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Addendum to Supplementary 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

13 November 2018

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Findings

Introduction

1.1 This document is an addendum to the Supplementary Report and should be read as an extension of that document.

1.2 For the sake of simplicity, the figures quoted below are drawn from the Scheme Report. There are small differences in the corresponding figures in the Supplementary Report dated 19 October 2018 which reflect updated data and a change to the Proposed Scheme Date.

Change in risk profile of RNICE policyholders

1.3 As noted in paragraph 2.28 of the Scheme Report dated 4 July 2018:

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.***

1.4 This paragraph is solely a reference to the increase in RNICE's current policyholders' risk exposure after the Proposed Scheme, prior to mitigation by capital resources, because RNICE will have materially increased the scale of its total assets and liabilities and therefore the scale of the risks to which it is subject. This increase in pre-mitigation risk exposure is not specific to RNICE and would in principle apply to any insurer receiving a Part VII transfer from a materially larger portfolio. On a UK GAAP basis, the increase in RNICE's total assets and liabilities is from \$5.5 million (£4.5 million) to \$136.5 million (£110.9 million).

1.5 For the avoidance of doubt, the reference to "material additional risks" should not be taken as a reference to the strength of the financial security of the RNICE policyholders after the Proposed Scheme which depends on the capital resources of RNICE in relation to its increased risk profile. The risks listed in paragraph 2.28 of the Scheme Report originate from the run-off of the Transferring Portfolio and represent the key risks in my opinion.

1.6 A quantification of the material additional risks, prior to mitigation, referred to in paragraph 2.28 of the Scheme Report is provided by the increase in the SF SCR for the RNICE portfolio before and after the Proposed Scheme. Pre-Scheme the SF SCR of RNICE is \$1.1 million and after the Proposed Scheme the SF SCR is projected to increase to \$29.8 million. On my tailored SCR basis, the corresponding increase is from \$4.1 million to \$38.3 million. The adjustments to the SF SCR to produce the tailored SCRs are explained in paragraphs 1.8 to 1.10 below.

1.7 Capital requirements under Solvency II determined by the SF SCR are intended to represent the level of free capital in addition to required provisions that would allow an insurer to remain solvent over a 1-year timeframe with a probability of 99.5%. The likelihood of insolvency of 0.5% is regarded as remote although it is normal for companies which are subject to Solvency II regulation to seek to maintain Available Capital Resources at a level which is at least 120% of the required SCR. The SF SCR calculation is a risk-based capital assessment that is intended to take account of the risk characteristics of individual companies.

1.8 Although the SF SCR is risk-based it is a standardised calculation and will not necessarily match the risk profile of an individual undertaking. To allow for my perception of reserve volatility above the allowance embedded in the SF SCR due to the Transferring Portfolio, I have made an adjustment to the RNICE SF SCR calculation after the Proposed Scheme on my tailored basis. This adjustment increases the SF SCR from $29.8 million to $38.3 million.

1.9 The pre-scheme SF SCR for the current RNICE portfolio of $1.1 million is less than the Solvency II Absolute Minimum Capital Requirement, the AMCR, of $4.1 million which defines the minimum level of capital that an insurer needs to meet regulatory requirements. As noted in paragraph 5.65 of the Scheme Report, I consider that the SF SCR would understate the economic capital at a 99.5% confidence level over a 1-year timeframe because the Standard Formula is calibrated in the context of larger more diversified entities than RNICE.

1.10 RNICE's Solvency II Technical Provisions of $0.3 million arise from a relatively small number of policies (4,336 UK employers' liability and 16 non-employers' liability policies) with coverage in respect of loss occurrences during the applicable insured periods. The lower level of diversification of RNICE and the nature of its loss occurrence coverage would, in my opinion, result in a higher level of potential reserve volatility than implicit in the SF SCR. I therefore adopted the AMCR as my tailored SCR for the current RNICE portfolio as a more appropriate, albeit prudent, indication of economic capital at a 99.5% level of confidence because this higher capital level would allow for the emergence of material unanticipated losses that could arise under remote scenarios.

