



# Supplementary Report by Simon Sheaf FIA, Independent Expert, on the Proposed Transfer of a Portfolio of Policies from Arch Insurance (UK) Limited to Arch Insurance (EU) dac

3 December 2020



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# 1 Introduction

- 1.1 Arch Insurance (UK) Limited (“AIUK”) and Arch Insurance (EU) dac (“AIEU”) have jointly nominated Simon Sheaf (“I” or “me”) of Grant Thornton UK LLP (“Grant Thornton”, “we” or “us”) to act as the Independent Expert for the proposed insurance business transfer of a portfolio of insurance business from AIUK to AIEU (“the Scheme”). This nomination has been approved by the PRA in consultation with the FCA. The Scheme is intended to be effected on 31 December 2020 (“the Effective Date”).

## Scope of this report

- 1.2 I prepared a report for the High Court of Justice, England and Wales (“the Court”) dated 2 September 2020 and entitled “Report by Simon Sheaf FIA FSAI, Independent Expert, on the Proposed Transfer of a Portfolio of Policies from Arch Insurance (UK) Limited to Arch Insurance (EU) dac” (“the Report”). The Report sets out my considerations as to the likely effects of the proposed Scheme on the affected policyholders. This included my assessment as to whether the Scheme will result in material detriment to any policyholders affected by the Scheme relative to their current situation.
- 1.3 The conclusions within the Report were based on financial information as at 31 December 2019 and other information available to me when I prepared the Report. Since submitting the Report to the Court, I have been provided with more recent information. A list of the additional information that I have been provided with is contained within Appendix A.
- 1.4 This report (“the Supplementary Report”) provides an update to the conclusions I set out in the Report in light of this additional information. It also considers any other changes that have occurred since the Report was submitted and provides an update to the conclusions set out in the Report in light of those changes. In addition, this report also provides my opinion on the correspondence with policyholders and reinsurers that has taken place in connection with the Scheme.
- 1.5 I am not aware of any further matters not discussed in this report that have the potential to change my conclusions in the Report.

## Layout of this report

- 1.6 This report is structured as follows:
- This section sets out an introduction to the Scheme and to this report
  - Section 2 is an executive summary, which summarises the Scheme and the various analyses conducted and describes my conclusion
  - Section 3 sets out significant changes to each of AIUK and AIEU since the Report, along with any relevant developments external to AIUK and AIEU
  - Section 4 describes the work that I have carried out to review my conclusions in respect of the claims reserves for AIUK and AIEU
  - Section 5 describes the work that I have carried out to review my conclusions in respect of the capital requirements of AIUK and AIEU
  - Section 6 describes the work that I have carried out to review my conclusions in respect of policyholder security, including under insolvency
  - Section 7 describes the work that I have carried out to review my conclusions in respect of my assessment of other financial considerations

- Section 8 describes the work that I have carried out to review my conclusions in respect of my assessment of other non-financial considerations
- Section 9 describes the work I have done to consider the communications process
- Section 10 sets out my conclusions on the Scheme.

## Independence

- 1.7 I have no financial interest in AIUK, AIEU or the group of companies to which they belong, Arch Capital Group Ltd. and its subsidiaries (“ACGL” or “Arch Group”).
- 1.8 I have never provided any consulting services or acted in any advisory capacity to AIUK, AIEU or any companies who were at the time in ACGL.
- 1.9 I have provided consulting services to an entity that has subsequently been acquired by ACGL in a professional capacity; however, it was not part of ACGL at the time and I do not believe these previous assignments impair my independence to act as the Independent Expert on the Scheme.

## Use of this report

- 1.10 This Supplementary Report should be read in conjunction with the Report as reading this report in isolation may be misleading. In particular, this report has an analogous scope and is subject to the same reliances and limitations and restrictions on distribution and use as the Report. All abbreviations and technical terms used in this Supplementary Report have the same meaning as in the Report. These abbreviations and technical terms are included in Appendices B and C, respectively, of the Report.
- 1.11 This report is provided for the use of the Court, the AIUK Board, the AIEU Board, AIUK’s policyholders, AIEU’s policyholders, the PRA, the FCA, the CBI and any other relevant regulator for the sole purpose of considering the impact of the Scheme on the affected policyholders.
- 1.12 Copies of the final version of this report may be made available for inspection by policyholders and copies may be provided to any person requesting the same in accordance with legal requirements. The final version of this report may also be made available on websites hosted by or on behalf of AIEU and AIUK in connection with the Scheme.
- 1.13 However, notwithstanding the above, Grant Thornton does not accept any liability to any party other than AIUK, AIEU, or the Court, who chooses to act on the basis of any of the reports we have issued in connection with the Scheme.
- 1.14 Judgements about the conclusions drawn in this report should only be made after considering the report in its entirety as any part or parts read in isolation may be misleading.
- 1.15 The underlying figures in this report are calculated to many decimal places. In the presentation of the figures in the various tables, there may be reconciliation differences due to the effect of rounding.

- 1.16 Unless otherwise stated, the figures used throughout this report are shown in sterling and, where necessary, have been converted at the following exchange rates:

**Table 1.1 Exchange rates**

	US Dollar per £1	Euro per £1
<b>31 December 2019</b>	0.757	0.850
<b>30 June 2020</b>	0.809	0.909

- 1.17 These are the Bank of England rates at the nearest dates available.

## Professional Guidance

- 1.18 As an Independent Expert reporting to the Court, I am required to act in accordance with Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Guidance for the Instruction of Experts in Civil Claims. Accordingly, this report is prepared for the assistance of the Court and I confirm that I understand my duty to the Court and have complied with that duty.
- 1.19 This report has been prepared under the terms of the Statement of Policy produced by the PRA in April 2015, namely "The Prudential Regulation Authority's approach to insurance business transfers" and the guidance set out in Chapter 18 of the Supervision Manual ("SUP18") contained in the FCA Handbook of Rules and Guidance to cover scheme reports on the transfer of insurance business. In addition, this report has been prepared in accordance with the FCA's guidance paper, entitled "The FCA's approach to the review of Part VII insurance business transfers".
- 1.20 In my opinion, this report has been produced in line with the requirements of the Technical Actuarial Standards ("TASs") issued by the Financial Reporting Council ("FRC"). In particular, this report has been prepared in accordance with TAS 100: Principles of Technical Actuarial Work and TAS 200: Insurance.
- 1.21 This report has also been produced in line with the requirements of APS X3: The Actuary as an Expert in Legal Proceedings, issued by the IFoA.
- 1.22 In addition, this report has been internally peer reviewed in line with the requirements of APS X2: Review of Actuarial Work, issued by the IFoA.
- 1.23 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 that I have expressed and conclusions that I have drawn represent my true and complete professional opinions on the matters to which they refer.

# 2 Executive Summary

## My approach

- 2.1 In preparing this report, I have considered relevant events and experience since completing the Report and their impact on the conclusions set out in the Report. In particular, I have sought to:
- Understand changes to AIUK and AIEU since the Report, both financial and non-financial
  - Understand the impact of changes in the external environment on AIUK and AIEU
  - Consider the implications of these changes on the level of security provided to the affected policyholders
  - Consider the potential impact of changes since the Report on levels of customer service
  - Consider the changes in other factors that might affect policyholders since the Report
  - Consider the implication of changes since the Report on any reinsurers transferring as a result of the Scheme
  - Consider the implication of changes since the Report on any co-insurers transferring as a result of the Scheme.
- 2.2 Since the Report was issued, I have been provided with financial information as at 30 June 2020 for each of AIUK and AIEU. In addition, I have held discussions with AIUK and AIEU and been provided with confirmation from them of the changes in respect of financial and non-financial factors relating to AIUK and AIEU.
- 2.3 I have also considered the correspondence with policyholders and reinsurers that has taken place in connection with the Scheme. I have considered the correspondence up to 1 December 2020.

## Findings

- 2.4 The findings set out in this report are summarised in this section. The detailed explanation behind these conclusions follows in the body of this report and within the Report.

### Policyholder security

#### Transferring policyholders

- 2.5 With respect to the Transferring Portfolio, I do not expect any material adverse impact on policyholder security, including under insolvency, as a result of the Scheme. This is because I consider that AIEU will have a sufficient level of capital in order to meet policyholder obligations following the Scheme.
- 2.6 Please note this conclusion is subject to the capital injection that I discuss in paragraph 3.8 being made.

#### Remaining policyholders

- 2.7 With respect to the remaining AIUK policyholders, I do not consider that there will be any material adverse impact on policyholder security, including under insolvency, as a result of the Scheme. This is because I consider that AIUK will have a sufficient level of capital in order to meet policyholder obligations following the Scheme.

#### Existing policyholders

- 2.8 With respect to the existing AIEU policyholders I do not expect any material adverse impact on policyholder security, including under insolvency, as a result of the Scheme. This is because I consider

that AIEU will have a sufficient level of capital in order to meet policyholder obligations following the Scheme.

- 2.9 Please note this conclusion is subject to the capital injection that I discuss in paragraph 3.8 being made.

#### **Levels of service**

- 2.10 I do not anticipate any material changes to the level of service provided to any of the groups of policyholders following the Scheme.

#### **Other financial and non-financial considerations**

- 2.11 I do not expect any material adverse impact to any group of policyholders following the Scheme as a result of the other financial and non-financial factors considered.

- 2.12 The other financial factors that I have considered are:

- Financial impact of COVID-19
- Investment strategy
- Liquidity position
- Implications of the Scheme on ongoing expense levels
- Pension arrangements
- Tax implications
- Impact of other transfers

- 2.13 The other non-financial factors that I have considered are:

- Regulatory regime
- Complaints
- Claims handling and policy administration
- Recognition of the Scheme in other jurisdictions
- Governance and management frameworks
- 'Brexit'
- Ruling of Mr Justice Snowden on the proposed Part VII transfer of a book of in-payment annuities from The Prudential Assurance Company Limited to Rothesay Life Plc
- Non-financial impact of COVID-19
- The impact on policyholders should the Scheme not become effective.

#### **Impact on transferring reinsurers**

- 2.14 I identify no reinsurers transferring from AIUK to AIEU that would be materially adversely affected by the Scheme.

#### **Impact on existing co-insurers**

- 2.15 I identify no co-insurers transferring from AIUK to AIEU that would be materially adversely affected by the Scheme

## Conclusion

- 2.16 I conclude that I do not consider that the Scheme will result in material detriment to any policyholders, reinsurers or co-insurers affected by the Scheme, relative to their current situation and therefore, I see no reason why the Scheme should not proceed.
- 2.17 Please note this conclusion is subject to the capital injection that I discuss in paragraph 3.8 being made.

# 3 Business developments

## AIUK

### The FCA's Business Interruption test case

- 3.1 In paragraph 7.71 of the Report, I noted that AIUK is one of the insurers involved in the test case brought by the FCA on business interruption covers affected by COVID-19. The High Court has since handed down its judgement on this case and has ruled against the insurers on certain aspects of the case.
- 3.2 I understand that AIUK has, along with a number of other insurers, appealed certain aspects of the High Court judgement to the Supreme Court. I further understand that the appeal hearing commenced on 16 November 2020. It is possible that AIUK may, following this appeal, not be liable for some of the claims relating to the FCA's test case. However, this will not become clear until the Supreme Court issues its judgement.
- 3.3 AIUK has informed me that it has assessed the impact of this High Court judgement on its claims reserve and has calculated that the judgement has resulted in a £5.5m increase in its insurance liabilities on a gross of reinsurance basis. AIUK has also informed me that these claims are fully protected by AIUK's reinsurance covers and the outcome of the judgement has therefore not resulted in an increase in AIUK's insurance liabilities on a net of reinsurance basis. As a result, the judgement has not resulted in an increase in AIUK's net best estimate reserves or its net Solvency II Technical Provisions.
- 3.4 I have considered the impact from this High Court judgement on the estimated SCR and Own Funds for AIUK at the Effective Date both before and after the Scheme in paragraphs 5.18 and 5.19. In addition, in paragraphs 5.20 to 5.22, I have also considered what the impact would be to AIUK's solvency position if it was not able to recover any of the additional losses arising from the High Court judgement from its reinsurers. I have further considered the impact that this scenario would have on the security of transferring and remaining policyholders in paragraphs 6.3 and 6.4.

