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**Report of the Independent Expert on the proposed transfer of the Irish,  
French, German and Dutch branches of Travelers Insurance Company  
Limited to Travelers Insurance DAC**

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## 1. PURPOSE AND SCOPE

### PURPOSE OF THE REPORT

- 1.1 It is proposed that the Irish, French, German and Netherlands branch businesses of Travelers Insurance Company Limited (“TICL”), a UK-based company, be transferred to Travelers Insurance DAC<sup>1</sup> (“TIDAC”), a company based in Ireland, by an insurance business transfer scheme (the “Scheme”) as defined in Section 105 of the Financial Services and Markets Act 2000 (“FSMA”).
- 1.2 Section 109 of FSMA requires that an application to the High Court of Justice in England and Wales (the “Court”) for an order sanctioning an insurance business transfer scheme must be accompanied by a report on the terms of the transfer (the “FSMA Report”) by an independent person (“the Independent Expert”) having the skills necessary to make the report and who is nominated or approved by the Prudential Regulation Authority (“PRA”), having consulted with the Financial Conduct Authority (“FCA”). The FSMA Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.
- 1.3 TICL and TIDAC have nominated me to act as Independent Expert to provide the FSMA Report in respect of the Scheme, and the PRA has approved my appointment in consultation with the FCA (see paragraph 1.12 below).
- 1.4 This report (the “Report”) describes the proposed Scheme and discusses its possible effects on the policyholders of TICL (in respect of all business of TICL), including effects on security and levels of service. As such, the Report fulfils the requirements of the FSMA Report. I note that TIDAC presently carries on no trading activities, and therefore has no policyholders (and will not have any policyholders on the Effective Date unless the Transferring Business is transferred to TIDAC under the Scheme as outlined in paragraph 1.8 below).
- 1.5 TICL is domiciled and regulated in the UK, while TIDAC is domiciled and regulated in Ireland (subject to approval by the Central Bank of Ireland or “CBI”, which is expected in December 2018).
- 1.6 TICL is a direct subsidiary and TIDAC an indirect subsidiary of The Travelers Companies, Inc. (“Travelers”). In this Report I refer to Travelers and its direct and indirect subsidiaries collectively as the “Travelers Group”.
- 1.7 A list of terms defined in the Report is shown in Appendix A. Otherwise I use the same defined terms as are in the document that sets out the terms of the Scheme. Further, unless stated otherwise, the rates of exchange<sup>2</sup> used in the Report are £1.00 = \$1.35 = €1.13 (as at 31 December 2017).

#### The Proposed Scheme

- 1.8 In a national referendum held in June 2016, the UK voted to leave the EU (otherwise known as “Brexit”). Although the terms of Brexit, including any transitional arrangements, are still being negotiated by the UK and the EU members who will remain, there is a risk that those UK insurers (including TICL), who have hitherto been able to provide services to their policyholders elsewhere in the EEA through the UK’s membership of the EU, being unable to provide continuity of service to those policyholders post-Brexit. To mitigate this risk, the Travelers Group has decided to restructure its operations in Europe as follows:
  - Renewal of the business written by TICL’s freedom of establishment branch in Ireland with TIDAC, such renewal rights being transferred under the Scheme in respect of the Transferring Business (from the Effective Date – as described in paragraph 1.10 below);

<sup>1</sup> Note that TIDAC’s name, for the purpose of the application to the CBI is XYZ Risk DAC, and will be changed to TIDAC upon authorisation by the CBI.

<sup>2</sup> Source: Lloyd’s Market Bulletin Y5149, dated 2 January 2018.

- Transfers to TIDAC of the business written up until the Effective Date by TICL's freedom of establishment branch in Ireland; and the business written up until 2001 (and subsequently in run-off) by TICL's freedom of establishment branches in France, Germany and the Netherlands (collectively the "Transferring Business"), i.e. the Scheme.

- 1.9 Under the Scheme all of the Transferring Business and all of TICL's related liabilities and assets (including all external and intra-group reinsurance contracts protecting the Transferring Business) are to be transferred into TIDAC.
- 1.10 The date on which the Scheme is to be implemented (the "Effective Date") is expected to be 31 March 2019. The transfer under the Scheme is therefore intended to have the effect that all the liabilities and assets (including reinsurance) in relation to the Transferring Business (of TICL) will pass under the Scheme to TIDAC.
- 1.11 The business involved, the arrangements for the transfers and the effect of the transfers are discussed in more detail in Sections 3 to 10 of this Report.

## THE INDEPENDENT EXPERT

- 1.12 I, Gary Wells, have been appointed by TICL and TIDAC as the Independent Expert to consider the Scheme under Section 109 of FSMA. My appointment has been approved by the PRA in consultation with the FCA; this was confirmed in a letter dated 2 March 2018.
- 1.13 I am a Principal of Milliman LLP ("Milliman") and I am based in its UK General Insurance practice in London. I am a Fellow of the Institute and Faculty of Actuaries which was established in 2010 by the merger of the Institute of Actuaries and the Faculty of Actuaries. I became a Fellow of the Institute of Actuaries in 1986. My experience of general insurance includes the (reserved) roles as Chief Actuary (non-life including Lloyd's) and Signing Actuary to Irish non-life insurance companies, as well as acting as the Independent Expert in a number of insurance business transfer schemes. A list of previous schemes for which I have acted as independent expert under the terms of FSMA, and as an independent actuary under the Insurance Companies Act 1982, the legislation replaced by FSMA, can be found in Appendix B.
- 1.14 To the best of my knowledge I do not have, and have never had, any policies issued by any part of the Travelers Group, of which TICL and TIDAC are ultimately subsidiaries. I am not a shareholder of any entity that is part of the Travelers Group. I have undertaken no work for TIDAC or for TICL – save for acting as the Independent Expert for the proposed transfer of the French, German and the Netherlands branch business of TICL to an EU insurance entity. Travelers informed the PRA in September 2018 that the proposed transfer was suspended, because the aforesaid transferring business now forms part of the Scheme.
- 1.15 I note that Milliman is part of Milliman, Inc., a global consulting firm and, as such, Milliman Inc. practices have worked with parts of the Travelers Group on assignments globally. Milliman Inc.'s worldwide annual revenue in respect of the Travelers Group has not, however, exceeded 0.1% of the firm's total fee income over each of the last 5 years.
- 1.16 I do not believe that my involvement or that of other consultants within the Milliman Group with the Travelers Group subsidiaries affects my ability to act independently in my assessment of the Scheme.
- 1.17 The Scheme is subject to sanction by the Court under Section 111 of FSMA.
- 1.18 TICL will meet the costs of my work as Independent Expert. No costs of the Scheme will be borne by any of the policyholders of any of TICL and TIDAC.

## THE SCOPE OF MY REPORT

- 1.19 My terms of reference have been reviewed by the PRA and are set out in Appendix C.
- 1.20 I have considered the terms of the Scheme only and have not considered whether any other scheme or alternative arrangement might provide a more efficient or effective outcome. I note that Travelers considered a variety of arrangements so as to provide continuity of services to its policyholders in the EEA (excluding the UK) post-Brexit and concluded that implementation of the Scheme was the most effective way to address affairs.
- 1.21 The Report describes the Scheme and the likely effects on policyholders of TICL and proposed policyholders of TIDAC, including effects on security and levels of service.

- 1.22 The Report should be read in conjunction with the full terms of the Scheme.
- 1.23 My work has required an assessment of the liabilities of TICL and TIDAC for the purposes of describing the effect of the Scheme. My review of the liabilities was based on the actuarial reserve assessments conducted by internal and/or external actuaries of TICL and TIDAC. I have reviewed the methodology and assumptions used in their work and assessed the key areas of uncertainty in relation to these liabilities. I have not attempted to review in detail the calculations performed by the internal actuaries of TICL or TIDAC or to produce independent estimates of the liabilities.
- 1.24 In addition to the liabilities, I have assessed the appropriateness in nature and amount of any assets to be transferred under the Scheme, and the capital position of TICL and TIDAC pre and post Scheme. Again, I have not attempted to review in detail the calculations of the capital position performed by TICL or TIDAC or to produce independently my own estimates.
- 1.25 As far as I am aware, there are no matters which I have not taken into account in undertaking my assessment of the Scheme and in preparing the Report, but which nonetheless should be drawn to the attention of policyholders in their consideration of the Scheme.
- 1.26 In reporting on the Scheme as the Independent Expert, I recognise that I owe a duty to the Court to assist the Court on matters within my expertise. This duty overrides any obligation to TICL and / or to TIDAC. I confirm that I have complied with this duty.
- 1.27 I have taken account of the requirements regarding experts set out in Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Protocol for Instruction of Experts to give Evidence in Civil Claims.
- 1.28 I confirm that I have made clear which facts and matters referred to in the Report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.
- 1.29 Shortly before the date of the Court hearing at which an order sanctioning the Scheme will be sought, I will prepare a supplementary report (the "Supplemental Report") covering any relevant matters which might have arisen since the date of the Report.
- 1.30 It is intended that both this Report and the Supplemental Report will be published on the TICL website, on pages dedicated to the Scheme, and that copies of this Report and the Supplemental Report will be sent to any policyholders who request them. The Report will be made available in this way immediately following the directions hearing relating to the Scheme (or as soon thereafter that the dedicated pages on the TICL website has been set up) and the Supplemental Report will likewise be made available at least one week before the date of the final Court hearing.

## THE STRUCTURE OF MY REPORT

- 1.31 The remainder of the Report is set out as follows:
- Section 2: I provide an executive summary of the Report (I have also provided a separate summary of the Report as described in paragraph 1.39 below).
  - Sections 3 & 4: I provide some background information regarding the regulatory environments in which TICL and TIDAC (collectively, the "Companies") operate, and then regarding the Companies themselves.
  - Section 5: I summarise the key provisions of the Scheme.
  - Section 6: I consider the likely impact of the Scheme on those policyholders whom the Scheme would move from TICL to TIDAC.
  - Section 7: I consider the likely impact of the Scheme on the policyholders who would remain within TICL after the transfers have taken place.
  - Section 8: I cover more general issues relating to the Scheme and the management of TICL and TIDAC.

- Section 9: I summarise my conclusions.

## RELIANCES AND LIMITATIONS

- 1.32 In carrying out my review and producing the Report, I have relied, without detailed verification, upon the accuracy and completeness of the data and information provided to me, in both written and oral form, by TIDAC and TICL. I note that the data and information has been provided to me by PRA and FCA approved persons or other members of the senior management of TICL or by responsible professionals from TICL's advisors.
- 1.33 I have been assisted in my review of the information and my analyses by my colleagues at Milliman, but I have not relied on their work or their advice. Further, I have met in person or conducted conference calls with representatives of the Companies to discuss the information provided to me and specific matters arising out of the considerations and analysis conducted.
- 1.34 Reliance has been placed upon, but not limited to, the information detailed in Appendix D. My opinions depend on the substantial accuracy of this data, information and the underlying calculations. I am unaware of any issue that might cause me to doubt the accuracy of the data and other information provided to me. All information that I have requested in relation to my review has been provided.
- 1.35 I have also relied upon the draft witness statement made on behalf of TICL and TIDAC that confirm all information that has been provided to me by the Companies is correct and complete in all material aspects; and there has been no material adverse change to the financial position of the Companies since that information was provided to me.
- 1.36 The Report has been prepared for the purposes of the Scheme in accordance with Section 109 of FSMA. A copy of the Report will be sent to the FCA and PRA, and will accompany the Scheme application to the Court.
- 1.37 The Report must be considered in its entirety as individual sections, if considered in isolation, may be misconstrued.
- 1.38 Neither the Report, nor any extract from it, may be published without me having provided my specific written consent, save that copies of the Report may be made available for inspection by policyholders and by the financial regulatory authorities in Ireland (the CBI), and copies may be provided to any person requesting the same in accordance with legal requirements. I also consent to the Report being made available on the TICL website, on pages dedicated to the Scheme.
- 1.39 No summary of the Report may be made without my express consent. I will provide a summary of the Report (the "IE Summary") for inclusion in a document (the "Policyholder Statement") that will be made available to the policyholders of TICL, to the reinsurers of TICL, and to others affected, e.g. anyone with an interest in the policies being transferred who has notified TICL or TIDAC of their interest. That document will be sent to the FCA and PRA, will accompany the Scheme application to the Court, will be available for inspection by the CBI, and will be available on the TICL website, on pages dedicated to the Scheme.
- 1.40 The Report has been prepared within the context of the assessment of the terms of the Scheme, and must not be relied upon for any other purpose. No liability will be accepted by Milliman, or me, for any application of the Report to a purpose for which it was not intended or for the results of any misunderstanding by any user of any aspect of the Report. In particular, no liability will be accepted by Milliman or me under the terms of the Contracts (Rights of Third Parties) Act 1999, as may be amended from time to time.
- 1.41 Actuarial estimates are subject to uncertainty from various sources, including changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, economic and investment conditions. Therefore, it should be expected that the actual emergence of claims, premiums, expenses and investment income will vary from any estimate. Such variations in experience could have a significant effect on the results and conclusions of the Report. No warranty is given by Milliman or me that the assumptions, results and conclusions on which the Report is based will be reflected in actual future experience.
- 1.42 This review does not comprise an audit of the financial resources and liabilities of TICL or TIDAC.
- 1.43 The Report should not be construed as investment advice.

- 1.44 Nothing in the Report should be regarded as providing a legal opinion on the effectiveness of the Scheme. For the avoidance of doubt, where I have repeated the legal opinion of external lawyers, these are lawyers of the parties to the proposed Scheme and, while the contents of such legal opinion has informed my view, I am not expressing a personal legal opinion.
- 1.45 At the date of the Report, I am not aware of any material changes in circumstances of TICL since 31 December 2017 (the date of TICL's most recent audited financial statements) other than those referred to in the Report. The Report also takes no account of any information that I have not received, or of any inaccuracies in the information provided to me. I will review all further audited financial statements as at 31 December 2017 and other financial updates of TICL and TIDAC as and when they become available, and will comment (as appropriate) on this information in my Supplemental Report.
- 1.46 I have relied on the currency exchange rates found in the financial statements and in other information provided. Unless otherwise stated the rates of exchange used are as set out in paragraph 1.6 above.
- 1.47 The Report has been seen by TICL (i.e. by PRA and FCA approved persons or other members of the senior management of TICL and by responsible professionals from TICL's advisors) and TICL has agreed it is correct in terms of all factual elements of the Scheme. Likewise, the Report has been seen by TIDAC (i.e. by persons to be approved by the CBI or other members of the proposed senior management of TIDAC and by responsible professionals from TIDAC's advisors) and TIDAC has agreed it is correct in terms of all factual elements of the Scheme.
- 1.48 The use of Milliman's name, trademarks or service marks, or reference to Milliman directly or indirectly in any media release, public announcement or public disclosure, including in any promotional or marketing materials, websites or business presentations, is not authorised without Milliman's prior written consent for each such use or release, which consent shall be given in Milliman's sole discretion.

## PROFESSIONAL AND REGULATORY GUIDANCE

- 1.49 I am required to comply with relevant professional standards and guidance maintained by the Financial Reporting Council ("FRC") and by the Institute and Faculty of Actuaries, including *TAS 100: Principles for Technical Actuarial Work* and *TAS 200: Insurance*. I confirm that I have complied with such standards, subject to the principles of proportionality and materiality.
- 1.50 In accordance with Actuarial Profession Standard ("APS") X2, as issued by the Institute and Faculty of Actuaries, I have considered whether this Report should be subject to review ("Work Review"). I concluded that it should and I have also decided that the Work Review should be conducted by an individual who has not otherwise been involved in the analysis underlying this Report or in the preparation of the Report, but who would have had the appropriate experience and expertise to take responsibility for the work himself. In other words I have decided that the Report should be subject to Independent Peer Review. I confirm that this Report has been subject to Independent Peer Review prior to its publication.
- 1.51 The Report has been prepared under the terms of the guidance set out in the Statement of Policy entitled *The Prudential Regulation Authority's approach to insurance business transfers* (the "Policy Statement"), issued in April 2015 (see Appendix E), in Section 18 of the FCA Supervision Manual ("SUP18") contained in the Handbook of Rules and Guidance to cover scheme reports on the transfer of insurance business. In addition, in completing the Report I have considered the FCA's finalised guidance on its approach to the review of Part VII insurance business transfers (published in FCA document FG18/4, issued in May 2018).

## 2. EXECUTIVE SUMMARY

### CONCLUSION

- 2.1 In my opinion:
- The security of benefits to policyholders of TICL and TIDAC will not be materially adversely affected by the implementation of the Scheme (in conjunction with the Reinsurance Contracts – see paragraph 2.6 below) on the Effective Date; and
  - The Scheme (in conjunction with the Reinsurance Contracts) will not materially adversely impact on the service standards experienced by the policyholders of TICL and TIDAC.
- 2.2 I have explained in Appendix F what I mean by “materially adversely” and how I have evaluated whether I would consider something to be “materially adverse”.
- 2.3 I summarise below the key aspects of the Scheme, the aspects of the Scheme that I considered, and the conclusions that I reached in respect of those aspects.
- 2.4 I will review my analyses and conclusions in the light of any relevant information of which I become aware prior to the Court hearing to sanction the Scheme, and I will summarise my additional review and conclusions, explaining any revisions to those contained within this Report, in a Supplemental Report.

### THE SCHEME

- 2.5 Under the Scheme, the Transferring Business together with all associated rights, benefits, powers and liabilities, in concert with the transferring assets (including reinsurances, modified as described in paragraph 2.20 below, together with any security arrangements or letters of credit which have been arranged by the relevant reinsurers for the benefit of TICL), will be transferred to TIDAC from TICL.
- 2.6 Pre-Scheme, TIDAC is to purchase two reinsurance contracts from TICL (together the “Reinsurance Contracts”) each expressed to come into force on the Effective Date:
- an 80% whole account quota share reinsurance arrangement in respect of the Transferring Business and the prospective underwriting of TIDAC. Further, in order to protect the position of the Transferring Policyholders and prospective business written by TIDAC from the risk of default by TICL, the assets associated with the 80% whole account quota share reinsurance of TIDAC by TICL will be held by TIDAC in a designated collateral account; and
  - a stop-loss reinsurance arrangement to protect TIDAC’s compliance with its regulatory capital requirements. Specifically, the stop-loss cover will trigger if the ‘Negative Change’ in TIDAC’s Own Funds available to meet the solvency requirements under Solvency II is greater than €10.9 million with a limit of recovery up to €10.0 million.

### Motivation for the Scheme

- 2.7 The vote by the UK to leave the EU (i.e. Brexit) puts TICL at risk of being unable to provide continuity of service to those of its customers with insurable interests in the EEA. As a result, Travelers has started the process of establishing a new insurance company in Ireland (i.e. TIDAC) in order to continue to provide admitted insurance services to those customers on or after the Effective Date.
- 2.8 In order that the remaining EEA (excluding UK) insurance business of TICL is moved to TIDAC, the Scheme needs to be implemented, subject to the Court’s consent, on the Effective Date.
- 2.9 The proposed Scheme is therefore part of an internal reorganisation of the Travelers Group, that enables Travelers to continue to provide policy servicing, administration, claims management and handling, and underwrite EEA (excluding UK) business and UK and non-EEA business, as well as to ensure compliance with EEA laws and regulations following the departure of the UK from the EU.

## Policyholders Affected

2.10 I have considered the effects of the Scheme on the following two groups of policyholders<sup>3</sup> (noting that TIDAC will not have any policyholders prior to the implementation of the Scheme):

- those holders of policies issued by TICL through its branches in Ireland, France, Germany or the Netherlands – the “Transferring Policyholders”. I note that the holders of policies issued by TICL through its branch in Ireland consist of ‘live’ policies (i.e. with unexpired exposures) and policies in ‘run-off’ (i.e. whose policy term has expired, but have unsettled claims and/or need to meet claims that may occur during the policy period irrespective of when the claim is made); and the holders of policies issued through its French, German or Dutch branches consist of ‘run-off’ policies only;
- the current policyholders of TICL who have policies that are not being transferred – the “Non-Transferring Policyholders”.

2.11 In relation to the two groups of policyholders identified in paragraph 2.10 above I have, where necessary, also considered a split on a more granular basis, in particular:

- Policyholders<sup>4</sup> eligible for protection under the Financial Services Compensation Scheme (“FSCS”) and/or eligible for dispute resolution services provided by the Financial Ombudsman Service (“FOS”). Some of the SME business of the Companies is protected under the FSCS. Policyholders eligible for protection under the FSCS will receive at least 90% of any claim incurred in the unlikely event of the insolvency of TICL or TIDAC (as appropriate). While the Scheme is not anticipated to change eligible policyholders access to the FSCS (as explained herein) policyholders not covered under the FSCS may have less security than those covered under the FSCS and I comment herein on the impact within each of the Companies. In a similar manner, some of the SME business of the Companies is eligible for dispute resolution services as provided by the FOS. While the Scheme is not anticipated to change eligible policyholders access to the FOS (as explained herein) policyholders not covered under the FOS may have less access to adequate complaint handling procedures and I comment herein on the impact within each of the Companies; and
- Direct and Assumed Reinsurance policyholders – under the laws of both the UK and Ireland, inwards (or assumed) reinsurance policyholders rank behind direct policyholders in the event of insolvency. This means that, in the unlikely event that TICL or TIDAC is declared insolvent, all valid direct policyholders’ claims will be paid in full before any inwards reinsurance policyholders’ claims start to be paid. Direct and Assumed Reinsurance policyholders therefore have different rights and need to be considered separately.

