they wanted me to consider in this report. A draft of this report has been made available to the PRA and FCA whose comments have been taken into account. The PRA, in consultation with the FCA, has approved the form of this report.

Limitations

This report has been prepared on the basis of financial forecasts based on data as at 31 December 2016. Subsequent developments will be taken into account in my supplementary report that will be prepared in advance of the Sanction Hearing.

I consider that I have been able to conduct my review of the Proposed Scheme in an unfettered manner and the opinions in this report are mine, based on the information provided to Willis Towers Watson. In my opinion, I have considered the material matters that should be relevant to policyholders' consideration of the Proposed Scheme. In the event that additional matters should arise as part of the Court proceedings, I will consider these in due course.

This report has been prepared on an agreed basis for the purpose of reporting on the Proposed Scheme, and must not be relied upon for any other purpose. It must be considered in its entirety because individual sections, if considered in isolation, may be misleading. This report is subject to the terms and conditions, including a limitation of liability, set out in my firm's engagement letter.

This report must not be construed as investment advice.

This report has been prepared on the joint instruction of QIE and RNICE for the benefit of the Court solely for the purposes of the FSMA requirements for Part VII transfers. It has not been prepared for use by any third party. Accordingly, neither the Independent Expert nor Towers Watson Limited accepts any responsibility or duty of care to any third party in relation to this report. Any reliance placed by such third parties on the report is entirely at their own risk.

This Independent Expert report is based on financial information in respect of QIE, RNICE and the Transferring Portfolio as at 31 December 2016, and does not take into account any developments after that date unless stated explicitly to the contrary in this report.

I expect to produce a supplementary report in due course, based on the financial positions of QIE, RNICE and the Transferring Portfolio as at 30 June 2017 (or another appropriate date), which will take into account any significant developments between 1 January 2017 and 30 June 2017 (or another appropriate date).

Figures in all tables in this report are subject to possible rounding differences.

This report is governed by and shall be construed in accordance with English law. Willis Towers Watson, QIE and RNICE submit to the exclusive jurisdiction of the English courts in connection with all disputes and differences arising out of, under or in connection with this report.