### Capital injection from the Arch Group

- 3.5 AIUK has informed me that it received a capital injection of £15.0m from the Arch Group on 15 April 2020. I have been informed by AIUK that the purpose of the injection was to restore AIUK's capital position following the losses AIUK sustained from reserve deterioration in its Executive Assurance and Professional Liability classes of business and from the COVID-19 event. I discuss these losses in more detail in paragraph 4.5. The capital injection has offset these losses and also led to an improvement in AIUK's SCR coverage ratio prior to the Scheme from 178.9% at 31 December 2019 to 201.0% at 30 June 2020.
- 3.6 I discuss the impact of this capital injection on my conclusions in the Report in respect of the security of the transferring policyholders and remaining policyholders in paragraphs 6.3 and 6.4.

### Other developments

- 3.7 I understand from AIUK that there have been no other material changes in its business since the Report was issued.

## AIEU

### Capital Injection from the Arch Group

- 3.8 In paragraph 8.142 of the Report, I noted that the Arch Group will inject an additional £8.9m (€10.5m) in Tier 1 capital to AIEU prior to the Scheme. AIEU has informed me that it has since agreed an increase in the quantum of this capital injection with Arch Group and AIEU now expects to receive an injection of £27.3m (€30.0m) in additional Tier 1 capital on 4 December 2020. For the avoidance of doubt, I note that this £27.3m injection includes the originally proposed injection of £8.9m.
- 3.9 Allowing for the £27.3m capital injection, the projected after Scheme SCR coverage ratio for AIEU at the Effective Date, has increased to 170.1% from 157.8% at the time of the Report.

### Collateral under the Intercompany Quota Share

- 3.10 I discussed the Intercompany Quota Share (“IQS”) in paragraphs 5.15 and 5.16 of the Report. In paragraphs 8.49 and 9.22 of the Report, I noted that AIUK’s recoveries under the IQS are 100% collateralised. In paragraphs 9.25, I noted that the policyholders of the Transferring Portfolio will continue to be protected under the IQS following the Scheme; however, I noted that the reinsurance recoveries in respect of the transferring policyholders will no longer be collateralised following the Scheme.
- 3.11 AIEU has informed me that Arch Reinsurance Ltd. (“ARL”) has since agreed with AIEU that it will transfer sufficient collateral to AIEU under the Scheme to match the best estimate of the reinsurance recoveries under the IQS that relate to the transferring policyholders. AIEU has informed me that it expects the transfer of collateral to take place on the Effective Date of the Scheme. This represents an improvement to the security of the transferring policyholders since my conclusions in the Report.
- 3.12 AIUK has informed me that sufficient collateral will remain with AIUK following the transfer of collateral discussed in paragraph 3.11 to ensure that the remaining collateral matches the best estimate of the reinsurance recoveries under the IQS that relate to the remaining policyholders.
- 3.13 I discuss the impact of this change on the security of the remaining policyholders in further detail in paragraph 6.4.

### Application to recognise Retrospective Capital Contribution as Tier 1 Own Funds

- 3.14 In paragraph 9.13 of the Report I discussed AIEU’s intention to apply to the CBI to allow it to recognise £1.9m of funds, which it has currently classified as Ineligible Own Funds, as Tier 1 Eligible Own Funds. AIEU has informed me that it has since applied to the CBI to recognise these funds as Tier 1 Eligible Own Funds and that the CBI approved AIEU’s application on 12 October 2020.
- 3.15 I discuss the impact of this change on AIEU’s capital position in paragraph 5.33.

### Other developments

- 3.16 I understand from AIEU that there have been no other material changes in its business since the Report was issued.

## Brexit

- 3.17 At the time of writing the Report, the UK was no longer a member of the EU and had entered into a transition period during which EU rules and permissions will continue to apply in the UK. The transition period was expected to end on 31 December 2020. At the time of this report, the transition period is still in effect and there has been no change to the expected end date of the transition period.
- 3.18 At the time of this report, discussions between the UK and the EU on the terms of the UK's relationship with the EU following the transition period are still ongoing and the outcome of these discussions continues to remain highly uncertain.
- 3.19 I am not aware of any developments in relation to Brexit that give me reason to change the conclusions in the Report.

## COVID-19

- 3.20 I discuss the financial impact of developments in the COVID-19 loss event on AIEU and AIUK in paragraphs 7.3 to 7.8 of this report and the non-financial impacts in paragraphs 8.13 to 8.16 of this report.
- 3.21 In paragraphs 8.88 to 8.93 and 8.193 to 8.201 of the Report, I considered the impact on AIEU and AIUK from a very pessimistic but plausible economic loss event due a new pandemic event or a worsening or second wave of the current COVID-19 pandemic event.
- 3.22 At the time of this report, a number of countries in Europe, including the UK, have entered a second wave of the pandemic. However, I have reviewed my analysis in the Report and I am not aware of any developments that would require me to update my assumptions or my analysis. I believe therefore that my conclusions for AIEU and AIUK in the Report are still appropriate at the time of this report.
- 3.23 At the time of this report, the duration of the COVID-19 pandemic and the severity of its impact on the economic, political, regulatory, judicial and social environments across territories globally remains highly uncertain. However, I am not aware of any developments, other than those discussed in paragraphs 3.20 and 3.23, in relation to the COVID-19 pandemic that impact on my conclusions in the Report.

## Other developments

- 3.24 I am not aware of any other market or financial developments since the date of the Report that would have an impact on my conclusions.

# 4 Claims reserves

## Reserve strength of the Remaining AIUK Portfolio

### Process for setting reserves

- 4.1 I have been informed by AIUK that there have not been any material changes to its processes for calculating its best estimate claims reserves and Solvency II technical provisions since the Report.
- 4.2 As I discussed in paragraph 7.8 of the Report, the best estimate claims reserves and the Solvency II technical provisions for the Remaining Portfolio and the Transferring Portfolio are calculated together as part of AIUK's quarterly reserving process.

### Best estimate claims reserves

- 4.3 The table below shows the best estimate claims reserves for the Remaining AIUK Portfolio as at 30 December 2019 compared to the reserves at 30 June 2020, including the impact of COVID-19.

**Table 4.1 Best estimate claims reserves movements for the Remaining AIUK Portfolio (£m)**

£m	31-Dec-19	30-Jun-20	Movement
<b>Gross of reinsurance</b>	302.7	388.3	<b>85.6</b>
<b>Ceded external reinsurance</b>	105.6	131.9	<b>26.3</b>
<b>Ceded Intercompany Quota Share RI</b>	167.5	220.5	<b>53.0</b>
<b>Net of reinsurance</b>	29.6	35.9	<b>6.3</b>

- 4.4 From the table above, the gross best estimate claims reserves for the Remaining Portfolio have increased by £85.6m however most of the increase in the gross reserves have been offset by a corresponding increase in the reinsurance recoveries. The net reserves have increased by £6.3m between 31 December 2019 and 30 June 2020.
- 4.5 AIUK has informed me that the most significant drivers of the increase in the gross and net best estimate reserves are the losses from the COVID-19 event, as well as unfavourable prior year development for the Executive Assurance and Professional Liability classes due to large loss experience. I further understand from AIUK that the increase in AIUK's reserves was partially offset by benign experience from its Energy and Marine business in the 2020 accident year.
- 4.6 The table below shows a breakdown of AIUK's best estimate claims reserves for the Remaining Portfolio as at 30 June 2020 into reserves held for the COVID-19 loss event and all other claims.

**Table 4.2 Best estimate claims reserves for the Remaining AIUK Portfolio as at 30 June 2020 (£m)**

£m	Excluding COVID-19	COVID-19	Total
<b>Gross of reinsurance</b>	354.7	33.6	<b>388.3</b>
<b>Ceded external reinsurance</b>	118.0	13.9	<b>131.9</b>
<b>Ceded Intercompany Quota Share RI</b>	203.8	16.7	<b>220.5</b>
<b>Net of reinsurance</b>	32.9	2.9	<b>35.9</b>

- 4.7 From Table 4.2, COVID-19 accounted for £33.6m (8.6%) and £2.9m (8.1%), respectively, of AIUK's total gross and net best estimate claims reserves as at 30 June 2020.
- 4.8 Based on AIUK's explanations for the changes in the actuarial best estimate claims reserve and AIUK's confirmation that the process for setting reserves has not changed materially since the Report, I have no reason to change the conclusions contained within the Report with respect to AIUK's best estimate claims reserves for the Remaining Portfolio lying within a range of reasonable estimates.

#### Solvency II technical provisions

- 4.9 The table below shows AIUK's Solvency II technical provisions as at 30 June 2020 compared to the technical provisions as at 31 December 2019.

**Table 4.3: Solvency II technical provisions for the Remaining AIUK Portfolio (£m)**

	31-Dec-19	30-Jun-20	Movement
Gross of reinsurance	358.3	421.8	63.5
Net of reinsurance	54.9	57.3	2.4

- 4.10 The changes in AIUK's Solvency II technical provisions are directionally consistent with the movements in the best estimate results outlined in Table 4.1, I understand from AIUK that they also allow for the impact of COVID-19.
- 4.11 Given this explanation for the change in the Solvency II technical provisions and since the process for setting the Solvency II technical provisions within AIUK has not changed materially since the Report, I have no reason to change the conclusions contained within the Report with respect to AIUK's Solvency II technical provisions lying within a range of reasonable estimates.

#### Impact of the FCA Business Interruption Test Case on the Remaining Portfolio

- 4.12 As discussed in paragraphs 3.1 to 3.4, AIUK is one of the insurers involved in the test case brought by the FCA on business interruption covers affected by COVID-19. Since the Report, the High Court has handed down its judgement on this case and has ruled against the insurers on a number of points.
- 4.13 AIUK has informed me that the best estimate claims reserves and Solvency II technical provisions in Tables 4.1 to 4.3 above do not include the impact of the recent judgement on the FCA Business Interruption Test Case as the outcome of the judgement was not yet known at the time when these best estimate reserves were calculated.
- 4.14 I understand from AIUK that the High Court's judgement has only impacted the Remaining Portfolio and that it has not impacted the Transferring Portfolio as there are no claims in the Transferring Portfolio that are subject to the FCA Business Interruption Test Case.
- 4.15 AIUK has provided me with its best estimate scenario and its worst case scenario of the impact of the Court ruling (and the appeal against it discussed in paragraph 4.18, below) on AIUK's reserves. These figures are summarised in the table below.