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<sup>3</sup> Travelers broadly estimates, based on information available to it, that Transferring Policyholders comprise approximately 5,766 “live” Irish policyholders. However, due to the age and nature of records kept with respect to the “back book” of the Irish branch and the other EEA branches (which have been in run-off for several years) Travelers is unable to confirm the numbers of policyholders (but if one assumes that each policyholder equates to one policy it may be in the region of 750,000 policyholders).

<sup>4</sup> Travelers broadly estimates that the proportion of the Transferring Policyholders that are eligible for protection by FSCS is likely to be over 90%. Additionally, Travelers broadly estimates that the proportion of the Transferring Policyholders that are eligible for protection under FOS is likely to be negligible. This takes account of the fact that the vast majority of the Transferring Business is EEA branch business, which is locally brokered and administered, would be subject to local conduct rules and any disputes would be within the ambit of the local dispute mechanisms, e.g. there have been very few complaints made to the FPSO (the Irish body providing a similar service to the FOS in the UK) as noted in paragraph 6.109 below.

## Administration

- 2.12 The Scheme is primarily a legal and financial reorganisation of the EEA businesses operating under the Travelers brand and will not result in any significant changes to the administration of TICL or TIDAC businesses. Nonetheless, I note that TIDAC plans to establish a UK branch (initially on a Freedom of Establishment basis). TIDAC also plans to apply to the PRA for direct authorisation of the UK branch, so that (even assuming that passport rights will cease to apply after the UK leaves the EU) the PRA/FCA will directly regulate TIDAC's UK branch. As such, policies that involve exposures across the UK and other parts of the EEA can be serviced if needed in the UK. If, for whatever reason, approval of a UK (third country) branch by the PRA/FCA is not forthcoming on or before the UK finally leaving the EU single market, then any insurance activities taking place in the UK will be administered by TIDAC's offices outside the UK (as, subject to my comments in paragraph 5.35 below, there is no UK legal requirement for UK risks to be serviced in the UK).

## THE IMPACT OF THE SCHEME UPON THE TRANSFERRING POLICYHOLDERS

- 2.13 I am satisfied that the proposed Scheme (in conjunction with the Reinsurance Contracts) does not affect in a materially adverse way either the security or the policy servicing levels of the Transferring Policyholders. I have reached this conclusion by considering:
- 2.13.1 the reserves of the Companies as at 31 December 2017 (and subsequently where available);
  - 2.13.2 the excess assets of the Companies as at 31 December 2017 (and subsequently where available);
  - 2.13.3 the Reinsurance Contracts purchased by TIDAC from TICL;
  - 2.13.4 the guarantees provided to the Companies pre- and post-Scheme;
  - 2.13.5 the risk exposures in the Companies and the impact that the Scheme might have on those; and
  - 2.13.6 the impact of the Scheme on non-financial aspects (e.g. standards of policy servicing in each of the Companies).
- 2.14 I concluded that:
- 2.14.1 the reserves of TICL appeared reasonable as at 31 December 2017;
  - 2.14.2 TIDAC is expected to be reasonably reserved from the Effective Date as it will follow TICL's reserving policy for the Irish branch business (and that adopted for the Dutch, German and French branches of TICL);
  - 2.14.3 there is no reason to think that the reserve strength of TICL or TIDAC will be impacted by the Scheme;
  - 2.14.4 as at 31 December 2017, TICL is a more than sufficiently capitalised company (I have defined this term in paragraph 6.5 below);
  - 2.14.5 as at the Effective Date (of the Scheme), TICL is forecast to be a well-capitalised company (I have defined this term in paragraph 6.5 below) and is forecast to continue to be a well-capitalised company over the (post-Scheme) forward looking (projection) period (2019 -2021);
  - 2.14.6 as at the Effective Date (of the Scheme), TIDAC is forecast to be a more than sufficiently capitalised company (close to the boundary of well-capitalised) allowing for the reinsurance arrangements outlined in paragraph 2.6 above, and is forecast to continue to be a more than sufficiently capitalised company (close to the boundary of well-capitalised) allowing for the reinsurance arrangements outlined in paragraph 2.6 above, over the (post-Scheme) forward looking (projection) period (2019 -2021);
  - 2.14.7 the holders of the Transferring Policies will not be materially adversely affected due to relative differences in the financial strength of TICL pre-Scheme to that of TIDAC post-Scheme (as outlined in sub-paragraphs 2.14.5 and 2.14.6 above);
  - 2.14.8 for the holders of the Transferring Policies (all of whom are Direct Policyholders) moving to TIDAC under the Scheme:

- the additional security (over and above the capital resources held within TICL) that (pre-Scheme) they enjoy under the SPFMG (see paragraph 2.17 below) is assumed to cease on and from the Effective Date (as the SPFMG applies to TICL). However, such policyholders (and all new/renewed policyholders underwritten by TIDAC) will indirectly enjoy the additional security (over and above the capital resources held within TIDAC) provided under the SPFMG post-Scheme to the extent of 80% of the risk via the proposed whole account quota share reinsurance arrangement (to be entered into by TIDAC and TICL, see paragraph 2.6 above) that benefits directly from the SPFMG, because it is a reinsurance policy issued by TICL and thus is within the scope of the SPFMG;
- they will enjoy the additional security (over and above the capital resources held within TIDAC) provided via the stop-loss reinsurance arrangement to be entered into by TIDAC and TICL (see paragraph 2.6 above) that will become operative on and from the Effective Date, and will benefit indirectly from the SPFMG, because it is a reinsurance policy issued by TICL and thus is within the scope of the SPFMG; and
- that pre-Scheme were eligible for FSCS protection and/or eligible for dispute resolution services provided by the FOS are not expected to undergo any change in access to these bodies<sup>5</sup> as a result of the Scheme (essentially because TIDAC plans to operate with a UK branch as outlined in paragraph 2.12 above). Nevertheless, if such policyholders lose access to the FSCS from the Effective Date, as TIDAC is forecast to be a more than sufficiently capitalised company (close to the boundary of well-capitalised), its insolvency appears to be only a remote possibility and so a call on the protection provided by the FSCS likewise appears remote. Therefore, were policyholders to lose access to the FSCS from the Effective Date, I consider the impact on them to be not material. As mentioned above, policyholders access to the FOS is not expected to be impacted by the Scheme (as explained more fully herein). Nonetheless, if policyholders lose access to the FOS from the Effective Date then they may be able to have their complaints heard by other local dispute schemes such as the Ireland ombudsman service.

2.14.9 although the proposed Scheme will lead to a change to the risk exposures of the holders of the Transferring Policies, this will not have a materially adverse impact on the security of policyholder benefits; and

2.14.10 the proposed Scheme will not result in any significant changes to the standards of policy servicing experienced by holders of the Transferring Policies compared to their current position.

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

2.15 I have concluded that the Scheme will have negligible impact on those policyholders remaining within TICL.

2.16 In reaching this conclusion, I have noted that the effect of moving the Transferring Business out of TICL (in conjunction with the whole account quota share arrangements) is projected to represent a small part of TICL's portfolio at the Effective Date (i.e. around 4% of the expected net Technical Provisions, or circa £27 million, as at 31 December 2018). The proposed Scheme will therefore result in a small decrease to the liabilities of TICL and with a *de minimis* net effect on the capital (and regulatory capital position) of TICL. Further, the policy servicing of the non-transferring business of TICL will be unchanged by the proposed Scheme.

2.17 I also note that for the Non-Transferring Policyholders, the additional security (over and above the capital resources held within TICL) they enjoy under the guarantee provided by St. Paul Fire & Marine Insurance Company ("SPF&M") to TICL (i.e. the SPFMG, as outlined in paragraph 4.50 below) will continue on and from the Effective Date.

<sup>5</sup> I note the proposed continuation of FSCS protection in accordance with the PRA consultation document (CP26/18) for eligible customers whose policies are transferred for the period between the Effective Date and the date that the UK finally leaves the single market.

- 2.18 Furthermore, the holders of the Non-Transferring Policies that pre-Scheme were eligible for FSCS protection and/or eligible for dispute resolution services provided by the FOS will not undergo any change in access to either of these bodies as a result of the Scheme.

#### THE IMPACT OF THE SCHEME UPON REINSURERS AND INDEMNITORS OF TICL

- 2.19 The SPFMG provided (by SPF&M) to TICL (pre-Scheme) will continue to operate with no change to the terms and conditions post-Scheme. There will be a small reduction in the amount of business covered by the SPFMG post-Scheme as only 80% of the business comprising the Transferring Business (and that written post-Scheme by TIDAC) will be reinsured by TICL (via the 80% whole account quota share reinsurance arrangement) and therefore be indirectly covered under the SPFMG (because the Reinsurance Contracts are policies issued by TICL and thereby are within the scope of the SPFMG). Accordingly, SPF&M will experience no material change to its guarantee of the business written by TICL.
- 2.20 Travelers intends to modify certain outwards reinsurance contracts that currently provide reinsurance protection to the business written by TICL by adding TIDAC as a named insured on any intra-group treaties, and on relevant treaties with external reinsurers. This means that Travelers intends to reach agreement with each reinsurer that the reinsurance that they provide will continue to apply to the Transferring Business moving to TIDAC. Furthermore, after the modification of reinsurance is completed there would be no material change to the reinsurance protecting the Non-Transferring Business, because the risk profiles of the transferring/modified reinsurance treaties will not be changed as a result of the Scheme.
- 2.21 I am informed that Travelers has already reached an internal agreement in principle to proceed with modifications with those reinsurers of TICL that are part of the Travelers Group. There are a number of reinsurers of TICL external to the Travelers Group, and Travelers is currently carrying out a project to identify such reinsurance contracts of TICL and to reach agreement with the providers of those contracts by 1 March 2019. I anticipate providing an update on the progress made by TICL in achieving these modifications in my Supplemental Report.
- 2.22 I am informed by Travelers that all necessary modifications of both internal and external reinsurance treaties of TICL are expected to be completed by 1 March 2019 (i.e. prior to the Effective Date).

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

- 2.23 I have been informed by Travelers that, based on specialist tax advice that it has received, the Scheme is not expected to have tax implications that would affect any of the Companies or any of the groups of policyholders identified in paragraph 2.10 above. I have not identified any reasons for a material tax liability to be incurred and, on that basis, I have no reason to disagree with the conclusion reached by Travelers that there are no material tax implications as a result of the Scheme.
- 2.24 TICL has provided me with an estimate of the external costs of the Scheme, and while these costs are not insubstantial, they are one-off in nature and not material in the context of the available capital of TICL as at 31 December 2017 (and as forecast over the period 2018 – 2021). I therefore consider it unlikely that the costs of the Scheme will be such as to jeopardise the security of any of the groups of policyholders.

#### APPROACH TO COMMUNICATION WITH POLICYHOLDERS

- 2.25 The Companies intend to communicate details of the Scheme to their policyholders. I have set out my understanding of the proposed approach to communicating the Scheme to policyholders in Section 9.
- 2.26 When evaluating the proposed approach to communicating the Scheme to policyholders, I have considered a number of factors, including whether the policyholders in TICL or TIDAC are likely to be interested in being informed of the proposed Scheme. In this context, I believe that the approach to policyholder notifications needs to consider the likelihood of a policyholder having a claim, whether the policyholder's policy is transferring and the impact of the Scheme on security. I have therefore weighed these issues up against the risk of policyholder notifications causing confusion or annoyance in relation to an issue that policyholders may consider to be insignificant, and the practicability of notifying policyholders.

- 2.27 I consider the proposed approach to communicating the Scheme to be appropriate, reasonable and proportionate, but note and accept that the Court is the final arbiter on this issue. If the aforesaid proposed approach is amended, I will comment on whether there are any consequential changes to my conclusions in my Supplemental Report.

## KEY ASSUMPTIONS

- 2.28 In conducting my analysis I have made the following key assumptions:
- 2.28.1 TIDAC will be authorised by the CBI to write (re)insurance business by the Effective Date, and can therefore accept the business moving to it under the Scheme on the Effective Date (expected to be 31 March 2019). If I am able, I will confirm to the Court in my Supplemental Report that TIDAC has received its authorisation from the CBI (which is expected in December 2018);
  - 2.28.2 TIDAC will have set up a branch in the UK (on a Freedom of Establishment basis) from the Effective Date as approved by the CBI (and the host country regulators). If I am able, I will confirm to the Court in my Supplemental Report that TIDAC has received all of the necessary permissions required to conduct business in its UK branch (formed on a Freedom of Establishment basis);
  - 2.28.3 TIDAC will have established, if necessary, a third country branch in the UK, subject to approval from the PRA, on or before end of the Brexit Transition Period or expiry of any temporary permissions regime. I do not anticipate that TIDAC will have received the necessary permissions and hence authorisation of its UK branch (established on a third country basis) at the time I complete my Supplemental Report;
  - 2.28.4 TIDAC (once authorised) will have purchased from TICL: (1) an 80% whole account quota share reinsurance arrangement (expressed to take effect on the Effective Date) in respect of the Transferring Business (and the prospective underwriting of TIDAC) – the assets associated with this reinsurance arrangement are to be held in a designated collateral account by TIDAC; and (2) a stop-loss reinsurance arrangement (expressed to take effect on the Effective Date) to protect TIDAC's compliance with its regulatory capital requirements. If I am able, I will confirm to the Court in my Supplemental Report that TICL and TIDAC have entered into the aforesaid reinsurance arrangements (including, as appropriate, the designated collateral account);
  - 2.28.5 it is not planned that there will be an increase in the aggregate liability or risk exposures in the Companies as an immediate consequence of the Scheme that would not have occurred were the Scheme not to proceed;
  - 2.28.6 the same level of assets and liabilities will exist in the Companies in aggregate after the Scheme as before the Scheme (when valued on the same accounting basis before and after);
  - 2.28.7 all the necessary modifications (as described above) of both internal and external reinsurance treaties of TICL are completed prior to the Effective Date. I anticipate providing an update on the progress made by TICL in achieving these modifications in my Supplemental Report;
  - 2.28.8 no significant additional tax liabilities will arise as a result of the Scheme for any of the Companies;
  - 2.28.9 TICL (and, when authorised, TIDAC) have no current intention to cease underwriting or carry out further restructuring of their businesses as a result of the Scheme (save as referred to in paragraph 8.23 below);
  - 2.28.10 the risk of the whole of the Travelers Group getting into major financial difficulties is suitably remote (and I have not therefore analysed this risk in detail), because Travelers has a very high financial strength rating given by the two major credit rating agencies, S&P and A.M. Best; and this is a contingency to which the Policyholders Affected are already exposed (and, is not, in my view materially changed as a result of the Scheme); and
  - 2.28.11 while the Scheme allows for Excluded Policies, none are expected at this time, and any Excluded Policies would be known before the date of the final Court hearing. In the event that such policies are identified I will address them in a Supplemental Report.

2.29 The above assumptions underlie the analysis and conclusions in my Report. If these assumptions were to change, my opinion may also change. At the time of writing my Report, the above assumptions are the current intentions for the Scheme and the Companies, as informed to me by Travelers.

### 3. BACKGROUND REGARDING THE REGULATORY ENVIRONMENTS

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

#### OVERVIEW OF THE UK INSURANCE MARKET

##### Background

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

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

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

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

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

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

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

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

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

##### Taxation

3.8 In the UK, general insurance companies are taxed on profits achieved at the main rate of corporation tax (currently 19%<sup>6</sup> for the financial year ending 31 March 2018).

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<sup>6</sup> The UK Corporation Tax rate is expected to reduce to 17% with effect from 1 April 2020.

### Financial Services Compensation Scheme

3.9 As well as through the PRA and FCA regulations, consumer protection is also provided by the FSCS. This is a statutory “fund of last resort” which compensates customers in the event of the insolvency (or other defined default) of a financial services firm authorised by the PRA or FCA, subject to certain eligibility rules. Insurance protection exists for private policyholders and small businesses<sup>7</sup> that hold eligible policies in the situation when an insurer is unable to meet fully its liabilities. For general insurance business, the FSCS will pay 100% of any claim incurred before the default:

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

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

### Financial Ombudsman Service

3.10 The FOS provides private individuals (and micro enterprises<sup>8</sup>) with a free, independent service for resolving disputes with financial companies. It is not necessary for the private individual (or micro enterprise) to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the FOS; it is necessary for the insurance policy concerned to be, or have been, administered from within the UK.

### FCA Conduct Principles

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

- Outcome 1: Consumers can be confident that they are dealing with insurers where the fair treatment of customers is central to the corporate culture;
- Outcome 2: Products and services marketed and sold in the retail market are designed to meet the needs of identified consumer groups and are targeted accordingly;
- Outcome 3: Consumers are provided with clear information and are kept appropriately informed before, during and after the point of sale;
- Outcome 4: Where consumers receive advice, the advice is suitable and takes account of their circumstances;
- Outcome 5: Consumers are provided with products that perform as insurers have led them to expect, and the associated service is both of an acceptable standard and as they have been led to expect; and
- Outcome 6: Consumers do not face unreasonable post-sale barriers imposed by insurers to change product, switch provider, submit a claim or make a complaint.

<sup>7</sup> In accordance with Section 382 of the Companies Act 2006, a small business is defined as one for which two of the following three conditions apply over the preceding financial year: turnover not more than £10.2 million; balance sheet not more than £5.1 million; and not more than 50 employees.

<sup>8</sup> Micro-enterprises (an EU term covering smaller businesses) can bring complaints to the FOS as long as they have an annual turnover of less than €2 million and fewer than ten employees.

- 3.12 These principles, which are often summarised as “Treating Customers Fairly” (“TCF”), apply even for firms that do not have direct contact with retail customers. The FCA’s rationale is that risks and poor conduct can be carried from wholesale to retail markets.
- 3.13 The UK (like all other European Union (“EU”) Member States) will also be obliged to implement the Insurance Distribution Directive (see paragraph 3.20 below) by 1 October 2018 (following transposition into local regulations/laws by 1 July 2018).

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

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

## **OVERVIEW OF THE IRISH INSURANCE MARKET**

### **Background**

- 3.15 Ireland is a relatively small country with a population of around 4.6 million (less than 8% of the UK’s). In addition to servicing the domestic market, Ireland’s insurance industry is also focused on distributing products under the EU freedom to provide services rules, with numerous international insurers and insurance captives domiciled in Ireland. In 2016 total gross insurance premiums written in Ireland amounted to €12.9bn. Around €3.3bn (or 25%) of these premiums related to non-life insurance business<sup>9</sup>. As of 2016, there were 227 life and non-life insurance companies operating in Ireland.
- 3.16 Ireland’s insurance regulator is the CBI. The CBI has wide-ranging responsibilities across monetary policy, financial stability, financial regulation and consumer protection.
- 3.17 The CBI’s Insurance Supervision Directorate is responsible for the prudential supervision of insurance and reinsurance undertakings authorised in Ireland. In carrying out this role, the Insurance Supervision Directorate monitors the risks posed by undertakings along with issuing standards, policies and guidance that undertakings are expected to meet.
- 3.18 The Consumer Protection Directorate of the CBI has a role in ensuring that the best interests of consumers of financial services are protected. Its objective is to have a financial services industry where consumers’ interests are protected. This means that:
- consumers should be provided with clear, relevant and accurate information, including on cost, during the sales process;
  - consumers should be recommended a product/service appropriate to their needs and suitable for them; and
  - consumers should receive a high standard of follow-up services, e.g. making a claim, making a complaint, switching product, dealing with errors, policy renewals, follow-up advice on investments/pensions, etc.
- 3.19 The CBI also requires all insurance companies in Ireland to appoint a Head of Actuarial Function (“HoAF”) who must assess the company’s Technical Provisions on an annual basis and issue an Actuarial Opinion on those Technical Provisions (for further details see paragraph 3.44 below).

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<sup>9</sup> <https://www.insuranceireland.eu/media/Factfile%202016-Final.pdf>

## Conduct Principles

- 3.20 On 20 January 2016, the Council of the EU issued Directive (EU) 2016/97, the Insurance Distribution Directive (the “IDD”), applies in Ireland (and all other EU Member States) from 01 October 2018 (following transposition into local laws by 1 July 2018).
- 3.21 The key requirements of the IDD are:
- Product oversight and governance arrangements (“POG”) aimed at ensuring customers’ interests are taken into consideration throughout the whole life cycle of an insurance product;
  - Transparency of inducement schemes aimed at ensuring respect of customers’ interests;
  - The insurance undertaking (or insurance intermediary) providing advice to a customer is responsible for the assessment as to whether the insurance product(s) is/are suitable and appropriate having regard to the customer’s profile; and
  - A conflict of interest policy to facilitate customers’ understanding of an insurance undertaking’s actions taken on their behalf.
- 3.22 Business carried-on through a branch is subject to the conduct of business regulations, including consumer protection rules, of the host country of each respective branch. The regulator in the country hosting each branch oversees the compliance of that branch with its insurance laws and regulations, implementing, *inter alia*, the relevant EU Directives.

## Consumer Protection

- 3.23 In Ireland, consumer protection is provided by the Insurance Compensation Fund (the “ICF”) that is primarily designed to facilitate payments to policyholders in relation to risks in Ireland where an Irish authorised non-life insurer goes into liquidation or administration. In such circumstances, not all policyholder liabilities are covered and exclusions include health, dental and life policies. The ICF operates a limit on the available compensation – in the case of liquidation the limit is set at 65% of the sum due to the policyholder or €825,000, whichever is less.

