

*Scheme Report of the Independent Expert  
on the proposed transfer of insurance  
business from Royal & Sun Alliance  
Insurance plc to RSA Luxembourg S.A. in  
accordance with Part VII of the Financial  
Services and Markets Act 2000*

26 July 2018



Prepared by:

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LCP



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## 1. Executive summary

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### 1.1. The Proposed Transfer

Royal & Sun Alliance Insurance plc (RSAI) currently operates across the European Economic Area (EEA) utilising the EEA's Freedom of Services (FoS) and Freedom of Establishment (FofE) arrangements.

In the event of a so called "Hard Brexit" where RSAI no longer has FofS or FofE rights, RSAI may not legally be able to carry on the non-UK EEA business. For example, RSAI would not be able to issue new insurance policies across the EEA, and might not legally be able to pay valid claims to existing EEA policyholders.

To provide certainty that RSAI can continue to carry on EEA business post-Brexit with minimum disruption, RSAI is proposing to transfer the relevant EEA business from RSAI into RSA Luxembourg S.A. (RSAL), a newly established Luxembourg subsidiary of RSAI.

### 1.2. My role as Independent Expert

RSAI and RSAL have jointly appointed me to act as the Independent Expert (IE) for this Proposed Transfer. The Prudential Regulation Authority (PRA), in consultation with the Financial Conduct Authority (FCA), has approved my appointment.

As IE, my overall role is to assess whether:

- The security provided to policyholders of RSAI will be materially adversely affected by the implementation of the Proposed Transfer.
- The Proposed Transfer will have any adverse impact on service standards experienced by policyholders.
- Any reinsurer of RSAI covering the transferring business will be materially adversely affected.

This report is my Scheme Report for the Proposed Transfer. I will also prepare a Supplementary Report ahead of the Sanctions Hearing (expected to be 29 November 2018) for the Proposed Transfer. The purpose of the Supplementary Report is to confirm and/or update my conclusions in this report, based on any new material or issues that arise.

3336900 **1.3. Summary of my conclusions**

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I have set out below my summary conclusions, considering the effect of the Proposed Transfer from three perspectives:

- “Non-transferring policyholders”, who will remain with RSAI after the Proposed Transfer.
- “Transferring policyholders”, who will transfer from RSAI to RSAL as a result of the Proposed Transfer.
- Reinsurers whose contracts with RSAI are transferring to RSAL.

**Non-transferring policyholders**

The non-transferring policyholders are expected to represent c. 94% of RSAI’s business (based on booked provisions net of reinsurance). This means that the significant majority of policyholders will not be transferring and the risk profile of RSAI will not be materially affected by the Proposed Transfer.

RSAI is not planning any material changes to how the non-transferring business is carried out. In particular, following the Proposed Transfer:

- There are no plans to change how policyholders are serviced.
- RSAI has no plans to change the approaches for providing policyholder security (including how insurance provisions and capital requirements are set).

**Therefore, I have concluded that the security provided to non-transferring policyholders will not be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for non-transferring policyholders following the Proposed Transfer.**

**Transferring policyholders**

The transferring policyholders will remain within the RSA Group, and RSAL will be subject to the same Group-wide policies as RSAI.

RSAI is planning to minimise any changes as to how the transferring business is carried out, to avoid disruption to the operating model or its customers. For example, RSAL is not planning any changes to how transferring policyholders are serviced following the Proposed Transfer.

Policyholder security for the transferring policyholders is to be provided through a combination of assets held within RSAL itself and security provided by RSAI. The security provided by RSAI will be a significant quota share arrangement (covering nearly 90% of RSAL’s business) and an arrangement whereby RSAL can call on additional capital from RSAI if required in the future (Solvency II-compliant ancillary own funds).

**3336900** Due to this structure, the security provided to RSAL policyholders is significantly reliant on RSAI. Given this reliance, I have considered two scenarios where RSAI either remains solvent or the unlikely event it becomes insolvent:

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- Whilst RSAI remains solvent, the combination of the quota share and ancillary own funds arrangements are expected to provide a similar level of protection to transferring policyholders compared to pre-transfer. Therefore, under this scenario, I do not expect the security provided to transferring policyholders to be materially adversely affected by the implementation of the Proposed Transfer.
- In the event that RSAI were to become insolvent post-transfer, then RSAL would no longer have the security provided by the quota share and ancillary own funds arrangements. RSAL will have in place monitoring and other arrangements for RSAL to reclaim assets from RSAI under these circumstances, but these are not a guarantee. If the arrangements were to fail, then the transferring policyholders would be materially adversely affected.

As an illustration, under an RSAI insolvency event where RSAL is unable to reclaim assets from RSAI, if there were sufficient assets to pay c. 90% of valid claims to non-transferring policyholders, then the transferring policyholders might receive only c. 20% of valid claims.

This insolvency scenario is very unlikely, due to the financial strength of RSAI. I have considered a range of factors in this report to assess this, including RSAI's credit ratings, capital strength and findings from RSAI's recovery and resolution planning.

The above considerations relate to the security provided to transferring policyholders following the Proposed Transfer. If the Proposed Transfer does not proceed then, under a Hard Brexit scenario, RSAI might not legally be able to pay any claims to existing EEA policyholders, unless arrangements are agreed as part of the UK Government's Brexit negotiations with the European Union (EU).

**In summary, based on the above considerations, I have concluded that it is very unlikely that the security provided to transferring policyholders will be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for transferring policyholders following the Proposed Transfer.**

**3336900 Reinsurers**

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All of RSAI's reinsurance with external reinsurers that provides cover for the transferring business will be transferred to RSAL. Exposure to claims faced by RSAI's reinsurers will not increase following the Proposed Transfer and they will continue to be required to pay out claims in respect of the same events as before the Proposed Transfer.

**I have, therefore, concluded that reinsurers of RSAI will not be materially affected by the Proposed Transfer.**

**Considerations around the UK EL Part VII transfer**

RSAL is currently proposing another insurance business transfer of a legacy book of mainly UK Employer's Liability (EL) latent exposures to a third party external to the RSA Group. The business to be transferred is already reinsured with the third party, so the transfer will not have a material effect on RSAI's overall financial position or risk profile. Therefore, my conclusions in this Scheme Report would not be changed if the UK EL transfer did not proceed.

The UK EL transfer will be the subject of a separate scheme report prepared by a different IE not connected in any way with me. Policyholders may receive separate correspondence relating to the UK EL transfer.

Further details on my conclusions, and other supporting information, are set out in this report.

I will be reviewing these conclusions and preparing a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer. The purpose of the Supplementary Report is to confirm and/or update my conclusions based on any new material or issues that arise.

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## 2. Introduction

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### 2.1. Background

Section 109 of the Financial Services and Markets Act 2000 (FSMA) requires that a scheme report (the Scheme Report) must accompany an application to the High Court of Justice of England and Wales (the Court) to approve an insurance business transfer scheme.

The Scheme Report should be produced by a suitably qualified independent person (the Independent Expert or IE) who has been nominated or approved by the Prudential Regulation Authority (PRA) having consulted with the Financial Conduct Authority (FCA). The Scheme Report should address the question of whether any policyholders or reinsurers impacted by the insurance business transfer are adversely affected to a material extent.

RSAL and RSAL have jointly nominated Stewart Mitchell (I or me) of Lane Clark & Peacock LLP (LCP, we, or us) to act as the Independent Expert for the proposed insurance business transfer scheme (the Proposed Transfer) of the insurance business of RSAI to RSAL under Section 105 of the FSMA. The Proposed Transfer is intended to be effected on or around 1 January 2019 (the Effective Date).

This report is the Scheme Report for the Proposed Transfer. I will also prepare a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer. The purpose of the Supplementary Report is to confirm and/or update my conclusions in this report, based on any new material or issues that arise.

### 2.2. The Proposed Transfer

RSAL currently operates across the EEA utilising the EEA's FofS and FofE arrangements, including through a network of five EEA branches (the EEA business).

In the event of a so called Hard Brexit where RSAI no longer has FofS or FofE rights, RSAI's current operating model would no longer be viable. Under this scenario, RSAI may not legally be able to carry on the non-UK EEA business. For example, RSAI would not be able to issue new insurance policies across the EEA, and might not legally be able to pay valid claims to existing EEA policyholders.

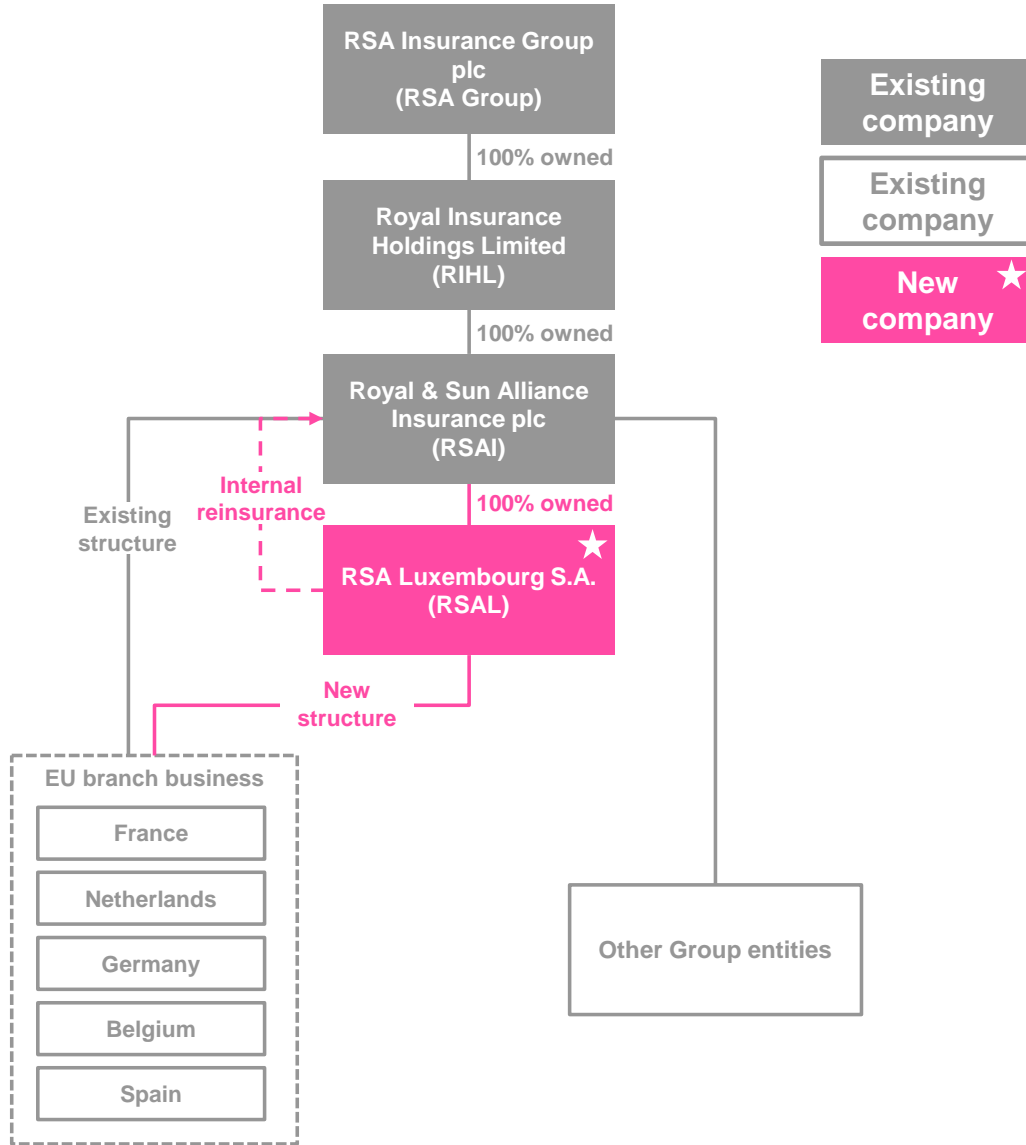
Under the Proposed Transfer, the relevant EEA business will transfer from RSAI into RSAL, a newly established Luxembourg subsidiary of RSAI. The purpose of the Proposed Transfer is to provide certainty that RSA can continue to carry on EEA business post-Brexit with minimum disruption to its operating model and its customers.

RSAL's immediate parent company is Royal Insurance Holdings Limited (RIHL), a company incorporated in England and Wales. The Company's ultimate parent and controlling party is RSA Insurance Group plc (RSA Group), which is registered in England and Wales. RSAI is the sole shareholder of RSAL.



**3336900** The following diagram shows a simplified structure chart of the RSA Group pre- and post- the Proposed Transfer.

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RSAI is proposing another insurance business transfer that will transfer a legacy book of mainly UK Employer's Liability (EL) latent exposures to a third party external to the RSA Group. This transfer is being led by a different team within RSAI and will be the subject of a separate scheme report to the Court prepared by a different IE not connected in any way with me. Both remaining (ie non-transferring) and transferring policyholders may receive separate correspondence relating to the UK EL transfer at the appropriate time.

3336900 **2.3. Independent Expert appointment**

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**My appointment**

RSAL and RSAL have jointly appointed me to act as the IE for the Proposed Transfer. The PRA, in consultation with the FCA, has approved my appointment. RSAL will bear the costs associated with the production of my report.

**My experience**

I am a Fellow of the Institute and Faculty of Actuaries (IFoA) and am certified to act as a Signing Actuary for Statements of Actuarial Opinions for Lloyd's.

I am a Partner in the Insurance Consulting practice at LCP and have 30 years' experience in general insurance.

I have skills in all areas of general insurance actuarial work (including reserving, capital, pricing and transactions), and have previously supported or provided peer review to the Independent Expert for four other insurance business transfer schemes. I have also led the work on Section 166 regulatory reports for the PRA.

Appendix 3 contains my CV with further details of my experience.

**Independence statement**

I confirm that I have no direct or indirect interests in RSAI or RSAL, either personally or via LCP. In particular:

- I am not a shareholder in RSA Group, including its subsidiaries and I am not a member of any pension scheme under the management of RSA Group.
- I held a pet insurance policy and I am a member of a group travel policy with RSAI, but I have no other policies issued by the company or its subsidiaries. The policies are on standard commercial terms and the premiums are immaterial in the context of the Proposed Transfer. Therefore, this does not impinge on my ability to act as the IE.
- Work carried out by LCP for RSA Group and its subsidiaries in any one year, including the estimated work to support the Proposed Transfer, represents less than 0.25% of LCP's annual revenue. I have not been personally involved in any work LCP has carried out for RSA Group and its subsidiaries to date other than this Proposed Transfer.

**3336900**      **2.4. Scope of this Scheme Report**

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Appendix 2 contains an extract from my terms of reference, which defines the scope of my work in relation to the Proposed Transfer. The actual work performed is in line with this agreed scope.

This Scheme Report considers the effect of the Proposed Transfer upon the policyholders of RSAI and RSAL, and reinsurers whose contracts with RSAI are transferring to RSAL. It contains a description of the Proposed Transfer, the methodology I have used to analyse the Proposed Transfer, the opinions I have formed, and reasons why I have formed those opinions.

The use of “I”, “me” and “my” in this report generally refers to work carried out by me or by the team operating under my direct supervision. However when it is used in reference to an opinion, it is mine and mine alone.

The Proposed Transfer assumes a Hard Brexit where RSAI no longer has FofS or FofE rights for existing or new policyholders. There are significant uncertainties as to how the UK Government’s Brexit negotiations and other Brexit arrangements will develop over the coming months and I have considered contingencies in section 3.5.

**2.5. Use of this Scheme Report**

This Scheme Report has been produced by Stewart Mitchell FIA of Lane Clark & Peacock LLP under the terms of our written agreement with Royal & Sun Alliance Insurance plc. It is subject to any stated limitations (eg regarding accuracy or completeness).

This Scheme Report has been prepared for the purpose of accompanying the application to the Court in respect of the proposed insurance business transfer scheme described in this report, in accordance with Section 109 of the Financial Services and Markets Act 2000. The Scheme Report is not suitable for any other purpose.