**Table 4.4: AIUK additional claims reserves following FCA Business Interruption Test Case (£m)**

£m	Gross of reinsurance impact	Net of reinsurance impact
Worst case scenario	15.5	0.0
Best estimate scenario	5.5	0.0

- 4.16 AIUK has provided me with an explanation as to why it expects these claims to be fully recoverable from its reinsurance programme. I have considered this explanation and, based on it, I do not consider this assumption to be unreasonable. However, AIUK has informed me that the explanation that it has provided is commercially sensitive and, for that reason, I have not included it in this report. I have however set out the reasons supporting my conclusion above in a separate Confidential Note; copies of which have been provided to the Court, the PRA and the FCA.
- 4.17 Following from paragraph 4.16, although the High Court judgement has resulted in an increase in AIUK's gross best estimate reserves and Solvency II Technical Provisions, I do not consider the impact to change my conclusions in paragraphs 4.8 and 4.11 on AIUK's net best estimate claims reserves and net Solvency II Technical Provisions lying within a range of reasonable estimates. I have however allowed for the increase in AIUK's gross and ceded best estimate claims reserves and Solvency II Technical Provisions in my analysis of AIUK's capital position. I discuss this further in Section 5 of this report in paragraphs 5.17 to 5.22.
- 4.18 I understand that AIUK has, along with a number of other insurers, appealed certain aspects of the High Court judgement to the Supreme Court. The appeal hearing commenced on 16 November 2020. AIUK has informed me that, based on its analysis, AIUK does not believe that there is any realistic conclusion from the Supreme Court appeal that would result in a loss that exceeds the worst case scenario loss shown in Table 4.4. I have reviewed AIUK's analysis and discussed it with AIUK and I am comfortable with this conclusion. In addition, I also note that it is possible that AIUK may, following this appeal, not be liable for some of the claims relating to the FCA's test case that it is currently holding reserves for. It follows that the appeal does not give me a reason to change my conclusion in paragraph 4.17.

## Reserve strength of the Existing AIEU Portfolio

### Process for setting reserves

- 4.19 I have been informed by AIEU that there have not been any material changes to its processes for calculating its best estimate claims reserves and Solvency II technical provisions for the Existing AIEU Portfolio since the Report.

### Best estimate claims reserves

- 4.20 The table below shows the best estimate claims reserves for the Existing AIEU Portfolio as at 31 December 2019 compared to the reserves as at 30 June 2020, including the impact of COVID-19.

**Table 4.5 Best estimate claims reserves movements for the Existing AIEU Portfolio (£m)**

£m	31-Dec-19	30-Jun-20	Movement
<b>Gross of reinsurance</b>	21.9	65.0	<b>43.1</b>
<b>Ceded external reinsurance</b>	1.7	5.7	<b>4.0</b>
<b>Ceded Intercompany Quota Share RI</b>	17.7	51.0	<b>33.3</b>
<b>Net of reinsurance</b>	2.5	8.3	<b>5.8</b>

- 4.21 From the table above, the gross best estimate claims reserves for the Existing Portfolio have increased by £43.1m however most of the increase in the gross reserves have been offset by a corresponding increase in the reinsurance recoveries. The net reserves have increased by £5.8m between 31 December 2019 and 30 June 2020.
- 4.22 AIEU has informed me that the increase in its reserves is driven by growth in AIEU written premiums between 31 December 2019 and 30 June 2020 and the losses from the COVID-19 event. As discussed in my report in paragraphs 5.9 and 5.10, since 1 January 2020, non-UK EEA policies previously

underwritten by AIUK have been written by AIEU upon renewal with the exception of a small book of 40 policyholders comprising of marine insurance policies domiciled in the Netherlands. This increase is in line with my expectations as at the time of writing the Report, AIEU had already commenced the writing of business within its P&C Division and had informed me of the plan to write significantly more business over the course of 2020.

- 4.23 In addition, I also understand from AIEU that there was a relatively small increase in the best estimate claims reserves following changes made to the loss ratio assumptions in its Mortgage business in Q1 2020 to take into account the deterioration in economic conditions as a result of the COVID-19 event.
- 4.24 The table below shows a breakdown of AIEU's best estimate claims reserves for the Existing Portfolio as at 30 June 2020 into reserves held for the COVID-19 loss event and all other claims.

**Table 4.6 Best estimate claims reserves split by COVID-19 impact for the Existing AIEU Portfolio as at 30 June 2020 (£m)**

£m	Excluding COVID-19	COVID 19	Total
<b>Gross of reinsurance</b>	62.5	2.5	<b>65.0</b>
<b>Ceded external reinsurance</b>	5.7	0.0	<b>5.7</b>
<b>Ceded Intercompany Quota Share RI</b>	48.7	2.3	<b>51.0</b>
<b>Net of reinsurance</b>	8.1	0.3	<b>8.3</b>

- 4.25 From Table 4.6, COVID-19 accounted for £2.5m (3.8%) and £0.3m (3.6%) of AIEU's total gross and net best estimate claims reserves as at 30 June 2020.
- 4.26 Based on AIEU's explanations for the changes in the actuarial best estimate claims reserve and AIEU's confirmation that the process for setting reserves has not changed materially since the Report, I have no reason to change the conclusions contained within the Report with respect to AIEU's best estimate claims reserves lying within a range of reasonable estimates.

#### Solvency II technical provisions

- 4.27 The table below shows AIEU's Solvency II technical provisions as at 30 June 2020 compared to its technical provisions as at 31 December 2019.

**Table 4.7: Solvency II technical provisions for the Existing AIEU Portfolio (£m)**

	31-Dec-19	30-Jun-20	Movement
Gross of reinsurance	38.3	108.3	70.0
Net of reinsurance	8.8	20.4	11.6

- 4.28 As was the case with AIEU's best estimate claims reserves, the Solvency II technical provisions have also increased significantly since 31 December 2019 on both a gross and net basis.
- 4.29 The changes in AIEU's Solvency II technical provisions are directionally consistent with the movements in the best estimate results shown in Table 4.5 and discussed in paragraphs 4.21 to 4.23. I understand from AIEU that they also allow for the impact of COVID-19.
- 4.30 Given the explanations for the changes in the Solvency II technical provisions provided by AIEU and since the process for setting the Solvency II technical provisions within AIEU has not changed materially since the Report, I have no reason to change the conclusions contained within the Report with respect to AIEU's Solvency II technical provisions lying within a range of reasonable estimates.

#### Impact of the FCA Business Interruption Test Case on the Existing Portfolio

- 4.31 I understand from AIEU that the High Court's judgement on the FCA Business Interruption Test Case discussed in paragraph 4.12 has not impacted the Existing Portfolio as there are no UK business interruption liabilities in the Existing Portfolio.
- 4.32 Based on paragraph 4.31, the FCA Business Interruption Test Case does not change the conclusions within the Report with respect to the strength of AIEU's best estimate reserves and Solvency II technical provisions for the Existing Portfolio.

## Reserve strength of the Transferring portfolio

- 4.33 As I discussed in paragraph 7.8 of the Report and paragraph 4.2 of this report, the best estimate claims reserves and the Solvency II technical provisions for the Remaining Portfolio and the Transferring Portfolio are calculated together as part of AIUK's quarterly reserving process.
- 4.34 It follows from paragraph 4.1 that there have not been any material changes to the processes for calculating its best estimate claims reserves and Solvency II technical provisions for the Transferring Portfolio since the Report.

#### Best estimate claims reserves

- 4.35 The table below shows the best estimate claims reserves for the Transferring Portfolio as at 30 December 2019 compared to the reserves at 30 June 2020, including the impact of COVID-19.

**Table 4.8 Best estimate claims reserves movements for the Transferring Portfolio (£m)**

£m	31-Dec-19	30-Jun-20	Movement
<b>Gross of reinsurance</b>	200.4	218.2	<b>17.8</b>
<b>Ceded external reinsurance</b>	90.7	92.6	<b>1.9</b>
<b>Ceded Intercompany Quota Share RI</b>	93.3	106.7	<b>13.4</b>
<b>Net of reinsurance</b>	16.5	19.0	<b>2.5</b>

- 4.36 From the table above, the gross best estimate claims reserves for the Transferring Portfolio have increased by £17.8m however most of the increase in the gross reserves have been offset by a corresponding increase in the reinsurance recoveries. The net reserves have increased by £2.5m between 31 December 2019 and 30 June 2020.
- 4.37 AIUK has informed me that the increase in the gross and net best estimate reserves is mainly driven by adverse development on the prior year reserves for the Executive Assurance and Professional Liability classes of business as the emerging experience on these portfolios has been worse than previously expected.

- 4.38 The table below shows a breakdown of the best estimate claims reserves for the Transferring Portfolio as at 30 June 2020 into reserves held for the COVID-19 loss event and all other claims.

**Table 4.9 Best estimate claims reserves split by COVID-19 impact for the Transferring Portfolio as at 30 June 2020 (£m)**

£m	Excluding COVID-19	COVID 19	Total
<b>Gross of reinsurance</b>	197.8	20.4	<b>218.2</b>
<b>Ceded external reinsurance</b>	92.6	0.0	<b>92.6</b>
<b>Ceded Intercompany Quota Share RI</b>	89.3	17.4	<b>106.7</b>
<b>Net of reinsurance</b>	15.9	3.1	<b>19.0</b>

- 4.39 From Table 4.9, COVID-19 accounted for £20.4m (9.3%) and £3.1m (16.3%), respectively, of the total gross and net best estimate claims reserves for the Transferring Portfolio as at 30 June 2020.
- 4.40 Given the explanations for the changes in the actuarial best estimate claims reserve provided by AIUK and since the process for setting reserves for the Transferring Portfolio has not changed materially since the Report, I have no reason to change the conclusions contained within the Report with respect to the best estimate claims reserves for the Transferring Portfolio lying within a range of reasonable estimates.

#### Solvency II technical provisions

- 4.41 The tables below compare AIUK and AIEU's Solvency II technical provisions for the Transferring Portfolio as at 31 December 2019 and 30 June 2020. For the avoidance of doubt, the figures below as at 31 December 2019 are AIUK's estimates of the Solvency II technical provisions, which had a different risk margin to that calculated by AIEU. I discuss this further in paragraph 4.44 below.

**Table 4.10: Solvency II technical provisions for the Transferring Portfolio (£m)**

	31-Dec-19	30-Jun-20	Movement
Gross of reinsurance	203.6	227.8	24.2
Net of reinsurance	21.0	27.3	6.2

- 4.42 The Solvency II technical provisions for the Transferring Portfolio have increased since 31 December 2019 on both a gross and net basis. I understand that from AIUK that the main driver of the changes in the Solvency II technical provisions for the Transferring Portfolio is the change in the best estimate results outlined in Table 4.9.
- 4.43 In paragraph 7.64 of the Report, I discussed that there was a £0.7m difference between AIUK's estimate and AIEU's estimate of the Solvency II technical provisions for the Transferring Portfolio as at 31 December 2019 and that this difference was due to the recalculation of the risk margin post-transfer on the AIEU balance sheet.
- 4.44 AIEU has informed me that it has not performed a recalculation of the risk margin for the Transferring Portfolio as at 30 June 2020 and that it has adopted the risk margin calculated by AIUK.
- 4.45 As I discussed in paragraph 7.65 of the report, AIUK and AIEU employed the same calculation methodology to derive their respective risk margins as at 31 December 2019 and their risk margin calculations included an allowance for each entity's overall risk profile and the level of diversification within each entity's insurance portfolio. The difference in the risk margins calculated by these entities was driven by the differences in the risk profile and level of diversification of these two entities.
- 4.46 The difference between the volume of AIUK's and AIEU's insurance exposures reduced between 31 December 2019 and 30 June 2020, mainly driven by the increase in AIEU's best estimate claims

reserves and written premium volume, as discussed in paragraphs 4.21 and 4.25. As a result, I expect that the difference between the levels of diversification for AIUK and AIEU to reduce. Based on this, I expect that the recalculation of the risk margin based on the post-transfer AIEU balance sheet would result in a smaller difference if this calculation was repeated for the position as at 30 June 2020.