Financial security of RNICE policyholders

1.11 The financial security of the RNICE policyholders before and after the transfer depends on the level of the Available Capital Resources relative to its risks. My quantification of the risk level is the tailored SCR which is intended to reflect my view of a bespoke 99.5% confidence capital requirement for RNICE as opposed to the Solvency II Standard Formula SCR. The adjustments to the SF SCR are explained in paragraphs 1.8 to 1.10 above.

1.12 Under the Proposed Scheme the Available Capital Resources for RNICE would increase from $4.7 million to $60.0 million. This results in a significant increase in the tailored SCR cover from 114% to 157% notwithstanding the increase in the absolute amount of the tailored SF SCR from $4.1 million to $38.8 million. As noted in paragraph 5.51 of the Scheme Report which is repeated below, I consider that the tailored SCR cover ratio is satisfactory.

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.

1.13 In effect, after the Proposed Scheme, although the existing RNICE policyholders will be part of an entity that is exposed to a materially increased level of pre-mitigation risk as explained in paragraph 1.4 above, I consider that the additional capital that will be transferred to RNICE under the Proposed Scheme is commensurate with the increased risk exposure that will arise from the Transferring Portfolio. In other words, the likelihood of RNICE having inadequate resources to fulfil its obligations remains remote and lower than the minimum regulatory threshold of 0.5%, both prior to and after the Proposed Scheme. Hence, I consider that the security of the current policyholders of RNICE is not materially adversely affected by the Proposed Scheme.

Stress Test Scenarios

1.14 The material additional risks highlighted in paragraph 2.28 of the Scheme Report are that:

- 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.

1.15 Stress test scenarios covering each of the three points above are included in paragraphs 5.42 and 5.43 of the Scheme Report, where I consider RNICE's capital adequacy after the Proposed Scheme under a number of remote scenarios that emerge over 1 year to reflect the key risks as follows:

- Reserve Risk scenarios: Adverse scenarios of this nature are remote possibilities and would require significant unforeseen claims emergence. Such emergence would probably be due to a systemic issue such as a legislative change which substantially increases awards to individuals, as the large claims in this portfolio arise from compensation to individuals for damages caused by medical negligence:
  - A 40% increase in the Solvency II Technical Provisions (being the sum of the present value of expected future cash flows relating to the run-off of the claims and a prescribed risk margin) 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 Solvency II Technical Provisions as at 30 September 2018.
  - A 60% increase in the Solvency II 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 Solvency II 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 that this is fully recognised after 1 year. Deductibles are elements of claims payments under a policy for which the policyholder is responsible. In some cases, QIE pays claims in full, and then recovers the deductible amounts from policyholders. This scenario relates to the risk that some policyholders default on the repayment of deductible amounts.
- 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 from US dollar assets instead of assets in Euro which would match the liabilities. This scenario is hypothetical and does not reflect RNICE's proposed post-transfer investment strategy.

1.16 The following table summarises the results of these stress test scenarios. The base scenario is based on the best estimate projected balance sheet after the Proposed Scheme as at 30 September 2019. I conclude from the results that RNICE is robustly capitalised under the Proposed Scheme because in all cases it remains solvent with capital above the SF SCR which is the regulatory minimum.