## Dispute Resolution

- 3.24 In 2017, the Irish government decided to merge the offices of the Financial Services Ombudsman's Bureau (“IFSO”) and the Office of the Pensions Ombudsman to form the Financial Services and Pensions Ombudsman (“FSPO”). The FSPO was established by the Financial Services and Pensions Ombudsman Act 2017 and opened for business on 1 January 2018. The FSPO is a statutory body (funded by levies on financial services providers and by a grant from the Irish government) that deals independently with unresolved complaints from consumers about their individual dealings with all financial service providers. It is a free service to complainants. It is applicable to personal customers of financial services providers, as well as limited companies, charities, clubs, trusts and partnerships with turnovers of less than €3 million. Where the provider operates on a “Freedom of Services” basis and its head office is based in another EU country, the complaint will be referred to an alternative service such as the FOS in the UK (see above). However, where there is no such satisfactory means of redress the complaint will remain within the jurisdiction of the FSPO. The FSPO may pay maximum compensation of up to €250,000 or €26,000 per annum in the case of an annuity.
- 3.25 Further, where an entity based in Ireland operates in other EEA territories (in whole or part) on a Freedom of Establishment (“FoE”) basis, policyholders of that entity may be eligible to make complaints via the host state regulator or other organisation in the country in which their respective branch is located.

## Winding-up legislation

- 3.26 My understanding is that in the event of the winding-up of an insurance company under Ireland regulations, insurance claims take absolute precedence over any other claim on the insurer, with respect to assets representing the Technical Provisions (subject to certain rules). Therefore, direct insurance creditors rank ahead of inwards reinsurance creditors and all other unsecured/non-preferential creditors in the event that an insurer is wound-up.
- 3.27 The comparative position of policyholders in a UK insurer versus policyholders in a Ireland insurer in a winding-up situation is therefore a function of the assets available (and their size relative to the Technical Provisions) and the proportion of inwards reinsurance business relative to direct business.

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## SOLVENCY CAPITAL FRAMEWORK (SOLVENCY II)

- 3.28 The current regulatory solvency and reporting requirements for (re)insurers regulated within the EU came in to effect from 1 January 2016. The regime, which is commonly referred to as Solvency II, has introduced, consistently across the EU, solvency requirements that reflect the risks that individual (re)insurers actually face.
- 3.29 Under Solvency II, EU (re)insurers are now required to adhere to a set of risk-based capital requirements, some of the results of which will be shared with the public.
- 3.30 Solvency II is a principles-based regime, based on three so-called pillars:
- Under Pillar I, quantitative requirements define a market consistent framework for valuing the company's assets and liabilities, and determining the Solvency Capital Requirement ("SCR").
  - Under Pillar II, insurers must meet minimum standards for their corporate governance, and also for their risk and capital management. There is a requirement for permanent internal audit and actuarial functions. Insurers must regularly complete an Own Risk and Solvency Assessment ("ORSA").
  - Under Pillar III, there are explicit requirements governing disclosures to supervisors and policyholders.
- 3.31 A key change under Solvency II, compared to GAAP, is that the liabilities are valued on a market consistent basis, which gives rise to a number of differences in the determination of Technical Provisions (as discussed in paragraph 3.33 below).
- 3.32 I set out in Appendix G simplified details for the balance sheet, and the calculation of Technical Provisions (in respect of claims incurred and losses arising from unexpired exposures), for an insurer under Solvency II.
- 3.33 The Technical Provisions required under Solvency II as relating to general insurance business are:
- the premium provision – the expected present value (with no allowance for optimism or prudence) of all future cash-flows (claim payments, expenses and future premiums due) relating to future exposures arising from policies that the insurer is obligated to at the valuation date;
  - the claims provision – the expected present value (with no allowance for optimism or prudence) of all future cash-flows (claim payments, expenses and future premiums due) relating to claim events prior to the valuation date; and
  - the risk margin – the risk margin is intended to be the balance that another (re)insurer taking on the liabilities at the valuation date would require over and above the sum of the premium provision and claims provision. Under Solvency II, the risk margin is calculated using a cost-of-capital approach (presently employing a 6% cost of capital parameter as set out in EU regulation<sup>10</sup>).
- 3.34 The Technical Provisions in respect of claims required under Solvency II differ from the GAAP claims reserves as follows:
- The Technical Provisions contain no element of conservatism above a best estimate that may be held in the undiscounted GAAP reserves;
  - The Technical Provisions include an allowance for events not in data ("ENID"), which are events or future developments that might occur but which are not represented in the historical data upon which the actuarial projections are based;
  - The Technical Provisions include a discount to account for the time value of money in the future cashflows; and
  - The Technical Provisions include a risk margin.

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

I discuss the impact of these differences in Appendix H.

- 3.35 The SCR under Solvency II is the amount of capital required to ensure continued solvency over a one-year time frame with a probability of 99.5%. There are two main approaches to calculating the SCR:
- Using an internal model approved by the local supervisor: an internal model calculation of the SCR is based upon an assessment of the risks specific to an insurer, and is calibrated so as to correspond to a confidence level of 99.5% over a one-year trading period that net assets remain positive (i.e. the insurer remains solvent); or
  - Using the standard formula specified in detail in the Solvency II legislation: the standard formula is designed to be applicable to all insurers and is not therefore tailored to the circumstances of an individual insurer. In summary, the basic SCR consists of 5 risk modules (non-life, life, health, market and counterparty) that are in turn further subdivided into 18 sub-modules (e.g. premium and reserve risk, catastrophe risk and currency risk). The results for each sub-module are aggregated using a correlation matrix to arrive at a capital charge for each of the 5 main modules, which in turn are aggregated using a further correlation matrix to determine the basic SCR. A further module is used to calculate operational risk which is added to the basic SCR to produce the (standard formula) SCR.
- 3.36 The Minimum Capital Requirement under Solvency II (“MCR”) defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over a one-year time frame (compared to 99.5% for the SCR). The MCR is calculated as a linear function of the Technical Provisions and written premium but must be between 25% and 45% of the firm’s SCR, subject to an absolute floor of €2.5 million (or €3.7m for (re)insurers writing liability, credit or suretyship classes).
- 3.37 If an insurer’s available resources fall below the SCR, then supervisors are required to take action with the aim of restoring the insurer’s finances back to the level of the SCR as soon as possible. If, however, the financial situation of the insurer continues to deteriorate, then the level of supervisory intervention will be progressively intensified. The aim of this “supervisory ladder” of intervention is to capture any ailing insurers before their situation becomes a serious threat to policyholders’ interests. If the available resources of the insurer were to fall below the level of the MCR, then “ultimate supervisory action” would be triggered, i.e. the insurer’s liabilities would be transferred to another insurer and the license of the insurer would be withdrawn, or the insurer would be closed to new business and its in-force business run-off. In practice, supervisors would be expected to have determined earlier on whether or not the insurer’s finances could be restored to above the level of the SCR – an insurer whose supervisor determined would not be able to restore its solvency position would be placed into run-off before it breached its MCR.
- 3.38 Article 30 of the Solvency II Directive states that “*the financial supervision of insurance and reinsurance undertakings, including that of the business they pursue either through branches or under the freedom to provide services, shall be the sole responsibility of the home Member State*”. The financial supervision of all the business written by or transferred to TICL is currently the responsibility of the PRA. If the Scheme is sanctioned then the Ireland regulator (the CBI) is expected to assume responsibility for the financial regulation of the Transferring Business, while the PRA will continue to have responsibility for the financial regulation of the Non-Transferring Business (I discuss this situation further in paragraph 8.47 below).

## Brexit

- 3.39 In the UK Referendum on Continuing EU Membership in June 2016, the majority of participants voted for the UK to leave the EU. On 29 March 2017, in a letter to the EU Council, the UK Government triggered Article 50 of the Lisbon Treaty and formally started the process by which the UK will leave the EU (commonly referred to as “Brexit”). Article 50 of the Lisbon Treaty gives both sides two years to reach agreement on the terms of such an exit so, unless the UK and all of the remaining EU Member States agree to extend the deadline for negotiating those terms, the UK will cease being a Member State of the EU on or before 29 March 2019. The UK might, however, remain part of the EU single market after Brexit, based on the negotiation of a transition period or any other deal.

3.40 I consider some of the other possible impacts of Brexit as they might affect the Scheme later in this Report, but at this stage I note that, following Brexit, the UK Government might seek to cancel certain pieces of legislation that were enacted in accordance with EU Directives. One such legislative item might be that which implemented Solvency II. However, I note the following:

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

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

## COMPARISONS BETWEEN THE UK AND IRELAND

### Capital and Reserve Requirements

3.42 The majority of EU insurers have implemented the solvency regime, known as Solvency II (see paragraph 3.28 above) from 1 January 2016. This has had the effect of putting regulatory capital and reserve requirements in the UK and Ireland onto essentially the same basis.

### Domestic Actuarial Regime

3.43 Under Solvency II all (re)insurance undertakings (including TICL and, when authorised, TIDAC) must comply with the requirements related to the actuarial function in line with the relevant national implementing legislation. Nonetheless, the CBI has introduced additional specific domestic requirements regarding the actuarial function and related governance arrangements that apply to all Irish domiciled (re)insurance undertakings subject to Solvency II rules.

3.44 The domestic actuarial regime and related governance requirements under Solvency II in Ireland (the “Domestic Actuarial Regime”) became effective on and from 1 January 2016, and compliance with these requirements is a condition of ongoing authorisation for (re)insurance undertakings. In summary, the additional specific domestic requirements in Ireland are:

- (Re)insurance undertakings must appoint a Head of Actuarial Function (the “HoAF”), which is a controlled function that requires CBI pre-approval before the proposed individual can be appointed to the position;
- The undertaking must ensure that the HoAF provides an actuarial opinion (on the Technical Provisions of the undertaking) to the CBI on an annual basis. Responsibility for the actuarial opinion rests with the HoAF, using his or her professional judgement. The opinion addresses:
  - The reliability and adequacy of the calculation of the Technical Provisions;
  - The sufficiency and quality, including appropriateness, completeness and accuracy, of data used in the calculation of the Technical Provisions; and
  - The appropriateness of the methodologies, models and assumptions used in the calculation of the Technical Provisions.

- The undertaking must also ensure that the HoAF provides an actuarial report on the Technical Provisions to the Board on an annual basis, which supports the aforesaid actuarial opinion, and is also provided to the CBI upon request.

### Security under Winding-Up

- 3.45 The rules governing the winding-up of an insurance or reinsurance company are broadly similar in the UK and Ireland. In both cases, where assets are insufficient to meet fully the company's liabilities, holders of reinsurance policies would rank behind direct policyholders and certain preferential claims, but ahead of other claimants such as holders of unsecured debt and equity investors.
- 3.46 In the case of a winding-up of an insurance company based in Ireland, where there are sufficient assets to cover the Technical Provisions the winding-up regime in respect of the priority of insurance debts generally would be expected to be at least as favourable to policyholders and beneficiaries as the UK regime.
- 3.47 Conversely, in the situation of a winding-up of a UK insurance company where there are insufficient assets to cover the Technical Provisions, the UK winding-up regime would be expected to be at least as favourable to policyholders and beneficiaries as the Ireland winding-up regime.
- 3.48 The comparative position of policyholders in a UK insurer versus policyholders in a Ireland insurer in a winding-up situation is therefore a function of the assets available (and their size relative to the Technical Provisions) and the proportion of inwards reinsurance business relative to direct business.
- 3.49 I discuss further the implications of the differences in winding-up regulations between the UK and Ireland in Section 6.

### Consumer Protection

- 3.50 In the UK, the FSCS compensates eligible customers of authorised financial firms (including insurers) in the event that the firm has insufficient assets to meet claims. The FOS provides eligible customers with a free, independent service to help settle disputes with financial firms (including insurers). The FOS has compulsory jurisdiction in respect of complaints raised by eligible policyholders (as identified in paragraph 3.10 above).
- 3.51 The ICF facilitates payments to policyholders in relation to risks in Ireland where an Irish authorised non-life insurer goes into liquidation or administration. The FSPO deals independently with unresolved complaints from consumers about their individual dealings with all financial service providers in Ireland. It is a free service to complainants.

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

### TICL

#### Background

- 4.1 TICL is an insurance company, incorporated in England and Wales (registered number 01034343). Until 2004, TICL was known as the St Paul International Insurance Company Limited (“SPIIC”) and until 2008 as St. Paul Travelers Insurance Company Limited. In February 2008, the company was renamed as TICL<sup>11</sup>. TICL is 100% owned by the Travelers Companies, Inc., a holding company principally engaged, through its subsidiaries (including via its Lloyd’s Syndicate 5000), in providing a wide range of commercial and personal insurance products. Travelers is incorporated as a general business corporation under the laws of the state of Minnesota in the United States.
- 4.2 TICL is authorised by the PRA to write general insurance and reinsurance business, and regulated by the FCA and the PRA. The active business of TICL (measured by gross written premiums of £230.3 million during 2017) is written largely in the UK (circa 83%), in Ireland through its branch located in Dublin (circa 15%), and elsewhere (2%). TICL covers risks located outside the UK and Ireland, on a freedom of services basis (in the EEA) or by facultative reinsurance (outside of the EEA), generally in support of its UK and Irish based insureds. TICL also has branches in the Netherlands, France and Germany that have been in run-off since 2001.
- 4.3 TICL’s allotted, called up and fully paid share capital as at 31 December 2017 comprised 203,822,115 ordinary shares of £1 each<sup>12</sup>.
- 4.4 The main elements of the business written by TICL are as follows (percentages in brackets are the proportions of total gross premiums written in 2017 which totalled £230.3 million<sup>13</sup>):
- Motor (8%);
  - Fire and other damage to Property (40%);
  - Third Party Liability (50%);
  - Marine (1%); and
  - Miscellaneous (1%).

<sup>11</sup> The history of TICL’s name changes is as follows:  
 10 December 1971 – the company incorporated as “St. Katharine Insurance Company Limited”  
 1 October 1992 – the company changed its name to “St. Paul International Insurance Company Limited”  
 29 October 2004 – the company changed its name to “St. Paul Travelers Insurance Company Limited”  
 1 February 2008 – the company changed its name to “Travelers Insurance Company Limited”

<sup>12</sup> Based on TICL’s Annual Report as at 31 December 2017, Note 20

<sup>13</sup> Based on TICL’s Annual Report as at 31 December 2017, Note 6

## Key financial information<sup>14</sup>

- 4.5 As at 31 December 2017, on a UK GAAP basis, the gross outstanding claims reserves<sup>15</sup> within TICL were £651.0 million. In addition, as at 31 December 2017, TICL held a gross provision for unearned premiums<sup>16</sup> of £124.0 million. The reinsurers' share of claims outstanding and unearned premiums<sup>17</sup> was £61.1 million as at 31 December 2017.
- 4.6 As at 31 December 2017, on a UK GAAP basis, the total assets<sup>18</sup> of TICL amounted to £1,256.8 million, and the total liabilities<sup>19</sup> amounted to £811.3 million respectively, giving net assets of £445.5 million (the corresponding figures<sup>20</sup> as at 30 June 2018 were £1,259.6 million, £827.0 million and £432.6 million respectively). The net assets represent the capital of the company under UK GAAP (it should be noted that this is not the same as the own funds available to meet the solvency requirements under Solvency II).
- 4.7 TICL's financial strength (as of 30 September 2018) is rated as follows:
- 'AA' by Standard & Poor's
  - 'A' (excellent) by A M Best.
- 4.8 As reported in TICL's SFCR as at 31 December 2017, on a Solvency II basis, TICL had assets of £1,191.1 million, (gross) Technical Provisions of £738.5 million and other liabilities of £15.8 million, thereby producing eligible own funds ("EOF") of £436.8 million. As TICL's SCR as at 31 December 2017 was calculated to be £309.7 million, it follows that the corresponding capital cover ratio (EOF : SCR) was calculated to be 141%.
- 4.9 TICL's EOF were therefore £8.7 million lower than the UK GAAP net assets reported in TICL's 31 December 2017 financial statements. This relatively small difference was primarily due to a number of adjustments (positive and negative) arising from the different bases of valuation of Technical Provisions within UK GAAP and Solvency II (see Appendix H) largely cancelling one another out.
- 4.10 As at 31 December 2017, TICL booked UK GAAP technical provisions equal to £152.2 million (gross of reinsurance) in respect of the Transferring Business; and £622.8 million (gross of reinsurance) in respect of the Non-Transferring Business. The booked technical provisions in respect of the Transferring Business are the equivalent of 20% of TICL's total gross technical provisions (as at 31 December 2017).

## The Transferring Business

- 4.11 The Transferring Business is predominantly commercial business classes (classified as per paragraph 4.12 below) currently written through the Irish branch of TICL. It also includes the run-off businesses of the Dutch, German and French branches of TICL, which includes some medical malpractice business (classified under Professional in paragraph 4.12 below). Further, I am informed by TICL that none of the Transferring Business was written on an Assumed Reinsurance basis, i.e. all the Transferring Policies were written on a Direct basis.

<sup>14</sup> It should be noted that all financial information used in the Report for TICL with an as at date of 31 December 2017 excludes the effect of the additional reinsurance purchased by TICL on 30 April 2018 as described in paragraph 4.15 below.

<sup>15</sup> Based on TICL's Annual Report as at 31 December 2017, Note 22

<sup>16</sup> Based on TICL's Annual Report as at 31 December 2017, Note 22

<sup>17</sup> Based on TICL's Annual Report as at 31 December 2017, Note 22

<sup>18</sup> Based on TICL's Annual Report as at 31 December 2017

<sup>19</sup> Based on TICL's Annual Report as at 31 December 2017

<sup>20</sup> Based on TICL's Management Accounts as at 30 June 2018

4.12 The main components of the Transferring Business are listed below together with their respective contributions to the Transferring Business' gross claims reserves as at 31 December 2017 (percentages in brackets are the proportions of total gross claims reserves that totalled €159.7 million<sup>21</sup>)

- Employers' Liability (22%)
- Motor (10%)
- Public and Products Liability (14%)
- Property (5%)
- Professional (49%).

### Investment Policy

4.13 As at 31 December 2017, on a UK GAAP basis, TICL held investment assets<sup>22</sup> valued at £1,065.9 million. Of this £392.6 million was held in UK fixed interest securities, and £673.3 million in overseas fixed interest securities. TICL's other assets comprised: £61.1 million of reinsured technical provisions; £60.4 million of debtors; £19.7 million of cash at bank and in hand; and £49.9 million of other assets.

4.14 As at 31 December 2017, TICL had an investment portfolio comprised of government and corporate bonds as outlined in paragraph 4.13 above. All investments are high quality, highly liquid and traded on a recognised investment exchange and as such comply with the prudent person principle embedded in the Solvency II directive. TICL does not invest in equities, and does not use derivatives other than to mitigate risk and did not utilise derivatives during 2017.

### Reinsurance

4.15 TICL uses outwards reinsurance to mitigate the risk of incurring significant losses linked to any one risk or any one event, principally risk excess-of-loss and property catastrophe reinsurance. Where an individual exposure is in excess of TICL's appetite additional facultative reinsurance is purchased. I note that on 30 April 2018, TICL purchased an additional layer (£40m xs £10m) of intra-group property catastrophe reinsurance placed 100% with Travelers Property Casualty Company of America (a US insurance company and a member of the Travelers Group).

4.16 TICL and TIDAC will, pre-Scheme, enter into two inwards (or assumed) reinsurance contracts (i.e. the Reinsurance Contracts) each subject to English law, and expressed to come into force on the Effective Date, whereby TICL will reinsure TIDAC (subject to approval by the CBI) as follows:

- Whole Account Quota Share Arrangement:
  - Transferring Business:
    - TICL Irish branch (commercial lines excluding International) business ceded 80% to TICL; and
    - TICL Irish branch business in run-off, and the French, German and Dutch branch businesses (in run-off) ceded 80% to TICL

<sup>21</sup> Based on TICL's internally booked figures as at 31 December 2017

<sup>22</sup> Based on TICL's Annual Report as at 31 December 2017

- New/Renewed Business (written on and from the Effective Date):
  - Business formerly written through the Irish branch of TICL (essentially commercial lines business in Ireland), i.e. the renewal rights for business being transferred under the Scheme in respect of the Transferring Business, ceded 80% to TICL;
  - Business formerly written by TICL on an FoS basis (supporting its UK insureds in providing coverage for their EU assets) ceded 80% to TICL; and
  - Business written by the Travelers Group Lloyd's underwriting teams (utilising TIDAC paper where the assets insured are in the EU) ceded 80% to TICL
- Stop-Loss Arrangement to protect TIDAC's compliance with its regulatory capital requirements – specifically, the stop-loss cover will trigger if the 'Negative Change' in TIDAC's Own Funds available to meet the solvency requirements under Solvency II is greater than €10.9 million, with a limit of recovery up to €10.0 million.