- 4.47 Following from paragraph 4.46, I believe that recalculation of the risk margin for the Transferring Portfolio based on the post-transfer AIEU balance sheet would not result in a material difference in the context of the total technical provisions for the Transferring Portfolio.
- 4.48 Given the explanations for the changes in the Solvency II technical provisions provided by AIUK and AIEU and since the process for setting the Solvency II technical provisions for either company has not changed materially since the Report, I have no reason to change the conclusions contained within the Report with respect to the Solvency II technical provisions for the Transferring Portfolio lying within a range of reasonable estimates.

#### Impact of the FCA Business Interruption Test Case on the Transferring Portfolio

- 4.49 I understand from AIUK and AIEU that the High Court's judgement on the FCA Business Interruption Test Case discussed in paragraph 4.12 has not impacted the Transferring Portfolio as there are no UK business interruption liabilities in the Transferring Portfolio.
- 4.50 Based on paragraph 4.49, the FCA Business Interruption Test Case does not change the conclusions within the Report with respect to the strength of AIEU's best estimate reserves and Solvency II technical provisions for the Existing Portfolio.

# 5 Capital Requirements

## AIUK

### Capital strategy

- 5.1 I understand from AIUK that there has been no change in its capital strategy as set out in paragraphs 8.25 to 8.30 of the Report.
- 5.2 AIUK has informed me that it continues to manage its solvency towards the target level of capital which equates to a 120% SCR coverage ratio.

### GAAP balance sheet

- 5.3 I have repeated below Table 8.2 of the Report, with the exception of the minor correction I discuss in paragraph 5.5 below, which showed the GAAP balance sheets for AIUK before the Scheme and after the Scheme on the basis that the Scheme had become effective as at 31 December 2019. I have also provided the equivalent information as at 30 June 2020.
- 5.4 AIUK has informed me that in Table 8.2 of the Report, Cash had been allocated incorrectly to Other Assets and that there should have been £30.3m of Cash in Table 8.2 for AIUK on both a Before Scheme and an After Scheme basis. In Table 5.1 below, I have therefore shown the corrected figures as at 31 December 2019 incorporating £30.3m in Cash and a corresponding reduction in Other Assets for the same amount.

**Table 5.1 AIUK's GAAP balance sheets, before and after the Scheme**

£m	As at 31 December 2019			As at 30 June 2020			Difference		
	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme
<b>Assets:</b>									
Investments	104.2	(23.5)	80.7	124.6	(28.8)	95.9	20.4	(5.3)	15.1
Cash	30.3	0.0	30.3	12.5	0.0	12.5	(17.8)	0.0	(17.8)
Reinsurers' share of technical provisions	579.5	(207.4)	372.1	671.4	(199.3)	472.2	91.9	8.1	100.0
Deposits with ceding undertakings	0.0	0.0	0.0	0.0	11.0	11.0	0.0	11.0	11.0
Debtors	72.2	(9.6)	62.6	75.4	(22.4)	53.0	3.2	(12.8)	(9.6)
Other assets	17.5	(1.0)	16.5	28.6	(1.6)	27.0	11.1	(0.6)	10.5
Prepayments and accrued income	35.0	(7.0)	28.0	34.9	(6.9)	28.0	(0.1)	0.1	0.0
<b>Total assets</b>	<b>838.8</b>	<b>(248.5)</b>	<b>590.2</b>	<b>947.5</b>	<b>(248.0)</b>	<b>699.5</b>	<b>108.7</b>	<b>0.5</b>	<b>109.3</b>
<b>Liabilities:</b>									
Gross technical provisions	639.0	(225.6)	413.3	731.2	(218.2)	512.9	92.2	7.4	99.6
Creditors	77.8	(5.0)	72.8	75.3	(3.3)	72.0	(2.5)	1.7	(0.8)
Accruals and deferred income	41.7	(8.7)	33.0	46.2	(9.2)	37.0	4.5	(0.5)	4.0
<b>Total liabilities</b>	<b>758.4</b>	<b>(239.2)</b>	<b>519.2</b>	<b>852.7</b>	<b>(230.7)</b>	<b>621.9</b>	<b>94.2</b>	<b>8.5</b>	<b>102.7</b>
<b>Net assets</b>	<b>80.3</b>	<b>(9.3)</b>	<b>71.0</b>	<b>94.8</b>	<b>(17.3)</b>	<b>77.6</b>	<b>14.5</b>	<b>(8.0)</b>	<b>6.5</b>

- 5.5 From Table 5.1 above, it can be seen that AIUK's net assets increased by £14.5m between 31 December 2019 and 30 June 2020 on a UK GAAP basis.
- 5.6 As mentioned in paragraph 3.3, I have been informed by AIUK that it received a capital injection of £15.0m from the Arch Group on 15 April 2020. I have further been informed by AIUK that the purpose of the injection was to restore AIUK's capital position following the losses AIUK sustained from the COVID-

19 event. As can be seen in the table above, the capital injection has increased investments on AIUK's GAAP balance sheet.

- 5.7 The increases in AIUK's gross technical provisions and reinsurer's share of technical provisions are driven by the reasons that I discuss in paragraphs 4.5, 4.10 and 4.37. In particular, the increase in the gross technical provisions and reinsurers' share of technical provisions are mainly driven by losses from the COVID-19 event and the strengthening of AIUK's prior year reserves on the Executive Assurance and Professional Liability classes of business.

## Solvency II balance sheet

- 5.8 I have repeated below Table 8.3 of the Report, which showed the simplified indicative Solvency II balance sheet for AIUK before and after the Scheme as at 31 December 2019. I also compare this to the equivalent information as at 30 June 2020.

**Table 5.2: AIUK's Solvency II balance sheets and SCR coverage ratios, before and after the Scheme (£m)**

	As at 31 December 2019			As at 30 June 2020			Difference		
	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme
<b>Assets:</b>									
Investments	107.7	(23.5)	84.3	128.3	(28.7)	99.6	20.6	(5.3)	15.3
Cash	30.3	0.0	30.3	12.5	0.0	12.5	(17.8)	0.0	(17.8)
Reinsurers' share of technical provisions	485.9	(182.5)	303.4	565.0	(200.5)	364.5	79.1	(18.0)	61.1
Insurance and other receivables	48.8	(5.1)	43.7	48.0	(3.0)	45.0	(0.8)	2.1	1.3
Other assets	18.7	1.0	19.7	18.3	0.0	18.3	(0.4)	(1.0)	(1.4)
<b>Total assets</b>	<b>691.4</b>	<b>(210.1)</b>	<b>481.4</b>	<b>772.1</b>	<b>(232.2)</b>	<b>539.9</b>	<b>80.7</b>	<b>(22.2)</b>	<b>58.5</b>
<b>Liabilities:</b>									
Gross technical provisions	558.3	(203.6)	354.7	642.9	(225.8)	417.1	84.7	(22.3)	62.4
Risk margin	5.1	(1.5)	3.6	6.6	(1.9)	4.7	1.5	(0.4)	1.1
Other liabilities	52.3	(5.0)	47.3	36.5	(4.5)	32.0	(15.8)	0.5	(15.3)
<b>Total liabilities</b>	<b>615.7</b>	<b>(210.1)</b>	<b>405.6</b>	<b>686.1</b>	<b>(232.3)</b>	<b>453.8</b>	<b>70.3</b>	<b>(22.2)</b>	<b>48.2</b>
<b>Own Funds:</b>									
Net assets	75.7	0.0	75.7	86.1	0.0	86.1	10.3	0.0	10.4
Subordinated liabilities	8.0	0.0	8.0	8.0	0.0	8.0	0.0	0.0	0.0
<b>Total Eligible Own Funds</b>	<b>83.7</b>	<b>0.0</b>	<b>83.7</b>	<b>94.1</b>	<b>0.0</b>	<b>94.1</b>	<b>10.3</b>	<b>0.0</b>	<b>10.4</b>
<b>SCR Coverage Ratio:</b>									
Solvency Capital Requirement (SCR)	46.8	(8.9)	37.9	46.8	(8.9)	37.9	0.0	0.0	0.0
Eligible Own Funds	83.7	0.0	83.7	94.1	0.0	94.1	10.3	0.0	10.4
<b>SCR coverage ratio</b>	<b>178.9%</b>	<b>41.9%</b>	<b>220.8%</b>	<b>201.0%</b>	<b>47.1%</b>	<b>248.1%</b>	<b>22.1%</b>	<b>5.2%</b>	<b>27.4%</b>

- 5.9 From Table 5.2 above, it can be seen that AIUK's net assets and Eligible Own Funds increased by £10.3m between 31 December 2019 and 30 June 2020.
- 5.10 As mentioned in paragraph 3.3, I have been informed by AIUK that it received a capital injection of £15.0m from the Arch Group on 15 April 2020. I have further been informed by AIUK that the purpose of

the injection was to restore AIUK's capital position following the losses AIUK sustained from the COVID-19 event. As can be seen in the table above, the capital injection has increased investments on AIUK's Solvency II balance sheet.

- 5.11 The increase in AIUK's gross and reinsurer's share of Solvency II technical provisions are driven by the reasons that I discuss in paragraphs 4.5, 4.10 and 4.37. In particular, the increase in the gross and reinsurers' share of technical provisions is mainly driven by losses from the COVID-19 event and the strengthening of AIUK's prior year reserves on the Executive Assurance and Professional Liability classes of business.
- 5.12 As a result of the capital injection, partially offset by losses arising from the COVID-19 event, AIUK's net assets have increased by £10.3m. AIUK's SCR coverage ratio has also improved from 178.9% on 31 December 2019 to 201.0% on 30 June 2020.

#### Projected Solvency II Balance Sheet at the Effective Date, 31 December 2020

- 5.13 I have repeated below Table 8.6 of the Report, which showed the simplified projected Solvency II balance sheet for AIUK before and after the Scheme as at the Effective Date, 31 December 2020, projected based on information available as at 31 December 2019. I have also provided an updated projection based on information available to AIUK as at 30 June 2020.