Table1: Stress Test projections as at 30 September 2019

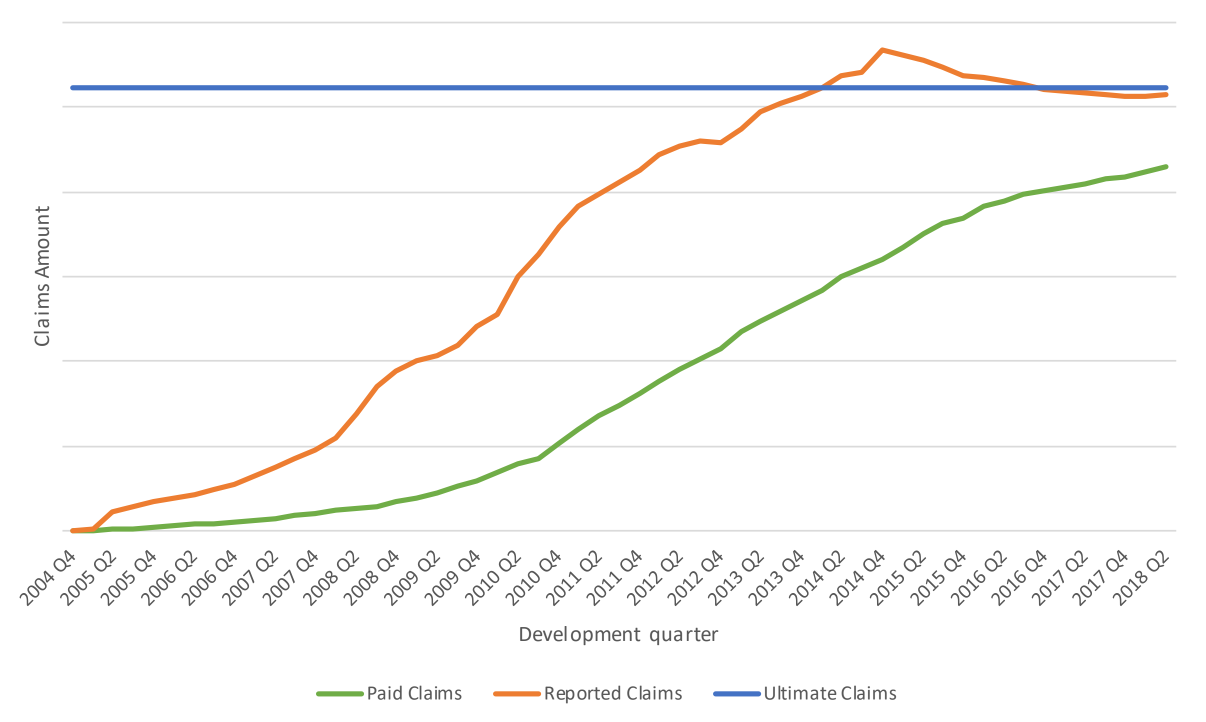
Amounts in US$ million		Reserve risk scenarios			
	Proposed Scheme	40% increase in 2019 TPs	60% increase in 2019 TPs	Credit risk scenario	Market risk scenario
Available Capital Resources	61.5	42.1	32.4	53.9	61.5
Reduction in Capital Resources	0.0	19.3	29.0	7.6	0.0
SF SCR	20.3	26.7	29.9	19.8	23.0
Solvency 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%

Claim reserves from the transferring portfolio

1.17 After the Proposed Scheme, the most significant risk for RNICE is that the claim reserves prove to be inadequate. For information purposes, to demonstrate the adequacy of the assets to be transferred into RNICE under the Proposed Scheme, we have set out claim development graphs for the Transferring Portfolio that support my conclusions.

1.18 The historical development of cumulative gross paid and reported claims of a representative sample of the claims of the Transferring Portfolio is shown in Graph 1 below. The graph indicates that, after a peak in 2014 Q4, the trend of the Reported Claims amounts is reducing. The Reported Claims amounts are the sum of the aggregate of payments and the estimated unpaid outstanding claim amounts in respect of the reported claims at the reporting date. Eventually, as all claims are settled, the Paid and Reported Claims (green and orange lines) will converge. The blue line shows the estimate of the ultimate total claims settlement cost implied by the current best estimate reserves.

Graph 1: Historical gross claims development by quarter of the Transferring Portfolio