### System of Governance

- 4.17 The Board of Directors is the governing body of TICL. The Board is responsible for the strategic oversight of TICL and, *inter alia*, for the establishment and maintenance of a governance environment.
- 4.18 The Board has documented terms of reference in place, which includes a list of matters reserved to the Board, e.g. strategy and management, structure and capital, etc. In addition, the Board is supported by two constitutional committees:
- An Audit Committee, which is chaired by and comprises only independent non-executive directors and is responsible, *inter alia*, for oversight and challenge of the financial and internal controls of TICL and the integrity of statutory reporting and financial statements; and
  - A Risk & Remuneration Committee, which is chaired by and comprises only independent non-executive directors and is responsible, *inter alia*, for the oversight of TICL's framework of risk management and compliance with regulatory requirements and expectations, and for the oversight of TICL's remuneration framework (i.e. general compensation philosophy, compliance with regulatory compensation matters, etc.).
- 4.19 TICL has also established certain management committees, made up of executive management, namely a Senior Leadership Team, Finance Committee and an Executive Risk Committee which provide more granular oversight and review of the business and operations of TICL
- 4.20 The four Key Functions identified by the Board as those providing the firm's controls are:
- The Risk Management Function, which is responsible, *inter alia*, for the implementation of TICL's system of risk management, as well as designing and developing TICL's risk register. The Risk Management Function reports to the Executive Risk Committee, the Risk & Remuneration Committee and the Board of TICL on a quarterly basis;
  - The Compliance Function, which is responsible, *inter alia*, for providing the Board of TICL with assurance of compliance with all relevant regulations and legislation to which TICL is subject; as well as for assessing and advising on the impact of any changes in such provisions on the operations of TICL, and for the identification and assessment of compliance and regulatory risk. The Compliance Function reports to the Executive Risk Committee and the Board of TICL on a quarterly basis;
  - The Internal Audit Function, which is responsible, *inter alia*, for the evaluation of the adequacy and effectiveness of TICL's internal control system. The Internal Audit Function reports to the Audit Committee and the Board of TICL on a regular basis; and
  - The Actuarial Function, which is responsible, *inter alia*, for the calculation of Technical Provisions, the appropriateness of the methodologies and assumptions used in the calculation of Technical Provisions, for the assessment of the data used in the calculation of Technical Provisions, for expressing various opinions as required by the Solvency II Directive, and for contributing to the effective implementation and operation of TICL's system of risk management. The Actuarial Function reports to the Audit Committee and the Board of TICL on a regular basis.

## Risk Management

- 4.21 The Board of TICL sets the company's risk appetite and reviews it on a formal basis annually as part of the business planning process. It also reviews it on an ongoing basis as part of its regular business review processes. TICL has a Board Risk and Remuneration Committee ("RRC") and an Executive Risk Committee ("ERC") that meet regularly to review and update risks and issues arising from risk register and to monitor performance against risk appetite using a series of key risk indicators. The principal risks and uncertainties facing TICL are set out below.
- 4.22 For the purposes of managing its risk, TICL classifies risk into the following categories:
- Insurance risk (which it further subdivides between reserving and underwriting);
  - Credit risk;
  - Market risk;
  - Liquidity risk;
  - Operational risk; and
  - Group risk.

### *Insurance risk*

- 4.23 Insurance risk relates to underwriting, claims management and the risk that arises from the inherent uncertainties as to the occurrence, amount and timing of insurance liabilities.
- 4.24 The Underwriting Committee ("UC") oversees the management of underwriting risk and in particular ensures adherence to the Board determined risk appetite in terms of product, line of business, geographical exposure, line sizes and rating adequacy. The underwriting strategy includes limits on TICL's total exposure to specific risks together with limits on geographical and industry exposures. The aim is to ensure a well diversified book is maintained with no over exposure in any one industry, line of business or geographical region. The UC meets quarterly and will address new product ideas, emerging claims issues, product and line of business profitability matters, as well as monitoring the overall portfolio performance.
- 4.25 TICL uses sophisticated modelling tools to monitor and manage the concentration of exposure from weather events and to ensure they remain within the Board's risk appetite. Authority limits are accorded to individual underwriters based on experience. TICL also makes use of reinsurance to mitigate risk as described in paragraph 4.15 above.
- 4.26 On a monthly basis, management undertake performance reviews to monitor premium production, business mix, rate adequacy and claims activity relative to targets set out in TICL's annual business plan. On an annual basis each portfolio is subjected to a detailed review to identify actions to be taken to improve performance where necessary and opportunities to further develop the portfolio.
- 4.27 The Finance Committee oversees the management of reserving risk. TICL's in-house actuaries perform a reserving analysis on a quarterly basis liaising closely with underwriters and claims handlers. The use of proprietary and standardised modelling techniques, internal and external benchmarking<sup>23</sup>, and the review of claims development patterns are all instrumental in mitigating reserving risk. The aim of the quarterly reserving analysis is to produce a probability-weighted average of expected future cash outflows arising from the settlement of incurred claims. These projections include an analysis of claims development compared to the previous "best estimate" projections.

<sup>23</sup> Benchmarking is an approach to estimating ultimate claims based on market experience and data. Often a market-based ratio is applied to the (re)insurer's claims data, e.g. IBNR to outstanding ratios applied to outstanding claims. Benchmark-based estimates tend to be used in situations where the claims data does not lend itself to standard actuarial methods (e.g. APH claims) and/or the (re)insurer has limited claims experience applicable to the business to be projected. By their nature, benchmarking techniques are relatively crude tools for estimating a (re)insurer's liabilities and therefore require the exercise of expert judgement in their application

- 4.28 The Finance Committee performs a comprehensive review of the projections, both gross and net of reinsurance and following this review makes recommendations to the Board of the appropriate claims provisions to be established. In arriving at the level of the claims provisions to be carried by TICL a margin is applied over and above the actuarial “best estimate” so no adverse run-off deviation is envisaged.

#### *Credit risk*

- 4.29 The primary sources of credit risk within TICL arises from the risk of default by one or more of TICL's reinsurers and/or investment counterparties, and/or non-payment of amounts due from brokers and policyholders.
- 4.30 The Finance Committee oversees the management of credit risk, and is responsible for ensuring that the Board approved credit risk appetite is not exceeded. Limits are placed on exposures to individual banks and investment counterparties and groups of counterparties based on the likelihood of default having regard to the credit rating of the underlying counterparty.
- 4.31 TICL's strategy is to purchase reinsurance only from reinsurers who meet the company's security standards. Reinsurance counterparties are subject to a rigorous internal assessment process by reviewing credit ratings provided by credit rating agencies and other publicly available financial information. Due to the nature of the reinsurance market and the restricted range of reinsurers with acceptable with acceptable credit ratings, TICL is exposed to credit and concentration with individual reinsurers and groups of reinsurers.
- 4.32 TICL's exposure to brokers and policyholders is monitored as part of its regular credit control processes. The payment histories of brokers and policyholders are monitored on a monthly basis.

#### *Market risk*

- 4.33 The TICL Finance Committee oversees the management of market risk. TICL is exposed to the risk of adverse movements in net assets due to movements in interest rates, currency rates and the market value of securities. I note that these exposures are controlled by setting limits and asset-liability matching in terms of both duration and foreign currency composition in line with TICL's risk appetite.
- 4.34 TICL's investment portfolio is comprised exclusively of high quality fixed income government and corporate bonds, and had a market value of £1,065.9 million as at 31 December 2017.
- 4.35 TICL operates principally in the UK and Ireland. It also has exposures to the company's run-off branches in France, Germany and the Netherlands, and to inter-company transactions with its parent company in the USA. Accordingly, TICL's net assets are subject to foreign exchange movements between Sterling and the Euro and US Dollar. I note that TICL manages these exposures by monitoring them regularly and ensuring its Euro and US dollar liabilities are broadly matched by Euro and US dollar assets respectively, with any surplus net assets held in Sterling.
- 4.36 TICL also has a contingent exposure to a defined benefit pension scheme based in the UK in the event the sponsoring employer, an affiliated Travelers company, is unable to meet its liabilities as they fall due.

#### *Liquidity risk*

- 4.37 Liquidity risk is the risk that TICL is unable to settle its obligations as they fall due as a result of insufficient assets being available in a form that can be readily convertible in to cash.
- 4.38 TICL's Finance Committee oversees the management of liquidity risk. TICL's financial assets are held in highly liquid investments that can be readily convertible in to cash in a prompt fashion and with minimal expense. TICL has no external debt portfolio and has access to financial support from a financially strong parent company, i.e. Travelers. Further, cash-flow forecasts are prepared and reviewed by TICL on a regular basis.

#### *Operational risk*

- 4.39 The primary source of operational risk is the failure of people, processes or systems. TICL manages these risks through well documented policies and procedures, sound internal control processes attested through the risk register, and business continuity and disaster recovery procedures. Operational risks are monitored by the Executive Risk Committee.

4.40 The primary source of operational risk is the failure of people, processes or systems. These risks are managed through documented policies and procedures, sound internal control processes attested through the risk register, and business continuity and disaster recovery procedures. Operational risk also includes:

- Legal and Regulatory Risk, which comprises the failure to comply with relevant regulations and laws. During 2017, TICL was in full compliance with the capital requirements enforced by the PRA. TICL continues to be in full compliance with its regulatory capital requirements under the Solvency II regime that commenced on 1 January 2016; and
- Conduct risk, i.e. the risk that TICL (or its agents) will fail to pay due regard to the interests of its customers or will fail to treat them fairly at all times. Conduct risk exposures are monitored by the ERC, which reports regularly to the Board and the RRC.

#### *Group risk*

4.41 TICL is a member of the Travelers Group and therefore is exposed to group risk, i.e. the current or prospective risk to earnings and capital arising from adverse perception of the image of the Travelers Group (and/or to other members of the Travelers Group) on the part of customers, shareholders, investors or regulators.

4.42 As the Travelers Group has considerable financial resources (as demonstrated by its Standard & Poor's Rating of AA), the risk of the Travelers Group's insolvency is remote. However, were the Travelers Group to fail the major risks to TICL in relation to membership of the Travelers Group are: (1) the inability on the part of St. Paul Fire & Marine Insurance Company ("SPF&M")<sup>24</sup> to support the SPFMG (see paragraph 4.49 below) under which SPF&M agrees to cause TICL to have adequate resources to meet its policyholder obligations; (2) the potential loss of resources or loss of access to services or benefits provided to TICL by or through the Travelers Group; and (3) the potential for reputational risk affecting the Travelers Group causing the loss of clients. Nonetheless, should one or more of these major risks crystallise, the solvency position of TICL as at 31 December 2017 should provide the financial resources to mitigate (at least in part) any emerging group risk.

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

4.43 TICL's primary objectives when managing its capital position are as follows:

- to protect its ability to continue as a going concern and thus to protect its policyholders;
- to enable an appropriate return to the group's shareholders by allocating appropriate amounts of capital to its products commensurate with the risks taken, and measuring the return on this capital;
- to comply with its regulatory capital requirements; and
- to maintain a financial strength rating of AM Best A (excellent).

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<sup>24</sup> SPF&M is a direct subsidiary of Travelers. It is a Connecticut domiciled and regulated insurer incorporated on 20 April 1925, and is rated A++ by A.M. Best and AA by S&P. As at 31 December 2017, SPF&M's total net assets were \$5.4 billion and its net of reinsurance GAAP technical provisions were \$12.2 billion. During 2017, its net written premiums were \$5.7 billion. The annual accounts reported a post-tax profit for 2017 of \$0.7 billion.

- 4.44 TICL is subject to capital requirements enforced by the PRA and imposed by the rating agencies. Under Solvency II, TICL's regulatory capital is determined using the standard formula. As management set the target economic capital for TICL, the regulatory and rating agency capital requirements are treated as minimum requirements. In setting target economic capital and determining capital to be allocated to different products, TICL employs its capital model (the "TCM", which is not an approved internal model under Solvency II). As at 31 December 2017, TICL's solvency capital requirement (under Solvency II) was £310 million, and adjusting net assets of £445 million (under UK GAAP) for the deferred tax assets (£21 million) and assets pledged to Lloyd's<sup>25</sup>, the coverage ratio was 128%.
- 4.45 TICL has stated in its Solvency Financial Condition Report (as at 31 December 2017) that it was in full compliance with its regulatory capital requirements throughout 2017, and TICL has informed me that this continues to be the case during the current year (2018).
- 4.46 TICL conducts its ORSA (i.e. a forward looking assessment of all of the current and possible future risks TICL has within its business to determine the level of capital needed to mitigate these risks) on (at least) an annual basis:
- To develop and embed an ongoing process enabling the assessment of TICL's own solvency needs that takes into account its specific risk profile, approved risk appetite limits, and its short and long term business and capital strategies; and
  - To provide sufficient information that enables TICL's management to:
    - Ensure continuous compliance with regulatory capital requirements relating to Solvency Capital Requirements (SCR), Minimum Capital Requirements (MCR), and technical provisions.
    - Test, validate and challenge its short and long term business and capital strategies, and understand the capital resources required to support them.
- 4.47 In its latest full ORSA (dated 13 December 2016), TICL states that its internal solvency target<sup>26</sup> is 113% of SF SCR. Events leading to the capital ratio falling below this 113% target would trigger mitigating measures from TICL (e.g. requesting financial support from other Travelers Group companies and/or reducing its premium income).

#### SPF&M Guarantee

- 4.48 St. Paul Fire & Marine Insurance Company ("SPF&M") is a direct subsidiary of Travelers. As one of the largest underwriting companies in the Travelers Group it is a participating company of an intercompany pooling arrangement (the "TRV Pool") under which Travelers' major subsidiaries reinsure one another to share their loss experience. The lead company of the TRV Pool is The Travelers Indemnity Company, and other participating companies include SPF&M, and Travelers Casualty and Surety, Inc.
- 4.49 On 22 August 1995, SPF&M and SPIIC executed a guarantee in the form of a Deed Poll, as Guarantor and beneficiary respectively. Under the aforesaid Deed Poll, SPF&M has provided a guarantee (the "SPFMG") to meet the claims of policyholders of TICL (formerly known as SPIIC) in the event that TICL proves unable to do so in a timely manner. The SPFMG was put in place to enable TICL to obtain the benefit from rating agencies of the financial strength rating assigned to SPF&M (and is not taken into account by TICL when determining financial resources that it requires to meet its regulatory capital requirements).

<sup>25</sup> TICL has pledged assets at Lloyd's to support the underwriting activity of Travelers Syndicate 5000 (being FAL of £29 million as at 31 December 2017). Travelers believes that, if required, the pledged assets can be replaced at short notice by arranging for a bank to issue a letter of credit ("LOC") to Lloyd's (and relying on the strong financial strength of the Travelers Group).

<sup>26</sup> The excess of the solvency target over 100% of the SF SCR represents the capital buffer adopted by the entity to allow for: (1) the risk of short-term fluctuations in asset and liability values; and (2) uncertainty in the choice of some parameters in the regulatory capital calculation (i.e. the SF SCR).

- 4.50 I have reviewed the wording to the SPFMG and discussed it with Travelers (Europe) General Counsel. Based on my review and the comments I have received from Travelers (Europe) General Counsel on the wording of the guarantee, I have concluded that my interpretation is appropriate. In particular, under the terms of the SPFMG, SPF&M guarantees the faithful and complete performance of all obligations of TICL arising out of all insurance and reinsurance contracts entered into by TICL to the extent that TICL is unable to do so in the normal course of business within the times and manners described within the contracts.
- 4.51 Further, the SPFMG can be amended or terminated, however it states that twelve months' notice must be provided by SPF&M to the rating agencies and, in the event of termination, TICL prior to any changes coming into force<sup>27</sup>. Any such changes would only affect contracts entered into by TICL after the operative date of amendment.
- 4.52 I note that as at 31 December 2017, the TICL net GAAP technical provisions were approximately 8% of those of SPF&M and the TICL net written premiums were approximately 5% of those of SPF&M, i.e. the TICL business (that is separate from that of SPF&M) represents a relatively small proportion of the business of SPF&M.
- 4.53 I further note that the net assets of SPF&M (\$5.4 billion as at 31 December 2017) are substantial and, while they cannot be assumed to provide absolute security, provide very significant financial resources to support the SPFMG.
- 4.54 My interpretation of the SPFMG is that post-Scheme the Reinsurance Contracts (i.e. the 80% whole account quota share contract and the stop-loss reinsurance contract) entered into by TICL and TIDAC (see paragraph 4.16 above) will have the benefit of the guarantee because all claims under (re)insurance policies issued by TICL are within the scope of the SPFMG.

#### Administration

- 4.55 TICL employs no staff itself. At present TICL uses the services of Travelers' UK-based service company, Travelers Management Limited ("TML"). TML directly, and through its branch in Ireland provides services across Travelers European entities (including TICL and TIDAC) in the administration and operations of its business, including underwriting and claims. I am informed by TICL that these services do not at any time amount to regulated activities, and these arrangements will continue following the implementation of the Scheme.

#### Proposed Transfer of Travelers Casualty and Surety Company of Europe Limited ("TCSCE") to TICL

- 4.56 I note that it is proposed to move the insurance business of TCSCE to TICL under Part VII of FSMA (the "TCSCE Transfer") and that the transfer has gone through its Directions Hearing and is scheduled to complete on 28 February 2019, i.e. ahead of the Effective Date. As such the insurance business of TCSCE will have moved to TICL ahead of the implementation of the Scheme.
- 4.57 I have liaised with Travelers on the proposed TCSCE Transfer (and reviewed the summary of the independent expert's report on the TCSCE Transfer). I note that there will be a small increase in the risk to the existing policyholders of TICL as a result of the TCSCE transfer. This stems from the credit risk exposure of TICL to two intra-group reinsurers of TCSCE that between them reinsure 100% of the technical provisions and underwriting of TCSCE.
- 4.58 Travelers has also advised me that no changes will take place to any claims handling or policy administration as a result of the TCSCE transfer.
- 4.59 Additionally, I note that TCSCE has one surety bond written on a FoS basis in Ireland, and that it is Travelers intention that this bond will form part of the Transferring Business moving from TICL to TIDAC under the Scheme (following the bond's move from TCSCE to TICL under the TCSCE Transfer outlined in paragraph 4.56 above).

<sup>27</sup> If both rating agencies confirm that the change does not affect the ratings awarded, then the change may be made in less than 12 months.

- 4.60 Based on my high-level review, I do not believe that of the TCSCE Transfer will materially affect the policyholders of TICL, because: (1) the two intra-group reinsurers who wholly reinsure TCSCE are highly-rated insurers and core operating companies within the Travelers Group; (2) the policyholders of TICL retain the benefit of the SPFMG; and (3) there is no change in policy servicing. If, for whatever reason, the TCSCE Transfer is not implemented then, all other things being equal, there will be no change to the position of TICL and hence that of the policyholders of TICL, prior to the implementation of the Scheme. Nonetheless, I will comment on any further developments on this issue in my Supplemental Report.

#### Major catastrophe events (to-date) during 2018

- 4.61 At the date of the Report, I note that there have been a number of catastrophe events (including hurricanes, typhoons, wildfires and earthquakes) particularly in the second half of 2018, which in aggregate have given rise to significant losses to the (re)insurance industry.
- 4.62 TICL is not directly exposed to these catastrophe events through underwriting activity, but it has indirect exposures to them from assets TICL has pledged at Lloyd's to support the underwriting activity of Travelers Syndicate 5000 (see paragraph 4.44 above).
- 4.63 I have liaised with Travelers on the potential for these assets to be impaired as a result of the underwriting activity of Syndicate 5000. I have been informed that Syndicate 5000 will only have a very modest exposures to these catastrophe events, and at the date of the Report they are expected to be within Syndicate 5000's planned allowances for catastrophe losses for the year (2018). As such there is no expectation of making use of the Funds at Lloyd's ("FAL") pledged by TICL.
- 4.64 Based on this, I have assumed that no use will be made by Travelers of the FAL pledged by TICL, and therefore concluded that there is not a material impact from these catastrophe events on my conclusions.

#### Post-Brexit

- 4.65 Assuming that the Scheme takes place as planned, the (pre-Scheme) the insurance liabilities (and associated assets, including reinsurance) of the Irish, French, German and Dutch branches will have been transferred from TICL to TIDAC, and the (pre-Scheme) other (non-branch) insurance liabilities (and associated assets, including reinsurance) of TICL will have remained in TICL.
- 4.66 TICL will continue (post-Scheme and Brexit) to use the same administration systems for policy servicing and claims handling.

#### TIDAC

##### Background

- 4.67 Travelers Insurance DAC (i.e. TIDAC<sup>28</sup>) is a company registered in Ireland (registered number 620416). It has made an application to the CBI, for permission to effect and carry out contracts of insurance in and from Ireland. TIDAC anticipates that it will be authorised and regulated by the CBI prior to the Effective Date (expected to be in December 2018), and is anticipated to be in a position to carry out contracts of non-life insurance on and from the Effective Date for the following classes: Accident, Aircraft, Ships, Goods in Transit, Fire and Natural Forces, Damage to Property, Motor Vehicle Liability, Aircraft Liability, Liability for Ships, General Liability, Suretyship, and Miscellaneous Financial Loss.

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<sup>28</sup> Note that TIDAC's name, for the purpose of the application to the CBI is XYZ Risk DAC, and will be changed to TIDAC upon authorisation by the CBI.

- 4.68 TIDAC has been established to conduct insurance business in EEA territories on both FoS and FoE bases directly and via a branch established with effect from the Effective Date in the UK (and TIDAC will also apply to the PRA for direct authorisation of the UK branch, so that, even assuming that passport rights will cease to apply after the UK leaves the EU single market, the PRA and FCA will directly regulate TIDAC's UK / third country branch – I note that in the absence of enabling legislation, TIDAC plans to seek approval of the UK branch from the PRA by the end-December 2020 or the expiry of any temporary permissions period, which could be later); and on an FoS basis from its head office in Ireland (and its established branches) for other EEA territories not served by a branch of TIDAC.
- 4.69 TIDAC is a direct, wholly owned subsidiary of TICL, which is in turn a direct, wholly-owned subsidiary of Travelers.