A copy of the Scheme Report will be sent to the Prudential Regulation Authority, the Financial Conduct Authority and will accompany the Scheme application to the Court.

This report is only appropriate for the purpose described above and should not be used for anything else. No liability is accepted or assumed for any use of the Scheme Report for any other purpose other than that set out above.

**2.6. Reliances**

I have based my work on the data and other information made available to me by RSAI. Appendix 4 contains a list of key data and other information that I have considered. I have also held discussions with the relevant staff of RSAI and their advisors.

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I have used data as at 31 December 2016 to align with the last full audit of RSAI available at the time of my core analysis. RSAI has also provided a summary of key developments within RSAI up to 31 December 2017 and I am satisfied that these do not affect my conclusions in this report. Prior to the Sanctions Hearing for the Proposed Transfer, I will prepare a Supplementary Report to confirm and/or update my conclusions in this report, based on any new material or issues that arise.

I have received all of the information that I have requested for the purposes of the production of my report. In this respect:

- RSAI will submit witness statements to the Court stating that all information provided to me by RSAI is correct and complete in all material aspects, and there have been no material adverse changes to the financial position of RSAI since that information was provided to me.
- I have conducted checks on the data provided to me for internal consistency and reasonableness.
- My checks of the data have not revealed any cause for me to doubt that it is materially appropriate for me to rely on the integrity of the information provided for the purpose of this report.

The conclusions in my report take no account of any information that I have not received, or of any inaccuracies in the information provided to me.

I have not needed to take any third party legal advice on any aspects of the Proposed Transfer. RSAI's legal advisors have provided advice to them confirming the impact on policyholder rights in the event of insolvency pre- and post- the Proposed Transfer (considered in Section 7.4) and RSAI has provided me with a copy of this advice. RSAI has confirmed that it has received no other specific legal advice relevant to my role as IE for the Proposed Transfer.

RSAI has provided a Data Accuracy Statement confirming that the data and information provided to me regarding the Proposed Transfer are accurate and complete.

In order to calculate the provisions for the transferring London business, RSAI has made certain assumptions to approximate the proportion of provisions to transfer. This is because RSAI does not hold full claims information for some policies eg where insurance brokers carry out the claims handling process on behalf of a number of insurers who provide cover on the same policy.

RSAI has confirmed that the impact of the approximations is within  $\pm 5\%$  of the estimated provisions. This margin of error does not impact the conclusions I have reached.

**3336900**      **2.7. Professional standards**

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This report complies with the applicable rules on expert evidence and with the guidance for Scheme Reports set out by the PRA in their Statement of Policy and by the PRA and the FCA in their Handbooks.

This report complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) and Technical Actuarial Standard 200: Insurance (TAS 200) issued by the Financial Reporting Council (FRC). The FRC is responsible for setting technical actuarial standards in the UK.

I have considered The Actuaries' Code as issued by the IFoA while producing this report.

This report has been subject to independent peer review prior to its publication, in line with Actuarial Professional Standard X2: Review of Actuarial Work (APS X2) as issued by the IFoA. This peer review has been undertaken by Charl Cronje FIA. Charl is a Partner at LCP. He was not involved in the production of the report. He has appropriate experience and expertise to act as peer reviewer of this report.

**2.8. Materiality**

The FRC considers that matters are material if they could, individually or collectively, influence the decisions to be taken by users of the actuarial information. It accepts that an assessment of the materiality is a matter of reasonable judgement that requires consideration of the users and the context.

I have applied this concept of materiality in planning, performing and reporting the work described in this Scheme Report. In particular, I have applied this concept of materiality when using my professional judgement to determine the risks of material misstatement or omission and to determine the nature and extent of my work.

In complying with the reporting requirements of TAS 100, I have made judgements on the level of information to include in this Scheme Report. For example, to make the report easier to read, I have not included all the details that would normally be included in a formal actuarial report, such as details of the methodologies and assumptions underlying the reserve and capital assessments.

**3336900**      **2.9. Definition of “materially adverse”**

Page 14 of 76      In order to determine whether the Proposed Transfer will have a “materially adverse” impact on any group of policyholders or on any reinsurers covering transferring business, it has been necessary for me to exercise my judgement in the light of the information that I have reviewed.

The Proposed Transfer will affect different policyholders in different ways and, for any one group of policyholders, there may be some effects of the Proposed Transfer that are positive, and others that are adverse. When assessing whether the Proposed Transfer will have a “materially adverse” impact, I have considered the aggregate impact of these different effects on each group of policyholders and on reinsurers.

Throughout the report, I have provided the rationale for my judgements and conclusions. These explain why, in each case, I have concluded whether policyholders and reinsurers are materially adversely affected or otherwise.

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## 3. Outline of Proposed Transfer

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### 3.1. The companies involved in the Proposed Transfer

#### Royal & Sun Alliance Insurance plc (RSAI)

Royal & Sun Alliance Insurance Group plc was formed in 1996 from the merger of Sun Alliance Group and Royal Insurance Holdings and is the ultimate parent company of RSAI.

RSAI is an insurance company incorporated in England and Wales, authorised by the PRA and regulated by the PRA and FCA.

RSAI effects and carries out contracts of general insurance both through RSAI itself and via a network of five branches across the EEA. The branches are located in:

- The Netherlands;
- Belgium;
- Germany;
- France; and
- Spain.

RSAI itself is permitted to carry out business in the UK and across 30 other countries on an FofS basis. The branches are permitted to carry out business in each of the branch countries on an FofE basis and, together, across 30 countries on an FofS basis. There are also policyholders outside of the EEA.

RSAI sells both commercial lines and personal lines insurance. These are operationally two distinct areas of the business.

**Commercial lines** insurance is sold to businesses, and is a mix of compulsory insurance (eg employers' liability) and optional insurance that covers losses that companies do not wish to bear (either due to appetite for risk or inability to pay losses should they occur).

RSAI's commercial lines insurance business is split into two market-facing businesses:

- "Global Risk Solutions" sells policies to large multinational businesses and businesses with specialist risk requirements. The main products are multinational property and liability policies, as well as specialty lines policies such as marine, construction, renewable energy and professional indemnity. These products are distributed mostly through global, London market and specialist brokers. Customers are serviced by RSAI in the UK, across the five EEA branch countries and in the Dubai International Financial Centre for the Dubai branch of RSAI.

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- “Commercial Risk Solutions” focuses on UK-based businesses (from small to mid-market size). The main products are traditional property, liability and motor policies, as well as specialty lines policies such as construction, renewable energy and professional indemnity. These products are distributed mostly through local and national brokers. Commercial Risk Solutions also sells policies to some private individuals based in the UK.

**Personal lines** insurance is sold to individuals, and is a mix of compulsory insurance (eg motor third party liability insurance) and optional insurance providing protection against losses the individual does not wish to remain liable for (eg home insurance).

Personal lines customers may not necessarily recognise RSAI as their insurer, as their relationship will be more aligned to a brand name (eg More Than, RSAI's direct to customer brand) or the intermediary that sold the policy. The significant majority of the personal lines business is carried out in the UK.

The Proposed Transfer involves commercial lines policies.

#### **Royal Insurance Holdings Limited**

RSAI is 100% owned by Royal Insurance Holdings Limited (RIHL).

#### **RSA Insurance Group plc**

RIHL is 100% owned by RSA Insurance Group plc (RSA Group).

RSA Group is the ultimate parent company. RSA Group is the holding company of an international insurance group and is listed on the London Stock Exchange. RSA Group has a credit rating of “A” from S&P, and a rating of “A2” from Moody's.

#### **RSA Luxembourg S.A.**

RSA Luxembourg S.A. (RSAL) is an insurance company, regulated by the Luxembourg regulator, Commissariat Aux Assurances (CAA), incorporated in Luxembourg on 7 November 2017 and is 100% owned by RSAI.

At the Effective Date of the Proposed Transfer, RSAL will have no existing policyholders. Initially the only business will be that which transfers from RSAI as a result of the Proposed Transfer.

RSAI have confirmed that there are no other insurance business transfers currently expected into RSAL.



**3336900**      **3.2. Description of the Proposed Transfer**

**Transferring policies**

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If sanctioned by the Court, the Proposed Transfer will move the following business written by RSAI and its branches to RSAL:

- All business written by the EEA Branches of RSAI – RSAL will receive the business of these branches, which it will carry on using its own branch network.
- The Non-UK EEA components of FofS business written by RSAI itself – the part of this business relating to exposure in EEA30 member states (ie the 30 member states of the EEA after the UK leaves) will transfer to RSAL

All rights and obligations of RSAI and its branches relating to the transferring policies will also be transferred to RSAL.

Following the Effective Date, any new or renewed Non-UK EEA policies will be written by RSAL's branch network and multinational policies will be written as two policies – one covering the UK and non-EEA risk insured by RSAI and a separate policy covering the EEA30 risk insured by RSAL. Alternatively, RSAI may decide to write some of the FofS business through RSAI's Global Network where each territory with exposure will have its own policy.

As at November 2017 there were c. 5.5 million RSAI policyholders (including 5.2 million policyholders of personal business) of which there were c. 30,000 holders of policies in scope to transfer to RSAL.

In 2016, the RSAI branch network wrote approximately £280m of premium, representing c. 8% of RSAI's gross written premium. In the same year, £40m of premium was written in the UK in respect of this EEA30 business (this excludes Irish and Scandinavian business written by other subsidiaries of RSAI that are not part of the Proposed Transfer).

Some of the RSAI EEA Branches carry on reinsurance business in respect of reinsureds domiciled in certain non-EEA jurisdictions (the Excluded Reinsurance Jurisdictions).

Reinsurance policies written or assumed by the RSAI EEA Branches in respect of reinsureds domiciled in an Excluded Reinsurance Jurisdiction, together with related reserves and reinsurance assets (the Excluded Reinsurance Business) are not included in the Proposed Transfer to RSAL and are excluded from the transferring business under the Scheme.

There may be some policies that RSAI wish to transfer to RSAL but for some reason may not be able to transfer as at the Effective Date of the transfer. There are provisions within the Scheme Document to allow for the transfer of such policies at a later date.

**3336900 Reinsurance**

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Reinsurance is an arrangement with another insurer to share or pass on risks. Reinsurance contracts may be underwritten by an external reinsurer or by a reinsurance entity in the same group.

RSAL has confirmed that the reinsurance arrangements currently protecting the transferring business will move to RSAL as part of the Proposed Transfer. This includes cover in respect of the transferring business under the Group-wide treaty, which covers all lines of business and where the legal contract sits with RSAI. The transferring policyholders will continue to benefit from this treaty as branch policyholders of RSAL.

Although any formal objections from reinsurers may not be known until after the Directions Hearing, RSAI has confirmed that no issues have been raised in initial discussions with reinsurers regarding the Proposed Transfer. I will address this point further in my Supplementary Report.

RSAL plans to buy similar external reinsurance going forward, such as the Group-wide treaty, from which RSAL will benefit. In addition, RSAL intend to purchase a quota share reinsurance contract from RSAI. Quota share is a common type of reinsurance arrangement, where an insurer shares a set proportion of premiums and claims with the reinsurer. The percentage of the quota share contract will be set at around 90%, so as to retain 10% of gross business within RSAI, after consideration of any external reinsurance. The CAA has indicated that they will approve this level of reinsurance back to RSAI.

RSAL and RSAL have each engaged independent third parties to advise on the appropriate terms of the quota share reinsurance contract. This advice will be supplemented by a report demonstrating that the price of the quota share reinsurance contract is on an arm's length basis ie in line with standard commercial terms. With intra-group reinsurance policies, this is a common approach to demonstrate the policy is not significantly under- or over-priced. I will address this point further in my Supplementary Report.

### 3.3. Purpose of the Proposed Transfer

The purpose of the Proposed Transfer is to provide certainty that RSA can continue to carry on EEA business post-Brexit with minimum disruption to its operating model and its customers.

### 3.4. Alternative options considered

Two alternative options were considered and subsequently discounted by RSAI with regards to the Proposed Transfer and RSAI's approach to responding to Brexit. These were:

- A transfer of renewal rights to RSAL, so that future EEA business could be written through RSAL.

- 3336900**     ▪     Utilising the RSA Global Network to write future EEA business.

Page 19 of 76 Both of these alternatives were discounted as appropriate solutions. RSAI concluded that the renewal rights and Global network approaches would not give the same level of certainty to policyholders and may have an adverse impact on current services and cover levels when compared to the Proposed Transfer. RSAI concluded that the Proposed Transfer would be more certain, complete and cost effective, and therefore, overall, better for policyholders.

### 3.5. Contingency plans

The Proposed Transfer assumes a Hard Brexit where RSAI no longer has FofS or FofE rights for existing or new policyholders.

There are significant uncertainties as to how the UK Government's Brexit negotiations and other Brexit arrangements will develop over the coming months.

For example, under a Hard Brexit, RSAI may not legally be able to pay valid claims to existing EEA policyholders. Under alternative Brexit scenarios, a legal route for paying these claims may be agreed by the UK Government and the EEA.

The purpose of the Proposed Transfer is to provide certainty that RSA can continue to carry on EEA business post-Brexit with minimum disruption to its operating model and its customers. To achieve this objective, RSAI plans to proceed with the transfer unless certainty is achieved sufficiently early in the process that the Proposed Transfer is no longer necessary. In addition, RSAI has a contingency plan for a scenario where there is a Hard Brexit, and the Proposed Transfer has not yet completed. In this scenario:

- RSAI will not be able to manage an orderly wind-down of the policies sold in the EEA30 countries without approval from each EEA30 regulator to do so.
- RSAI will not be able to renew any policies from the EEA branch network or those that require FofS access.

For policies that have already incepted, RSAI's contingency plan is to seek approval from the relevant regulators to conduct an orderly wind-down of the existing policies.

For policies due for renewal, RSAI has two contingency options:

- RSAL renews policies. This would be the preferred contingency option.
- RSAI utilises its existing Global Network model, which is established for non-EEA policies.

I will consider these plans further in my Supplementary Report.

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## 4. My approach as IE

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As IE, my overall role is to assess whether:

- The security provided to policyholders of RSAI will be materially adversely affected by the implementation of the Proposed Transfer.
- The Proposed Transfer will have any adverse impact on service standards experienced by the policyholders.
- Any reinsurer of RSAI covering the transferring business will be materially adversely affected.

To make these assessments, I have considered the effect of the Proposed Transfer from the perspectives of each of:

- “Non-transferring policyholders”, who will remain with RSAI after the Proposed Transfer.
- “Transferring policyholders”, who will transfer from RSAI to RSAL as a result of the Proposed Transfer.
- Reinsurers whose contracts with RSAI are transferring to RSAL.

I would typically also consider the perspective of existing policyholders of the transferee (ie RSAL), but this is not required for the Proposed Transfer as RSAL has no existing policyholders.

Some policyholders have policies that cover both UK and EEA30 risks – eg, multinational policies written by RSAI under FofS. For these policyholders, I have considered the non-transferring and transferring portions, respectively, to be part of non-transferring and transferring policyholders.

My approach to assessing the Proposed Transfer has been to perform the following five steps analysing evidence provided by RSAI to support the Proposed Transfer.

### Step 1: Assessing the provisions of RSAI and RSAL

The first important form of security that an insurer provides to policyholders is the level of provisions. Provisions are based on an estimate of the amount of money the insurer will need to pay policyholders' claims and to cover the other costs associated with running the insurer.

I have, therefore, assessed the appropriateness of the provisions included on RSAI's balance sheet and the approach to be used for the calculations for both RSAI and RSAL pre- and post-transfer. Details of this step are set out in Section 5.

**3336900**      **Step 2: Assessing the capital positions of RSAI and RSAL**

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In addition to the level of provisions, insurers hold capital designed to withstand more extreme levels of claims. The level of capital held is the second important form of security provided to policyholders.