**Table 5.3: AIUK's projected Solvency II balance sheets and SCR coverage ratios, before and after the Scheme, as at the Effective Date (£m)**

	Projected using information available on 31 December 2019			Projected using information available on 30 June 2020			Difference		
	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme
<b>Assets:</b>									
Investments	109.6	(11.1)	98.5	128.3	(16.8)	111.5	18.7	(5.7)	13.0
Cash	30.0	0.0	30.0	12.5	0.0	12.5	(17.5)	0.0	(17.5)
Reinsurers' share of technical provisions	472.1	(139.4)	332.7	499.4	(178.6)	320.8	27.3	(39.2)	(11.9)
Insurance and other receivables	51.2	(4.5)	46.7	52.0	(5.0)	47.0	0.8	(0.5)	0.3
Other assets	11.6	0.0	11.6	20.0	0.0	20.0	8.4	(0.0)	8.4
<b>Total assets</b>	<b>674.5</b>	<b>(155.0)</b>	<b>519.5</b>	<b>712.2</b>	<b>(200.4)</b>	<b>511.8</b>	<b>37.6</b>	<b>(45.4)</b>	<b>(7.7)</b>
<b>Liabilities:</b>									
Gross technical provisions	548.1	(152.2)	395.9	573.5	(195.8)	377.7	25.3	(43.6)	(18.2)
Risk margin	5.5	(1.4)	4.1	5.7	(1.6)	4.1	0.2	(0.2)	(0.0)
Other liabilities	54.9	(1.5)	53.5	38.0	(3.0)	35.0	(16.9)	(1.5)	(18.5)
<b>Total liabilities</b>	<b>608.6</b>	<b>(155.0)</b>	<b>453.5</b>	<b>617.2</b>	<b>(200.4)</b>	<b>416.8</b>	<b>8.6</b>	<b>(45.3)</b>	<b>(36.7)</b>
<b>Own Funds:</b>									
Net assets	66.0	0.0	66.0	95.0	(0.0)	95.0	29.0	(0.0)	29.0
Subordinated liabilities	8.0	0.0	8.0	8.0	0.0	8.0	0.0	0.0	0.0
<b>Total Eligible Own Funds</b>	<b>74.0</b>	<b>0.0</b>	<b>74.0</b>	<b>103.0</b>	<b>(0.0)</b>	<b>103.0</b>	<b>29.0</b>	<b>(0.0)</b>	<b>29.0</b>
<b>SCR Coverage Ratio:</b>									
Solvency Capital Requirement (SCR)	49.0	(5.8)	43.2	47.1	(7.7)	39.4	(1.9)	(1.9)	(3.8)
Eligible Own Funds	74.0	(0.0)	74.0	103.0	(0.0)	103.0	29.0	(0.0)	29.0
<b>SCR coverage ratio</b>	<b>150.8%</b>	<b>20.3%</b>	<b>171.1%</b>	<b>218.6%</b>	<b>42.7%</b>	<b>261.3%</b>	<b>67.8%</b>	<b>22.4%</b>	<b>90.2%</b>

- 5.14 From Table 5.3 above, it can be seen that the net assets and Eligible Own Funds at the Effective Date, both before and after the Scheme, have increased by £29.0m. In addition, the SCR coverage ratio before the Scheme has increased from 150.8% to 218.6% and the SCR coverage ratio after the Scheme has increased from 171.1% to 261.3%.
- 5.15 AIUK has informed me that the increase in projected net assets and improvement in SCR coverage ratios are mainly due to the following:
- The higher starting capital position at 30 June 2020 as a result of the £15.0m capital injection that I discuss in paragraphs 3.3 and 5.10
  - AIUK's achieved premium rates in the period between 31 December 2019 and 30 June 2020 being better than the premium rates that were assumed in the projection of net assets using information available on 31 December 2019
  - An improvement in AIUK's expected loss ratios for the period between 30 June 2020 and 31 December 2020.
- 5.16 The reasons in paragraph 5.15 also resulted in a reduction in AIUK's projected Solvency II net technical provisions and an increase in its projected premium receivables at the Effective Date.

### Projected SCR and Own Funds on the Effective Date and adjustment for COVID-19 event

- 5.17 In the Report, adjustments were made to the projected figures as at the Effective Date to allow for the impact of the COVID-19 event. The COVID-19 pandemic event is more developed now and therefore there is more information available on the associated losses to AIUK.
- 5.18 In addition, I understand from AIUK that the figures provided already allow for COVID-19 losses other than the recent judgement on the Business Interruption test case brought by the FCA. Due to AIUK's reinsurance protections, the judgement had a zero-net impact on AIUK's Solvency II technical provisions. There was also no impact on AIUK's Own Funds from the recent judgement on the Business Interruption test case brought by the FCA.
- 5.19 I have also undertaken a calculation to estimate the impact of the recent High Court judgement, and the appeal against it, on AIUK's SCR. In particular, I have calculated the increase in the credit risk component of AIUK's SCR and in AIUK's total SCR under the Solvency II standard formula, allowing for an increase in reinsurance recoveries. I performed this calculation considering both AIUK's best estimate and worst case scenario estimate of the additional losses due to the recent judgement, shown in Table 4.4. Based on these calculations, I have concluded that there is a very small increase (less than £75,000, or 0.2%) in AIUK's SCR under AIUK's worst case scenario estimate of the loss, both before and after the Scheme, and this impact is even lower assuming AIUK's best estimate of the additional losses.
- 5.20 In addition, I have also calculated what AIUK's SCR and Own Funds at the Effective Date would be before and after the Scheme assuming that the additional losses incurred by AIUK due to the recent judgement, and the appeal against it, is equal to AIUK's worst case scenario estimate in Table 4.4 and that AIUK is unable to recover any of these amounts from its reinsurance protections. The results from this calculation and a comparison to the equivalent figures from Table 5.3 are summarised below:

**Table 5.4: AIUK's coverage ratios assuming no recoveries and AIUK's worst case scenario High Court Judgement outcome on gross losses**

£m	Before Scheme			After Scheme		
	Before adjustment	Impact from loss of RI recoveries	After adjustment	Before adjustment	Impact from loss of RI recoveries	After adjustment
SCR	47.1	2.1	49.2	39.4	2.1	41.5

<b>Own funds</b>	103.0	(15.5)	87.5	103.0	(15.5)	87.5
<b>Coverage ratio</b>	218.6%	(40.8%)	177.8%	261.3%	(50.5%)	210.8%

- 5.21 From Table 5.4 above, it can be seen that the loss of the reinsurance recovery leads to increases of £2.1m in AIUK's SCR before and after the Scheme. By comparison AIUK's Own Funds, before and after the Scheme, decrease by £15.5m. This results in a decrease in AIUK's SCR coverage ratio from 218.6% to 177.8% before the Scheme and from 261.3% to 210.8% after the Scheme.
- 5.22 As illustrated in Table 5.3, the projected SCR coverage ratios for AIUK at the Effective Date, both before and after the Scheme, have increased from the equivalent projected SCR Coverage ratios I considered in my Report. I note that, after allowing for the adjustment in Table 5.4 above, the SCR coverage ratios, absolute value of Own Funds and the excess of Own Funds over the SCR for AIUK are still higher than the equivalent values I considered in my Report. As a result, I have not found it necessary to repeat the stress testing from paragraphs 8.64 to 8.118 of my Report and I have found no reason to change the conclusion under paragraph 8.118 of the Report that, should the Scheme become effective, the likelihood of AIUK's assets falling beneath its liabilities is remote.

### Pessimistic but plausible loss due to worsening of COVID-19 event

- 5.23 In paragraphs 8.88 to 8.93 of the Report, I considered the impact on AIUK from a very pessimistic but plausible economic loss event due a new pandemic event or a worsening or second wave of the current COVID-19 pandemic event.
- 5.24 At the time of this report, the UK has entered a second wave of the pandemic. However, I have reviewed my analysis in the Report and I am not aware of any developments that would require me to update my assumptions or my analysis.
- 5.25 In addition, as discussed in paragraphs 5.13 to 5.15, AIUK's Eligible Own Funds and SCR Coverage Ratio at the Effective Date both before and after the Scheme have improved since the Report.
- 5.26 Based on paragraphs 5.23 to 5.25 above, I have no reason to change my opinion from paragraph 8.93 of the Report that I consider that AIUK will have sufficient assets to meet its liabilities following a reasonably foreseeable worsening of the COVID-19 global pandemic or following a new reasonably foreseeable global pandemic.

### ORSA

- 5.27 The ORSA report that I was provided with for the Report remains the latest ORSA report available. Therefore, I have no updates to provide in relation to AIUK's ORSA.

### Conclusions

- 5.28 AIUK's SCR coverage ratio at the Effective Date has increased, as has the value of its excess of Own Funds over the SCR. Therefore, there is no reason for me to repeat the stress tests described in paragraphs 8.64 to 8.118 of the Report.
- 5.29 Furthermore, there is no reason for me to change my conclusion contained in paragraph 8.118 of the Report that, should the Scheme become effective, the likelihood of the assets of AIUK falling beneath its liabilities is remote.

## AIEU

### Capital strategy

- 5.30 I understand from AIEU that there has been no change in its capital strategy as set out in paragraphs 8.132 to 8.135 of the Report.
- 5.31 AIEU has informed me that it continues to manage its solvency towards the target level of capital which equates to a 120% SCR coverage ratio.

### GAAP balance sheet

- 5.32 I have repeated below Table 8.8 of the Report, which showed the Irish GAAP balance sheets for AIEU before the Scheme and after the Scheme on the basis that the Scheme had become effective as at 31 December 2019. I have also provided equivalent information as at 30 June 2020.

**Table 5.5 AIEU's GAAP balance sheets, before and after the Scheme**

£m	As at 31 December 2019			As at 30 June 2020			Difference		
	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme
<b>Assets:</b>									
Investments	66.0	23.5	89.4	74.2	29.0	103.3	8.3	5.6	13.9
Cash	4.5	0.0	4.5	8.4	(0.0)	8.3	3.8	(0.0)	3.8
Reinsurers' share of technical provisions	80.2	207.4	287.6	144.6	202.5	347.1	64.4	(4.9)	59.5
Deposits with ceding undertakings	1.0	0.0	1.0	2.5	6.5	9.1	1.6	6.5	8.1
Debtors	31.8	9.6	41.4	37.9	5.0	42.9	6.1	(4.6)	1.5
Other assets	0.1	1.0	1.2	5.1	1.7	6.8	5.0	0.6	5.6
Prepayments and accrued income	12.8	7.0	19.8	21.1	7.0	28.1	8.3	(0.1)	8.3
<b>Total assets</b>	<b>196.4</b>	<b>248.5</b>	<b>444.9</b>	<b>293.8</b>	<b>251.7</b>	<b>545.5</b>	<b>97.4</b>	<b>3.2</b>	<b>100.6</b>
<b>Liabilities:</b>									
Gross technical provisions	91.0	225.6	316.6	165.4	230.0	395.4	74.5	4.4	78.9
Creditors	37.7	5.0	42.7	37.8	3.3	41.2	0.1	(1.6)	(1.5)
Accruals and deferred income	17.4	8.7	26.1	35.0	9.3	44.3	17.5	0.6	18.2
<b>Total liabilities</b>	<b>146.1</b>	<b>239.2</b>	<b>385.3</b>	<b>238.2</b>	<b>242.6</b>	<b>480.9</b>	<b>92.1</b>	<b>3.4</b>	<b>95.5</b>
<b>Net assets</b>	<b>50.3</b>	<b>9.3</b>	<b>59.6</b>	<b>55.6</b>	<b>9.0</b>	<b>64.7</b>	<b>5.3</b>	<b>(0.2)</b>	<b>5.1</b>

- 5.33 It can be seen that AIEU's technical provisions, before the Scheme, have increased by £74.5m from 31 December 2019 to 30 June 2020. There has been a corresponding increase in reinsurers' share of technical provisions of £64.4m. The increase in the technical provisions is driven by the same reason that I discussed in paragraph 4.22, in particular, as a result of growth in AIEU written premiums between 31 December 2019 and 30 June 2020.
- 5.34 Overall, AIEU's net assets on a GAAP basis before the Scheme have increased by £5.3m between 31 December 2019 and 30 June 2020. Its net assets on a GAAP basis after the Scheme have increased by £5.1m between 31 December 2019 to and 30 June 2020.

## Solvency II balance sheet

- 5.35 I have repeated below Table 8.9 of the Report, which showed the simplified indicative Solvency II balance sheet for AIEU before and after the Scheme as at 31 December 2019. I also compare this to the equivalent information as at 30 June 2020.