#### *Lines of Business*

- 4.70 The main lines of business to be written by TIDAC are:
- Accident (Personal Accident and General Aviation Personal Accident);
  - Aircraft (General Aviation; Airline Hull & Liability; and Space Insurance – launch & orbit);
  - Ships (Marine Hull; P&I Insurance; and Yacht);
  - Goods in Transit (Marine Cargo);
  - Damage to Property (Global Construction; Commercial Accounts; Personal Golfer; Custom Markets; Office; Technology; Renewable Energy; Contractors Plant & Equipment; Political Violence; Specie; and Aero Engine Breakdown Insurance);
  - Motor Vehicle Liability (Automotive and Motor Trade);
  - Aircraft Liability (General Aviation; Airline Hull & Liability; and Space Insurance – launch & orbit);
  - Liability for Ships (Marine Liability and P&I Insurance);
  - General Liability (Commercial Accounts; Personal Golfer; Custom Markets; Office; Technology; Public & Private Directors & Officers; Public Offerings of Security Insurance; Commercial Crime; Pension Trustees Liability; Employment Practices Liability; ERISA; Lifeboat; Financial Institutions Crime; Financial Institutions Professional Indemnity; Financial Institutions Directors & Officers; Construction All Risks; Erection All Risks; Upstream Energy; Midstream Energy; Downstream Energy; Renewable Energy; Power & Utilities; Ports & Terminals; Marine Builders Risk; Marine Professional Indemnity; Marina Package; and Aviation Products);
  - Suretyship (Performance Bonds); and
  - Miscellaneous Financial Loss (Kidnap & Ransom; Solicitors Professional Indemnity; Directors & Officers; Other Professions Professional Indemnity; General Aviation Loss of Licence; Cyber; Transactional Liability; Construction All Risks; Erection All Risks; Marine Logistics).

#### *Distribution Channels*

- 4.71 All products to be written by TIDAC are planned to be sold through authorised and regulated independent insurance intermediaries. The taking-on of new intermediaries is to be managed by the Agency Group, a team within the Travelers Europe Compliance Function.
- 4.72 At the date of writing this Report, TICL operates two delegated underwriting arrangements (both based in Ireland) written through its Irish branch, which will be transferred to TIDAC upon renewal (after the Effective Date).
- 4.73 TICL has estimated that from the Effective Date (on an annual basis) there will be approximately 5,530 Irish domestic policies written from TIDAC in Dublin, and 480 multinational policies and 300 speciality policies written from TIDAC's branch in the United Kingdom.

### *Transfer of Business*

- 4.74 On the Effective Date (anticipated to be 31 March 2019), TICL will transfer to TIDAC its Irish, French, German and Dutch branch businesses, i.e. the insurance assets (including reinsurance) and liabilities, by way of a transfer under Part VII of FSMA, subject to the approval of the Court. TIDAC will administer (or outsource in whole or part) the run-off of the transferred business until all liabilities are extinguished.

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

- 4.75 At the time of writing this Report, the authorised share capital of TIDAC is €35 million, divided into 35 million ordinary shares of €1 each, which is to be issued and paid-up in accordance with the authorisation (or otherwise) of TIDAC by the CBI. TIDAC's dividend policy will be conditional, i.e. capable of being cancelled and withheld at any time prior to payment.
- 4.76 TIDAC's basic own fund items are to be immediately available to absorb losses and have no duration restrictions. All of TIDAC's own funds are eligible to cover both the SCR and the MCR. Changes to TIDAC's own funds over time will therefore be a result of operating and/or investing activities; no changes are anticipated as a result of redemption, repayment or maturity of basic own fund items.
- 4.77 TIDAC plans to manage its regulatory capital by reference to risk-based capital determined under Solvency II. Specifically, TIDAC will calculate its SCR using the SF and aims to maintain capital at a level giving a circa 25% surplus over and above the corresponding SF SCR (i.e. TIDAC plans to operate with a capital buffer of at least 25%).
- 4.78 The appropriateness of the SF for TIDAC has been reviewed by the Travelers capital modelling team. This review, which was endorsed by Travelers' management, concluded that the SF to be an appropriate basis for setting regulatory capital requirements for TIDAC, but that the TCM (see paragraph 4.44 above) provides a more appropriate basis for management decisions. I have not reviewed the TCM, but have instead considered the suitability of the SF in assessing an appropriate level of financial resources required by TIDAC as described in paragraphs 6.64 to 6.69 below.
- 4.79 TIDAC has conducted an ORSA (as required as part of the CBI authorisation process) that assesses:
- The key risks to which TIDAC is exposed, namely underwriting and reserving risk, market risk (asset liability management, investment risk, and concentration risk), liquidity risk, operational risk and credit risk (reinsurance and other risk mitigation techniques) as outlined above for TICL (from paragraph 4.22 above);
  - Forward looking projections over a 3-year period; and
  - A series of stress and scenario tests (using the TCM and risk register).
- 4.80 Once authorised, TIDAC will operate an annual ORSA process, which will cover its overall solvency needs, taking into account the current and future business plan, risk profile, overall business strategy and approved risk appetite and tolerance limits. TIDAC's risk appetite and risk tolerances will therefore be reviewed annually and updated as part of the ORSA process.

### **Risk Management**

- 4.81 I am informed that TIDAC will adopt the risk analysis framework and risk strategy currently employed at TIDAC's direct parent (i.e. TICL) as described above. The risk analysis framework and risk strategy to be employed by TIDAC will be overseen by the Board of Directors of TIDAC in Ireland.

### **Investment Management**

- 4.82 TIDAC's investment strategy aims to ensure that it can to meet its obligations to its policyholders, whilst maximising the available net investment income within the stated constraints.
- 4.83 TIDAC will only invest in high quality fixed income securities, both government and corporate bonds. The average credit quality of the portfolio will be AA-. All investments acquired will be rated at least A-. Investments will be denominated in Euros or the currency of the liabilities to the extent other than Euros, as TIDAC's capital and insurance liabilities will be denominated in Euros or British pounds for the business contemplated for the UK branch of the applicant. The duration of the portfolio will be maintained at or around the average duration of the underlying insurance liability exposures.

- 4.84 Any investments which are downgraded below Investment Grade shall be subject to review and recommendation for potential orderly disposal as determined to be in the best interests of the applicant and the portfolio. The outsourced Investment Manager may request, and the Finance Committee of TIDAC may grant, an exemption from specific Investment Policy limits.
- 4.85 TIDAC does not intend to not invest in equities, property or in hedge funds. Neither does TIDAC intend to utilise derivatives.

### Governance

- 4.86 The Board of Directors is the governing body of TIDAC. The Board is responsible for the strategic oversight of TIDAC and, *inter alia*, for the establishment and maintenance of a governance environment.
- 4.87 The structure and terms of reference of the Board and management committees will follow that described above for TICL.
- 4.88 Likewise, the four Key Control Functions identified by the Board are as described above for TICL, namely the Risk Management Function, Compliance Function, Internal Audit Function and the Actuarial Function.
- 4.89 TIDAC is to comply with the requirements of the Corporate Governance Requirements for Insurance Undertakings 2015. In particular, TIDAC's Board will meet at least four times per year in accordance with the Requirements. The Board will meet regularly at TIDAC's offices in Dublin. Directors will normally be expected to attend Board meetings in person.
- 4.90 Within Travelers Dublin office, there are 54 members of Travelers Europe staff as at the date of this Report. These members of staff work across various functional areas and are predominantly working on Irish business. Some of those staff also undertake Travelers Europe shared work where required.

#### *Overview of the Operation of the UK Branch*

- 4.91 Following its establishment, TIDAC will set up a UK branch (established initially on an FoE basis, but subsequently to be established as a third country branch of TIDAC, subject to the prior approval by the PRA/FCA).
- 4.92 In the absence of any political or regulatory obstacles, the UK branch will undertake all underwriting, administration and claims activities relating to the multinational business and specialty business currently written by TICL. This is business covering assets and risks located outside of the UK and in the EEA. The staff carrying out these activities on behalf of the UK branch are currently and will continue to be employed by Travelers' UK-based service company, Travelers Management Limited. They will continue to be based at Travelers offices in London, and will use the same systems and facilities. The systems will be modified however to allow entry of a policy which has been written by the TIDAC branch.
- 4.93 The costs of the staff who work on business relating to the branch will be allocated to the branch. Underwriters who underwrite risks to be written by the branch are the same underwriters currently writing the business on behalf of TICL. Following the Scheme, each underwriter will be given a UK branch stamp.
- 4.94 Back office services are currently provided on a shared services basis in Europe across all European platforms, and the branch will be included as an additional platform. Investments however will be managed on behalf of TIDAC. This function will be outsourced to the Travelers enterprise investments function based in St. Paul, Minnesota, USA.
- 4.95 Governance of the UK branch will be provided by a branch manager based in Travelers' London office. The UK branch manager will have a reporting line to the TIDAC CEO, and will report on the UK branch's activities to the TIDAC Management Committee and Board. Business underwritten in the UK branch will also be within the scope of the Europe Underwriting Committee.

### Reinsurance Arrangements

- 4.96 The reinsurance arrangements currently utilised by TICL, including all outwards reinsurance covering the Transferring Business are to be extended to cover the business written by TIDAC, i.e. TIDAC will be a named reinsured under TICL's excess of loss reinsurance programmes, which already covers this business as it is written in the current TICL Ireland branch.

- 4.97 Pre-Scheme, TIDAC will enter into the Reinsurance Contracts expressed to come into force on the Effective Date:
- a whole account quota share reinsurance arrangement with TICL (see paragraph 4.16 above) intended to maintain a low volatility net risk profile relative to its gross written premium, and for capital management and rating agency purposes. All TIDAC's business, including European (excluding Ireland) run-off and continuing portfolios will also be 80% reinsured to TICL. Further, the Irish domiciled business will be 80% ceded to TICL; and
  - a stop-loss reinsurance arrangement with TICL intended to protect TIDAC's compliance with its regulatory capital requirement. Specifically, the stop-loss cover will trigger if the 'Negative Change' in TIDAC's Own Funds available to meet the solvency requirements under Solvency II is greater than €10.9 million with a limit of recovery up to €10.0 million.
- 4.98 I note that the Reinsurance Contracts will be covered by the SPFMG (see paragraph 4.54 above), which essentially removes the risk that these contracts will have any shortfall. This is an important aspect of the proposed Scheme, operating in conjunction with the Reinsurance Contracts, because these contracts allow TIDAC to function at a lower level of explicit capital (i.e. shareholder funds) than would be the case were they not in place. As they are covered under the SPFMG, I believe that they are suitable as an alternate form of capital. I further consider the operation of, and reliance by TIDAC on the Reinsurance Contracts in Section 6 (in particular paragraphs 6.68 and 6.81 below).
- 4.99 Further, in order to protect the position of the Transferring Policyholders post-Scheme (and prospective business written by TIDAC) from the risk of default by TICL, a collateral account arrangement, subject to Irish law, will be implemented by an escrow agency agreement between TICL and TIDAC, to mitigate TIDAC's credit risk exposure to TICL arising from the proposed 80% whole account quota share reinsurance agreement. Under the escrow agency agreement, reinsurance premiums due to TICL will be paid into an escrow account at Barclays Bank Ireland plc, which will act as escrow agent (i.e. the assets of the collateral account will be held in Ireland). The balance of the escrow account will be maintained at the amount of net written premiums due to TICL under the 80% whole account quota share reinsurance agreement. If and to the extent that the funds credited to the escrow account in respect of net written premiums for any year exceed TIDAC's reserves (for claims paid, and estimated reported and IBNR claim amounts) for that year, a "Surplus" on the escrow account will arise. No Surplus can be released within three years of the inception of the 80% whole account quota share reinsurance agreement. After that, Surplus can be released only by agreement at Chief Financial Officer level between TIDAC and TICL.
- 4.100 The collateral account is structured such that funds may be withdrawn to meet claims obligations by TIDAC at any time in its absolute discretion. If TICL becomes insolvent, TIDAC may withdraw the entire amount, and the funds will revert to TIDAC. In the absence of a withdrawal of funds by TIDAC on TICL's insolvency, the escrow arrangement terminates automatically, and the funds will revert to TIDAC for claims payment purposes. The escrow agent is not permitted to allow withdrawal of funds in any circumstances other than as contemplated under the escrow agency agreement.
- 4.101 I have reviewed the legal advice provided to me by Travelers as prepared by the solicitors (retained by Travelers in relation to the operation of the proposed collateral account) and discussed it with Travelers (Europe) General Counsel. Based on my review and discussions with Travelers (Europe) General Counsel, I understand that: (1) other than the provision of this advice (and other Brexit related advice) there is no commercial or other relationship between the solicitors and Travelers; (2) the aforesaid solicitors are a long established firm in Ireland whose expertise covers 30 practice areas, including Insurance, Finance and Capital Markets, Insolvency and Corporate Restructuring, and EU and Competition; and (3) the firm of solicitors has many hundreds of people working across its six offices (4 outside of Ireland) including over 80 partners and tax principals and over 440 legal and tax professionals. As such, I am satisfied that the advice has been independently prepared by suitably qualified lawyers with experience in this field (i.e. the operation of the proposed collateral account). This advice is consistent with my interpretation of the proposed collateral account, i.e. the funds credited to the collateral (escrow) account would only be capable of being withdrawn in accordance with the terms of the escrow agency agreement.
- 4.102 I am advised by Travelers that the CBI will make it a condition of the authorisation of TIDAC that the Reinsurance Contracts are signed and in place ahead of the implementation of the Scheme. I have therefore not considered the scenario that the Reinsurance Contracts are not in place pre-Scheme, since in such a scenario TIDAC would not be authorised and would therefore be unable to accept the Transferring Business moving from TICL to TIDAC.

- 4.103 If, for whatever reason, the Reinsurance Contracts fall away post-Scheme, the business (including the Transferring Business) reinsured at the date of termination would continue to be covered under the 80% whole account quota share arrangement<sup>29</sup>, the collateral account would revert to TIDAC, and this business would also be covered by the SPFMG (because the 80% whole account quota share arrangement is a reinsurance policy entered into by TICL, and is therefore covered under the SPFMG).
- 4.104 I am advised by Travelers that the termination clause of the stop-loss agreement will tie in with the termination provisions under the 80% whole account quota share arrangement (but would also include an option for TICL and TIDAC to mutually agree to terminate the treaty if the Transferring Business has to all intents and purposes run-off). If, for whatever reason, the stop-loss arrangement falls away then the benefit to TIDAC would cease. However, while the stop-loss arrangement covers TIDAC, its primary purpose (as envisaged by Travelers) is to provide additional financial security for the Transferring Business (post-Scheme). In practice, therefore, the benefit of the stop-loss cover to the Transferring Policyholders is skewed to the short-term period following the Effective Date and becomes less significant in the medium to long-term as the Transferring Business runs-off. Furthermore, as the conditions leading to the termination of either (or both) of the Reinsurance Contracts appear remote (particularly in the short-term) I do not believe that the scenario whereby the stop-loss arrangement falls away will materially adversely affect the Transferring Policyholders.

#### Administration

- 4.105 TIDAC will enter into an inter-company services agreement with TML (that comes into force on the Effective Date), pursuant to which TIDAC will have access to services provided by TML to all of Travelers European subsidiaries, including TICL, viz. IT systems, support services and controls.

#### Post-Brexit

- 4.106 As noted in paragraph 4.67 above, TIDAC is an Irish company, which is anticipated to be authorised and regulated by the CBI (with effect from the Effective Date). Thus, but for the Scheme, its licence would not be impacted by Brexit.
- 4.107 From the Effective Date, TIDAC will outsource the administration of the Transferring Business, as well as all other business that TIDAC writes, to TML. TML is a member company of the Travelers Group based in the UK and operates as a service company for Travelers' European operations. TIDAC management will ultimately decide whether liability should be accepted, claims should be settled and the level of appropriate reserves to maintain. The authority to conclude commutations also rests wholly with TIDAC. Therefore, TML will not provide services that are subject to regulation, and this will remain so post-Brexit.
- 4.108 There are currently data protection rules that could preclude certain types of data, including personal details, being transferred from inside to outside the EU. Post-Brexit, TIDAC would have to ensure that no such data was transferred electronically from within the EU to (or even via) a server based outside the EU without appropriate measures having been put in place to enable such transfer. I am informed that TIDAC (and the wider Travelers Group) has adopted model contract clauses to enable such transfers, and that TIDAC will be a party to such an agreement.
- 4.109 Although the terms of Brexit are currently far from being settled, there is a strong possibility that UK (re)insurers will lose passport rights to undertake business within the EU and that EU (re)insurers, including TIDAC, will similarly lose their passport rights to undertake business within the UK.

<sup>29</sup> The draft 80% whole account quota share agreement has a special termination clause which provides for termination by the Reinsured (i.e. TIDAC) only if:

- The Reinsurer's (i.e. TICL's) S&P rating falls below "A-" (it is presently "AA")
- The Reinsurer becomes insolvent (in which case the collateral account would revert to TIDAC and the SPFMG would respond)
- The UK declares war
- UK regulations prevent the Reinsurer from performing.

## 5. THE PROPOSED SCHEME

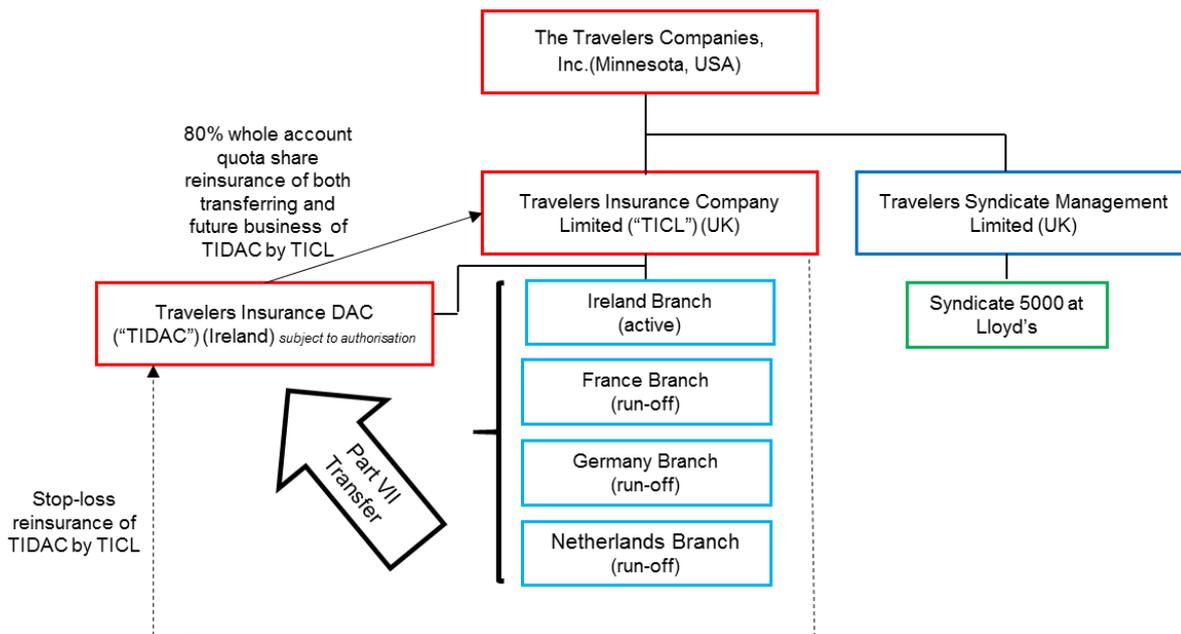
### MOTIVATION FOR THE SCHEME

- 5.1 TIDAC has been established in order to allow Travelers to access and underwrite EEA (excluding UK) business, as well as to ensure compliance with EEA laws and regulations following the departure of the UK from the EU in respect of business underwritten prior to the UK’s departure from the EU.
- 5.2 TIDAC is formed to be a licensed operating entity in Ireland. From the Effective Date, TIDAC is to start underwriting business in Ireland, and service the run-off business previously written by TICL’s Ireland Branch as well as of the three run-off branches in France, Germany and the Netherlands. Further, TIDAC intends to establish a UK branch (as outlined in paragraph 5.27 below).
- 5.3 From the Effective Date, TICL will transfer to TIDAC the renewal rights to its existing EEA business (such renewal rights being transferred under the Scheme in respect of the Transferring Business). From the Effective Date, TIDAC will commence the underwriting of all of the Travelers Group’s incumbent EEA risks incepting from that date.
- 5.4 On the Effective Date, TICL will transfer to TIDAC the insurance assets (including reinsurance) and liabilities of the Transferring Business by way of a transfer under Part VII of FSMA, i.e. the proposed Scheme.
- 5.5 To accomplish the transfer contemplated under the Scheme the Court’s consent is needed.

### OUTLINE

- 5.6 Under the proposed Scheme, the Transferring Business (being the branch businesses in TICL) will be transferred to TIDAC on or with effect from the Effective Date (expected to be 31 March 2019). Figure 5.1 below illustrates the effect of the Scheme in moving the Transferring Business in TICL to TIDAC.