For both RSAI and RSAL, the level of capital required is set under the European Solvency II standard. A key metric under Solvency II is the Solvency Capital Requirement (SCR). This is an estimate of capital required to ensure that an insurer is able to meet its obligations over the next 12 months with a probability of at least 99.5%.

I have assessed the appropriateness of the projected capital requirements of RSAI and RSAL. This includes considering key differences between the way that the SCR is calculated for each insurer – specifically, RSAI uses an approved “internal model” and RSAL uses the “standard formula” (these are two of the ways for calculating the SCR allowed under Solvency II). Details of this step are set out in Section 6.

**Step 3: Assessing overall policyholder security**

Under this step, I have considered the level of provisions and capital (from steps 1 and 2) in the context of the assets held by each of RSAI and RSAL and other forms of security such as reinsurance.

For this analysis, I have considered the current balance sheet of RSAI and the post-transfer pro-forma balance sheets for each of RSAI and RSAL. Details of this step are set out in Section 7.

**Step 4: Assessing policyholder communications**

I have assessed the appropriateness of RSAI’s communication strategy to inform policyholders and other stakeholders of the Proposed Transfer.

The key focus of my assessment was whether the policyholders and other stakeholders are to be provided with sufficient and clear enough information so that they can understand how the Proposed Transfer may affect them. Details of this step are set out in Section 8.

**Step 5: Assessing potential impact on customer service and other considerations that might affect policyholders**

I have considered how the level of customer service provided to policyholders could change following the Proposed Transfer. I have also considered a range of other factors that might affect policyholders, such as ongoing expense levels and tax implications. Details of this step are set out Section 9.

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## 5. Reserving considerations

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### 5.1. Introduction to insurance reserving

For an insurance company, the primary purpose of reserving is to assess the provisions that need to be set in order to pay policyholders' claims and to cover the other costs associated with running an insurer.

Depending on how they are set, the provisions may be on a "best estimate" basis (ie with no deliberate optimism or pessimism) or include a "margin for prudence" (ie additional provisions to cover higher than expected claims). Where the provisions include a margin for prudence, this is typically designed to cover claims that are moderately higher than expected rather than more extreme levels of claims.

In addition to any margin for prudence, the insurer would nearly always hold additional capital designed to withstand more extreme levels of claims. My considerations related to capital for the Proposed Transfer are set out in Section 6.

### 5.2. Introduction to reserving bases

Insurers use a range of different reserving bases (ie different measures of the provisions), for different purposes.

For example, financial accounting standards require the provisions to be calculated in particular ways, and the insurer may also use a different basis for internal management accounts. Solvency II calculates the provisions in yet another way.

For the Proposed Transfer, I have considered the provisions under two reserving bases, which are each relevant for different purposes, namely:

- *International Financial Reporting Standards ("IFRS")* – these are the accounting standards used to set the provisions underlying the consolidated published financial accounts of RSA Group, covering RSAI and RSAL (local reporting for RSAL will be under Luxembourg Generally Accepted Accounting Principles ("GAAP")). IFRS provisions are relevant for policyholders as they are used as a reference point when setting provisions to cover future claims and other costs.
- *Solvency II technical provisions* – these are calculated in line with the European Solvency II regulations that came into effect in both UK and Luxembourg with effect from 1 January 2016. These provisions are relevant for policyholders as they are the basis for calculating the capital required and assessing solvency, for each of RSAI and RSAL.

**3336900** **5.3. My considerations relating to reserving**

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As IE, my overall assessments related to reserving are:

- whether an appropriate level of provisions is maintained for both non-transferring and transferring policyholders; and
- whether any aspects of the reserving may lead to policyholders being materially adversely affected by the Proposed Transfer.

To make these assessments, I have considered the following areas:

- Appropriateness of provisions (Section 5.5);
- Key uncertainties when setting the provisions (Section 5.6);
- Current RSAI reserving process and governance (Section 5.7);
- Future reserving approach and governance (Section 5.8); and
- Setting of case estimates (Section 5.9).

Within these areas, I have also considered any expected differences in the reserving approach between RSAI and RSAL to understand how this may affect policyholders.

Further details on each of these considerations are set out below, and I have stated my overall conclusion related to reserving in Section 5.10.

**5.4. Approach to my review**

I have reviewed a number of documents provided by RSAI relating to the setting of provisions, including the reserving process and governance. In addition, I have had meetings with key members of RSAI's reserving team to discuss the information provided and any questions I have had on the approach. A list of the key data and documentation is provided in Appendix 4.

I have also performed a walk-through of a sample of the reserving calculation spreadsheets with RSAI staff to understand the process followed and how the spreadsheets are used by RSAI in calculating provisions.

Additionally, I have independently calculated my best estimate provisions for a number of the material classes that are proposed to transfer to RSAL, and compared my results to those of RSAI.

**5.5. Appropriateness of provisions**

**RSAL's reserving basis**

The provisions calculated by the RSAI actuarial team (known as the "actuarial indication") are on a best estimate basis – ie with no deliberate optimism or pessimism.

**3336900** In addition to the actuarial indication, RSAI hold an explicit margin on IFRS provisions, in line with the principles set out in the RSA Group Reserving Policy. As at 31 December 2016, these principles resulted in an additional margin on the best estimate provisions in aggregate across RSAI.

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The level of margin held by RSAI, at c. 5% of best estimate provisions, is similar to the level typically held by other similar insurers and is included in the “booked provisions” reported in RSAI’s IFRS financial accounts.

The 2016 year end annual accounts for RSAI stated that the margin is held for uncertainties including Swedish Personal Accident, Danish Workers’ Compensation, Canadian Liability and Ogden/PPO exposed liabilities. RSAI has confirmed that, as the transferring business is not materially affected by the uncertainties for which the margin is held, no margin will be transferred to RSAL.

The majority of IFRS provisions are not discounted for the “time value of money”. To the extent that claims will be paid out some time in the future, there is an argument that having no discounting provides an additional element of prudence in the provisions. This is due to the ability to earn investment income up to the point that the claims are paid.

#### **My assessment of appropriateness of provisions**

The main focus of my assessment of the appropriateness of the provisions was a review of the key documents provided to me by RSAI relating to the calculated provisions as at 31 December 2016 (the latest date that full audited results were available), and my discussions with key members of RSAI’s reserving team.

Based on this review, I concluded that the methodology used to set the provisions was appropriate, and I did not identify any concerns around the appropriateness of the provisions. (This review also considered the current reserving process and governance, which I consider further in Section 5.7).

In addition, for the transferring business, I independently calculated my best estimate provisions for a number of the more material classes transferring to RSAL – covering c. 50% of the transferring provisions. My independent estimates further support my conclusions that the best estimate provisions as at 31 December 2016 are appropriate.

During my review of the provisions for the transferring business, I identified that the level of IBNR (IBNR is defined in Section 5.9) for the transferring business looked low compared to my expectations from my wider experience. Following discussions with RSAI’s actuarial team, I am satisfied that this is due to RSAI’s approach to recognising subrogated recoveries, discussed in Section 5.9. On this basis, I was satisfied that the level of IBNR was appropriate.



**3336900** The booked provisions also include amounts for the unearned premium reserve (UPR), unallocated loss adjustment expenses (ULAE) and reinsurance bad debt (see the glossary for definitions). I have reviewed RSAI's procedures for setting these amounts and these procedures are in line with market practice. As Group procedures will continue to be followed post-transfer, policyholders will be unaffected.

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I have not undertaken my own independent calculations of the non-transferring provisions, as this was not required to support my conclusions on the Proposed Transfer. Specifically, the transferring provisions represent c. 7% of those of RSAI, net of reinsurance (as shown in the following table). I am satisfied that the Proposed Transfer will not have a material impact on the non-transferring business. In addition, RSAI has confirmed that the future reserving process and governance for RSAI will be unchanged post-transfer.

#### Summary of booked provisions for RSAI

31 December 2016

£m	Gross of reinsurance	Net of reinsurance
Non-transferring	3,695	2,859
Transferring to third party (UK EL transfer)	658	595
Transferring to RSAL	304	225
<b>Total</b>	<b>4,657</b>	<b>3,679</b>

Source: RSAI, figures include ULAE but exclude UPR and bad debt

#### Summary of booked provisions by class for business transferring to RSAL

31 December 2016

£m	Gross of reinsurance	Net of reinsurance
Property	54	38
Engineering	101	58
Liability	52	44
Professional Indemnity	3	3
Marine	95	82
<b>Total</b>	<b>304</b>	<b>225</b>

Source: RSAI, figures include ULAE but exclude UPR and bad debt

The figures in the tables above are based on certain assumptions to approximate the proportion of provisions for the transferring London business.

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As discussed in section 2.6, RSAI has confirmed that the impact of the approximations is within  $\pm 5\%$  of the estimated provisions. This margin of error does not impact the conclusions I have reached. To assess the appropriateness of the Solvency II technical provisions, I have reviewed RSAI's approach to calculating Solvency II provisions. I have reviewed the areas which, in my experience, are the areas of greatest interest to an independent reviewer due to their subjective nature. This included the treatment of Events Not in the Data (ENIDs) and the run-off of the Risk Margin provision. I concluded that RSAI's approach used to calculate Solvency II provisions is appropriate, and did not seek to re-perform the calculation of Solvency II provisions or verify the calculations performed by RSAI.

#### Other considerations related to the appropriateness of provisions

In addition to my analysis described above, I have also considered the following:

##### External audit by RSAI's auditors

- The external auditors (KPMG) opined that RSAI's financial statements for the year ended 31 December 2016 give a true and fair view of RSAI's state of affairs and that the financial statements had been properly prepared.
- I have reviewed selected relevant parts of reports prepared by RSAI's external auditors as at 31 December 2016, including their management letter to RSAI and the summary of the supporting analysis undertaken by their actuaries. These contained no material issues in relation to either RSAI's IFRS or Solvency II provisions that would lead me to conclude that the provisions for RSAI or the transferring business are not appropriate.
- KPMG have asked that a "notice of the auditor" is included in this Scheme Report. This can be found in Appendix 6.

##### Internal review by RSAI

- I have been informed by RSAI that, other than the external audit, RSAI has not been subject to any other recent external independent reserving reviews. However, Group Actuarial (a function within RSAI) performed an internal assurance review in 2016 on the provisions for the UK Commercial business as at 31 March 2015. This covered around half of the provisions for RSAI, including c. 98% of the transferring business. The team from Group Actuarial that performed this review was independent of the RSAI actuarial team who originally calculated the provisions.
- Group Actuarial made some recommendations on the reserving process (eg to reduce the complexity of systems and processes in order to reduce the likelihood of errors) but concluded that the methodology and assumptions used were appropriate. As part of this work, Group Actuarial calculated their own independent provisions and their calculated provisions were within 0.2% of the best estimates produced by the RSAI actuarial team.

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- While this independent review does not directly relate to the 31 December 2016 provisions, the closeness of the two sets of independent figures provides additional evidence of the appropriateness of the provisions.
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## 5.6. Key uncertainties when setting the provisions

The ultimate costs of settling general insurance claims are subject to uncertainty in terms of both the frequency (ie how many valid claims there will be) and severity (ie the cost of settling each claim). Therefore, there are uncertainties when setting the corresponding provisions.

### Key uncertainties in the transferring business

The transferring business is a mixture of property business, which is “shorter tail” (ie claims are reported and settled in a relatively short time) and liability business, which is “longer tail” (ie claims take longer to report and settle). A breakdown of the transferring provisions is shown in the second table of the previous section. The table below shows the timeframes in which claims are expected to be paid.

#### Expected proportion of claims expected to be paid within each timeframe

Class of business	Within 1 year of the Proposed Transfer	Between 1 year and 5 years	After more than 5 years
Property	68%	30%	2%
Engineering	57%	41%	2%
Liability	29%	51%	20%
Professional Indemnity	4%	39%	57%
Marine	58%	37%	5%
<b>Total</b>	<b>55%</b>	<b>39%</b>	<b>7%</b>

Source: RSAI (estimates based on business profile as at 31 December 2016)

When setting provisions, the liability business is typically more uncertain than the property business. This is due to the nature of the cover provided and uncertainties relating to longer tail business, such as uncertainty in future claims inflation.

I have not identified any specific issues related to RSAI's business that would lead me to conclude that the underlying uncertainty is materially different to other similar liability portfolios.

One of the key uncertainties in the level of provisions required for the transferring business is the consistency of case estimates being set by claims handlers. I have discussed this further in Section 5.9.

**3336900**      **Key uncertainties in the non-transferring business**

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RSAL sell certain classes eg UK motor insurance which result in exposure to Periodical Payment Orders (PPOs) and the Ogden discount rate. There is also exposure to latent claims.

- PPOs are a form of settlement of large personal injury claims in the UK via regular payments for the life of the claimant. These usually include payments relating to care costs, which are linked to an inflation index. PPOs add considerable uncertainty to the provisions required as both the ultimate amount and number of payments required are unknown.
- The personal injury discount rate (Ogden rate) impacts the amount of lump sum court awards from PPOs, by making an allowance for the assumed future investment return (in real terms) that the claimant could earn on the award. The Ogden discount rate reduced from 2.5% pa -0.75% pa in February 2017, which increased claim costs significantly. The government have announced the method will change in the future and have indicated that the rate may increase to between 0% pa and 1% pa, although the timing of this change is currently unclear. This adds considerable uncertainty to the provisions required, the reduction in the rate in February 2017 resulted in some claims more than doubling in value.
- Latent claims are typically defined as claims that take a very long time to manifest themselves and for the claims to settle, eg asbestos exposure.

Since the transferring portfolio is predominantly non-UK business it would not be expected to be impacted by changes in the Ogden rate, but some UK exposures will be transferring which were written under FofS rules by non-UK EEA countries. However, from discussions with RSAI, I understand that there is a very limited indirect exposure to the Ogden discount rate in the transferring portfolio as a proportion of provisions affected by this issue is allocated across the whole portfolio. Also it is possible there could be some exposure to PPOs or similar annuity exposures in other jurisdictions.

**3336900**      **5.7. Current RSA reserving process and governance**

Page 29 of 76      The RSAI actuarial team in the UK produce actuarial estimates of provisions for the whole of RSAI, including for the transferring business.

**RSAI reserving process**

RSAI use generally accepted actuarial methods, such as the chain ladder model, the Bornhuetter-Ferguson model and IBNR loads (IBNR is defined in Section 5.9) on outstanding case estimates. The approach taken by RSAI is in line with standard market practice to calculate provisions for the business written.

RSAI also maintain indices of movements of rates and historical claims inflation to allow for changes over time. This is in line with good market practice for general insurance reserving.

I noted that the assumptions for rate movements and historical claims inflation looked comparable to those of other insurers and my wider experience, and that the selected initial expected loss ratios derived from these assumptions were appropriate.

RSAI use commercially available reserving software, together with Excel spreadsheets and their own bespoke reserving models to calculate their provisions. This approach is in line with typical industry practice, and I did not identify any material concerns with the appropriateness of the processes used.

**Wider stakeholder involvement in the reserving process**

The documents that I have reviewed show evidence of input into the reserving process being provided from the key relevant functions within the business, including the claims management function, with detailed reserving packs being presented to various reserve meetings and committees for challenge and approval. This helps to evidence a robust reserving process.

**Documentation of the reserving process**

The level of detail provided in the reserving packs is more than I typically see given my wider experience and the packs contain sufficient detail for decisions to be taken.

**Reserving process governance**

There is clear evidence of internal peer review of RSA's reserving analysis. Actions from meetings are captured and monitored. There are terms of reference in place for the various committees involved in the reserving process. Each of these is evidence of robust governance around the reserving process.

**3336900**      **5.8. Future reserving approach and governance**

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RSA have confirmed that no changes to the reserving approach for either IFRS or Solvency II provisions are planned for RSAI post-transfer, and that the same overall reserving approach will also apply for RSAL.