**Table 5.6: AIEU's Solvency II balance sheets and SCR coverage ratios, before and after the Scheme (£m)**

	As at 31 December 2019			As at 30 June 2020			Difference		
	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme
<b>Assets:</b>									
Investments	66.0	23.5	89.4	74.2	29.0	103.3	8.3	5.6	13.8
Cash	4.5	0.0	4.5	8.4	(0.0)	8.3	3.8	(0.0)	3.8
Reinsurers' share of technical provisions	29.6	182.5	212.1	87.9	202.5	290.4	58.4	20.0	78.3
Insurance and other receivables	6.4	5.1	11.5	4.8	3.1	7.8	(1.6)	(2.1)	(3.7)
Other assets	0.0	(1.0)	(1.0)	7.9	(0.0)	7.9	7.9	1.0	8.9
<b>Total assets</b>	<b>106.5</b>	<b>210.1</b>	<b>316.5</b>	<b>183.2</b>	<b>234.5</b>	<b>417.8</b>	<b>76.8</b>	<b>24.5</b>	<b>101.2</b>
<b>Liabilities:</b>									
Gross technical provisions	35.3	203.6	238.8	105.2	228.1	333.3	69.9	24.5	94.5
Risk margin	3.1	2.2	5.3	3.1	1.9	5.1	0.1	(0.3)	(0.2)
Other liabilities	15.8	5.0	20.7	21.1	4.5	25.6	5.3	(0.4)	4.9
<b>Total liabilities</b>	<b>54.1</b>	<b>210.7</b>	<b>264.8</b>	<b>129.4</b>	<b>234.6</b>	<b>363.9</b>	<b>75.3</b>	<b>23.8</b>	<b>99.1</b>
<b>Own Funds:</b>									
Net assets	52.4	(0.7)	51.7	53.9	(0.0)	53.8	1.5	0.6	2.1
<b>Total Basic Own Funds to meet SCR</b>	<b>52.4</b>	<b>(0.7)</b>	<b>51.7</b>	<b>53.9</b>	<b>(0.0)</b>	<b>53.8</b>	<b>1.5</b>	<b>0.6</b>	<b>2.1</b>
Ineligible Own Funds	(1.9)	0.0	(1.9)	(2.0)	0.0	(2.0)	0.1	0.0	0.1
<b>Total Eligible Own Funds to meet SCR</b>	<b>50.5</b>	<b>(0.7)</b>	<b>49.8</b>	<b>51.8</b>	<b>(0.0)</b>	<b>51.8</b>	<b>1.3</b>	<b>0.6</b>	<b>2.0</b>
<b>SCR Coverage Ratio:</b>									
Solvency Capital Requirement (SCR)	23.3	10.3	33.6	31.4	8.2	39.6	8.1	(2.1)	6.0
Eligible Own Funds	50.5	(0.7)	49.8	51.8	(0.0)	51.8	1.3	0.6	2.0
<b>SCR coverage ratio</b>	<b>216.2%</b>	<b>-68.0%</b>	<b>148.1%</b>	<b>165.0%</b>	<b>-34.2%</b>	<b>130.8%</b>	<b>-51.2%</b>	<b>33.9%</b>	<b>-17.3%</b>

### Changes in AIEU's Before Scheme Solvency II Balance Sheet between 31 December 2019 and 30 June 2020

- 5.36 From Table 5.6 above, it can be seen that AIEU's net assets before the Scheme increased by £1.5m between 31 December 2019 and 30 June 2020. AIEU's Eligible Own Funds have also increased by £1.3m over the same period.
- 5.37 In comparison, AIEU's SCR has increased by £8.1m over the same period. AIEU has informed me that the increase in the SCR is due to growth in the volume of insurance business written by AIEU since 31 December 2020 and the corresponding increase in its reserves and Solvency II technical provisions which I discuss in paragraphs 4.22 and 4.29.
- 5.38 As a result of the increase in AIEU's Eligible Own Funds and the increase in AIEU's SCR, AIEU's SCR Coverage Ratio, before the Scheme, decreased to 165.0% at 30 June 2020 from 216.2% at 31 December 2019.

### Changes in AIEU's After Scheme Solvency II Balance Sheet between 31 December 2019 and 30 June 2020

- 5.39 From Table 5.6 above, it can be seen that AIEU's net assets assuming that the Scheme is in place increased by £2.1m between 31 December 2019 and 30 June 2020. AIEU's Eligible Own Funds have also increased by £2.0m over the same period.
- 5.40 In comparison, AIEU's SCR assuming that the Scheme is in place increased by £6.0m between 31 December 2019 and 30 June 2020. AIEU has informed me that the increase in the after Scheme SCR is due the same reasons I discuss in paragraph 5.37 above.
- 5.41 As a result of the increase in AIEU's SCR, partially offset by the increase in AIEU's Eligible Own Funds, AIEU's SCR Coverage Ratio, assuming the Scheme is in place, decreased to 130.8% at 30 June 2020 from 148.1% at 31 December 2019.

### Projected Solvency II Balance Sheet at the Effective Date, 31 December 2020

- 5.42 I have repeated below Table 8.12 of the Report, which showed the simplified projected Solvency II balance sheet for AIEU before and after the Scheme as at the Effective Date, 31 December 2020, projected based on information available as at 31 December 2019. I have also provided an updated projection based on information available to AIEU as at 30 June 2020.

**Table 5.7: AIEU's projected Solvency II balance sheets and SCR coverage ratios, before and after the Scheme, as at the Effective Date (£m)**

	Projected using 31 December 2019 figures			Projected using 30 June 2020 figures			Difference		
	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme	Before Scheme	Impact of Scheme	After Scheme
<b>Assets:</b>									
Investments	71.1	20.1	91.1	75.1	44.2	119.2	4.0	24.1	28.1
Cash	4.3	0.0	4.3	4.5	0.0	4.5	0.3	0.0	0.3
Reinsurers' share of technical provisions	58.3	139.4	197.7	104.8	180.4	285.2	46.5	41.0	87.4
Insurance and other receivables	12.8	4.5	17.3	18.5	5.0	23.5	5.7	0.6	6.2
Other assets	0.0	0.0	0.0	7.9	(0.0)	7.8	7.9	(0.0)	7.8
<b>Total assets</b>	<b>146.4</b>	<b>164.0</b>	<b>310.4</b>	<b>210.7</b>	<b>229.6</b>	<b>440.3</b>	<b>64.3</b>	<b>65.6</b>	<b>129.9</b>
<b>Liabilities:</b>									
Gross technical provisions	71.7	152.2	223.9	123.3	197.7	321.0	51.6	45.5	97.1
Risk margin	4.9	1.5	6.4	4.1	1.0	5.1	(0.8)	(0.5)	(1.3)
Other liabilities	14.0	1.5	15.5	29.2	3.0	32.3	15.2	1.6	16.8
<b>Total liabilities</b>	<b>90.6</b>	<b>155.2</b>	<b>245.8</b>	<b>156.6</b>	<b>201.8</b>	<b>358.4</b>	<b>66.0</b>	<b>46.6</b>	<b>112.6</b>
<b>Own Funds:</b>									
Net assets	55.8	8.8	64.6	54.1	27.8	81.9	(1.7)	19.0	17.4
<b>Total Basic Own Funds to meet SCR</b>	<b>55.8</b>	<b>8.8</b>	<b>64.6</b>	<b>54.1</b>	<b>27.8</b>	<b>81.9</b>	<b>(1.7)</b>	<b>19.0</b>	<b>17.4</b>
Ineligible Own Funds	(1.9)	0.0	(1.9)	0.0	0.0	0.0	1.9	0.0	1.9
<b>Total Eligible Own Funds to meet SCR</b>	<b>53.9</b>	<b>8.8</b>	<b>62.7</b>	<b>54.1</b>	<b>27.8</b>	<b>81.9</b>	<b>0.2</b>	<b>19.0</b>	<b>19.3</b>
<b>SCR Coverage Ratio:</b>									
Solvency Capital Requirement (SCR)	33.7	6.0	39.7	35.9	12.2	48.2	2.3	6.2	8.5
Eligible Own Funds	53.9	8.8	62.7	54.1	27.8	81.9	0.2	19.0	19.3
<b>SCR coverage ratio</b>	<b>160.1%</b>	<b>-2.3%</b>	<b>157.8%</b>	<b>150.6%</b>	<b>19.5%</b>	<b>170.1%</b>	<b>-9.5%</b>	<b>21.8%</b>	<b>12.3%</b>

- 5.43 From Table 5.7 above, it can be seen that the net assets and Eligible Own Funds at the Effective Date, before the Scheme have decreased £1.7m, I understand from AIEU that this is driven by an increase in AIEU's estimate of the net Solvency II technical provisions at the Effective Date which have increased for the same reasons I discussed in paragraph 5.37. Meanwhile the projected SCR, before the Scheme, has increased by £2.3m. I understand from AIEU that this is also primarily driven by the increase in AIEU's estimate of the net technical provisions at the Effective Date. As a result, the projected SCR coverage ratio for AIEU before the Scheme has decreased from 160.1% to 150.6%.
- 5.44 In comparison, AIEU's projected SCR coverage ratio at the effective date after the Scheme has increased from 157.8% to 170.1%. The main reasons for the increase in the SCR coverage ratio are summarised below:
- As discussed in paragraph 3.8, the Arch Group has agreed to increase the amount of additional Tier 1 capital it will provide to AIEU prior to the Scheme from £8.9m (€10.5m) to £27.3m (€30.0m).
  - As discussed in paragraph 3.14, on 12 October 2020, the CBI approved AIEU's application to allow it to recognise £1.9m of funds, which were previously classified as Ineligible Own Funds.
  - As discussed in paragraph 3.11, AIEU has informed me that ARL has agreed with AIEU that it will transfer sufficient collateral to AIEU under the Scheme to match the best estimate of the reinsurance recoveries under the IQS that relate to the transferring policyholders. This has resulted in a reduction in AIEU's projected SCR at the Effective Date following the Scheme to reflect the fact that the collateral will reduce the level of credit risk that AIEU will be exposed to.
- 5.45 From Table 5.7 above, it can also be seen that AIEU's projected SCR at the Effective Date following the Scheme has increased by £8.5m. AIEU has informed me that this increase is mainly due to the increase in the capital injection from the Arch Group discussed in paragraph 3.8. In particular, AIEU has informed that the additional capital will be invested in US Dollar denominated assets. This will increase the currency risk component of AIEU's SCR as a significant proportion of AIEU's liabilities are denominated in Euros. This increase in the SCR is however compensated by the increase in AIEU's Eligible Own Funds and overall AIEU's projected SCR Coverage Ratio at the Effective Date after the Scheme has improved.

### Adjustments for COVID-19 event

- 5.46 In the Report, I made adjustments to the projected figures as at the Effective Date to allow for the impact of the COVID-19 event. The COVID-19 pandemic event is more developed now and therefore there is more information available on the associated losses to AIEU. I understand from AIEU that the figures it provided to me already allow for COVID-19 losses. For this reason, I have not found it necessary to adjust AIEU's latest estimates of the SCR and Own Funds at Effective Date.

### Pessimistic but plausible loss due to worsening of COVID-19 event

- 5.47 In paragraphs 8.192 to 8.201 of the Report, I considered the impact on AIEU from a very pessimistic but plausible economic loss event due to a new pandemic event or a worsening or second wave of the current COVID-19 pandemic event. At the time of this report, Europe has entered a second wave of the pandemic. However, I have reviewed my analysis in the Report and I am not aware of any developments that would require me to update my assumptions or my analysis.
- 5.48 In addition, as discussed in paragraphs 5.44 and 5.45, AIEU's Eligible Own Funds and SCR Coverage Ratio at the Effective Date after the Scheme have improved since the Report.
- 5.49 Based on paragraphs 5.47 and 5.48 above, I have no reason to change my opinion from paragraph 8.201 of the Report that I consider that AIEU will have sufficient assets to meet its liabilities following a

reasonably foreseeable worsening of the COVID-19 global pandemic or following a new reasonably foreseeable global pandemic.