**Figure 5.1**  
Simplified Corporate Structure and Effect of the Scheme for the Travelers Group



- 5.7 Pre-Scheme, an 80% whole account quota share reinsurance contract(s) in respect of the Transferring Business (and the prospective underwriting of TIDAC), and a stop-loss reinsurance arrangement, will each be purchased by TIDAC from TICL (see paragraph 4.97 above). Further, in order to protect the position of the Transferring Policyholders (and prospective business written by TIDAC) from the risk of default by TICL, the assets associated with the 80% whole account quota share reinsurance of TIDAC by TICL will be held in a designated collateral account (see paragraph 4.99 above).
- 5.8 Specifically, by order of the Court, the following shall be transferred to and vested in TIDAC on or with effect from the Effective Date:
- 5.8.1 the rights, benefits and powers of the Transferring Business or arising as a result of TICL having carried on the Transferring Business;
  - 5.8.1 all assets (including reinsurances together with any security arrangements or letters of credit which have been arranged by the relevant reinsurers for the benefit of TICL) relating directly to the Transferring Business, and all the interest and title of TICL in them;
  - 5.8.2 all liabilities of TICL under or in connection with the Transferring Policies or attributable to the Transferring Business (which will then cease to be liabilities of TICL).
- 5.9 All costs and expenses incurred in connection with the preparation and carrying into effect of the Scheme, whether before or after the Effective Date, shall be paid by TICL (and not by the policyholders of the Transferring Business).
- 5.10 The Scheme is severable in that if an order to transfer any specific policies cannot be obtained, the other policies can nonetheless be transferred.
- 5.11 The terms of the Scheme are governed by English law.
- 5.12 Table 5.1 below shows the effect of the Scheme on TICL's balance sheet (on a GAAP basis) at the Effective Date (assumed to be 31 December 2018 for illustrative purposes). Specifically, if the Scheme is sanctioned, the assets (including reinsurance together with any security arrangements or letters of credit that have been arranged by the relevant reinsurers for the benefit of TICL) and liabilities of the Transferring Business will transfer to TIDAC. In addition, the whole account quota share arrangements between TICL and TIDAC will come in to force (see paragraph 4.16 above) whereby 80% of the Transferring Business will be ceded back from TIDAC and assumed by TICL.

**Table 5.1**  
**Simplified Balance Sheets for TICL at the Effective Date (£m)**

£m	Pre-Scheme <sup>1</sup> (1)	Transferred Business-out (2)	Assumed Intra-Group Reinsurance <sup>2</sup> (3)	Post-Scheme (4)
<b>Assets</b>				
Investments	1,049.7	118.5	102.8	1,034.0
Debtors and salvage	44.5	6.2	4.9	43.2
Cash in hand	20.0	10.1	0.0	9.9
Other assets	48.4	2.9	1.8	47.3
	1,162.6	137.7	109.5	1,134.4
<b>Liabilities</b>				
Shareholder funds	435.5	0.0	0.0	435.5
Technical provisions (net amount)	705.8	136.9	109.5	678.4
Creditors and provisions	11.6	0.7	0.0	10.9
Other liabilities	9.7	0.1	0.0	9.6
	1,162.6	137.7	109.5	1,134.4

<sup>1</sup>In relation to column (1), the investments include the anticipated capital injection of €35m in to TIDAC by TICL assuming the authorisation of TIDAC is forthcoming from the CBI prior to the Effective Date.

<sup>2</sup>In relation to column (3), the Assumed Intra-Group Reinsurance represents the Transferred Business (net of inuring reinsurance) assumed by TICL from TIDAC under the whole account quota share contracts (at a cession rate of 80%).

- 5.13 As simple capital measures, Table 5.1 above gives a ratio of shareholder funds to net technical provisions of 62% immediately pre-Scheme, and 64% immediately post-Scheme. Likewise, the ratio of shareholder funds to total assets is 37% immediately pre-Scheme, and 38% immediately post-Scheme. Based on these simple capital measures, the Non-Transferring Policyholders enjoy a small increase in their financial security immediately post-Scheme relative to that immediately pre-Scheme. While I note these results based on the simple capital measures, my detailed analysis of the impact of the Scheme on the Non-Transferring Policyholders is contained in Section 7 of the Report.
- 5.14 No compensation will be paid to the policyholders (or to the shareholders) of TICL in consideration of the transfer of the Transferring Business to TIDAC, although TIDAC will assume the (re)insurance liabilities in respect of the Transferring Business.
- 5.15 There will be no changes to the terms and conditions of any policy included within the Transferring Business as a result of the Scheme. TICL's rights and obligations under the Transferring Policies will be transferred, without alteration, to TIDAC.
- 5.16 Similarly, all holders of Transferring Policies will be entitled to the same rights against TIDAC as were available to them against TICL under such policies and will be accountable to TIDAC for any further or additional premiums or other amounts attributable or referable thereto as and when the same become due and payable.
- 5.17 Any pending or current proceedings or complaints issued or served before the Effective Date by or against TICL in connection with the Transferring Business shall be continued by or against TIDAC in place of TICL, and TICL shall cease to have any liability under those proceedings following the Effective Date. Any proceedings or complaints issued or served on or after the Effective Date that would hitherto have been by or against TICL will instead be by or against either TIDAC. TIDAC will be entitled to all defences, claims, counterclaims and rights of set-off that would have been available to TICL in respect of the Transferring Business.
- 5.18 Any judgment, order or award in respect of the Transferring Business that is not fully satisfied before the Effective Date will become enforceable by or against TIDAC in the place of TICL.
- 5.19 TIDAC shall indemnify TICL against any loss or expense incurred by TICL, whether before or after the Effective Date, that is attributable to the Transferring Business.

- 5.20 For the holders of the Transferring Policies moving to TIDAC, the additional security (over and above the capital resources held within TICL pre-Scheme) that they enjoy under the SPFMG will continue (albeit indirectly) on and from the Effective Date, but only to the extent of 80% of the risk, because the guarantee covers the whole account quota share (and stop-loss) reinsurance contract(s) to be provided (issued) by TICL to TIDAC (see paragraph 4.16 above) and thereby essentially removes the risk that these contract(s) will have any shortfall.
- 5.21 Table 5.2 below shows the effect of the Scheme on TIDAC's balance sheet (on a GAAP basis, denominated in €m) at the Effective Date (assumed to be 31 December 2018 for illustrative purposes, using an exchange rate of £1.00 = €1.10). Specifically, if the Scheme is sanctioned, the assets (including reinsurance together with any security arrangements or letters of credit that have been arranged by the relevant reinsurers for the benefit of TICL) and liabilities of the Transferring Business, will transfer to TIDAC. Table 5.2 below further assumes that capital of circa €35 million is paid in prior to the commencement of underwriting (scheduled from the Effective Date) and that the whole account quota share arrangements between TICL and TIDAC will come in to force (see paragraph 4.16 above) whereby 80% of the Transferring Business will be ceded back from TIDAC to TICL.

**Table 5.2**  
**Simplified Balance Sheets for TIDAC at the Effective Date (€m)**

€m	Pre-Scheme <sup>1</sup> (1)	Transferred Business-in (2)	Ceded Intra- Group Reinsurance <sup>2</sup> (3)	Post-Scheme (4)
<b>Assets</b>				
Investments	35.0	130.4	113.1	52.3
Debtors and salvage	0.0	6.8	5.4	1.4
Cash in hand	0.0	11.1	0.0	11.1
Other assets	0.0	3.2	2.0	1.2
	35.0	151.5	120.5	66.0
<b>Liabilities</b>				
Shareholder funds	35.0	0.0	0.0	35.0
Technical provisions (net amount)	0.0	150.6	120.5	30.1
Creditors and provisions	0.0	0.8	0.0	0.8
Accruals and deferred income	0.0	0.1	0.0	0.1
	35.0	151.5	120.5	66.0

<sup>1</sup>In relation to column (1), the assets represent the anticipated capital injection of €35m by TICL in to TIDAC assuming the authorisation of TIDAC is forthcoming from the CBI prior to the Effective Date.

<sup>2</sup>In relation to column (3), the Ceded Intra-Group Reinsurance represents the Transferred Business (net of inuring reinsurance) ceded out of TIDAC back to TICL under the whole account quota share contracts (at a cession rate of 80%).

- 5.22 Table 5.3 below is equivalent to Table 5.2 above, but denominated in £m (using an exchange rate of £1.00 = €1.10 as adopted by Travelers in making its financial projections) to allow a direct comparison with Table 5.1 above.

**Table 5.3**  
**Simplified Balance Sheets for TIDAC at the Effective Date (£m)**

£m	Pre-Scheme (1)	Transferred Business-in (2)	Ceded Intra- Group Reinsurance (3)	Post-Scheme (4)
<b>Assets</b>				
Investments	31.8	118.5	102.8	47.5
Debtors and salvage	0.0	6.2	4.9	1.3
Cash in hand	0.0	10.1	0.0	10.1
Other assets	0.0	2.9	1.8	1.1
	31.8	137.7	109.5	60.0
<b>Liabilities</b>				
Shareholder funds	31.8	0.0	0.0	31.8
Technical provisions (net amount)	0.0	136.9	109.5	27.4
Creditors and provisions	0.0	0.7	0.0	0.7
Accruals and deferred income	0.0	0.1	0.0	0.1
	31.8	137.7	109.5	60.0

- 5.23 All (post-Scheme) future income and outgoings arising from the Transferring Business will pertain to TIDAC (together with all future income and outgoings of the current TIDAC business).
- 5.24 Tables 5.2 and 5.3 above give a ratio of shareholder funds to net technical provisions of 116% immediately post-Scheme, and a ratio of shareholder funds to total assets of 53% immediately post-Scheme (while it should be noted that TIDAC will have been capitalised pre-Scheme, subject to CBI approval, it will not have any policyholders until the Scheme is implemented). Based on these simple capital measures, the Transferring Policyholders enjoy an increase in their financial security immediately post-Scheme relative to that immediately pre-Scheme (as shown in paragraph 5.13 above). While I note these results based on the simple capital measures, my detailed analysis of the impact of the Scheme on the Transferring Policyholders is contained in Section 6 of the Report.

## POLICYHOLDERS AFFECTED

- 5.25 I have considered the effects of the Scheme on two main groups of policyholders (see paragraph 2.10 above) namely:
- those policyholders of TICL whose policies are to be transferred to TIDAC, i.e. the holders of Transferring Policies; and
  - those policyholders remaining in TICL, i.e. the holders of Non-Transferring Policies.

## COMPENSATION AND COMPLAINTS

- 5.26 After the implementation of the Scheme, as with all other insurance companies with an establishment in the UK, TICL will continue to be required to participate in the FSCS. Therefore, to the extent that they currently meet the qualifying criteria (as set out in Section 3), the holders of the Non-Transferring Policies will continue to be protected by the FSCS if the Scheme is sanctioned.
- 5.27 In terms of FSCS protection currently available to eligible Transferring Policyholders there is not expected to be any change as a result of the Scheme. TIDAC will have a UK branch, which will be established initially by the exercise of passport rights. TIDAC will also apply to the PRA for direct authorisation of the UK branch, so that (even assuming that passport rights will cease to apply after the UK leaves the EU) the PRA and FCA will directly regulate TIDAC's UK branch. As a result of this, TIDAC will be a "firm" for the purposes of the FSCS and so policyholders will have the same access to the FSCS that they may have had before. FSCS protection will continue to apply to claims under Transferring Policies arising before or after the Effective Date, because TIDAC is a participant firm within the scope of the FSCS regime (initially, as an incoming EEA firm exercising passport rights and in future as an authorised UK branch). In respect of such claims, the Transferring Policyholders will not have access to any additional compensation scheme in Ireland.

- 5.28 Since TICL is subject to the compulsory jurisdiction of the FOS, the Scheme will have no effect on the eligibility of the holders of Non-Transferring Policies to bring complaints to the FOS. If, as described in Section 3, they are currently able to bring complaints to the FOS, this will remain the case after the implementation of the Scheme. If they are currently not eligible to complain to the FOS this will also remain the case after the implementation of the Scheme.
- 5.29 Further, FOS compulsory jurisdiction covers complaints about the activities of a firm in the UK, which includes the UK branch activities of a pass-porting EEA insurer, such as TIDAC, so there should be no change for the Transferring Policyholders as a result of the Scheme. In particular, activities carried on in an EEA establishment outside the UK are not covered by FOS before or after the Scheme, but activities carried on by an establishment in the UK (whether through a head office or branch of a firm) are covered by FOS both before and after the Scheme. In the event that there were an intention to shift activities that may become the subject of a complaint policyholders may be able to bring complaints to the FSPO (formerly the IFOS), as described in paragraph 3.24 above.
- 5.30 In Ireland, the FSPO (formerly the IFOS) provides a free complaints mediation service for eligible complainants. This scheme operates as described in paragraph 3.24 above.
- 5.31 Finally, for this sub-section, I set out in Appendix I a summary, by policyholder category, of policyholders' access to the FSCS and/or the FOS pre- and post-Scheme.

## ADMINISTRATION

- 5.32 After implementation of the proposed Scheme, the Non-Transferring Business will continue to be administered by TML as it currently does, i.e. undertaken pursuant to an inter-company services agreement using the services of TML (provided across the Travelers European platform) in the administration and operations of its business, including underwriting and claims. I further note that the services provided by TML are not regulated activities.
- 5.33 The administration (including claims handling) of the Transferring Business will also be undertaken pursuant to an inter-company services agreement using the services of TML (provided across all of Travelers European subsidiaries, including TICL).
- 5.34 I am informed that the current inter-company services agreement using the services of TML will not change as a result of the Scheme, i.e. there will be no change for the Transferring Policyholders between the systems and processes used, the contact details needed to make a claim or amend a policy, or the locations in which they are dealt with as a direct result of the Scheme, and therefore there will be no anticipated impact on policyholders with regard to administration.
- 5.35 I note that TIDAC will establish a UK branch as described in paragraph 5.27 above, in order that any renewed policies with EEA exposures currently written by TICL can be serviced if needed in the UK. If, for whatever reason, the UK (third country) branch is not authorised by the PRA/FCA, then there is a risk that such policies could not be serviced if needed in the UK. I would therefore expect TIDAC to closely monitor its application for the authorisation of a UK (third country) branch, and if there was a strong likelihood of the application not being granted on or before passport rights cease to apply (after the UK leaves the EU single market or the expiry of any temporary permissions regime) take appropriate action to ensure that any policy servicing activities were not in breach of any relevant regulations.

## EXCLUDED POLICIES

- 5.36 Any policies that are not capable of being transferred for legal reasons will be treated as excluded policies and will remain with TICL. I am informed by the lawyers advising TICL and TIDAC (in relation to the Scheme) that based on their experience on transfers it is not expected that there will be any such policies. I will update the position at the time of my Supplemental Report.

## CAPITAL POLICY AFTER THE SCHEME

- 5.37 TICL and TIDAC are currently required to comply with the capital requirements of Solvency II. Compliance with solvency capital requirements is currently overseen by the CBI in respect of TIDAC and the PRA in respect of TICL.

- 5.38 TICL and TIDAC each use the SF approach to calculating their respective regulatory Solvency II capital requirements.
- 5.39 I discuss in Section 6 the implications of the Scheme on the security of the holders of Transferring Policies as provided by the capital strength of TIDAC as compared to TICL.

#### APPROACH TO COMMUNICATION WITH POLICYHOLDERS

- 5.40 The intended approach that TICL and TIDAC plan to take in communicating information about the proposed Scheme to the affected policyholders and other parties is set out in Section 9.
- 5.41 The main objectives of the communications are to:
- Give affected policyholders the information that they need to understand the proposed changes;
  - Inform affected policyholders about the implications for them of the proposed changes;
  - Give affected policyholders access to further relevant information (beyond that in the communications pack);
  - Let affected policyholders know what steps they should take if they object to any of the proposed changes;
  - Maintain customers' confidence in TIDAC's willingness and ability to continue to meet its obligations under transferring policies;
  - Maintain customers' confidence in TICL's willingness and ability to continue to meet its obligations under transferring and non-transferring policies; and
  - Meet legal and regulatory requirements.

#### COSTS

- 5.42 All costs and expenses, including, without limitation, fees and disbursements of legal and financial advisers and accountants, incurred in connection with the Scheme and the transactions contemplated by the Scheme shall be paid by TICL. None of the costs of the Scheme will be borne by the policyholders.

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

### INTRODUCTION

- 6.1 Under the Scheme, the Transferring Business will be transferred to TIDAC.
- 6.2 The main issues affecting the transferring policyholders of TICL as a result of the Scheme are likely to arise from relative differences in:
- The financial strength of TIDAC post-Scheme compared with that of TICL pre-Scheme. Financial strength is derived from:
    - the strength of the reserves held, relative to a best estimate of the outstanding liabilities;
    - excess assets or capital; and
    - specific financial support arrangements.
  - The risk exposures in TIDAC post-Scheme compared with that of TICL pre-Scheme.
  - The policy servicing levels provided by TIDAC post-Scheme compared with those currently provided by TICL pre-Scheme.
- 6.3 In this Section I deal with each of these in turn.
- 6.4 I note that the reserves held on a GAAP basis differ from the Technical Provisions that help determine the own funds available to meet the SCR under Solvency II. However, the best estimate of the liabilities under GAAP is usually used as the base for the best estimate of the liabilities under Solvency II, which then forms a key part of the Solvency II Technical Provisions. Furthermore, I note that the process of estimating reserves for insurance liabilities is inherently uncertain due to unknown future events or circumstances and the effect these may have on the frequency and cost of claims. For example, future legal changes may increase the number of claims to which insurers are exposed, inflation may change the costs of remediation of insured events, and new types of claim may emerge that are not currently anticipated. Recent examples of uncertainty include the market-observed increases in the number of claims reported to Employers' Liability policies for Noise-Induced Hearing Loss ("NIHL"), or increasing costs to the market from the change in the Ogden discount rate to be applied on settlement to certain lump sum bodily injury claims.
- 6.5 While key metrics under Solvency II, such as the SCR, MCR and EOF, are intended to be made public as part of each insurer's annual SFCR, there are other relevant metrics (for example, projected values of own funds and of solvency capital requirements as set out in insurers' ORSAs) that are private matters between the entities and the relevant regulators. Therefore, I am not at liberty to disclose in the Report the actual values of those metrics, or figures by which those values could be calculated. In the Report, I have considered the extent to which TICL and TIDAC each hold capital in excess of various solvency capital measures. I refer to the ratio of the actual capital that the entity under consideration holds to the regulatory solvency capital requirement as the "Capital Cover Ratio". Each entity will have different Capital Cover Ratios for different solvency measures. Where permitted I have expressed Capital Cover Ratios in numeric terms. In other instances, for comparative purposes in the Report, I have defined the following terms:
- "sufficiently capitalised" refers to a Capital Cover Ratio between 100% and 119%;
  - "more than sufficiently capitalised" refers to a Capital Cover Ratio between 120% and 149%;
  - "well-capitalised" refers to a Capital Cover Ratio between 150% and 199%, and
  - "very well-capitalised" refers to a Capital Cover Ratio in excess of 200%.

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

- 6.6 As at 31 December 2017, the gross Technical Provisions held by TICL (on a GAAP basis) were £651.0 million for outstanding claims (including ULAE) and £124.0 million for unearned premiums. The corresponding ceded amounts were £48.8 million and £12.3 million respectively.
- 6.7 The most significant classes within the gross reserves for claims outstanding (including ULAE) of £651.0 million (on a GAAP basis) as at 31 December 2017 were: Employers Liability (19%), Property (6%), Professional Indemnity (32%), Public and Products Liability (27%), Motor (13%) and Other (3%).
- 6.8 I have reviewed the work carried out by the in-house actuaries responsible for estimating reserves for TICL, in order to satisfy myself that it is reasonable for me to rely on their work. In this regard, I have:
- Sought to understand the process and methods used by TICL to set reserves and discussed with the actuaries responsible for reserving this process;
  - Performed a high-level review of the major classes of business (including a comparison of the actual versus expected claims experience over the preceding 5 quarters relative to the reserves held as at 31 December 2017); and
  - Reviewed the reasonableness of the translation of these (GAAP) reserve estimates onto a Solvency II basis.
- 6.9 Firstly, I note that those responsible for the reserve estimates include suitably qualified in-house actuaries, and that their results and conclusions have been reviewed by the Audit Committee for recommendation to the TICL Board.
- 6.10 In overview the (GAAP) claims reserves are determined based on prior claims experience, knowledge of market conditions and trends, and the terms and conditions of the underlying policies of (re)insurance.
- 6.11 The Actual versus Expected incurred claims movement analysis<sup>30</sup> (referred to in paragraph 6.8 above) is a preliminary part of the reserving process (for the accident years prior to the year of valuation) and is updated each quarter by the in-house actuaries to give an initial view of the movement in ultimate claims (for the prior accident years).
- 6.12 A variety of different analytical techniques are then used by the in-house actuaries to determine an appropriate level of claims provision to carry (informed by the findings of the Actual versus Expected analysis) including the Chain Ladder method (applied to paid and incurred claims) and the Bornhuetter-Ferguson technique (that combines the use of initial expected loss ratios ("IELRs" as defined in Appendix A) for the more recent and under-developed accident years with the Chain Ladder). For latent claims (e.g. deafness, asbestos related, stress, abuse/bullying, etc.) which are relevant for EL and PPL, non traditional methods are used including frequency-severity<sup>31</sup> and multiplier<sup>32</sup> approaches. All claim projections are carried out separately for each country (for core business, countries include the UK and Ireland), product, line of business, and separately on a gross and ceded basis. Further, capped and excess claims are reserved separately based on a cap of £250,000 as are more than 10 categories of latent claims, arising from EL and PPL exposures.
- 6.13 Where possible, TICL adopts multiple techniques to estimate the required level of claims provision. This assists in giving a greater understanding of the trends inherent in the claims data being projected and setting the range of reasonable outcomes. The most appropriate estimation technique is then chosen taking into account the characteristics of the business class under consideration.