RSA have supported this statement with an overarching reserving strategy paper, set out in the proposed RSAL System of Governance (as provided to the CAA) and other supporting information. Specific details include:

- Currently, Regional and Local Reserve Committees provide governance over the level of provisions at a local level, and ultimately report into the Group Reserving Committee. Post-transfer, a similar reserving process will be maintained with the RSAL Reserve Committee reporting to the UK&I Reserve Committee which will report to the Group Reserving Committee. The RSAL Reserve Committee will also report to the RSAL Audit Committee.
- The RSAL actuarial function will provide assurance that appropriate methods, models and assumptions are used to set the IFRS provisions and confirm that the Solvency II technical provisions are appropriate. The key function holder for the actuarial function will be the RSAL Chief Financial Officer (CFO).
- The RSAL actuarial function will be supported by an outsourcing arrangement with RSA's UK actuarial function, which will leverage existing actuarial skills and experience of the transferring business. Final oversight and sign-off for the actuarial indication (best estimate provisions) will remain with the UK based team. This will help ensure there is consistency in the approaches used between RSAI and RSAL, where appropriate.
- The RSAL Board will be responsible for the booking of provisions in the RSAL report and accounts, which may include a margin in addition to the actuarial indication. As such, RSA has confirmed there will be no material changes to the actuarial approach for setting claim provisions.
- The RSAL Board is composed of the Dirigeant Agréé/RSAL Chief Executive Officer (CEO), the Managing Director – Global Risk Solutions, the UK & International CFO, an RSA Director (EU) and an Independent Non-executive Director. The UK&I Chief Actuary will be a member of the RSAL Reserve Committee.
- The RSAL executive team will consist of the RSAL CEO, CFO, Chief Underwriting Officer, Chief Risk Officer, Head of Compliance and the Country MDs.
- While RSAL will be an autonomous entity responsible for setting its own provisions, in my view, the overlap of key personnel on the Board will enable RSAL to achieve the stated aim of consistency with RSAI.
- For the transferring business, the local branches currently manage their own claims, including setting case estimates (see Section 5.9 below) in line with Group policies and this will continue to be the case post-transfer.

**3336900**      **5.9. Setting of case estimates**

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Claims handlers assess claims as they are notified to an insurer and use their judgement and experience to estimate the likely cost of each claim. This is known as setting a “case estimate”.

These case estimates are used in the reserving process as a basis for projecting the estimated costs of future claims, ie those that have not yet been reported and the additional cost of settling those that have been reported. The provision for these future claims is known as IBNR (Incurred But Not Reported). The IBNR includes estimated developments to existing open claims, ie those that have been reported but not fully settled. The provision for these open claims is called IBNER (Incurred But Not Enough Reported). Depending on the type of insurance being considered, and the claims handling approach, both the IBNR and IBNER can be either positive or negative.

Given how the case estimates are used when setting provisions, it is important that the case estimation process is clearly documented and followed consistently over time. Where there are any changes in the case estimate approach, these need to be clearly communicated to the actuarial reserving team so they can assess the impact of those changes and incorporate any required adjustments within the provisions.

I have reviewed RSAI’s internal policy documents which give guidance and instructions to claims handlers on the setting of case estimates. The stated policy is that case estimates should be “accurate, realistic, and neither deliberately optimistic nor pessimistic”. I have interpreted this as that they should be set on a best estimate basis.

However, based on my analysis of RSAI’s reserving calculations, I have noted that for the transferring business at an overall level, the final cost of claims is typically less than the initial case estimates set by the claims handlers. This observation is inconsistent with the case estimates being best estimates.

I have discussed this with the UK&I Actuarial Director of RSAI, who has confirmed that the reasons for this apparent anomaly are:

- RSAI do not include an estimate of expected subrogation recoveries in their case estimates until the recoveries are received. (Subrogation is where an insurer pursues a third party, that causes or partially causes an insured’s loss, for a contribution to the costs of that loss.)
- The impact of this approach is that at any point in time the overall initial case estimates do not allow for subrogation recoveries and so, all else being equal, will reduce over time upon the receipt of any subrogation recoveries.
- In addition, external loss adjusters are used to set the case estimates for some claims, eg more complex claims, and historically these case estimates have proven to be prudent with hindsight. This has a similar impact to the subrogation issue in

**3336900** that, all else being equal, the initial case estimates are expected to reduce over time.

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I have factored the impact of the reduction of initial case estimates over time into my analysis regarding the appropriateness of the provisions held and I am satisfied that the provisions are appropriate.

### 5.10. Overall conclusion: Reserving considerations

I have set out below my overall conclusions related to reserving. These reserving considerations should not be considered in isolation. For example, the overall level of protection for policyholders also depends on the level of capital held, and a range of other considerations. My overall conclusions on the Proposed Transfer are set out in Section 10.

#### Non-transferring policyholders

**Based on the work described above, I have concluded that an appropriate level of provisions will be maintained for the non-transferring policyholders and that they will not be materially adversely affected by the reserving aspects of the Proposed Transfer.**

The key reasons for reaching my conclusions for non-transferring policyholders are as follows:

- The transferring provisions are not material compared to the non-transferring provisions, particularly on a net of reinsurance basis, and so the Proposed Transfer will have a limited impact.
- RSAI has confirmed that the future reserving process and governance for RSAI will be unchanged post-transfer.

#### Transferring policyholders

**Based on the work described above, I have concluded that an appropriate level of provisions will be maintained for the transferring policyholders and that they will not be materially adversely affected by the reserving aspects of the Proposed Transfer.**

The key reasons for reaching my conclusions for transferring policyholders are as follows:

- RSAI have confirmed that the RSAL reserving process will be subject to the current RSAI and Group governance structure, and have provided sufficient evidence to support this statement.
- My independent calculation of best estimate provisions for the business transferring to RSAL, on a sample basis, supports the appropriateness of the provisions.



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## 6. Capital considerations

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### 6.1. Introduction to insurance capital setting

A key reason why insurers hold capital is to withstand adverse or extreme levels of claims and other losses. The capital is held in excess of the provisions for policyholders' claims and for the other costs associated with running an insurer.

An insurer's "capital coverage ratio" is calculated as the available capital in excess of provisions divided by the capital required under regulations. The coverage ratio is a measure of capital strength and, whilst it does not capture all aspects of policyholder protection, all else being equal, a higher coverage ratio provides more protection. A higher ratio indicates there is more capital available per £ of capital required. Under Solvency II, the level of available capital is referred to as "own funds".

For the purposes of this report, I describe a company as having "sufficient capital" (relative to the regulatory capital requirement under consideration) if the coverage ratio is above 100%. I describe a company as "well-capitalised" if the coverage ratio is between 150% and 200% and "very well-capitalised" if the coverage ratio is in excess of 200%.

### 6.2. Calculating capital requirements

For both RSAI and RSAL, the level of capital required is set under the European Solvency II standard.

A key metric under Solvency II is the Solvency Capital Requirement (SCR). This is an estimate of capital required to ensure that an insurer is able to meet its obligations over the next 12 months with a probability of at least 99.5%.

Under Solvency II, there are three ways in which the SCR can be calculated:

- *Standard formula:* under this approach, the SCR is set using a prescribed calculation and parameters, as specified in the Solvency II regulations. Within the standard formula framework, insurers can use undertaking-specific parameters (USPs) to help improve the parameterisation of the calculation for their specific business.
- *Internal model:* under this approach, the SCR is set using the insurer's own internal capital model. The internal model is developed and parameterised by the insurer to reflect their specific business.
- *Partial internal model:* under this approach, the SCR is set using a combination of the standard formula and the insurer's own internal capital model. Under this approach, some aspects of the SCR are calculated using the internal model, and the remainder is calculated using the standard formula.

**3336900** The choice of approach is made by the insurer; however, an insurer needs to obtain regulatory approval in order to use USPs, an internal model or a partial internal model to calculate their SCR. An insurer does not need approval to calculate their SCR using the standard formula without USPs, but does need to complete their own assessment of the appropriateness of the standard formula for this purpose.

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RSAL uses an approved internal model and RSAL intends to use the standard formula without USPs to calculate their SCR.

Whilst the SCR is being calculated using a different approach for the two insurers, assuming they have been calculated appropriately, it is valid to compare the two SCRs (and the corresponding capital coverage ratios) to give an indication of the relative capital strength. This comparison is valid because:

- For RSAI, the internal model has been specifically designed to appropriately reflect the risk profile of the business, and the model is subject to detailed independent validation by an independent team within RSAI.
- For RSAL, in line with Solvency II requirements, RSA have assessed the appropriateness of the standard formula for the purposes of calculating the SCR. This has concluded that the standard formula is materially appropriate and I have considered a summary of this assessment as part of my work in preparing this report (see section 6.7).

The SCR is a “one-year” view of risk as it focuses on risks that an insurer faces over the next 12 months. As part of their overall capital management, insurers typically also consider an “ultimate” view of risk that considers the risks faced over the period until the business is fully run-off. In this report, I have referred to this as the “Ultimate SCR”.

Another key measure of capital under Solvency II is the Minimum Capital Requirement (MCR). This is a simpler calculation than the SCR and typically a less onerous requirement. Both RSAI and RSAL are projected to be very well-capitalised on this measure (with MCR capital coverage ratios of 350%+ and 450%+ respectively). Therefore, I have not considered the MCR further as part of my assessment of capital considerations, and my primary focus is on the SCR. I have also considered the Ultimate SCR.

### 6.3. Components of capital requirements

The key components of the SCR common to both RSAI and RSAL are:

- *Underwriting risk*: the risk that the value of insurance claims proves to be higher than expected. For example, this covers the risk of large-scale floods or other catastrophe events, and uncertainties related to existing liabilities included on the balance sheet.

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- *Market risk*: the risk of changes in each insurer's financial position due to changes in the market value of assets, liabilities and financial instruments. For example, this covers the risk of falls in the value of assets that are being held to make future claims payments.
- *Counterparty default risk*: the risk of defaults or downgrades by counterparties that either owe the insurer money, or hold money on its behalf. For example, this covers the risk of the failure of a reinsurer or a broker.
- *Operational risk*: the risk of losses caused by failures in an insurer's operational processes, people and systems, or from events that are external to the insurer. For example, this would cover the risk of fraud or IT failure.

A further material component of the SCR for RSAI is:

- *Pension risk*: the risk that RSAI needs to pay more money than expected into RSA Group's defined benefit pension scheme.

RSAL does not have direct exposure to any material defined benefit pension schemes and pension risk is not included in the SCR for RSAL (see section 9.2 for further considerations related to pension arrangements for RSAL).

The most material component of the SCR for RSAI is underwriting risk, which represents c. 50% of the SCR, as reported in RSA Group's Solvency and Financial Condition Report as at 31 December 2016. This is as expected given that insurance is the core business of RSAI.

The most material component of the SCR for RSAL is counterparty default risk, which represents c. 52% of the SCR. This is because the majority of RSAL's underwriting risk is transferred back to RSAI through the intra-group quota share reinsurance. This means that RSAL has a high reliance on RSAI for financial security, and this is considered in section 6.11.

#### 6.4. My considerations related to capital

As IE, my overall assessments related to capital are:

- whether the projected capital requirements have been calculated appropriately for both non-transferring and transferring policyholders;
- whether there are expected to be any material adverse changes in the strength of capital protection for either group of policyholders (I have assessed this by comparing the projected SCR coverage ratios pre- and post- the Proposed Transfer); and
- whether any other aspects of the capital considerations may lead to policyholders being materially adversely affected by the Proposed Transfer.

**3336900** To make these assessments, I have considered the following areas:

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- The capital policy for each of RSAI and RSAL (section 6.6);
- SCR appropriateness for RSAI and RSAL (section 6.7);
- The planned capital structures for RSAI and RSAL (section 6.8);
- Projected SCR coverage ratios (section 6.9); and
- RSAL reliance on RSAI (section 6.11).

### 6.5. Approach to my review

I have reviewed a number of documents provided by RSAI relating to the calculation of capital requirements and projected coverage ratios. In addition, I have had meetings with key members of RSAI's capital team to discuss the information provided and any questions I had on the approach. A list of the key data and documentation reviewed is provided in Appendix 4.

I have also independently calculated selected aspects of the standard formula SCR calculation for RSAL using LCP's standard formula model, and compared my results to those of RSAI.

### 6.6. The capital policy for each of RSAI and RSAL

RSAI and RSAL are subject to the same overall RSA Group Capital Policy. This sets out the minimum requirements and standard controls that apply to all regulated insurance entities in the RSA Group.

In addition to the Group Capital Policy, each regulated entity is required to have its own specific policy, drafted with reference to the Group policy. The RSAL-specific capital policy will also set out details of the capital governance framework including the validation of capital calculations and reporting processes.

The RSAL actuarial function will be supported by an outsourcing arrangement with RSA's UK actuarial function, which will leverage existing actuarial skills and experience of the transferring business. This will help ensure there is consistency in the approaches used between RSAI and RSAL, where appropriate.

In my opinion, the proposed structure, as summarised above, provides an appropriate balance between:

- Group-wide policy, to ensure consistency between entities; and
- Entity-specific policy to ensure capital appetites and other considerations are appropriate for each individual entity.

**3336900**      **6.7. SCR appropriateness for RSAI and RSAL**

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Appropriateness of the internal model SCR for RSAI:

- RSAI's internal model (approved by the PRA) has been specifically designed by RSAI to reflect the risk profile of the business.
- The model has been developed by an experienced team of insurance capital modellers. It is subject to regular detailed validation by an independent team within RSAI, and review by senior individuals at RSAI including members of the Internal Model Governance Committee.
- In addition, RSAI has commissioned an external validation review of the model, due to be completed later during 2018. The findings from this external review are not yet available. However, based on my discussions with RSAI, I do not expect that the review will identify any issues that indicate that the internal model is materially inappropriate.
- At this stage, I have no reason to doubt the appropriateness of the SCR calculated by the internal model for RSAI. I plan to consider the findings of the external validation review once these are available and provide commentary on these findings in my Supplementary Report.

Appropriateness of the standard formula SCR for RSAL:

- RSAI has reviewed the appropriateness of the standard formula for the purpose of calculating the SCR for RSAL. The review concluded that the standard formula is materially appropriate at an overall SCR level. RSAI have confirmed the proposed investment strategy for RSAL and this is reflected in the standard formula SCR calculation.
- I have reviewed the summary standard formula assessment provided by RSAI and I am satisfied that it supports the conclusion that the standard formula is materially appropriate for RSAL.
- A potential limitation in the standard formula is that, when calculating counterparty default risk, the standard formula assumes the portfolio of counterparties is diversified. In the case of RSAL, a single counterparty (RSAI) will form the majority of the portfolio. Under these circumstances, the standard formula may understate counterparty default risk. However, I do not expect this to be material due to the financial strength of RSAI.
- I have also performed an independent calculation of certain aspects of the SF calculation for RSAL and compared my results to those of RSAI. This is based on LCP's standard formula model using data supplied by RSAI. My independent estimates further support my conclusion that the standard formula SCR for RSAL has been calculated appropriately.

**3336900** **6.8. The planned capital structures for RSAI and RSAL**

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RSAL’s target initial capitalisation for day 1 after the Proposed Transfer is:

- *Equity capital:* c. 110% coverage of the day 1 SCR by unrestricted “Core Tier 1” own funds – this will mean that RSAL will hold assets equal to 110% of the SCR.
- *Contingent equity capital:* A £31m (€35m) ancillary own funds (AOF) arrangement with RSAI. This will mean that, assuming that the funds are available within RSAI, RSAL can call on RSAI for further assets up to £31m as required in the future. Of this contingent equity capital, under Solvency II, an amount of up to 50% of the SCR is eligible for the purposes of calculating the SCR coverage ratio (the SCR is £41m, so £20m of AOF will be eligible on day 1).

The above equates to a day 1 SCR coverage ratio for RSAL of 160% (as shown in the second table in the following section) plus an additional c. 26% coverage “buffer” available from the ancillary own funds arrangement. The proposal for RSAL’s target initial capitalisation is awaiting approval from the CAA.

The RSAI capital structure is materially unchanged pre- and post- the Proposed Transfer.