## ORSA

- 5.50 The ORSA report that I was provided with for the Report remains the latest ORSA available. Therefore, I have no updates to provide in relation to AIEU's ORSA.

## Conclusions

- 5.51 AIEU's SCR coverage ratio after the Scheme at the Effective Date has increased, as has the value of its excess of Own Funds over the SCR. Therefore, there is no reason for me to repeat the stress tests described in paragraphs 8.64 to 8.118 of the Report.
- 5.52 Furthermore, there is no reason for me to change my conclusion contained in paragraph 8.118 of the Report that, should the Scheme become effective, the likelihood of the assets of AIEU falling beneath its liabilities is remote.

# 6 Policyholder security

## Impact of the Scheme on the security of the transferring policyholders

- 6.1 It follows from paragraphs 5.14 and 5.44 that, as a result of the Scheme, the transferring policyholders will be moving from an entity with a higher SCR coverage ratio to an entity with a lower SCR coverage ratio. In addition, the transferring policyholders will also be moving to an entity with a lower absolute value of Eligible Own Funds. Although this is a reduction in the security of the transferring policyholders, in my opinion, the transferring policyholders will still be moving to an entity which is sufficiently capitalised in order to meet policyholder obligations over the course of the run-off of its insurance liabilities.
- 6.2 My opinion in paragraph 6.1 is based on the fact that AIEU's projected SCR coverage ratio at the Effective Date following the Scheme and its excess of Eligible Own Funds over the SCR have increased since the Report. Following the stress testing analysis that I described in paragraphs 8.170 to 8.232 of the Report, I concluded in paragraph 8.231 of the Report that the likelihood of AIEU not being able to meet its policyholder obligations following the Scheme and over the course of the run-off of its liabilities is remote. As the projected capital position for AIEU at the Effective Date following the Scheme has improved since the Report, I have no reason to change my opinion in the Report.
- 6.3 Based on the information I have seen since the Report was issued, I have no reason to change the conclusions set out in paragraphs 9.45 to 9.47 of the Report in respect of the security of the transferring policyholders. In reaching this conclusion, I have considered the following:
- The projected SCR coverage ratio for AIEU at the Effective Date of the Scheme has increased to 170.1% from 157.8% since the Report and AIEU is still expected to have substantial Own Funds in excess of its SCR following the Scheme, as shown in Table 5.6
  - As discussed in paragraph 6.1, in my opinion, the likelihood of AIEU not being able to meet its policyholder obligations following the Scheme and over the course of the run-off of its liabilities is remote.
  - As I discussed in paragraph 3.11, the transferring policyholders are currently protected by an 85% intercompany quota share agreement with ARL and that sufficient collateral is currently held by AIUK to match the best estimate of the reinsurance recoveries under this quota share agreement. At the time of my Report, the collateral underlying this quota share was not expected to transfer to AIEU following the Scheme. ARL has since agreed with AIEU that it will transfer sufficient collateral to AIEU to match the best estimate of the reinsurance recoveries under the IQS that relate to the transferring policyholders. This represents an improvement to the security of the transferring policyholders since my conclusions in the Report.
  - As I discussed in paragraph 3.8, the Arch Group will provide a £27.3m capital injection to AIEU prior to the Effective Date. The quantum of the intended capital injection has increased by £18.4m from £8.9m since the Report. As I discussed in paragraph 4.22, AIEU's insurance liabilities have increased since the Report as a result of growth in AIEU's P&C Division and its motor insurance portfolio. This has resulted in an increase in AIEU's SCR. The £18.4m increase in the capital injection restores AIEU's SCR coverage ratio following the Scheme to a slightly higher level to the level I considered in the Report.
  - As I discussed in paragraphs 5.17 to 5.22, in the scenario that AIUK is not able to make reinsurance recoveries in respect of the losses arising from the recent High Court judgement relating to the FCA Business Interruption Test Case, AIUK's SCR coverage ratio and Own Funds will decrease. Under this scenario, the reduction in the coverage ratio of the transferring policyholders following the Scheme will be lower than if AIUK is able to make the reinsurance recoveries and, therefore, the Scheme will be a little more attractive from the perspective of the transferring policyholders.

- As stated in paragraph 9.45 of the Report, the majority of policyholders in the Transferring Portfolio are direct insurance contracts and will therefore have preferential access to any remaining funds in the event of insolvency both before and after the Scheme.
- I stated in paragraph 9.45 of the Report that no policyholders are expected to lose access to the FSCS as a result of the Scheme. There have been no developments since the Report that would give me reason to change this statement.

## Impact of the Scheme on the security of the policyholders remaining in AIUK

6.4 Based on the information I have seen since the Report was issued, I have no reason to change the conclusions set out in paragraph 9.48 of the Report in respect of the security of the policyholders remaining in AIUK. In reaching this conclusion, I have considered the following:

- It remains the case that AIUK's SCR coverage ratio is positively impacted as a result of the Scheme
- As shown in Table 5.3, the projected SCR coverage ratio for AIUK at the Effective Date following the Scheme has improved since the Report due to the £15.0m injection that AIUK received from the Arch Group on 15 April 2020
- As I discussed in paragraph 3.12, sufficient collateral will remain with AIUK in respect of its reinsurance recoveries under the IQS following the Scheme to match the best estimate of the reinsurance recoveries under the IQS that relate to the remaining policyholders.
- As I discussed in paragraphs 5.17 to 5.22, in the scenario that AIUK is not able to make reinsurance recoveries in respect of the losses arising from the recent High Court judgement relating to the FCA Business Interruption Test Case, AIUK's SCR coverage ratio and Own Funds will decrease both before and after the Scheme. Under this scenario, the security of the remaining policyholders will reduce both before and after the Scheme basis. This reduction in security of the remaining policyholders would occur whether or not the Scheme went ahead. Therefore, the remaining policyholders are not negatively impacted as a result of the Scheme, but rather as a result of the outcome of the FCA Business Interruption Test Case. Furthermore, even under this scenario, the impact of the Scheme on the policyholders' security will be that of an increase in security and therefore the Scheme will continue to be beneficial from the perspective of the remaining policyholders.

## Impact of the Scheme on the security of the existing policyholders in AIEU

6.5 Based on the information I have seen since the Report was issued, I have no reason to change the conclusions set out in paragraphs 9.49 of the Report in respect of the security of the existing policyholders in AIEU. In reaching this conclusion, I have considered the following:

- The projected SCR coverage ratio for AIEU at the Effective Date increases following the Scheme, in addition, the absolute value of its Own Funds in excess of the SCR also increases following the Scheme.
- As I discussed in paragraph 3.8, the Arch Group has increased the capital injection that it will provide to AIEU prior to the Effective Date. The quantum of the intended capital injection has increased to £27.3m from £8.9m since the Report. The increase in the capital injection will restore AIEU's SCR coverage ratio following the Scheme to a slightly higher level as the level I considered in the Report.



# 7 Other financial considerations

7.1 I considered the following financial considerations in Section 10 of the Report:

- Financial impact of COVID-19
- Investment strategy
- Liquidity position
- Implications of the Scheme on ongoing expense levels
- Pension arrangements
- Tax implications
- Impact on transferring reinsurers
- Impact of new business strategy
- Impact of other transfers

7.2 I discuss the financial impact of COVID-19 in paragraphs 7.3 to 7.7.

Based on my discussions with AIUK and AIEU, I understand that there have been no developments since the Report with respect to any of the other financial aspects listed above that would give me reason to change the conclusions contained in the Report.

## Financial impact of COVID-19

7.3 I discussed the financial impact of COVID-19 on AIUK and AIEU in paragraphs 10.2 to 10.4 of the Report. In the Report, I said that I would revisit my assessment of the impact from COVID-19 and my very pessimistic but plausible scenario in my Supplementary Report in order to take account of any further developments relating to this event.

7.4 Since the Report, as discussed in paragraphs 3.1 to 3.4, the UK High Court has handed down its judgement on the FCA's business interruption test case where AIUK is one of the affected insurers. I consider the impact of this judgement on AIUK's reserves, AIUK's capital position and the security of the transferring policyholders and remaining policyholders in paragraphs 6.1 and 6.4.

7.5 I understand that AIUK has, along with a number of other insurers, appealed certain aspects of the High Court judgement to the Supreme Court. I further understand that the appeal hearing commenced on 16 November 2020. It is possible that AIUK may, following this appeal, not be liable for some of the claims relating to the FCA's test case. However, this will not become clear until the Supreme Court issues its judgement.

7.6 Since the Report, the COVID-19 pandemic has entered into a second wave in the UK and across a number of European countries. This has resulted in additional lockdowns being announced by various governments and at the time of this report, the timing for the resolution of this pandemic remains uncertain. I have reviewed the assumptions and conclusions from my stress testing analysis in paragraphs 8.64 to 8.118 and 8.170 to 8.232 of the Report in light of this and I believe that they are still appropriate.

7.7 At the time of writing this report, I am not aware of any other developments affecting AIUK in respect of the financial impact of COVID-19.

7.8 As discussed in paragraph 3.20, I have reviewed my very pessimistic but plausible COVID-19 loss scenario and I am not aware of any developments that would require me to change my assumptions or my analysis. Given the information currently available, I believe that this scenario remains a reasonable representation of a very pessimistic but plausible outcome. I note that there remains considerable

uncertainty regarding the impact of COVID-19 as both the total losses suffered by insureds and the liability of insurers for those losses are subject to substantial uncertainty. As a result, it is possible that the actual losses due to COVID-19 may deviate, possibly materially so, from loss estimates including my pessimistic but plausible scenario.

# 8 Other non-financial considerations

- 8.1 I considered the following non-financial aspects in Section 11 of the Report:
- Regulatory jurisdiction
  - Claims handling and policy administration
  - Complaints
  - The recognition of the Scheme in other jurisdictions
  - Governance and management frameworks
  - 'Brexit'
  - Ruling of Mr Justice Snowden on the proposed Part VII transfer of a book of in-payment annuities from The Prudential Assurance Company Limited to Rothesay Life Plc
  - Non-financial impact of COVID-19
  - The impact on policyholders should the Scheme not become effective.
- 8.2 I discuss the developments in respect of Brexit in paragraphs 8.7 to 8.9 below.
- 8.3 I discuss the appeal in respect of Mr Justice Snowden's ruling on the proposed Part VII transfer of a book of in-payment annuities from The Prudential Assurance Company Limited to Rothesay Life Plc in paragraphs 8.10 to 8.12 below.
- 8.4 I discuss the developments in respect of the non-financial impact of COVID-19 in paragraphs 8.13 to 8.16 below.
- 8.5 Based on my discussions with AIUK and AIEU, I understand that there have been no other developments with respect to the above non-financial aspects since the Report that would give me reason to change the conclusions contained in the Report with respect to these aspects.
- 8.6 In particular, with respect to complaints, I note that there have been no changes with respect to complaint handling, including access to schemes such as the FOS, since the Report. As a result, I have no reason to change my conclusion in paragraph 11.34 of the Report that the Scheme will not create any material adverse impact to the transferring, remaining or existing policyholders' access to adequate complaints handling procedures.

## Brexit

- 8.7 I discussed the non-financial considerations in respect of Brexit in paragraphs 11.54 to 11.61 of the Report.
- 8.8 As discussed in paragraphs 3.17 and 3.18 of this report, at the time of writing this report, the Brexit transition period is still in effect and there has been no change to the expected end date of the transition period. Also, discussions between the UK and the EU on the terms of the UK's relationship with the EU following the transition period are still ongoing and the outcome of these discussions continues to remain highly uncertain.
- 8.9 I am not aware of any developments in relation to Brexit that give me reason to change the conclusion in paragraph 11.60 of the Report.