<sup>30</sup> An Actual versus Expected analysis identifies divergencies between the actual and expected claims emergence, which may indicate the reserving methodology and/or assumptions need to be reviewed and adjusted based on the findings of the review.

<sup>31</sup> A frequency-severity approach uses historical data to estimate the average number of claims and the average cost of each claim. The method multiplies the expected number of claims in each future year by the corresponding selected average size of claim for each future year (adjusted for inflation) to generate estimated future losses/claims.

<sup>32</sup> A multiplier (or survival ratio) approach assesses the number of years that the estimated reserves will suffice ("survive") if average future payments equal average current payments.

- 6.14 I further note that the in-house actuaries have identified the main sources of reserve uncertainty to be:
- Ogden – the impact of the change in the discount rate, from 2.5% to negative 0.75%, to be applied on settlement to certain lump sum bodily injury claims announced, on 27 February 2017, by the Lord Chancellor materially increased losses;
  - Uncertainties relating to new classes of business where it is more difficult to project than classes with which the business is familiar;
  - Uncertainties associated with long-tailed lines of business where there is inevitably doubt around the ultimate claims outcomes, e.g. the book contains a significant amount of professional liability business, where ultimate results are highly sensitive to adverse trends, such as a worsening legal climate regarding security class actions and litigation impacting financial institutions; and
  - The process for the selection of IELRs (as defined in Appendix A);
- which are consistent with the uncertainties I would expect to see in claims reserving for business of this nature.
- 6.15 In arriving at the level of claims provision, TICL also carries a margin over-and-above the in-house actuaries best estimate so that no adverse run-off is envisaged, and therefore make some allowance for the uncertainties outlined above (and in general).
- 6.16 Further, I note that TICL does not discount its reserves (on a GAAP basis) other than in respect of PPOs, which gives rise to an off balance sheet asset (or margin) equivalent to the time value of money inherent in the undiscounted part of the reserves. Such a margin increases the security of the policyholders.
- 6.17 The Travelers reserving documents provided to me, and my discussions with key members of the in-house actuarial team, have been in sufficient detail for me to understand the process by which reserves were set, the approach followed by the in-house actuaries, the key areas of reserve uncertainty and the apparent strength of the reserves based on these reviews. This has enabled me to consider the appropriateness of the methodologies and major assumptions used. I have concluded that the process, methodologies and major assumptions as at 31 December 2017 appear reasonable.
- 6.18 I have considered the run-off profit or loss on prior accident years exhibited by TICL (as per the Actual versus Expected analysis referred to above). TICL has seen favourable experience (i.e. Actual movement in incurred claims are less than Expected movement in incurred claims) and this trend has continued through to the third quarter of 2018 (while noting that the 2017 accident year has experienced some adverse Property movements at the start of 2018). Thus, my (high-level) review did not lead me to conclude that there was a manifest misstatement of aggregate reserves for TICL. However, reserve estimates, particularly for liability business, are as identified above, subject to a high degree of uncertainty, and as a result, there is a range of estimates for TICL that might be considered reasonable at any point in time.
- 6.19 I have undertaken (high-level) gross of reinsurance claim projections on three of the major classes of 'live' Irish branch business as at 31 December 2017, based on incurred claim triangles (split between claims capped at £250k and those in excess of £250k) for Employer's Liability, Public & Product Liability and Professional Indemnity (separately for Solicitors and all other). Based on the results of my claim projections for each of the three major classes and in total, I am satisfied that the claims reserves developed by TICL's in-house actuaries as at 31 December 2017, are in the range of reasonable Actuarial Central Estimates (as defined in Appendix A). I have also benchmarked the level of the estimated claims reserves of the Dutch, French and German branches (all in run-off) by comparing the IBNR amount as a percentage of the current outstanding claim amount, and the implied loss development factors-to-ultimate, with relevant benchmarks, and am satisfied that these claims reserves are in the range of reasonable market benchmarks. Overall, therefore, the results of my (high-level) reserve review did not lead me to conclude that there was a manifest misstatement of aggregate reserves for the Transferring Business. Again I note that reserve estimates, particularly for liability business, are as identified above, subject to a high degree of uncertainty, and as a result, there is a range of estimates that might be considered reasonable for the Transferring Business at any point in time.

- 6.20 The explicit margin within TICL's booked reserves (including the general non-allowance for the time value of money in the reserves), gives me some assurance that the total reserves held provide a reasonable allowance given the uncertainty around the final cost of these liabilities, the main sources of which I have noted above.
- 6.21 Based on my review (as set out above) I am satisfied that the methodology and assumptions of the TICL reserving process are reasonable, while noting the uncertainty associated with the exposures arising from the types of business written by TICL, and that it is reasonable for me to rely on the reserving work of the in-house actuaries.

#### *Transfer of Reserves*

- 6.22 I am informed by Travelers that the reserves moving from TICL to TIDAC in respect of the Transferring Business will do so (on the Effective Date) at the same balance sheet value, i.e. no credit is to be taken for any reserve strengthening or releases as a result of the Scheme. I do not therefore anticipate any associated change in reserve strength in respect of the Transferring Business as a result of the Scheme

#### *Conclusion*

- 6.23 ***Based on my review as described above, I have concluded that the methodologies and major assumptions underlying the reserve analyses as performed by the in-house actuaries as at 31 December 2017 are reasonable, that their best estimate of unpaid claim amounts also appear reasonable and that the reserves booked by TICL as at 31 December 2017 incorporate some margins (including the time value of money).***
- 6.24 ***Therefore I conclude that TICL's reserves appear reasonable at present, while noting the increased uncertainty associated with the types of business written by TICL. Furthermore, I have no reason to think that the reserve strength of TICL will be impacted as a result of the Scheme.***

#### **Solvency II Technical Provisions**

- 6.25 The in-house Actuarial Function report details the methodology, assumptions and the TPs under Solvency II so developed for TICL's business as at 31 December 2017.
- 6.26 The in-house actuaries have calculated TPs (on a Solvency II basis) using TICL's UK GAAP held reserves as at 31 December 2017 (as discussed above) as their starting point, and made a series of adjustments to those GAAP held reserves.
- 6.27 I have reviewed the translation of TICL's GAAP reserves to a Solvency II basis. The elements that I would have expected to see in the calculation have been included, and the adjustments appear to be of an appropriate magnitude. The key elements in this translation were:
- Removal of TICL management margin;
  - Conversion of the UPR to a Solvency II "best estimate" basis – see Appendix H;
  - Credit for future premiums on incepted business (i.e. recognition of profits expected to arise on such business);
  - BBNI business (as defined in Appendix A);
  - Allowance for share of the cost of internal and external XL contracts not yet renewed;
  - ENIDs (as defined in Appendix A);
  - Reinsurance bad debt reserve – see Appendix H;
  - Allowance for discounting – see Appendix H;
  - Solvency II expenses (i.e. charge a portion of future calendar year expenses, consistent with the business plan, to existing and legally obliged business) – see also Appendix H; and
  - Risk margin – see Appendix H.

- 6.28 I note that the in-house team responsible for the (GAAP reserves and) TP calculations include suitably qualified actuaries, and that the Actuarial Function report has been prepared in sufficient detail for me to understand the process by which the TPs were calculated and the approach followed by the in-house actuaries. I have therefore concluded that the methodologies, key assumptions and results as at 31 December 2017 appear reasonable, and that it is reasonable for me to rely on the TPs calculated by the in-house actuaries.
- 6.29 The impact of the aforesaid adjustments made by the in-house actuaries produced estimated gross (of reinsurance) TPs of £738.5 million as at 31 December 2017, which compares with gross (of reinsurance) GAAP reserves (claims reserves and UPR net of DAC) of £759.4 million as at 31 December 2017.

### **Conclusion**

- 6.30 ***Based on my review as described above, I have concluded that the approach and key assumptions underlying the calculation of Technical Provisions (under Solvency II) as performed by the in-house actuaries as at 31 December 2017 are reasonable, and that TIDAC's Technical Provisions (under Solvency II) appear reasonable at present.***

## **RESERVE STRENGTH OF TIDAC (POST SCHEME)**

- 6.31 I am informed by Travelers that TIDAC will follow TIDAC's reserving policy (pre-Scheme) in relation to the Transferring Business. As such, I anticipate no associated change in reserve strength in respect of the Transferring Business as a result of the Scheme, and further that the reserves moving to TIDAC from TIDAC in respect of the Transferring Business will do so (on the Effective Date) at the same balance sheet value, i.e. no credit is to be taken for any reserve strengthening or releases as a result of the Scheme.
- 6.32 Under Solvency II, the members of the TIDAC reserving team will have a primary responsibility for the calculation of the Technical Provisions within the context of the Actuarial Function.
- 6.33 In respect of the estimation of the Technical Provisions, these responsibilities include the following:
- Coordinate the calculation of the technical provisions;
  - Ensure the appropriateness of the methods, assumptions, and underlying models used as well as the assumptions made in the calculation of the technical provisions;
  - Assess the sufficiency and quality of data used in the calculation of technical provisions;
  - Compare best estimates against experience. In particular undertaking an analysis of actual versus expected experience as well as other appropriate validation; and
  - Ensure that information provided to the Board includes escalation of relevant information provided to regulators, a discussion of key issues, uncertainties, and market conditions.
- 6.34 An Actuarial Function report will be provided annually to TIDAC's management and the Board to outline the scope and work undertaken by the Actuarial Function, the results of the work and to highlight any limitations of the work and how these can be remedied. In addition, as described in paragraph 3.44 above, the HoAF for TIDAC will provide annually an actuarial opinion to the CBI (and a supporting actuarial report to the Board) covering the reliability and adequacy of the calculation of the Technical Provisions, the quality of the data used in the calculation of the Technical Provisions, and the appropriateness of the methodologies, models and assumptions used in the calculation of the Technical Provisions.
- 6.35 As TIDAC will follow the TIDAC's reserving policy as described above, and provide annually (via the company's HoAF) an actuarial opinion to the CBI on the Technical Provisions (as outlined in paragraph 6.34 above) I would expect TIDAC to be reasonably reserved on and from the Effective Date, and the uncertainty surrounding the reserves to be fairly typical for an entity writing primarily commercial lines business in Ireland (and to a lesser extent in other EEA states).

### Conclusion

- 6.36 ***Based on my review of reserving policy described as described above, I have concluded that the methodologies and major assumptions underlying the reserve analyses to be performed by TIDAC appear reasonable. I am therefore satisfied that the reserves to be established and held by TIDAC (from the Effective Date) would likewise be reasonable, and that the reserve strength of the Transferring Business (moved to TIDAC under the Scheme) will not be materially affected by the Scheme.***

### EXCESS ASSETS OF TICL

- 6.37 I have reviewed reports and documents prepared by Travelers in order to satisfy myself that it is reasonable for me to rely on the estimates of the SCR and of the EOF contained therein. This included reviewing the development of the technical provisions and hence the estimation of available own funds, the process by which capital estimates have been made, the approach taken to their calculation, the key assumptions employed, and the resulting capital amounts based on this review. I note that the capital estimates have been produced by suitably qualified in-house actuaries (and other individuals) and have been reviewed and approved by the Board of TICL.

### Solvency Capital Requirement

- 6.38 TICL is using, and intends to continue using, the SF to calculate its SCR under Solvency II (a regulatory capital measure that has been calibrated to meet general requirements of firms across Europe). It is therefore important for me to consider whether there is a risk that the SF underestimates an appropriate level of financial resources required by TICL.
- 6.39 Further, I have described above how TICL has determined its TPs, and concluded (as per paragraph 6.30 above) that TICL's TPs appear reasonable at present. This is an important item, since the level of the TPs is a key determinant in assessing the SCR and the amount of EOF that are available to meet the regulatory capital requirement, as illustrated in Appendix G.
- 6.40 I note that TICL is a company that continues to write new business. As a result, a large element of the risks it faces relate to factors that are sufficiently well represented when considered over a one-year time horizon. In my experience, this is a normal time frame for such calculations for 'live' underwriting entities. Further, the classes of business written and the investment assets of TICL appear to me to be relatively standard in nature and reasonably represented in the data used by EIOPA to calibrate the relevant parts of the SF SCR.
- 6.41 TICL faces employers liability and public liability claims, e.g. those arising from exposure to hazardous materials. While the risks relating to such claims may emerge over a number of years, in each year I would expect them to be only a small part of the overall risk profile of TICL. In my view this is a normal feature of insurance companies writing mainstream classes of business.
- 6.42 The counterparties for TICL's outwards reinsurance programme are intra-group and third-party reinsurers (the latter are required to have a credit rating of A- or better in order to participate on the programme). Based on rating agency analysis, the likelihood of a default by intra-group and third-party reinsurers is estimated to be of the order of a 1-in-1,000 year level of risk (or a 0.1% likelihood), which is well beyond the level of risk at which insurance companies are required to be capitalised under Solvency II (i.e. a 1-in-200 year level of risk). I am therefore satisfied that TICL's outwards reinsurance programme is structured to provide its policyholders with protection beyond the one-year time horizon of the SF SCR.
- 6.43 Based on my qualitative review of the nature of the risks underwritten by TICL, it is my view that the SF SCR is unlikely to underestimate the financial resource requirements of TICL (even though the SF considers liabilities on a 1-year view). Therefore, I am satisfied that the SF SCR provides a suitable economic capital reference point for TICL.
- 6.44 I note that at 31 December 2017, TICL had EOF of £436.8 million and an estimated SCR of £309.7 million, thereby generating a Capital Cover Ratio of 141%, i.e. TICL would be considered a more than sufficiently capitalised company at said date (based on my capital coverage criteria as per paragraph 6.5 above).

- 6.45 As mentioned in paragraph 4.15 above, TICL purchased an additional layer (£40m xs £10m) of intra-group property catastrophe reinsurance, which substantially reduces the catastrophe risk component of the SCR, while at the same time increasing the counterparty risk component, but only by a minor amount (because of the high credit rating of Travelers). The net effect of this additional layer of intra-group property catastrophe reinsurance is therefore, all other things being equal, to reduce significantly TICL's SCR. As at 30 June 2018, TICL had an estimated EOF of £427 million (compared to £436.8 million as at 31 December 2017) and an estimated SCR of £265 million (compared to £309.7 million as at 31 December 2017), thereby generating a Capital Cover Ratio of 161%, i.e. TICL would be considered a well-capitalised company at said date (based on my capital coverage criteria as per paragraph 6.5 above).
- 6.46 I note that as at 30 June 2018, the risk charge proportions of TICL's (pre-diversified) BSCR are estimated to be: 89% for non-life underwriting risk; 3% for counterparty risk; and 9% for market risk; while the diversified BSCR represented 92% of the SCR and operational risk the remaining 8%. The composition and size of TICL's SCR are consistent with what I would expect to see in regulatory capital calculated using the SF for the type of business written by TICL. In particular, the predominant non-life underwriting risk charge as a result of the relatively low usage of reinsurance (itself sourced from reinsurers with high credit ratings) and the conservative investment policy focused on government and good quality corporate bonds.

### Own Risk Solvency Assessment

- 6.47 I have reviewed TICL's ORSA Report that includes its assessment of its risks together with its SF SCR (i.e. a 99.5% VaR over a one-year time horizon) as at 31 December 2016 and includes a forward looking assessment of TICL's SCR and EOF over the period 2017 – 2019.
- 6.48 TICL has examined various stress scenarios within its ORSA to examine the robustness of its capital base. The stress scenarios cover a wide range of risks to which TICL is exposed, including:
- (1) Reserve deterioration, namely a 20% points increase in the combined ratio as a result of adverse prior year development. In this scenario, TICL would have sufficient capital to meet its SCR, but would not meet its target surplus of 113% of SCR without repatriating capital from Travelers' Lloyd's syndicate<sup>33</sup> or other form of capital injection from its parent;
  - (2) Premium volumes being less than anticipated under the multi-year plan – gross written premiums 80% of plan. This scenario leads to a loss in profitability, but does not seriously erode own funds while the SCR decreases;
  - (3) Brexit and other economic uncertainty leading to a combination of reduced business volumes (only 80% of plan) and a 20% points increase in the combined ratio. In this scenario, TICL would have sufficient capital to meet its SCR, but would not meet its target surplus of 113% of SCR without repatriating capital from Travelers' Lloyd's syndicate or other form of capital injection from its parent;
  - (4) Reinsurance - a large downgrade of all reinsurers to CCC. In this scenario, TICL would have sufficient capital to meet its SCR, but would not meet its target surplus of 113% of SCR without repatriating capital from Travelers' Lloyd's syndicate or other form of capital injection from its parent; and
  - (5) Reverse stress test (leading to a constructive failure of TICL) – withdrawal of parental support, including the SPFMG.

<sup>33</sup> TICL currently uses part of its excess capital to support the capital requirements of the Travelers Group's Lloyd's syndicate. It does this by putting investments in to a Third Party Deposit Trust at Lloyd's. For internal monitoring purposes TICL excludes assets so deposited from its admissible solvency assets. As at 31 December 2017, TICL had £29 million so deposited. TICL can recall this excess capital, but only if the Travelers Group's Lloyd's syndicate puts alternative forms of capital in place at Lloyd's.

6.49 The stress testing undertaken by TIGL demonstrates that in all scenarios (other than the reverse stress test designed to be a constructive failure scenario) TIGL would have sufficient capital to meet its SCR. I consider the range of stress scenarios that TIGL has examined to be reasonable and suitable for testing insurance and credit risks to ultimate (for the reasons outlined in the Solvency Capital Requirement sub-section above, and as concluded in paragraph 6.43 above).

#### **Financial Projections 2018 – 2021**

6.50 As the ORSA referred to in paragraph 6.47 above, is based on financials and forecasts that are now over 18 months out-of-date, I have asked TIGL to make projections of the company's SCR and Solvency II (and GAAP) balance sheet(s) as at year-ends 2018 to 2021, on the basis that the Scheme is implemented as at 31 December 2018 (for illustrative purposes) and at the same time the whole account quota share and stop-loss reinsurance arrangements with TIDAC come in to force.

6.51 TIGL's projected balance sheets and SCR calculations are based on the assumptions in TIGL's business plans over the period 2018 – 2021. The TIGL business plan shows it writing mainly the same lines of UK and non-EEA business as those formerly written by TIGL, together with an 80% whole account quota share of the TIDAC business. The plan shows net written premiums for the TIGL business (post-Scheme) to be circa £220 million, £231 million and £242 million in 2019, 2020 and 2021 respectively. The mix of business over the projection period is forecast to be reasonably stable with circa 83% derived from Direct Business (itself comprised of Property, Third Party Liability, Motor and Miscellaneous representing circa 40%, 50%, 8% and 2% respectively of gross written premiums over the period 2019 – 2021), and 17% derived from Assumed Reinsurance Business (predominantly that arising from the 80% whole account quota share with TIDAC). TIGL's projected loss ratios are generally fairly constant over the projection period, informed, as appropriate, by the relevant parts of the historic experience of TIGL.

6.52 TIGL's business plans have continuity with the relevant past experience of TIGL, while also reflecting TIGL's future strategy for UK and non-EEA business (e.g. a stable mix of business, as illustrated in paragraph 6.51 above). For these reasons, I do not believe that TIGL's plans are unreasonable. It should be understood, however, that TIGL's business plans are based on forecasts that may or may not materialise. For example, business volumes will not exactly match those forecast and claims experience will likely deviate from expectations, perhaps materially. The financial performance of TIGL will therefore vary, perhaps materially, from that anticipated in its business plans.

6.53 Based on TIGL's realistic projections: the company's EOFs are forecast to be around £425 million immediately pre-and immediately post-Scheme; and TIGL's SF SCR is forecast to be around £265 million immediately pre-Scheme and around £255 million immediately post-Scheme (i.e. a modest reduction on the pre-Scheme position to reflect the 20% retention of the Transferring Business in TIDAC). It follows that the Non-Transferring Policyholders enjoy a small increase in their Capital Cover Ratio immediately post-Scheme relative to that immediately pre-Scheme (and therefore a small increase in their financial security as per the findings in paragraph 5.13 above). Nonetheless, TIGL would be considered a well-capitalised company both immediately pre-Scheme and immediately post-Scheme.

6.54 Projections of TIGL's own funds and SCR over the period 2019 – 2021 have been made under three scenarios (in each case assuming the Scheme is either implemented (or not): (1) a realistic scenario, assuming premium volumes and business mix as per paragraph 6.51 above; (2) a pessimistic scenario that assumes a 10% reduction in planned gross written premiums, combined with a 5% point increase in the loss ratio in each of the planning years (plus fixed management expenses remain relatively stable over the planning period); and (3) an optimistic scenario that assumes a 10% increase in planned gross written premiums, combined with a 2.5% point favourable movement in the loss ratio in each of the planning years.

6.55 Under the realistic scenario (assuming the Scheme is implemented) TIGL's projected average combined ratio over the projection period 2019 – 2021 is circa 97%, and the average SF SCRs are estimated to be around £295 million relative to average EOFs of circa £480 million, leading to an average Capital Cover Ratio of circa 160% (i.e. TIGL would be considered a well-capitalised company) over the projection period 2019 – 2021.