**6.9. Projected coverage ratios of SCR**

The following tables set out the SCR and coverage ratios, prepared by RSAI, for RSAI and RSAL pre- and post- the Proposed Transfer. These figures are draft, subject to RSAI Board sign-off and I will comment on any updates to the figures in my Supplementary Report.

**RSAL –SCR and coverage ratio pre- and post- transfer**

£m	Pre-Transfer Day 0	Post- Transfer Day 1
Total own funds eligible to meet SCR	3,233	3,263
SCR	1,793	1,793
<b>SCR coverage ratio</b>	<b>180%</b>	<b>182%</b>

Source: RSAI

The figures for RSAI assume that the UK EL transfer completes successfully at the same time as the Proposed Transfer considered in this report, although my conclusions would be unchanged if this were not the case.

The projected SCR for RSAI is materially unchanged following the Proposed Transfer.

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**RSAL –SCR and coverage ratio post- transfer**

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£m	Pre-Transfer Day 0	Post- Transfer Day 1
Total own funds eligible to meet SCR	-	65
SCR	-	41
<b>SCR coverage ratio</b>	-	<b>160%</b>

Source: RSAI

As set out in the above tables, both RSAI and RSAL have projected day 1 SCR capital ratios within the range 150% to 200%. Therefore, as explained in section 6.1, on this measure I consider them to be “well capitalised”. The target SCR coverage ratio for RSAL is 150%. The corresponding target SCR coverage ratio for RSAI is 130% to 160%. The proposed day 1 RSAL and current RSAI coverage ratios are higher than their respective targets.

RSAI have also projected the SCR for RSAL up to 31 December 2020. Over this period, the projected SCR coverage ratio for RSAL is projected to increase to c. 180% with the SCR itself staying broadly unchanged. RSAI has confirmed that the expected increase in coverage is because profits from RSAL are expected to be retained by RSAL, but this will need to be formally approved by the RSAL Board.

The coverage ratio shown for RSAL above includes £20m coverage from the AOF arrangement with RSAI (assuming regulatory approval from day 1). There is a further £11m coverage from the AOF which is not eligible to meet the SCR until called. If this further coverage were to be called then, all else being equal, this would increase RSAL’s SCR coverage ratio to c. 186%. This would bring RSAL to the upper end of the “well capitalised” range, or make them “very well capitalised”.

RSAL is expecting modest growth and this is reflected in the projected coverage ratios to 31 December 2020. If RSAL’s business were to grow faster than expected, leading to a correspondingly higher SCR, then the AOF arrangement would not increase in proportion and the coverage ratio would be reduced. However, based on RSAI’s projections, the retention of profits is expected to more than offset this reduction in coverage ratio.

3336900 In summary, following the Proposed Transfer:

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- The SCR coverage ratio for non-transferring policyholders is projected to remain materially unchanged. Therefore, non-transferring policyholders will not be materially adversely affected by this aspect of the capital considerations.
- The SCR coverage ratio for transferring policyholders will reduce on day 1 after the Proposed Transfer. However, this reduced SCR coverage ratio is still projected to be within the “well capitalised” range, and the reduction would be reversed if the full AOF were called. Therefore, overall, I do not expect transferring policyholders to be materially adversely affected by this aspect of the capital considerations.

Therefore, I do not expect there to be any material adverse changes in the strength of capital protection for either group of policyholders.

#### 6.10. Projected coverage ratios of Ultimate SCR

I have also considered the Ultimate SCR and coverage ratios for RSAI and RSAL pre- and post- the Proposed Transfer, using the same approach as for the SCR in the previous section.

Based on the coverage ratios estimated by RSAI, I have concluded:

- Both RSAI and RSAL have projected day 1 Ultimate SCR capital ratios of between 100% and 150%. Therefore, as explained in section 6.1, I consider them to have “sufficient capital” on this measure.
- The Ultimate SCR coverage ratio is higher for RSAL than for RSAI. This is mainly due to two reasons:
  - The transferring business is on average “shorter tail” (defined in section 5.6) than the non-transferring business. Eg, based on the profile of the transferring business, the estimated average time for the RSAL provisions to be reported and settled is c. 1.8 years, compared to c. 2.8 years for RSAI.
  - RSAL will not be exposed to any material defined benefit pension schemes. RSAI is exposed to defined benefit pension risk, which increases the RSAI Ultimate SCR (and therefore reduces the RSAI coverage ratio).
- The Ultimate SCR coverage ratio for non-transferring policyholders is projected to remain materially unchanged pre- and post- the Proposed Transfer (comparing the day 0 and day 1 positions for RSAI). Therefore, non-transferring policyholders will not be materially adversely affected by this aspect of the capital considerations.
- The Ultimate SCR coverage ratio for transferring policyholders will increase on day 1 after the Proposed Transfer (comparing the day 0 position for RSAI to the day 1 position for RSAL). Therefore, all else being equal, the transferring policyholders will be in a more positive position under this aspect of the capital considerations.



**3336900** In summary, neither set of policyholders will be materially adversely affected by this aspect of the capital considerations.

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#### 6.11. RSAL reliance on RSAI

The capital structure of RSAL has a significant reliance on RSAI for its overall capital strength. In particular, as both the significant quota share reinsurance and the ancillary own fund arrangements will be with RSAI, this creates a material counterparty default risk.

This reliance becomes important in the unlikely event of an insolvency of RSAI. In particular, due to the structure of the arrangements post-transfer, transferring policyholders to RSAL will have a reduced priority order to RSAI assets during this insolvency. Specifically, this means that the transferring policyholders could receive a significantly lower proportion of valid claims under this scenario, than an equivalent non-transferring policyholder. This key consideration is discussed further in section 7.4.

#### 6.12. Overall conclusion: Capital considerations

I have set out below my overall conclusions related to capital. These capital considerations should not be considered in isolation. For example, the overall level of protection for policyholders also depends on a range of other considerations. My overall conclusions on the Proposed Transfer are set out in Section 10.

**Based on the work and rationale described above I have concluded that:**

- **The projected capital requirements for RSAI and RSAL have been calculated appropriately for both non-transferring and transferring policyholders.**
- **Following the Proposed Transfer, I do not expect there to be any materially adverse changes in the strength of capital protection for either group of policyholders.**

However, **I have also concluded that, following the Proposed Transfer, transferring policyholders could potentially be materially adversely affected in the unlikely event of RSAI insolvency.** This is considered further in section 7.4.

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## 7. Policyholder security

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### 7.1. My considerations relating to policyholder security

As IE, my overall assessments related to policyholder security are:

- whether the likelihood of valid policyholder claims being paid is maintained following the Proposed Transfer for both non-transferring and transferring policyholders.
- whether any change in policyholder security results in policyholders being materially adversely affected by the Proposed Transfer.

To make these assessments, I have considered the following areas:

- The IFRS balance sheets of RSAI and RSAL (Section 7.2)
- The solvency positions of RSAI and RSAL (Section 7.3)
- Impact on policyholder rights in the event of RSAI insolvency (Section 7.4)
- Access to the Financial Services Compensation Scheme (Section 7.6 )
- Access to the Financial Ombudsman Service (Section 7.7)
- Reinsurance arrangements with external reinsurers (Section 7.8)
- Considerations around the UK EL transfer (Section 7.9).
- Insurance regulation (Section 7.10)

Further details on each of these considerations are set out below, and my overall conclusion related to policyholder security is set out in Section 7.11.

### 7.2. Impact on the balance sheets of RSAI and RSAL

I have considered my analysis on data as at 31 December 2016 to align with the last full audit of RSAI available at the time of my core analysis.

The actual balance sheets immediately pre- and post- the Proposed Transfer will be different from those below as the anticipated Effective Date is intended to be on or around 1 January 2019.

I will also prepare a Supplementary Report ahead of the Sanctions Hearing for the Proposed Transfer, which will include an update of my conclusions in this report.

3336900 IFRS balance sheets of RSAI and RSAL

31 December 2016

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£m	RSAI Pre-Transfers	RSAI Post-UK EL transfer	RSAI Day 1 Post- both Transfers	RSAL Day 1 Post- both Transfers
Intangible assets	152	152	152	-
Investments	18,315	18,315	18,284	67
Reinsurers' share of technical provisions	1,675	1,675	1,269	346
Debtors	2,130	2,130	2,255	124
Other assets	787	787	787	-
Assets held for sale and disposal groups	658	-	-	-
<b>Total Assets</b>	<b>23,717</b>	<b>23,059</b>	<b>22,747</b>	<b>537</b>
Other capital instruments	292	292	292	-
Technical provisions	6,088	6,088	5,891	385
Provision for other risks	248	248	248	-
Creditors	9,360	9,360	9,245	114
Liabilities for disposal groups	658	-	-	-
<b>Total Liabilities</b>	<b>16,646</b>	<b>15,988</b>	<b>15,676</b>	<b>500</b>
<b>Total Equity</b>	<b>7,071</b>	<b>7,071</b>	<b>7,071</b>	<b>38</b>

Source: RSAI

The table above shows simplified balance sheets for RSAI pre- and post- the Proposed Transfer and the simplified pro-forma balance sheet for RSAL after the Proposed Transfer. These figures are draft and subject to RSAI Board sign-off.

### 7.3. Impact on the solvency positions of RSAI and RSAL

The solvency positions of RSAI and RSAL pre- and post-transfer are summarised in the following table.

#### Solvency positions of RSAI and RSAL

31 December 2016

£m	RSAI Pre-Transfers	RSAI Post-UK EL transfer	RSAI Day 1 Post- both Transfers	RSAL Day 1 Post- both Transfers
Total own funds eligible to meet SCR	3,233	3,263	3,263	65
SCR	1,793	1,793	1,793	41
SCR coverage ratio	180%	182%	182%	160%

Source: RSAI

**3336900** As set out in the above table, both RSAI and RSAL have projected day 1 SCR capital ratios of between 150% and 200% immediately before and after the Proposed Transfer. Therefore, as explained in section 6.1 and section 6.9, on this measure I consider them to be well capitalised.

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#### 7.4. Impact on policyholder rights in the event of RSAI insolvency

The transferring policyholders currently rank equally with other RSAI direct policyholders in the event of the insolvency of RSAI. The transferring policyholders rank ahead of secured creditors such as reinsurance policyholders and the pension schemes, which in turn rank ahead of subordinated creditors.

The transferring policyholders will effectively become reinsurance policyholders of RSAI post-transfer – ie indirectly they are beneficiaries of the quota share reinsurance arrangements with RSAI. This reinsurance will rank behind the direct policyholders of RSAI, and in line with other secured creditors.

**The implication of these changes is that transferring policyholders will have a reduced priority order in the event of the insolvency of RSAI, compared to if they had not transferred – and this could materially adversely affect transferring policyholders in that situation.**

As an illustration, under an RSAI insolvency event where RSAL is unable to reclaim assets from RSAI, if there were sufficient assets to pay c. 90% of valid claims to non-transferring policyholders, then the transferring policyholders might receive only c. 20% of valid claims.

Under this scenario:

- The non-transferring policyholders are direct policyholders. They would be paid ahead of transferring policyholders and would receive c. 90% of valid insurance claims.
- RSAL would receive zero recoveries from its quota share reinsurance arrangement with RSAI, and would no longer be able to call on the ancillary own funds arrangements.
- RSAL policyholders would receive c. 20% of valid claims, based on RSAL's projected balance sheet position, where, before allowing for the security from RSAI, the projected assets are around 20% of the projected value of liabilities.

**I have discussed these considerations and this scenario with RSAI and I have concluded that this scenario is very unlikely.** I have considered a range of factors to assess this, including:

- RSAI's credit rating and capital strength.
- Findings from RSAI's stress testing and recovery and resolution planning.

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- Details of the monitoring and other arrangements that RSAL will have in place to be able to reclaim assets from RSAI ahead of a potential RSAI insolvency event.

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RSAL is rated “A” by Standard & Poor’s (S&P) with a stable outlook, which S&P assesses to have a probability of insolvency of 1 in 2000 over a one-year period. In addition, as set out in section 6, I consider RSAL to be “well capitalised”.

RSAL’s stress testing and recovery and resolution planning have concluded that in order for RSAL to experience an insolvency event, the RSA Group would need to face an extreme scenario combining multiple events. I have considered this further in section 7.5 below.

RSAL has confirmed that RSAL will have regular monitoring and other arrangements in place to be able to reclaim assets from RSAI from both the quota share reinsurance and AOF arrangements ahead of a potential RSAI insolvency event. For example, the RSAL Board will have a unilateral right to call the AOF on demand, and/or terminate the quota share arrangements within 3 months – which compares to RSAI’s assessment that an insolvency event would typically emerge over at least 6-9 months. These monitoring and other arrangements help increase the likelihood that RSAL will be able to reclaim some or all of the assets ahead of an RSAI insolvency event.

I have also discussed with RSAI, other possible options to further address this issue of transferring policyholder security in the event of an RSAI insolvency event. The other options considered by RSAI have included:

- Introducing an intra-group guarantee for transferring policyholders, so that their priority order remains unchanged post-transfer.
- Providing collateral for the reinsurance and AOF arrangements, such as a letter of credit or holding assets in a trust.

At this stage, RSAI has concluded that none of the other options considered are proportionate in cost, certainty or complexity, compared to the additional policyholder security provided. These security arrangements will be subject to ongoing review by the RSAL Board.

In summary:

- If RSAI were to become insolvent, then RSAL would no longer have the security provided by the quota share and ancillary own funds arrangements.
- RSAL will have in place monitoring and other arrangements for RSAL to reclaim assets from RSAI under these circumstances, but these are not a guarantee.
- If the arrangements were to fail, then the transferring policyholders would be materially adversely affected.

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- However, this insolvency scenario is very unlikely. Eg, RSAI is rated “A” by S&P, which S&P assesses to have a probability of insolvency of 1 in 2000 over a one-year period.
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## 7.5. Stress testing, recovery and resolution

I have reviewed the findings from RSAI's stress testing and recovery and resolution planning, including:

- A summary of stress testing prepared by RSAI. This considers how certain extreme events could potentially affect RSAI's financial strength.
- RSAI's reverse stress testing. This considers events that could potentially cause RSAI to become insolvent or no longer financially viable.
- A summary of RSAI's Recovery Plan. This sets out a framework for escalating crisis management in the event that the capital strength of RSAI deteriorates.
- RSAI's Resolution Plan. This sets out the actions to be taken in the event of failure or likely failure of RSAI.

RSAI's analysis has concluded that in order for RSAI to experience an insolvency event, the RSA Group would need to face an extreme scenario combining multiple events such as:

- a combination of catastrophe, underwriting and reserving events in the UK leading to major losses and a steep reduction in future underwriting profitability; and
- at the same time, the profitability of the overseas businesses falling sharply, eg following a combination of reserving and underwriting events, leading to a large reduction in the business value. As a result, disposal of the overseas businesses would not enable the Group to become solvent again.

RSAI's analysis also considers the timeframe under which the scenarios could arise. This concluded that an RSAI insolvency event would typically emerge over at least 6-9 months. This is longer than the period required by RSAL to reclaim assets from RSAI. Extreme and fast emerging scenarios are possible across RSA Group, eg a Canadian earthquake, but the Group structure protects RSAI policyholders (and therefore, by extension, policyholders transferring to RSAL).

Further, the transferring business is relatively short tailed (defined in section 5.6). Eg, the estimated average time for the RSAL provisions to be reported and settled is c. 1.8 years. Therefore, if an insolvency event were to start to emerge, say, one year or more after the Effective Date of the Proposed Transfer, then more than half of claims to transferring policyholders would already have been expected to be paid. If this event was to occur, say, five years after the Effective Date of the Proposed Transfer, then it is expected that only 7% of claims would remain unpaid. The split by class of business is shown in section 5.6.

**3336900** Policyholders of longer tailed classes of business are more likely to be affected by an insolvency of RSAI than those holding insurance policies for shorter tail classes of business, as the likelihood of insolvency increases when considered over a longer time period.