## Appeal in respect of Mr Justice Snowden's ruling on the proposed Part VII transfer of a book of in-payment annuities from The Prudential Assurance Company Limited to Rothesay Life Plc

- 8.10 I considered Mr Justice Snowden's ruling on the proposed Part VII transfer of a book of in-payment annuities from Prudential to Rothesay in paragraphs 11.62 to 11.64 of the Report.
- 8.11 Prudential and Rothesay have since appealed this judgement and the appeal hearing, which started on Tuesday 27 October, has since concluded. At the time of writing the report, the Court of Appeal had not yet made its decision on the outcome of the appeal; however I understand from Prudential's website that it expects a decision from the Court of Appeal sometime in late 2020 or early 2021. If the appeal succeeds, I understand that there will still need to be a further hearing at the High Court to decide if the transfer should proceed.
- 8.12 In paragraph 11.64 of the Report, I noted a number of significant differences between this Scheme and the proposed Part VII transfer from Prudential to Rothesay. These differences will continue to be true regardless of the outcome of the appeal. Based on this, I do not see any reason to change the conclusions in paragraph 11.64 of the Report.

## Non-financial impact of COVID-19

- 8.13 I discussed the non-financial impact of COVID-19 on AIUK and AIEU in paragraphs 11.65 to 11.68 of the Report.
- 8.14 AIUK and AIEU have informed me that, since the Report, most of their employees have continued to work remotely and that their remote working arrangements have remained resilient. AIUK and AIEU have both also informed me that there have been no material delays or failures in their operations since implementing the Stay at Home Order. AIUK and AIEU have also confirmed that there have not been any material adverse impacts, up to the time of the writing of this Report, on their claims handling or policy administration processes. As a result, there has been no material adverse impact on the service standards experienced by their respective policyholders.
- 8.15 AIUK and AIEU have also informed me that it remains the case that they do not anticipate any future adverse effects from the remote working arrangements on their respective businesses.
- 8.16 Following from the above, I have no reason to change the conclusions set out in paragraph 11.68 of the Report in respect of the non-financial impacts of COVID-19 on the transferring policyholders following the Scheme.

# 9 Considerations of the communications process and objections received

## Policyholder and third-party communications

- 9.1 I understand from AIUK and AIEU that the approach to policyholder notifications set out in the Report proceeded as planned. The advertisements were placed in accordance with the Directions Order and the policyholder communications were undertaken as planned.
- 9.2 As a result, I am satisfied that that the communications exercise was appropriate.

## Returned correspondences

- 9.3 As at 1 December 2020, communications had been sent to all policyholders who it was intended to notify. This totalled 76,530 communications, comprising of 76,334 letters and 196 emails. Of this, 5,194 (6.8%) of communications to policyholders and third parties had been returned to AIUK and AIEU, none of which were from email correspondences. I understand from AIUK and AIEU that they have sought to trace alternative contact details for these policyholders and third parties by performing searches across a number of publicly available sources.
- 9.4 AIUK and AIEU have informed me that, out of the 5,194 returned communications, 3,957 relate to a single coverholder domiciled in Italy and that this coverholder has agreed to work with the relevant intermediaries to resend these communications.
- 9.5 I understand from AIUK and AIEU that, of the other 1,237 returned communications, alternative contact details have been identified for 1,220.
- 9.6 AIUK and AIEU have provided me with a breakdown of the total returns that were received for both the transferring policyholders and the existing AIEU policyholders. Of the original communications that were returned, I understand from AIUK and AIEU that the jurisdictions of the corresponding policyholders are as follows:
- Germany – 19%
  - Spain – 16%
  - Norway – 23%
  - Luxembourg – 16%
  - Sweden – 12%
  - UK – 9%
  - Denmark – 6%
  - Italy – 6%
  - Ireland – 1%
  - US – <1%
- 9.7 AIUK and AIEU have provided me with information regarding the steps which were taken before arriving at the conclusion that addresses could not be located for some policyholders, including how any further tracing exercises were undertaken. Having considered this, I am comfortable that all reasonable and proportionate avenues have been explored.

- 9.8 Based on my experience of fulfilling the role of Independent Expert on other Part VII transfers, I do not consider the number of communications that have been returned and which AIUK and AIEU have been unable to resend to be unusual in the context of the total number of transferring policyholders that AIUK and AIEU attempted to notify.

## Policyholder and third-party correspondence

- 9.9 As at 1 December 2020, I understand from AIUK and AIEU that there were no objections to the Scheme from policyholders.
- 9.10 I further understand from AIUK and AIEU that, as at 1 December 2020, 126 email communications had been received, of which 106 were general enquiries and 20 had been classified by AIUK and AIEU as 'Other'. Those classified as 'Other' arose from one of the following themes:
- The policyholder had passed away
  - The policy had already been cancelled
  - AIEU or AIUK are unknown to the recipient and a request for no future contact has been made
  - The policy had expired and had not been renewed
  - The recipient is not known at the address
  - The communication was sent to the wrong address
  - A request for information on insurance offerings from either AIUK or AIEU.
- 9.11 I understand from AIUK and AIEU that, of the 126 communications, 15 emails did not require a response and 19 emails were forwarded to the coverholder responsible for administering the policy in question. I understand that, for the 19 emails that were forwarded to the coverholder, the coverholder has responded to all of the affected policyholders directly. I further understand from AIUK and AIEU that the remaining 92 emails were responded to directly by AIUK and AIEU.
- 9.12 AIUK and AIEU have also informed that the communications above that are classified as "The recipient is not known at the address" and "The communication was sent to the wrong address" have been classified separately from the 5,194 returned communications which I discussed in paragraph 9.3 as a response was received in these cases where in other cases the correspondence was returned unopened. AIUK and AIEU have also informed me that there were four communications received under this category. Two of these said that the policyholder communications letter had been delivered to an old address, however, it had been received by the policyholder and therefore no action is required. The other two emails said that the policyholder was not known at the address. Of these, AIUK and AIEU have informed me that a letter has already been resent to an updated address for one of these and that they are in the process of identifying a new address for the remaining policyholder.
- 9.13 Following from paragraph 9.11, I am comfortable that AIUK and AIEU have either responded directly to communications raised by policyholders and third parties or arranged for the relevant coverholder to do so.

## Reinsurer communication

- 9.14 AIUK and AIEU have informed me that they have contacted all of their reinsurance counterparties that will be affected by the Scheme. At 1 December 2020, I understand from AIUK and AIEU that there were no objections or enquiries in relation to the Scheme from reinsurers.

## Co-insurer communication

- 9.15 I discussed in paragraph 12.74 of the Report that AIUK and AIEU have not identified any co-insurers that will be affected by the Scheme and therefore no co-insurers were included in AIUK's or AIEU's notifications.
- 9.16 Based on my discussions with AIUK and AIEU, I understand that there have been no developments with respect to AIUK and AIEU co-insurers since the Report that would give me reason to change the conclusion contained in the Report.

# 10 Conclusions

- 10.1 I have further considered the effect of the proposed Scheme on the transferring policyholders, the policyholders remaining in AIUK and the existing policyholders of AIEU. I confirm that the substance of my overall opinion and conclusions as set out in paragraphs 14.3 to 14.9 of the Report are unchanged. For ease of reference, I set out my conclusions in the following paragraphs.

## **Transferring policyholders**

- 10.2 I have concluded that there will be no material adverse impact to the service provided to the transferring policyholders and no material adverse impact on the security provided to them, including under insolvency. Therefore, I do not expect that the transferring policyholders would be materially adversely affected by the Scheme.
- 10.3 Please note that this conclusion is subject to the capital injection that I discuss in paragraph 3.8 being made.

## **Policyholders remaining in AIUK**

- 10.4 I have concluded that there will be no material adverse impact to the service provided to the policyholders remaining in AIUK and no material adverse impact on the security provided to them, including under insolvency. Therefore, I do not consider that the policyholders remaining in AIUK will be materially adversely affected by the Scheme.

## **Existing policyholders of AIEU**

- 10.5 In addition, I have concluded that there will be no material adverse impact to the service provided to the existing policyholders of AIEU and no material adverse impact on the security provided to them. Therefore, I do not consider that the existing policyholders of AIEU would be materially adversely affected by the Scheme.
- 10.6 Please note that this conclusion is subject to the capital injection that I discuss in paragraph 3.8 being made.

## **Co-insurers of the Transferring Portfolio**

- 10.7 I have concluded that the co-insurers of the Transferring Portfolio would not be materially adversely affected by the Scheme.

## **Reinsurers**

- 10.8 In addition, I have concluded that the reinsurers of the Transferring Portfolio would not be materially adversely affected by the Scheme.

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**Conclusion**

- 10.9 Given the above, I conclude that the risk of any group of policyholders, co-insurers or reinsurers being materially adversely affected by the Scheme is sufficiently remote that there is no reason why the Scheme should not proceed.
- 10.10 Please note that this conclusion is subject to the capital injection that I discuss in paragraph 3.8 being made.

*Simon Sheaf*

Simon Sheaf FIA

Partner and Head of General Insurance Actuarial & Risk

Grant Thornton UK LLP

# A Additional information received

## Information provided by or on behalf of AIUK

- AIUK UK GAAP balance sheet as at 30 June 2020
- AIUK Solvency II balance sheet as at 30 June 2020
- AIUK projected Solvency II balance sheet as at the Effective Date
- AIUK Investment Performance Summary Report for the month ended June 2020
- Actuarial Reserve Report – Q2 2020; Reserve Recommendation
- July 2020 Reserve Committee Papers
- EEA Regulators Comments on the Part VII Transfer
- Solvency II Quarterly Reporting Templates completed as at 30/06/2020
- Memo to the Board from Steven Loyens re. FCA Court Ruling Impact Assessment
- Standard & Poor Credit Ratings dated 28/08/2020

## Information provided by or on behalf of AIEU

- AIEU Irish GAAP balance sheet as at 30 June 2020
- AIEU Solvency II balance sheet as at 30 June 2020
- AIEU projected Solvency II balance sheet as at the Effective Date
- AIEU Actuarial Function Update 17/09/2020
- AIEU Q2 2020 QRT Review Meeting Minutes
- CBI Letter of Approval of approval of application for Retrospective Capital Contribution as Tier 1 Own Funds
- Capital contribution agreement between Arch Financial Holdings Europe II Limited and AIEU confirming an increased capital injection
- Letter from ARL to AIEU confirming the transfer of collateral for AIEU's liabilities under the IQS following the Scheme

## Information provided on behalf of both AIUK and AIEU

- Two emails, dated 30 November 2020 and 1 December 2020, summarising the results from AIUK's and AIEU's policyholder and reinsurer communications exercise

## Information provided by legal advisers

- Second Witness Statement of Hugh Robert Sturgess – Draft
- Second Witness Statement of Mark Nolan – Draft

## Other

I also relied on information arising from correspondence and discussions with AIUK, AIEU and their legal advisers.

I have checked that all of the above information has been supplied by persons appropriately qualified to provide such information and I am satisfied that it is reasonable for me to rely on this information.

A number of the items received are of a commercially sensitive or confidential nature. All relevant information received has been used to inform the conclusions given in this report while taking care to respect the confidentiality of the entities involved. It should be noted that in one instance I have omitted implications of this documentation from this report for the sake of respecting confidentiality. I have therefore produced a separate confidential note for the Court, the PRA and the FCA which includes these implications.