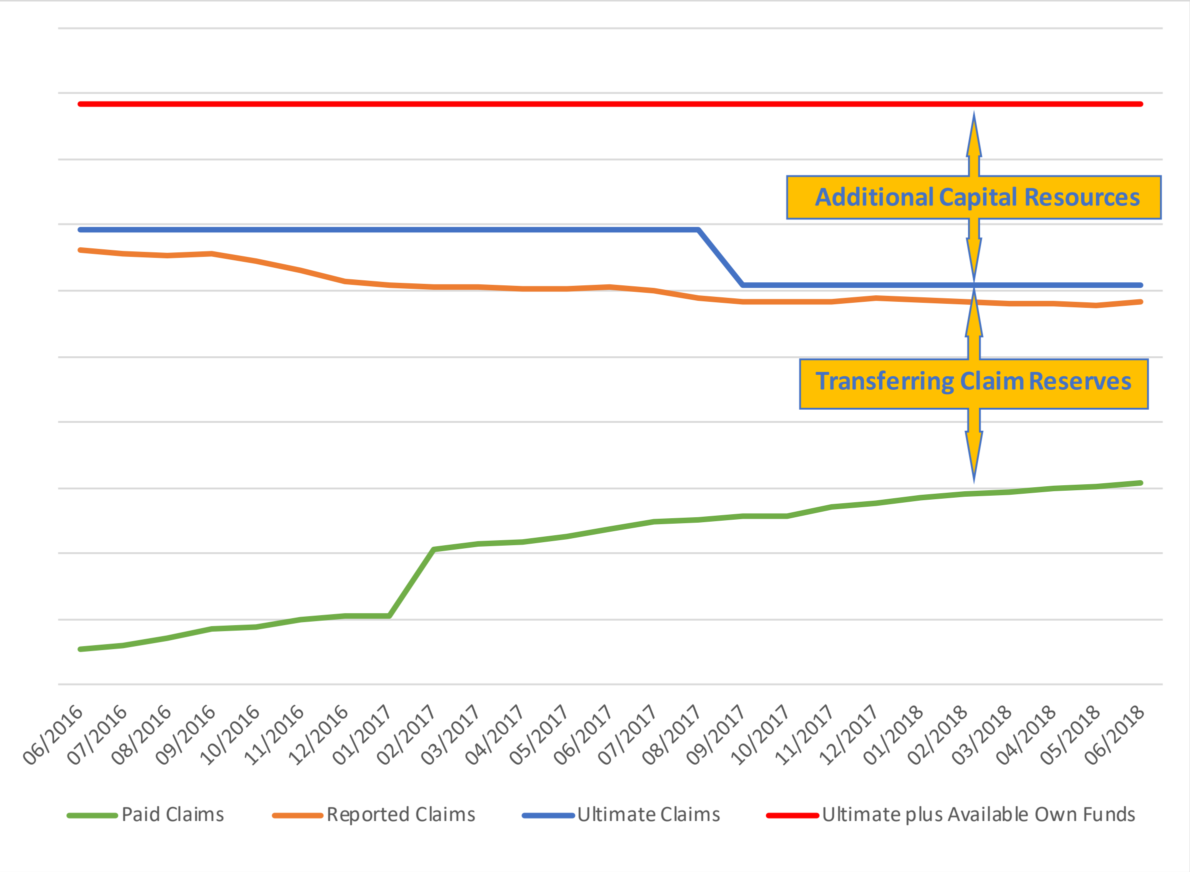


Note: The data underlying the graph is based on data representing 98% of the Reported Claims of the Transferring Portfolio that has been scaled up to represent the whole portfolio. The data has also been smoothed for 2009 Q3 and 2010 Q1 due to gaps in the available historical data. This smoothing does not affect the overall shape of the graph.

1.19 The progression of the Paid and Reported claims shown on Graph 1 by the green and orange lines indicates a reasonable expectation that the ultimate settlement amount of the claims will fall below the current Reported Claims as the Paid and Reported Claims will converge to the ultimate settlement amount. The transferring claim reserves are set above the current Reported Claims amount as indicated by the blue line. I therefore consider this to be a prudent reserving level.

1.20 Under the Proposed Scheme, the additional Available Capital Resources that will be transferred to RNICE will provide capital which can be used to meet unanticipated claim settlement costs in excess of the transferring claim reserves. Graph 2 illustrates the scale of the capital to be transferred to RNICE relative to the transferring claims reserves. The red line shows the scale of the additional Available Capital Resources that will transfer under the Proposed Scheme in relation to the transferring claim reserves. In my opinion, the trajectory of the historical Paid and Reported Claims development shown in Graph 1 demonstrates that the likelihood of the assets being transferred to RNICE proving to be inadequate in respect of the Transferring Portfolio is remote.

Graph 2: Monthly development of net claims of the Transferring Portfolio



Note: This graph is based on Appendix B of the Supplementary Report but has been rescaled to include paid claims and Available Own Funds. The discontinuity in the claim payments at February 2017 is due to a specific commutation settlement for a large account and is an atypical movement that is not representative of the underlying trend.

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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 99.5th 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.