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For those policyholders of longer tailed classes of business, this can be considered as a series one-year time horizons. RSAL will have in place monitoring and other arrangements for RSAL to reclaim assets from RSAI – and these have been designed to be effective over a period of less than one year.

Therefore, RSAI's analysis further supports my conclusion in section 7.4.

## 7.6. Access to the Financial Services Compensation Scheme

The Financial Services Compensation Scheme (FSCS) in the UK provides consumer protection. This statutory "fund of last resort" compensates customers in the event of the insolvency of a financial services firm. Insurance protection exists for individuals and small businesses in the situation where an insurer is unable to meet its liabilities for direct policyholders only (ie reinsured policyholders are not covered). For certain insurance that is compulsory in the UK (eg motor third party liability insurance), insurance protection also exists for direct policyholders whether or not they are individuals or small businesses.

The FSCS will pay 100% of any claim incurred for compulsory insurance (eg motor third party liability insurance) and 90% of claims incurred for non-compulsory insurance (eg home insurance), without any limit on the amount payable. The PRA fund the FSCS through levies on authorised firms. No protection is available for Goods in Transit, Marine, Aviation and Credit Insurance.

The transferring policyholders will lose access to the FSCS as a result of the Proposed Transfer. No similar schemes exist in Luxembourg to protect transferring policyholders other than for motor third-party liability and motor guarantee funds.

RSAL has completed a search across all five EEA Branches and the transferring London business to identify any transferring policyholders that would currently be eligible to make a claim under the FSCS. This search concluded that there are a number of policyholders who would currently be eligible to make a claim who will no longer be eligible following the Proposed Transfer. RSAL believe that less than 2% of the transferring gross written premium is written by customers who currently have FSCS eligibility.

Luxembourg does not have an equivalent scheme to the FSCS. RSAL have considered whether it is possible, practicable and proportionate to create a solution that would provide similar FSCS protection for the affected transferring policyholders.

**3336900** RSAI could not find a contractual solution involving RSAI, eg a guarantee or mirror policy that would be legal post-Brexit. RSAI's view is also that such a contractual solution would be unlikely to be available in a situation where RSAI became insolvent, so it would not provide protection similar to the FSCS protection.

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RSAI also considered other options to provide security to RSAL policyholders in the event of an RSAI insolvency event. At this stage, RSAI has concluded that none of the other options considered are proportionate in cost, certainty or complexity, compared to the additional policyholder security provided (further details on this are set out in section 7.4).

RSAI has confirmed that they do not plan to put in place measures to mitigate against the impact of the loss of FSCS protection. I have concluded that, due to the financial strength of RSAI, an insolvency scenario which would be required to trigger FSCS protection is very unlikely (I have considered this in more detail in the previous section). Therefore losing access to the FSCS is unlikely to have a materially adverse effect on the transferring policyholders.

### 7.7. Access to the Financial Ombudsman Service

The Financial Ombudsman Service (FOS) provides private individuals and micro-enterprises with a free, independent service for resolving disputes with financial companies. Micro-enterprises are defined to be businesses with less than €2m annual turnover and fewer than ten employees.

It is not necessary for the private individual or micro enterprise to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the FOS. However, it is necessary for the insurance policy concerned to be, or have been, administered from within the UK and/or issued from within the UK.

RSAI has confirmed that there are six transferring London policyholders that meet the eligibility criteria for access to the FOS.

In respect of these policyholders following the Effective Date, RSAL have undertaken within the Scheme document (section 7.4) to comply with the FCA rules (set out in DISP, the Dispute Resolution: Complaints part of the FCA Handbook) that apply to the handling of complaints brought to the FOS and any award or direction made or given by the FOS, relating to acts or omissions prior to the Effective Date.

These policyholders will lose access to the FOS for complaints relating to acts or omissions of RSAL occurring after the proposed transfer. Any such complaints can be made to the CAA, which has an objective to receive and examine complaints by policyholders and other interested parties. Whilst the CAA's complaints resolution process and the UK's FOS are both designed to channel and resolve policyholder



**3336900** disputes, there are some differences eg the CAA's complaints resolution process does not allow for binding decisions to be imposed upon the insurer.

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I have therefore concluded the transferring policyholders are not disadvantaged in this respect.

The FCA is currently consulting on potential changes to the FOS that may increase the scope of policyholders covered by the FOS. I have not considered this consultation in relation to the Proposed Transfer.

### 7.8. Reinsurance arrangements with external reinsurers

All of RSAI's reinsurance with external reinsurers that provides cover for the transferring business will be transferred to RSAL. Similarly, reinsurance arrangements providing cover for non-transferring business will remain with RSAI.

Therefore, there is no material change to the external reinsurance protection provided for either group of policyholders.

### 7.9. Considerations around the UK EL Part VII transfer

RSAL is currently proposing another insurance business transfer to transfer a legacy book of mainly UK Employer's Liability (EL) latent exposures to a third party external to the RSA Group.

The business to be transferred is already reinsured with the third party, so the transfer will not have a material effect on RSAI's overall financial position or risk profile. Therefore, my conclusions in this Scheme Report would not be changed if the UK EL transfer did not proceed.

### 7.10. Insurance regulation

#### **Prudential regulation**

Prudential regulation requires financial firms to control risks and hold adequate capital to ensure regulated firms are being run in a safe and sound way.

Both the UK and Luxembourg are currently regulated under Solvency II. Solvency II covers the prudential regulation of insurers, including risk management and capital requirements. The position regarding UK insurance regulation post-Brexit is currently unclear. However, the expectation is that the UK will seek to maintain equivalence with Solvency II.

In addition, Luxembourg has some specific prudential regulatory requirements, the most relevant to RSAL being the deposit agreement regime, a requirement for assets backing

**3336900** technical provisions to be held by a third party credit institution. RSA has appointed HSBC Bank plc to act in this capacity.

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Based on the above considerations, I do not expect transferring policyholders to be materially adversely affected by the changes in prudential insurance regulation governing their policies from UK to Luxembourg.

### **Conduct regulation**

Conduct regulation of financial firms typically includes consumer protection, market conduct rules and ethical codes of conduct. Conduct is generally regulated by the insurance regulator in the country in which a risk is located and/or the location from which the business is carried out.

There is currently less harmonisation in conduct regulation across the EEA compared to prudential regulation. However, a number of existing EU Directives govern consumer regulation across the EEA, so apply to both the UK and Luxembourg. For example, The Insurance Mediation Directive (IMD) aims to ensure appropriate levels of protection for customers.

The Insurance Distribution Directive (IDD) will replace the IMD and is expected to apply across EEA member states from 1 October 2018. Its intention is to strengthen and consolidate the existing rules of the IMD covering the distribution of insurance and reinsurance, and also the administration and performance of an insurance policy once it has been written. As for Solvency II, the position regarding the compliance with IDD in the UK post-Brexit is currently unclear.

The location of risks currently insured by RSAI will not change as a result of the Proposed Transfer. Therefore, the key relevant comparison is between the conduct regulations in the UK and those in Luxembourg. If these were materially different, this could potentially affect transferring policyholders where the business is currently carried out in the UK and post-transfer will be carried out in Luxembourg.

In addition, RSAI have confirmed that there is no intention to market products to Luxembourg resident customers. When considering the Luxembourg regime it is therefore in the context of a comparison of the Luxembourg regulations for business conducted on a FofS basis throughout the EEA with those of the FCA for the same activity.

In this respect, RSAI have confirmed that the conduct obligations on insurers in Luxembourg are broadly comparable to the FCA requirements set out in the FCA handbook, such as the provision for “treating customers fairly”. There are specific Luxembourg requirements concerning warnings to be contained in application forms, the content of contract documentation, use of local language and provisions concerning application of clauses within insurance contracts. The Luxembourg Civil Code also

**3336900** applies general fairness and good faith requirements that would be consistent with some of the FCA's Principles.

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Complaints may also be addressed to the CAA or the Luxembourg Insurance and Reinsurance Association (ACA) which has implemented an Insurance Ombudsman scheme to find extra-judicial solutions in insurance litigation between Luxembourg-based insurance companies and consumers residing in Luxembourg or in another State of the EEA. It should be noted these awards are non-binding on the insurer.

In summary, there is access to similar mechanisms in terms of conduct regulation in Luxembourg for the transferring policyholders.

#### **Conclusions on regulation**

Based on the above considerations, I do not expect transferring policyholders to be materially adversely affected by the change in insurance regulation governing their policies from UK to Luxembourg.

#### **7.11. Overall conclusion: Policyholder security**

**Based on the work and rationale described above, I have concluded that it is very unlikely that the security provided to transferring policyholders will be materially adversely affected by the Proposed Transfer.**

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## 8. Policyholder communications

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### 8.1. My considerations relating to policyholder communications

I have assessed the appropriateness of RSAI's proposed communication strategy to inform policyholders and other stakeholders of the Proposed Transfer.

The key focus of my assessment was whether the policyholders and other stakeholders are to be provided with sufficient and clear enough information so that they can understand how the Proposed Transfer may affect them.

### 8.2. Overview of communications strategy

RSAL has developed a communication strategy to notify affected parties of the Proposed Transfer and allow time for affected parties to raise objections to the Court. I have summarised the main points of the communications strategy below:

- *Transferring policyholders and claimants – policies in force and open claims:* RSAI will directly notify all policyholders where it holds names and postal addresses, or can source them from intermediaries.
- *Transferring policyholders and claimants – expired policies with open claims:* RSAI will directly notify relevant expired policyholders where it holds names and postal addresses, or can source them from intermediaries.
- *Transferring policyholders and claimants – expired policies with no open claims:* RSAI will directly notify the relevant policyholders as at 31 December 2016 that did not renew on 1 January 2017 where it holds names and postal addresses, or can source them from intermediaries.
- *Reinsurers:* RSAI will notify all reinsurers with in force policies or current claims or other counterparties that have been involved in the placement of reinsurance covering RSAI relating to the transferring business. Reinsurers of non-transferring business only will not be notified directly.
- *Delegated insurance authority arrangements (DIAs) (including brokers, managing general agents (MGAs) and schemes):* RSAI will request DIAs to disseminate information regarding the Proposed Transfer to the underlying policyholders in a manner that the DIAs deem appropriate, which can be either via post, email or notice or other suitable forms of communication. DIAs will also be requested to update their website to provide a link to the RSAI Brexit webpage. RSAI have offered to the DIAs that RSAI will contribute to the costs of mailing or provide pre-printed letters, booklets and postage-paid envelopes.
- The DIAs will confirm to RSAI their communication approach. In the event that the covering letter and the information booklet is not sent to the underlying policyholders by post, the DIAs will be requested to document their alternative approach, along with a reason for the alternative approach. RSAI will then consider whether appropriate dissemination of information in respect of the

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Proposed Transfer Scheme to underlying policyholders will be achieved. RSAI have requested an early indication from DIAs of how many policyholders of the total population that the alternative approach will impact.

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### 8.3. Planned dispensations and rationale

RSAL intends to request that the Court grant a dispensation from the need to notify a number of affected parties.

RSAL has provided a rationale to support their request for a dispensation by reference to the judgement of Norris J in the Directions Hearing in *Re Aviva International Insurance Limited [2011] EWCH 1901 (Ch.)* (the Aviva Judgement). The Aviva Judgement summarised the following factors as rationale for granting a dispensation:

1. the **impossibility** of contacting policyholders;
2. the **practicality** of contacting policyholders;
3. the **utility** of contacting policyholders;
4. the **availability of other information channels** through which notice of the application can be made available;
5. the **proportionality** of strict compliance and the impact of collateral commercial concerns; and
6. the likely **impact** of the Proposed Transfer on policyholders.

I have set out below the affected parties that RSAI propose not to notify and RSAI's rationale for the dispensation being sought. I have included in brackets the reference to the factors from the Aviva Judgement where applicable.

#### Non-transferring policyholders

RSAL's view is that the impact is not material enough to justify the significant cost of contacting all policyholders. RSAI will seek a dispensation from the Court on the grounds that the impact of the Proposed Transfer is not material to the non-transferring policyholders of RSAI (**proportionality**).

RSAL insures c. 5.5 million non-transferring policyholders; the cost of contacting each of these policyholders would be disproportionate given that they are not materially disadvantaged. RSAI will seek a dispensation from the Court on the grounds the Proposed Transfer does not materially impact the non-transferring policyholders (**impact**).

#### Transferring policyholders – certain in force policies

The transferring policies are mostly sold through intermediaries, meaning RSAI will not always have the names and addresses of in force policyholders without open claims.

RSAL is in the process of contacting intermediaries to obtain the names and addresses of all in force policies to notify these policyholders. In the event that this information is not

**3336900** forthcoming from the intermediaries, RSAI will make reasonable efforts to notify these policyholders, either via a mailing agent or via the intermediaries directly.

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RSAI expects to have the names and addresses for the majority of open claimants and therefore RSAI will notify this policyholder cohort. In the event that RSAI does not hold specific claimant details, RSAI will contact the relevant intermediaries and request the missing information.

Notwithstanding the above, RSAI expect that for a small number of policyholders it will not be possible to source names and addresses. RSAI will seek a dispensation from the Court on the grounds of it not being possible to contact policyholders (*impossibility*).

To mitigate this, RSAI will notify all intermediaries to provide sufficient information on the transfer in the event that they are contacted by policyholders regarding the transfer. RSAI will also advertise widely on a targeted and demographic basis to achieve as broad coverage as possible. RSAI will seek a dispensation from the Court on the grounds of the information being *available from other channels*.

#### **Transferring policyholders – expired policies with no open claims**

The vast majority of policy renewals take place annually on 1 January. RSAI will have procedures in place to identify policyholders as at 31 December 2016 that did not renew on 1 January 2017 and send notification to this cohort of expired policyholders. At the date of the Directions Hearing, (expected to be in the week commencing 25 June 2018), policies would have expired and lapsed for more than 16 months. Based on historical claims information of the transferring business, approximately 90% of claimants would have notified a claim by this date.

RSAI will maintain a customer database which will hold details of any non-renewing policies up to the date of the Directions Hearing so that communications can be sent to these policyholders.

The cost of obtaining up-to-date details of these remaining policies which have expired for more than 16 months is disproportionate as there is currently no significant expectation of liabilities. RSAI will seek a dispensation from the Court on three grounds:

- the claims liabilities are projected to reduce over time (*utility*);
- the cost of obtaining up-to-date contacts details is not proportional to the benefit these policyholders will receive by being notified (*proportionality*); and
- the majority of policies are sold through third party intermediaries, so it would not be possible to contact the policyholders (*impossibility*).

To mitigate the risk of a policyholder being unable to make a claim should they need to, there will be no change to correspondence and email addresses or telephone numbers, for branches as a result of the Proposed Transfer. For reasons unrelated to the

**3336900** proposed transfer, it is currently expected that the correspondence address of the Paris office in France will change in the period between the Directions Hearing and Sanctions Hearing. The email address and telephone number will not be affected and correspondence will be forwarded to any new office.

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Intermediaries who sold policies will be informed of the Proposed Transfer. RSAI will also advertise widely on a targeted and demographic basis to achieve as broad coverage as possible. RSAI will seek a dispensation from the Court on the grounds of information being [available from other channels](#).

#### **Transferring policyholders – claimants who RSAI do not have contact details for**

For some policies within the transferring London business, claims are handled by the insurance brokers on behalf of a number of insurers who provide cover within the same policy. RSAI do not have the contact details for such claimants. In its communications with the relevant brokers, RSAI will ask that the brokers notify such policyholders and will request a dispensation from the Court on the grounds of information being [available from other channels](#).

#### **Transferring policyholders – claimants who are not legal holders of the policy**

RSAI will expect holders of the policies to notify those who rely on the cover, eg where a parent company holds an insurance policy for the benefit of subsidiary companies. RSAI will seek a dispensation from the Court on the grounds that it will request in its communications that holders of policies notify parties who depend on the policy, so information is [available from other channels](#).

#### **Reinsurers**

All reinsurers with in force policies or open claims will be notified. It is expected that, for a small number of reinsurers, particularly reinsurers with expired policies, the current name or address will not be able to be sourced. RSAI will seek a dispensation from the Court on the grounds it is not possible to notify certain reinsurers ([impossibility](#)).

To mitigate this, RSAI will advertise widely on a targeted and demographic basis to achieve as broad coverage as possible. Brokers whom RSAI's records show are authorised to act on behalf of reinsurers will also be notified. RSAI will seek a dispensation from the Court on the grounds of the information being [available from other channels](#).

#### **8.4. Planned notices**

RSAI will publish notifications of the Proposed Transfer in professional and trade association journals. RSAI will request industry trade associations and claims representation organisations in relevant jurisdictions to publicise the Proposed Transfer to their members.

**3336900** RSAI will also publish Gazette notices and advertisements will be placed in national and regional newspapers that relate to the demographic profile of the industries insured and areas where policyholders and relevant third parties are likely to be located.

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Following the PRA's notification to relevant EEA regulators on the Proposed Transfer, RSAI will advertise in at least two relevant publications in each of the EEA branch jurisdictions (ie the Netherlands, Belgium, Germany, France and Spain) and Luxembourg and in at least one national newspaper in each other (non-UK) EEA state. RSAI will seek dispensation from the Court to not place notices in a second national newspaper in these other (non-UK) EEA states on the grounds of [proportionality](#).

RSAI has confirmed there are no reinsurance policies in Liechtenstein and Iceland and therefore there is no requirement to publish in business newspapers in those jurisdictions.

Notices will be placed on the RSAI website and websites of each of the RSAI branch network with links to the key transfer documents. Key transfer documents will be available for download free of charge from the websites or by contacting RSAI.

### 8.5. Translation of key documents

All publication notices and major documents (including this report) will be translated by RSAI into the appropriate languages for the audience. RSAI have confirmed that this report will be available in English, German, Dutch, Spanish and French. I am relying on RSAI to ensure that the translations into each language are accurate.

### 8.6. Clarity of communication

I have reviewed drafts of both the proposed letter and information booklet to be provided to policyholders explaining the background to the Proposed Transfer and the transfer process. I provided RSAI with some comments on these documents but did not find any material issues and overall I was satisfied with the clarity of communication to policyholders regarding the Proposed Transfer.

### 8.7. Overall conclusion: Communication strategy

**Based on my review of the communication strategy, I have concluded the planned communications strategy will ensure adequate coverage of affected parties. RSAI is applying for a number of dispensations from communicating to some affected parties. I have concluded that these are appropriate.**

**I have also concluded that the planned communication is sufficiently clear for policyholders to understand the effects of the Proposed Transfer.**



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## 9. Customer service and other considerations

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### 9.1. Customer service

#### Policyholders other than transferring London policyholders

This sub-section considers both non-transferring and transferring policyholders, other than those policyholders that have non-UK EEA components of FofS business written by RSAI (referred to in this section as “transferring London policyholders” and considered below). This includes:

- All transferring business written by the EEA Branches of RSAI
- Non-transferring business written by RSAI itself, that has no non-UK EEA components

RSAI has confirmed that, for these groups of policyholders, there will be no material changes to the customer facing aspects of the business.

In particular:

- The branches already carry out policyholder administration and claims handling and this will not change post-Transfer.
- There will be no changes to the terms and conditions of the transferring policies, RSAL will follow the same group wide policies and the branch IT will transfer to RSAL. Staff will also transfer from the EEA branches to RSAL, with the exception of staff deployed in respect of the business of the Netherlands branch, which are employed by Royal Insurance Global B.V. and seconded to the Netherlands branch. Following the Proposed Transfer, they will remain employed by Royal Insurance Global B.V. and be seconded to the Netherlands branch of RSAL.
- There will be no changes to the policyholder administration and claims handling for non-transferring policyholders.

#### Transferring London policyholders

This sub-section considers policyholders with non-UK EEA components of FofS business written by RSAI (“transferring London policyholders”).

For these policyholders, RSAI will need to provide separate claims touch points for existing customers for each of the “non-UK EEA” and “UK” components of policies. The reason for this change is that, post-Brexit, RSAI anticipates they will not be permitted by existing legislation to handle any non-UK EEA claims in the UK.

I have considered RSAI’s proposals and concluded that the transferring London policyholders will not receive a materially different level of customer service following the Proposed Transfer for the following reasons:

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- The skills and expertise used to handle these claims outside the UK in the EEA branches will be of a similar standard to the previous administration levels and will continue to adhere to RSA Group policies and procedures.
- Only policyholders with global programmes have FofS policies with RSAI. All of these policyholders are intermediated through brokers, meaning that very little will change in practice in terms of claims administration; and
- The majority of these policyholders are large multinationals and are already familiar with having their claims administered locally in relation to non-EEA risks. Therefore, the concept and process will not be new to them.

### Conclusion

Overall, based on the above considerations, I do not expect any policyholders will receive a materially different level of customer service following the Proposed Transfer.

### 9.2. Pension arrangements

RSAL employs staff in branches that will transfer to RSAL as part of the Proposed Transfer. RSAI has confirmed that, of the five transferring branches, only the branch in Germany has defined benefit pension exposure. The present value of pension scheme liabilities was c. €1.5m as at 31 December 2016, calculated by RSAI on an IAS19 basis, and this is not expected to grow materially in the future. Further, pensioners are paid as part of the RSA payroll and pension payments are not material compared to the expected overall RSAL payroll. My view is that this does not present a material risk to RSAL (and therefore policyholders) in the context of RSAL's overall financial position.

RSAL participates in RSA Group's defined benefit pension scheme. The transferring policies represent a small proportion of RSAI's total current policies and I am satisfied that RSAI's risk profile (including pension risk) will not be materially affected by the Proposed Transfer. RSAL will not participate in the Group's defined benefit pension scheme.

Hence I do not expect pensions considerations to have a material impact on either the non-transferring or transferring policyholders.

### 9.3. Tax implications

I have discussed potential tax implications of the Proposed Transfer with representatives of the RSAI tax team. RSAI's Deputy Group Tax Director also provided a paper which summarises the tax consequences of the Proposed Transfer.

The paper confirms that there are three relevant types of tax:

- Corporation tax: this is levied on profits, and policyholders are not directly affected by RSAI or RSAL's obligation to pay corporate tax.

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- VAT: policyholders do not pay VAT on insurance premiums.
- Insurance Premium Tax (IPT): The applicable IPT rate for each policyholder is determined by the location of the risk insured. Therefore, the amount of IPT charged will not be affected by the Proposed Transfer.

Having reviewed the paper provided, I have concluded that both non-transferring and transferring policyholders are not expected to be materially adversely affected by the tax consequences of the Proposed Transfer.

#### 9.4. Investment management implications

The investment strategy for RSAL will be the responsibility of the RSAL Board but will conform to existing Group policies and procedures. The asset mix is expected to be heavily weighted to fixed income and cash. Any assets held other than cash would be managed by a third party asset manager under an Investment Management Agreement in line with current practice.

RSAL's existing investment strategy will not change as a result of the Proposed Transfer and RSAL's strategy is expected to be similar to the current arrangements.

Therefore I do not anticipate that this will create any materially adverse impact to the non-transferring or transferring policyholders as a consequence of the Proposed Transfer.

#### 9.5. Implications on ongoing expense levels

All costs and expenses incurred relating to the Scheme will be borne by RSAI and RSAL. No such costs shall be borne by policyholders. Costs associated with the move to Luxembourg are expected to be modest and will be offset by wider transformation initiatives, with an increase in expense ratio of less than 0.5%. The current Group pricing tools will be used for the business written by RSAL post-transfer and little or no increase in the expense provision within future policyholder premiums is expected.

Therefore I do not anticipate that this will create any materially adverse impact to the non-transferring or transferring policyholders as a consequence of the Proposed Transfer.

#### 9.6. Impact on liquidity position

RSAL has provided a summary on the proposed liquidity management approach for RSAL. RSAL is expected to use the same guidelines and processes as the wider RSAI Group. Cashflow forecasting will be used for both short and long term views and liquidity will be optimised across the operating units of RSAL. The mix and minimum level of assets will be set based on the final capital composition and reported in line with the current Group approach.

**3336900** Having reviewed the summary provided, I have concluded that both non-transferring and transferring policyholders are not expected to be materially adversely affected by the impact of the Proposed Transfer on liquidity management, as the current Group approach will be followed.

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### 9.7. Set-off

I have considered whether the Proposed Transfer is likely to lead to any changes in the rights of set-off for creditors or debtors of RSAI or RSAL. "Set-off" is a right that allows parties to cancel or offset mutual debts with each other by subtracting one from the other, and paying only the balance.

I have not identified any material set-off rights as part of my review. Therefore, I do not believe considerations around set-off impact my conclusions.

### 9.8. Overall conclusions: Customer service and other considerations

**Based on the work and rationale described above, I have concluded that no material impact on service standards (or any other considerations within this section of the report) is expected following the Proposed Transfer.**

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## 10. Conclusions and Statement of Truth

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I have considered the Proposed Transfer and its likely effects on the non-transferring policyholders of RSAI, the policyholders transferring to RSAL and the transferring reinsurers.

In reaching the conclusions set out below, I have applied the principles as set out in relevant professional guidance, being the Technical Actuarial Standards (TASs) TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance.

**I have concluded that:**

- **The security provided to non-transferring policyholders will not be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for non-transferring policyholders following the Proposed Transfer.**
- **It is very unlikely that the security provided to transferring policyholders will be materially adversely affected by the Proposed Transfer. No material impact on service standards is expected for transferring policyholders following the Proposed Transfer.**
- **Reinsurers of RSAI will not be materially affected by the Proposed Transfer.**

### 10.1. Issues to highlight

I consider it necessary that I review the most recent information, up to the date of the Sanctions Hearing for the Proposed Transfer, when this becomes available later in the year, before confirming my opinion and conclusions.

Issues that I have highlighted in this report which require further review include:

- Any reinsurer and policyholder objections received.
- The final details of the reinsurance contract between RSAI and RSAL.
- The findings from the external review of the internal capital model.
- Any updates to RSAI's contingency plans in relation to the Proposed Transfer.

I will consider these points further as part of my Supplementary Report.

3336900 10.2. IE duty and declaration

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My duty to the Court overrides any obligation to those from whom I have received instructions or paid for this Report. I confirm that I understand my duty to the Court and I have complied with that duty.

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

I confirm that I am aware of the requirements of Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Protocol for Instruction of Experts to give Evidence in Civil Claims.

10.3. Sign-off



*Stewart Mitchell FIA*

Partner

26 July 2018

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**The use of our work**

This work has been produced by Lane Clark & Peacock LLP under the terms of our written agreement with Royal & Sun Alliance Insurance plc. It is subject to any stated limitations (eg regarding accuracy or completeness).

This Scheme Report, which is our work, has been prepared for the purpose of accompanying the application to the Court in respect of the insurance business transfer scheme described in this report, in accordance with Section 109 of the Financial Services and Markets Act 2000. The Scheme Report is not suitable for any other purpose.

A copy of the Scheme Report will be sent to the Prudential Regulatory Authority, the Financial Conduct Authority and will accompany the Scheme application to the Court.

This work is only appropriate for the purpose described above and should not be used for anything else. No liability is accepted or assumed for any use of the Scheme Report for any other purpose other than that set out above.

**Professional Standards**

Our work in preparing this document complies with Technical Actuarial Standard 100: Principles for Technical Actuarial Work, together with Technical Actuarial Standard 200: Insurance.

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Page 63 of 76 *Appendix 1 – Glossary*

**Appendix 1**

Term	Definition
Ancillary own funds	Arrangement whereby RSAL can call on additional capital from RSAI if required in the future.
Best estimate	An estimate prepared with no margin for either prudence or optimism included.
Bornhuetter-Ferguson (BF) method	A blend of the Chain Ladder Method and the Expected Loss Ratio Method (defined later in this glossary). The weighting given to each is dependent on how developed the claims are for a particular policy year.
Brexit	The expected exit of the UK from the EU following the referendum on continuing membership held in the UK in June 2016.
Commissariat Aux Assurances (CAA)	The regulator of the insurance sector in Luxembourg.
Capital Cover Ratio	The Capital Cover Ratio is the ratio of Available Capital to Required Capital. This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the insurer.
Chain Ladder method	An actuarial method for estimating future payments or numbers by using the historical pattern of past payments or numbers to estimate a development profile, which can be used to extrapolate future payments or numbers.
Core Tier 1	Under Solvency II, capital is categorised into 3 tiers based on the permanence and loss absorbency of the form of capital. Tier 1 capital is the highest quality.
Counterparty Default Risk	The risk of defaults or downgrades by counterparties that either owe an insurer money, or hold money on its behalf. For example, this covers the risk of the failure of a reinsurer or a broker.
Court	The High Court of Justice of England and Wales.
Direct policyholders	Any policyholders that are not insurers or reinsurers.
European Economic Area (EEA)	The EEA Agreement established the EEA on 1 January 1994. The EEA unites the 28 EU member states with Iceland, Liechtenstein, and Norway into an internal market governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely about the EEA in an open and competitive environment, a concept referred to as the four freedoms.
EEA30	The EEA30 is the EEA after Brexit, ie the remaining 30 member states.
Effective Date	The effective date of the Proposed Transfer, expected to be on or around 1 January 2019.

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**Appendix 1 (cont)**

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Term	Definition
European Union (EU)	The EU prior to Brexit, ie the 28 member states. Post-Brexit the EU will consist of 27 member states ie excluding the UK.
Events not in data (ENIDs)	An estimate of possible future events or developments that are not in existing data. Insurers need to make allowance for ENIDs in their Solvency II technical provisions.
Expected Loss Ratio method	An actuarial method for estimating future payments or numbers based on combining an exposure measure and an assumed rate per unit of exposure (the "initial expected loss ratio") for the written business.
Excluded Reinsurance Jurisdictions	Argentina, Bolivia, Brazil, Canada, Chile, China, Colombia, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Nicaragua, Panama, Paraguay, Peru, Puerto Rico, Ukraine, Uruguay, Venezuela and India.
Financial Conduct Authority (FCA)	The UK regulatory agency that focuses on the regulation of conduct by retail and wholesale financial services firms. The FCA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
Financial Ombudsman Service (FOS)	Set up by the UK Parliament, the FOS is the UK's official expert in sorting out problems with financial services. Parliament set up the FOS and has legal powers in the UK to address unresolved complaints between a business and a customer relating to financial services.
Financial Reporting Council (FRC)	The body responsible for setting actuarial standards in the UK. The FRC also regulates auditors and accountants, and sets the UK's Corporate Governance and Stewardship Codes.
Freedom of Establishment (FofE)	Under the EU Insurance Directives and Insurance Mediation Directive, insurance companies have the right to provide business services through a permanent presence within the EEA under the principle of FofE utilising the "passporting" system in place between EEA regulators.
Freedom of Services (FofS)	Under the EU Insurance Directives, insurance companies have the right to provide business services on a cross-border basis within the EEA under the principle of FofS utilising the "passporting" system in place between EEA regulators.
Financial Services Compensation Scheme (FSCS)	The FSCS is the compensation fund of last resort for customers of UK authorised financial services firms. This covers insurance for individuals and some insurance for small businesses.
Financial Services and Markets Act 2000 (FSMA)	The legislation under which Part VII governs the transfer of (re)insurance business between (re)insurance undertakings.
Generally accepted accounting principles (GAAP)	A collection of commonly-followed accounting rules and standards for financial reporting. GAAP specifications include definitions of concepts and principles, as well as industry-specific rules.



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Appendix 1 (cont)

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Term	Definition
Hard Brexit	A scenario where RSAI no longer has FofS or FofE rights and may not legally be able to carry on with non-UK EEA business. For example, RSAI would not be able to issue new insurance policies across the EEA, and might not legally be able to pay valid claims to existing EEA policyholders.
Incurred but not reported (IBNR)	The provision for claims that are reported in the future but relate to events that have already occurred. This includes provision for estimated developments to existing open claims, ie those that have been reported but not fully settled. The provision for these open claims is called IBNER (Incurred But Not Enough Reported). Depending on the type of insurance being considered and the claims handling approach, both the IBNR and IBNER can be either positive or negative.
Incurred but not enough reported (IBNER)	See definition of IBNR
Independent Expert	A suitably qualified person appointed by the Court to produce an independent report on an insurance business transfer scheme, in accordance with the FSMA. The Independent Expert's primary duty lies with the Court, and the opinion of the expert is independent of those of the sponsoring companies involved in the Transfer and the PRA.
Market risk	The risk of changes in an insurer's financial position due to changes in the market value of assets, liabilities and financial instruments. For example, this covers the risk of falls in the value of assets that are being held to make future claims payments.
Minimum Capital Requirement (MCR)	A formulaic calculation of the capital requirement as part of the existing European Solvency II regulations for insurers. Breaching the MCR defines the point of intensive regulatory intervention. The calibration of the MCR is to be the capital required to give an 85% confidence level of sufficient capital to last one year. The MCR is a simpler calculation than the SCR and is typically a less onerous requirement.
Operational risk	The risk of losses caused by failures in an insurer's operational processes, people and systems, or from events that are external to the insurer. For example, this would cover the risk of fraud or IT failure.
Own funds	The capital in excess of provisions available to meet the SCR capital requirements under Solvency II.
Prudential Regulation Authority (PRA)	The part of the Bank of England that carries out the prudential regulation of financial firms in the UK, including banks, investment banks, building societies and insurance companies. The PRA operates as part of the regulatory framework implemented under the Financial Services Act 2012.

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Appendix 1 (cont)

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Term	Definition
PRA's Statement of Policy	The Statement of Policy issued by the PRA entitled "Statement of Policy – The PRA's approach to insurance business transfers – April 2015"
Proposed Transfer	The proposed insurance business transfer of RSAI to RSAL under Section 105 of the FSMA.
Quota share reinsurance	A reinsurance contract in which the insurer and reinsurer share both claims and premiums in the same proportion. The reinsurer usually pays a commission to the insurer to allow for their costs of selling and administering the policy.
Required capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (ie the SCR).
Reinsurance	An arrangement with another insurer to share or pass on risks. For example, in the case of the Proposed Transfer, RSAL is transferring underwriting (insurance) risk back to RSAI using a reinsurance quota share arrangement.
Reinsurance bad debt	Reinsurance bad debt is a provision for amounts that are owed by reinsurers but which may not be paid, eg due to the insolvency of the reinsurer.
Scheme Document	A document submitted to the Court setting out details of the Scheme or Proposed Transfer.
Scheme Report	This report prepared by me, as the Independent Expert, for submission to the Court.
Solvency Capital Requirement (SCR)	The amount of capital insurers are required to hold under Solvency II regulations. This is an estimate of capital required to ensure that an insurer is able to meet its obligations over the next 12 months with a probability of at least 99.5%. If an insurer's capital (ie the excess of its assets over its liabilities) falls below the SCR, it will trigger regulatory intervention, with the intention of remedying that position.
Solvency Financial Condition Report (SFCR)	Solvency II requires each insurer to publish an SFCR annually that contains certain qualitative and quantitative information.
Solvency II	The system for establishing (among other things) minimum capital requirements for EEA (re)insurers under the Solvency II Directive 2009/138/EC.
Standard Formula	A prescribed approach under Solvency II for the calculation of capital based on an insurer's financial information (eg premiums and claims provisions).
TAS 100	The FRC issued Technical Actuarial Standard 100: Principles for Technical Actuarial Work (TAS 100) which applies to all actuarial work produced after 1 July 2017.
TAS 200	The FRC issued Technical Actuarial Standard 200: Insurance (TAS 200) which applies to all actuarial work produced after 1 July 2017.

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Appendix 1 (cont)

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Term	Definition
Technical provisions	Under Solvency II, the technical provisions cover the ultimate costs of settling all claims arising from events occurring up to the balance sheet date plus the provisions for future claims (and premiums) arising on unexpired periods of risk.
Transferee	The insurer to which the business is being transferred, RSA Luxembourg S.A. (RSAL).
Transferor	The insurer from which the business is being transferred, Royal & Sun Alliance Insurance plc (RSAI).
Unallocated Loss Adjustment Expenses (ULAE)	Unallocated Loss Adjustment Expenses are expenses relating to the handling of claims that are not allocated to specific claims, eg claim handlers' salaries and office space.
Underwriting risk	The risk that the value of insurance claims proves to be higher than expected.
Unearned Premium Reserve (UPR)	A provision for the unexpired portion of insurance policies and appears as a liability on the insurer's balance sheet, since the premium would be paid back upon cancellation of the policy.

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## *Appendix 2 – Extract from Terms of Reference*

Appendix 2

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### Summary of agreed scope of work

I, Stewart Mitchell will act as IE to support your planned Part VII transfer of Royal and Sun Alliance Insurance plc's (RSAI) Risk Solutions European Branch Network business into a newly created Luxembourg subsidiary entity of RSAI.

Your primary requirement is for the IE to act in line with Section 109 of the Financial Services Markets Act 2000.

The key deliverables from the work will be:

- The main and supplementary IE reports;
- Input as required to address any issues arising;
- Presenting my findings as IE to the Court and responding to any queries and additional court requests; and
- A summary report to support policyholder communications.

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## *Appendix 3 – Stewart Mitchell CV*

Appendix 3

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I am a Partner in LCP's Insurance Consulting practice and a Fellow of the Institute of Actuaries (qualified in 2004). I hold an MBA from City University Business School and qualified as an ACII with the Chartered Institute of Insurance.

I joined LCP in 2016, and prior to this was a Director at Ernst & Young LLP. I have 20 years' experience as a general insurance actuarial consultant, and a further 10 years' experience working in the insurance industry prior to joining Ernst & Young LLP.

### **Professional experience**

I have a broad experience of actuarial engagements over the last 20 years. This experience covers reserving, capital, pricing, reinsurance and transactions.

I have been involved in a number of Part VII transfers previously supporting the Independent Expert and as peer reviewer of the Scheme Report. I have also led the work on regulatory reviews, such as Section 166 reviews.

I hold a Lloyd's Signing Actuary practicing certificate and am currently the Signing Actuary for four Lloyd's syndicates. I have performed this role for many Lloyd's syndicates in the past, signing the opinions for up to nine Lloyd's syndicates in a single year-end.

I have previously been appointed as a Loss Reserving Specialist for Bermudan insurance companies and the Appointed Actuary for Lichtenstein insurance companies.

I have provided opinions on the adequacy of claims reserves for US regulators of UK based insurance companies and for HMRC for UK insurance companies.

I have extensive experience in independent reviews of claim liabilities for general insurance companies. I have also led capital modelling projects and reviews of Solvency II technical provisions.

I have worked with many insurers in reviews of claims liabilities and capital requirements for the purpose of mergers and acquisitions.

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## *Appendix 4 – Summary of data provided*

Appendix 4

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The following is a list of the key data items I have requested and received, or accessed directly, in assessing the Proposed Transfer. All data I have requested has been provided to me. RSAI has provided a Data Accuracy Statement confirming that the data and information provided to me regarding the Proposed Transfer are accurate and complete.

**1. Draft Court and regulatory documents prepared by RSAI for the Proposed Transfer, including:**

- Scheme Document (dated July 2018)
- RSAI First Witness Statement (dated July 2018)
- RSAL First Witness Statement (dated July 2018)
- Legal notice (dated July 2018)
- Directions Order (dated July 2018)

**2. Draft proposed communication plan and communication prepared by RSAI:**

- Proposed communication plan (letter to PRA dated July 2018)
- Template letters to policyholders, intermediaries, reinsurers and third parties (dated July 2018)
- Policyholder booklet (dated July 2018)

**3. Documents relating to the governance and target operating model of RSAL, including:**

- RSAL System of Governance (dated 19 December 2017)
- RSAL Valuation and Capital (dated 19 December 2017)

**4. Documents relating to provisions and reserving processes, including:**

- RSAI's actuarial reserving spreadsheets as at 31 December 2016
- Instructions and documentation for the UK actuarial modelling tool (dated 2 February 2017)
- UK and International Reserve Committee and Europe RM reserving slides as at 31 December 2016, 31 March 2017 and 30 June 2017
- Documentation of the actuarial peer review process, including peer review guidelines for the review as at 31 March 2017 (dated 9 February 2014)
- RSA Group Actuarial Reserving Policy (dated 24 May 2017)
- UK Commercial actuarial reserving philosophy document (dated November 2015)
- RSA Group Basis of Solvency II Balance Sheet Preparation document (dated 7 September 2017)
- UK Reserving Meetings Terms of Reference (dated 14 March 2016)

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**Appendix 4 (cont)**

- UK and International Reserve Committee Terms of Reference (dated July 2017)
- UK and International claims handling policy (dated 1 June 2017)
- Guidelines for the claims handling process issued to RSAI EEA branches for property claims (dated 13 October 2016)
- Internal reserve review reports:
  - Group actuarial review of UK Commercial reserves as at 31 March 2015 (dated 2 August 2016)
  - UK Finance Actuarial review of UK and International reserves as at 31 March 2017 (dated 23 June 2017)

**5. Documents relating to capital and related processes, including:**

- Internal model validation report produced by RSAI as at 30 August 2016
- Solvency Financial Condition Report (SFCR) for RSA Insurance Group plc as at 31 December 2016
- RSA Group 2017 Own Risk and Solvency Assessment (ORSA) executive summary (dated June 2017) and full report (dated 30 August 2017)
- RSA Group Capital Policy as at Q2 2017 (approved 23 May 2017)
- Slides summarising RSAI's assessment of standard formula appropriateness for RSAL (dated December 2017)
- Supporting spreadsheets for the calculation the standard formula SCR for RSAL (dated December 2017)

**6. Other evidence prepared by RSAI to support the Proposed Transfer, including:**

- Freedom of Services impact analysis (dated 3 October 2017)
- A summary of RSA's Recovery Plan (dated 6 December 2017) and RSA's Resolution Plan (dated 30 November 2017)
- Draft transfer pricing paper for the reinsurance from RSAL to RSAI (dated October 2017)
- Brexit contingency plan (dated October 2017)
- Internal report on the tax implications of the Proposed Transfer (dated 16 November 2017)
- Draft projections of future balance sheets and capital requirements up to 31 December 2020 for RSAI and RSAL
- Document on Policyholder Protection for transferring policyholders (dated January 2018)
- Valuation report of RSA Germany Branch defined benefit pension liabilities as at 31 December 2016

**7. Data Accuracy Statement**

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**Appendix 5**

The table below shows the relevant section references in the Scheme Report where I have addressed each point in the guidance from Chapter 18 of the Supervision Manual of the FCA Handbook and the PRA's "Statement of Policy - The PRA's approach to insurance business transfers – April 2015" with regards to the scheme report.

The guidance references for "PRA x.x" are taken from the PRA statement of policy and "FCA x.x" are taken from Chapter 18 of the Supervision Manual.

Guidance reference	Guidance	Scheme report reference
PRA 2.30 (1) FCA 18.2.33 (1)	Who appointed the independent expert and who is bearing the costs of that appointment	2.3 (page 10)
PRA 2.30 (2) FCA 18.2.33 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator (the PRA)	2.3 (page 10)
PRA 2.30 (3) FCA 18.2.33 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role	2.3 (page 10) Appendix 3
PRA 2.30 (4) FCA 18.2.33 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest	2.3 (page 10)
PRA 2.30 (5) FCA 18.2.33 (5)	The scope of the report	2.4 (page 11)
PRA 2.30 (6) FCA 18.2.33 (6)	The purpose of the scheme	3.3 (page 18)
PRA 2.30 (7) FCA 18.2.33 (7)	A summary of the terms of the scheme in so far as they are relevant to the report	3 (page 15)
PRA 2.30 (8) FCA 18.2.33 (8)	What documents, reports and other material information the independent expert has considered in preparing the report and whether any information that they requested has not been provided	Appendix 4



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Guidance reference	Guidance	Scheme report reference
PRA 2.30 (9) FCA 18.2.33 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgement of others	2.6 (page 11)
PRA 2.30 (10) FCA 18.2.33 (10)	The people the independent expert has relied on and why, in their opinion, such reliance is reasonable.	2.6 (page 11)
PRA 2.30 (11) FCA 18.2.33 (11)	Their opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee	Executive summary (page 4) 10 (page 61)
PRA 2.30 (12) FCA 18.2.33 (11A)	Their opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme.	Executive summary (page 4) 10 (page 61)
PRA 2.30 (13) FCA 18.2.33 (12)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in their opinion, be relevant to policyholders' consideration of the scheme.	10 (page 61)
PRA 2.30 (14) FCA 18.2.33 (13)	For each opinion that the independent expert expresses in the report, an outline of their reasons	Reserving: 5.10 (page 32) Capital: 6.12 (page 41) Policyholder: 7.11 (page 51) Communication: 8.7 (page 56) Other: 9.8 (page 60)
PRA 2.32 (1) FCA 18.2.35 (1)	A description of any reinsurance arrangements that it is proposed should pass to the transferee under the scheme	3.2 (page 17)
PRA 2.32 (2) FCA 18.2.35 (2)	A description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	3.2 (page 17)
PRA 2.33 (1) FCA 18.2.36 (1)	Include a comparison of the likely effects if it is or is not implemented	3.5 (page 19)

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Appendix 5 (cont)

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Guidance reference	Guidance	Scheme report reference
PRA 2.33 (2) FCA 18.2.36 (2)	State whether they considered alternative arrangements and, if so, what	3.5 (page 19)
PRA 2.33 (3) FCA 18.2.36 (3)	Where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences they consider may be material to the policyholders	Executive summary (page 4) 7.4 (page 44)
PRA 2.33 (4) FCA 18.2.36 (4)	<p>Include their views on:</p> <p>(a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;</p> <p>(b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, claims handling, expense levels and valuation bases in relation to how they may affect:</p> <p>(i) the security of policyholders' contractual rights;</p> <p>(ii) levels of service provided to policyholders; or</p> <p>(iii) for long-term insurance business, the reasonable expectations of policyholders; and</p> <p>(c) the cost and tax effects of the scheme, in relation to how they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations</p>	<p>(a) Executive summary (page 4) 7.4 (page 44) (b) and (c) 9 (page 57)</p>

The Proposed Transfer does not involve any mutual companies or long-term insurance business. As such, PRA 2.35 and PRA 2.36 (FCA 18.2.38 and FCA 18.2.39) do not apply.

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## *Appendix 6 – Notice of RSAI's auditor*

Appendix 6

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### Notice of RSAI's auditor

1. KPMG LLP ("the firm"), the auditor of Royal & Sun Alliance Insurance plc ("the Company") has, on certain conditions, allowed LCP ("the Independent Expert") to have access to those working papers by the firm as specified in Attachment 2 (not included) relating to the statutory audit of the Company' financial statements for the year ended 31 December 2016 and for the interim review for the half-year ended 30 June 2017 ("the Audit Working Papers").
2. The Auditor does not accept or assume responsibility to anyone other than the Company and the Company' members as a body, for its audit work, for its audit report or for the opinions it has formed. To the fullest extent permitted by law, the Auditor does not accept or assume responsibility to anyone as a result of the access given to the Audit Working Papers or for any information or explanation given to the Independent Expert in relation to the Audit Working Papers or in connection with the review by the Independent Expert of the Audit Working Papers.
3. The Audit Working Papers were not created for, and should not be treated as suitable for, any purpose other than the statutory audit and interim review. The statutory audit is undertaken in order that the Auditor might report to the Company' members, as a body, in accordance with Chapter 3 of Part 16 of the Companies Act 2006. The audit work of the Auditor is undertaken so that the Auditor might state to the Company' members those matters it is required to state to them in an auditor's report and for no other purpose.

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