6.56 For the pessimistic scenario (assuming the Scheme is implemented) TIGL's projected average combined ratio over the period 2019 – 2021 is circa 104%, and the average SF SCRs are estimated to be around £285 million relative to average EOFs of circa £450 million, leading to an average Capital Cover Ratio of circa 160% (i.e. TIGL would be considered a well-capitalised company) over the projection period 2019 – 2021.

- 6.57 Under the optimistic scenario (assuming the Scheme is implemented) TICL's projected average combined ratio over the period 2019 – 2021 is circa 91%, and the average SF SCR are estimated to be around £310 million relative to average EOFs of circa £500 million, leading to an average Capital Cover Ratio of circa 160% (i.e. TICL would be considered a well-capitalised company) over the projection period 2019 – 2021.
- 6.58 The composition and size of TICL's (post-Scheme) SCRs throughout the projection period (2019 – 2021) are consistent with what I would typically expect to see in regulatory capital calculated using the SF for the type of business projected to be written by TICL. In particular, a modest SCR reduction relative to the pre-Scheme position to reflect the 20% retention in TIDAC; but with a continued predominant non-life underwriting risk charge and relatively low counterparty and market risk charges (for the reasons outlined in paragraph 6.46 above).
- 6.59 In summary, the projected own funds of TICL over the period 2019 – 2021 are estimated, even in the absence of management actions, to be greater than TICL's corresponding regulatory capital requirements (i.e. its SCRs) under the aforesaid realistic, pessimistic and optimistic scenarios, and therefore the projected capital position of TICL is forecast to be reasonably robust over the 3-year period (2019 – 2021). In practice, I would expect the management of TICL to take appropriate actions to steer TICL onto a lower expense and profitable path should premium growth/volumes, expenses and/or claims be substantially different (adverse) to those used in the TICL business plan.
- 6.60 I have also tested the robustness of TICL's projected capital position by considering the impact of a range of severe stress tests on TICL's solvency, all of which represent stresses that fall outside the normal course of business. I have considered the effects of reserve inadequacy, reinsurance failure and a fall in investment values as detailed below. I have considered the impact of these stresses occurring at each of 31 December 2019, 31 December 2020 and 31 December 2021. While these stresses do not represent an exhaustive list of adverse events that could impact TICL, they include risks I consider most material and relevant to my analysis. The severe stress tests considered are as follows:
- 50% increase in gross technical provisions – in this scenario the gross technical provisions of TICL are considered to be deficient and require increasing by 50%. In doing this I have assumed that the reinsurance recoveries would likewise increase by 50%. I believe this is not unreasonable because TICL's reinsurance asset would itself increase albeit most of the outwards reinsurance is non-proportional and as it represents less than 5% of TICL's total assets. Based on TICL's projected balance sheets as at 31 December 2019, 2020 and 2021, a 50% increase in technical provisions would reduce own funds significantly by around 70% as at 31 December 2019, reducing to around 65% at both 31 December 2020 and 31 December 2021. Furthermore, this stress scenario would have an impact on the SCR, i.e. the SCR would increase (due to the increase in technical provisions). It follows, therefore, that while own funds remain positive (i.e. assets greater than liabilities) under this stress scenario, the SCR coverage ratio would drop below 100%, but TICL would not breach the MCR for all years (2019 – 2021). Accounting for the increase in SCR, I have estimated the additional capital required to bring TICL back to a 120% Capital Cover Ratio, and across all years (2019 – 2021), so as to be considered (albeit on the lower boundary of my criteria) a more than sufficiently capitalised company, and the amount is significantly less than the amount of capital (net assets) held in TICL's immediate parent (i.e. Travelers<sup>34</sup>) and so a capital injection should be a feasible mitigant in this scenario.
- I note that this stress scenario would trigger the first stress test for TIDAC as described in paragraph 6.81 below, i.e. a 50% increase in gross technical provisions. In this situation, TICL would be required to make a payment to TIDAC under the stop loss reinsurance arrangement between the Companies of up to €10 million. Such a payment would further reduce TICL's projected EOFs (by up to €10 million) but they are forecast to remain positive (i.e. assets greater than liabilities) and TICL would not breach the MCR for all years (2019 – 2021).

<sup>34</sup> For the year ending 31 December 2017, Travelers' consolidated shareholders' equity (capital) was \$23.7 billion, i.e. a substantial amount and, while it cannot be assumed to provide absolute security, provides very significant financial resources to support TICL (and/or other companies in the Travelers Group) if needed.

For this stress scenario, as noted above, TICL's capital position would breach the SCR, but not the MCR. This would result in some form of regulatory intervention and most probably prevent TICL from taking on new business until the capital position improved. Nonetheless, as described above, TICL is projected to remain solvent (i.e. assets greater than liabilities) under this scenario. Furthermore, I note the long emergence for the claims under the liability and professional classes of business that should give TICL sufficient time for resolution and recovery planning to occur (including a capital injection from its parent).

- The business of TICL is protected by reinsurance (see paragraph 4.15 above) although, as noted above, not substantially so. I have therefore considered the impact of the total failure of this reinsurance. Based on TICL's projected balance sheets as at 31 December 2019, 2020 and 2021, writing off 100% of the reinsurance asset would reduce own funds by about 11%. Furthermore, while this stress scenario would have an impact on the SCR, the effect on the SCR would be limited (i.e. an increase in reserve risk, as net Technical Provisions increase, but also a decrease in counterparty risk, both as a result of part of the reinsurance asset being written-off). I therefore estimate that in this scenario the SCR would be broadly unaffected in 2019, 2010 and 2021. It follows, therefore, that own funds remain positive (i.e. assets greater than liabilities) under this stress scenario, and the while the SCR coverage ratio falls, TICL remains a more than sufficiently capitalised company for all years (2019 – 2021).
- 25% reduction in the value of bonds – TICL's business plan shows investments to be held mainly in government and corporate bonds. It is also assumed that TICL will hold a small amount of cash, and an unlisted equity (i.e the €35 million investment in TIDAC). Over the projection period (2019 – 2021) it is assumed that cash will represent around 1% of investable assets, unlisted equities 3% and bonds 96%. The risks associated with these investments is therefore expected to be low. In particular, the SCR projections assume a well diversified portfolio with each bond holding having a credit rating of 'A' or better. A reduction in value of these bonds could be associated with a downgrading of the credit worthiness of the issuers (corporate and/or government), and/or with an increase in inflation expectations. For the purposes of the stress I have assumed a 25% reduction in the value of the bonds (together with a 100% reduction in the value of the unlisted equities). The effect of this would be a significant reduction in own funds of around 65% as at 31 December 2019, decreasing to around 60%, both at 31 December 2020 and 31 December 2021. I estimate that this stress scenario would have a limited impact on the SCR itself because a high proportion of the investments are assumed to be held in government bonds which in turn are assumed to be risk free in the standard formula methodology. It follows, therefore, that while own funds remain positive (i.e. assets greater than liabilities) under this stress scenario the SCR coverage ratio would drop below 100%, but TICL would not breach the MCR for all years (2019 – 2021). I have estimated the additional capital required to bring TICL back to a 120% Capital Cover Ratio, and across all years (2019 – 2021), so as to be considered (albeit on the lower boundary of my criteria) a more than sufficiently capitalised company, and the amount is significantly less than the amount of capital (net assets) held in TICL's immediate parent (i.e. Travelers) and so a capital injection should be a feasible mitigant in this scenario.

For this stress scenario, as noted above, TICL's capital position would breach the SCR, but not the MCR. This would result in some form of regulatory intervention and most probably prevent TICL from taking on new business until the capital position improved. Nonetheless, as described above, TICL is projected to remain solvent (i.e. assets greater than liabilities) under this scenario. Furthermore, this scenario does not allow for any management action to reallocate the investment portfolio. It therefore represents an extreme market movement rather than a gradual drop in values over a longer time period.

- 6.61 As described in paragraph 6.60 above, each stress, when considered in isolation, is not expected to cause TICL to become insolvent, i.e. own funds (available capital) remain positive over the 2019 – 2021 projection period, and therefore TICL would be expected to meet its existing policyholder obligations in full post-Scheme. This helps provide comfort that the capital requirement (SF SCR) calculations provided by TICL are at a reasonable level, and that there is not a material risk that policyholder claims will not be met in full. If any of these stress scenarios were to occur in combination, within a short period of time, TICL's solvency would be more likely to be compromised, although such scenarios are more remote. Based on my findings in relation to the stress tests above, I consider the likelihood of TICL's own funds being exhausted to be remote and beyond the 1-in-200 event likelihood.

### Conclusion

- 6.62 ***I have explained above why I consider that the TICL calculations and projections of its solvency requirements and available capital, and hence of its excess assets, are reasonable. Overall, these lead me to conclude that the policyholders of TICL currently benefit from the financial strength provided by a well-capitalised company and are expected to continue to do so in the near term thereafter (consistent with the post-Scheme financial projections for TICL over the 3-year period 2019 – 2021).***

### EXCESS ASSETS OF TIDAC

- 6.63 I have been provided with the Head of Actuarial Function report and the ORSA report (both for authorisation purposes) covering the 3-year period 2019 – 2021, and have reviewed these documents in order to satisfy myself that it is reasonable for me to rely on the estimates of the SCR and of the EOF contained therein, as I describe below.

#### Solvency Capital Requirement

- 6.64 TIDAC plans to use the SF to calculate its SCR under Solvency II. As for TICL, it is therefore important for me to consider whether there is a risk that the SF underestimates an appropriate level of financial resources required by TIDAC.
- 6.65 TIDAC is a company scheduled to commence underwriting new/renewed business from the Effective Date. As a result, a large proportion of the risks it faces relate to factors that are sufficiently well represented when considered over a one-year time horizon. In my experience, this is a normal time frame for such calculations for 'live' underwriting entities.
- 6.66 The types of business forecast to be written by TIDAC (i.e. a mixture of commercial lines, essentially Property, Employers' Liability, Motor, Professional Liability and Public/Products Liability, and relatively small volumes of inwards reinsurance of EEA risks) and the projected investment assets of TIDAC appear to me to be relatively standard in nature and well represented in the data used by EIOPA to calibrate the relevant parts of the SF SCR.
- 6.67 I note that TIDAC faces some long-tailed claims (e.g. those arising from liability business), and that TIDAC largely mitigates the risk arising from such claims via its outwards reinsurance programme (see paragraphs 4.96 and 4.97 above). While the risks relating to such claims may emerge over a number of years, in each year I would expect them to only be a small part of the overall risk profile of TIDAC (particularly at a net of reinsurance level). In my view, this is a normal feature of insurance companies writing the classes of business identified in paragraph 6.66 above.
- 6.68 I also note that TIDAC will have a heavy reliance on reinsurance inasmuch that it will only retain up to 20% of the risks from the Transferring Business (and the prospectively written business). The counterparties for TIDAC's outwards reinsurance programme are third-party reinsurers that are required to have a credit rating of A- or better (in order to participate on the programme) and TICL (in relation to the Reinsurance Contracts) which enjoys a Standard & Poor's rating of AA. Based on rating agency analysis, the likelihood of a default by TIDAC's third-party reinsurers and/or intra-group reinsurers (i.e. TICL) is estimated to be of the order of a 1-in-1,000 year level of risk (or a 0.1% likelihood) which is well beyond the level of risk at which insurance companies are required to be capitalised under Solvency II (i.e. a 1-in-200 year level of risk). I am therefore satisfied that TIDAC's outwards reinsurance programme is structured to provide its policyholders with protection beyond the one-year time horizon of the SF SCR.
- 6.69 My qualitative review of the nature of risks forecast to be written by TIDAC (as set out above) and the level at which TIDAC is projected to purchase outwards reinsurance (as outlined in paragraphs 4.96 and 4.97 above) have led me to conclude that the SF SCR is unlikely to underestimate the financial resource requirements of TIDAC. I am therefore satisfied that the SF SCR provides a suitable economic capital reference point for TIDAC.

#### Financial Projections 2019 – 2021

- 6.70 TIDAC has made projections of the SCR and Solvency II (and GAAP) balance sheet(s) as at year-ends 2019 to 2021, on the basis that the Scheme is implemented as at 31 December 2018 (for illustrative purposes) and that TIDAC also commences underwriting new/renewed business from the Effective Date (at the same time that the whole account quota share arrangements with TICL come in to force).

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- 6.71 Based on TIDAC's realistic projections, the company's EOFs will be €35 million immediately pre-and immediately post-Scheme (i.e. TIDAC will be capitalised at €35 million pre-Scheme, subject to CBI approval, while noting that it will not have any policyholders until the Scheme is implemented). TIDAC's SF SCR is forecast to be around €24 million immediately post-Scheme. It follows therefore that the Transferring Policyholders will experience a decrease in their Capital Cover Ratio (of circa 145%) immediately post-Scheme relative to that immediately pre-Scheme (of circa 160% with TICL) and therefore a modest decrease in their financial security (when measured using Capital Cover Ratios). Nonetheless, TIDAC would be considered a more than sufficiently capitalised company (close to the boundary of well-capitalised) immediately post-Scheme.
- 6.72 TIDAC's projected balance sheets and SCR calculations are based on the assumptions in TIDAC's business plans over the period 2019 – 2021. The TIDAC business plan shows it writing mainly the same lines of EEA (excluding UK) business as those formerly written by the Irish branch of TICL. The plan shows net written premiums for the TIDAC business (before internal whole account quota share arrangements) to be circa €53 million, €55 million and €58 million in 2019, 2020 and 2021 respectively. The mix of business over the projection period is forecast to be reasonably stable with Property, Employers' Liability, Motor, Professional Liability, Public/Product Liability and Marine representing circa 40%, 15%, 14%, 3%, 23% and 5% respectively of net written premiums in each year (2019 – 2021). TIDAC's projected loss ratios are generally fairly constant over the projection period, informed, as appropriate, by the relevant parts of the historic experience of the Irish branch of TICL.
- 6.73 TIDAC's business plans have continuity with the relevant past experience of the Irish branch of TICL, while also reflecting TIDAC's future strategy for Irish commercial lines business and to a lesser extent other EEA (excluding UK) business (e.g. a stable mix of business, as illustrated in paragraph 6.72 above). For these reasons, I do not believe that TIDAC's plans are unreasonable. It should be understood, however, that TIDAC's business plans are based on forecasts that may or may not materialise. For example, business volumes will not exactly match those forecast and claims experience will likely deviate from expectations, perhaps materially. The financial performance of TIDAC will therefore vary, perhaps materially, from that anticipated in its business plans.
- 6.74 Projections of TIDAC's own funds and SCR over the period 2019 – 2021 have been made under three scenarios (in each case assuming the Scheme is implemented): (1) a realistic scenario, assuming premium volumes and business mix as per paragraph 6.72 above; (2) a pessimistic scenario that assumes a 10% reduction in planned gross written premiums, combined with a 5% point increase in the loss ratio in each of the planning years (plus fixed management expenses remain relatively stable over the planning period); and (3) an optimistic scenario that assumes a 10% increase in planned gross written premiums, combined with a 2.5% point favourable movement in the loss ratio in each of the planning years.
- 6.75 Under the realistic scenario, TIDAC's projected average combined ratio over the period 2019 – 2021 is circa 94% (after the whole account quota share arrangements with TICL) and the average SF SCRs are estimated to be around €25 million relative to average EOFs of circa €36 million leading to an average Capital Cover Ratio of circa 145% (i.e. TIDAC would be considered a more than sufficiently capitalised company, close to the boundary of well-capitalised) over the projection period 2019 – 2021.
- 6.76 For the pessimistic scenario, TIDAC's projected average combined ratio over the period 2019 – 2021 is circa 102% (after the internal whole account quota share arrangements with TICL), and the average SF SCRs are estimated to be around €24 million relative to average EOFs of circa €34 million leading to an average Capital Cover Ratio of circa 140% (i.e. TIDAC would be considered a more than sufficiently capitalised company, close to the boundary of well-capitalised) over the projection period 2019 – 2021.
- 6.77 Under the optimistic scenario, TIDAC's projected average combined ratio over the period 2019 – 2021 is circa 89% (after the internal whole account quota share arrangements with TICL) and the average SF SCRs are estimated to be around €26 million relative to average EOFs of circa €37 million leading to an average Capital Cover Ratio of circa 140% (i.e. TIDAC would be considered a more than sufficiently capitalised company, close to the boundary of well-capitalised) over the projection period 2019 – 2021.
- 6.78 As at 31 December 2019 (i.e. the assumed end date of TIDAC's first full year of operation) the risk charge proportions of TIDAC's (pre-diversified) BSCR are estimated to be: 54% for non-life underwriting risk; 36% for counterparty risk; and 10% for market risk. These proportions remain broadly stable over the projection period.
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- 6.79 The composition and size of TIDAC's SCR's throughout the projection period are consistent with what I would typically expect to see in regulatory capital calculated using the SF for the type of business written by TIDAC. In particular, the relatively large counterparty risk charge as a result of the reinsurer default charge associated with the whole account quota share arrangements with TICL.
- 6.80 In summary, the projected own funds of TIDAC over the period 2019 – 2021 are estimated, even in the absence of management actions, to be greater than TIDAC's corresponding regulatory capital requirements (i.e. its SCR's) and within its risk appetite/capital management policy (see paragraph 4.77 above) under the aforesaid realistic, pessimistic and optimistic scenarios, and therefore the projected capital position of TIDAC is forecast to be reasonably robust over the 3-year period (2019 – 2021). In practice, I would expect the management of TIDAC to take appropriate actions to steer TIDAC onto a lower expense and profitable path should premium growth/volumes, expenses and/or claims be substantially different (adverse) to those used in the TIDAC business plan.
- 6.81 I have also tested the robustness of TIDAC's projected capital position by considering the impact of a range of severe stress tests on TIDAC's solvency, all of which represent stresses that fall outside the normal course of business. I have considered the effects of reserve inadequacy, reinsurance failure and a fall in investment values as detailed below. I have considered the impact of these stresses occurring at each of 31 December 2019, 31 December 2020 and 31 December 2021. While these stresses do not represent an exhaustive list of adverse events that could impact TIDAC, they include risks I consider most material and relevant to my analysis. The severe stress tests considered are as follows:
- 50% increase in gross technical provisions – in this scenario the gross technical provisions of TIDAC are considered to be deficient and require increasing by 50%. In doing this I have assumed that the reinsurance recoveries (other than those arising from the stop-loss reinsurance arrangement with TICL) would likewise increase by 50%. I believe this is reasonable as the reinsurance of TIDAC (including the Transferring Business) would increase proportionately, as most of the outwards reinsurance is proportional. Based on TIDAC's projected balance sheets as at 31 December 2019, 2020 and 2021, a 50% increase in technical provisions would reduce own funds significantly by around 45% as at 31 December 2019, increasing to around 50% at both 31 December 2020 and 31 December 2021, and thereby trigger recoveries payable to TIDAC under the stop loss reinsurance arrangement with TICL. Furthermore, this stress scenario would have an impact on the SCR, i.e. the SCR would increase (due to the increase in technical provisions). I estimate that the SCR would increase by around 17% in this scenario. It follows, therefore, that while own funds (augmented, as appropriate, by the recoveries under the aforesaid stop-loss reinsurance arrangement) remain positive (i.e. assets greater than liabilities) under this stress scenario, the SCR coverage ratio would drop below both the company's 125% risk appetite level and 100%, but would not breach the MCR for all years (2019 – 2021). Accounting for the increase in SCR, I have estimated the additional capital required to bring TIDAC back to a 125% Capital Cover Ratio, and across all years (2019 – 2021), and the amount is significantly less than the amount of capital (own funds) held in TIDAC's immediate parent (i.e. TICL) and so a capital injection should be a feasible mitigant in this scenario (and could be actioned so that both TICL and TIDAC can continue trading).

For this stress scenario, TIDAC's capital position would breach the SCR, but not the MCR. This would result in some form of regulatory intervention and most probably prevent TIDAC from taking on new business until the capital position improved. Nonetheless, as described above, TIDAC is projected to remain solvent under this scenario. Furthermore, I note the long emergence for the claims under the liability and professional classes of business that should give TIDAC plenty of time for resolution and recovery planning to occur, including a capital injection from TICL.

- The business of TIDAC (including the Transferring Business) will be 80% reinsured by a quota share reinsurance with TICL (see paragraph 4.16 above). I have considered the impact of a part-failure of this reinsurance. Based on TIDAC's projected balance sheets as at 31 December 2019, 2020 and 2021, writing off 10% of the reinsurance asset (primarily with TICL) would reduce own funds significantly, by about 30%. Furthermore, while this stress scenario would have an impact on the SCR, the effect on the SCR would be limited (i.e. an increase in reserve risk, as net Technical Provisions increase, but also a decrease in counterparty risk, both as a result of part of the reinsurance asset being written-off). I therefore estimate that in this scenario the SCR would be broadly unaffected in 2019, 2020 and 2021. It follows, therefore, that while own funds (augmented, as appropriate, by the recoveries under the stop-loss reinsurance arrangement with TICL) remain positive (i.e. assets greater than liabilities) under this stress scenario, the SCR coverage ratio would drop below the company's 125% risk appetite (but at the same time remain at around 100%) for all years (2019 – 2021). Accounting for the small change in SCR, I have estimated that the additional capital required to bring TIDAC back to a 125% Capital Cover Ratio, and across all years (2019 – 2021) is again significantly less than the amount of capital held in TIDAC's immediate parent and so a capital injection should be a feasible mitigant in this scenario (and could be actioned so that both TICL and TIDAC can continue trading).

For this stress scenario, I have made an implicit allowance for the operation of the SPFMG in respect of the 80% whole account quota share reinsurance with TICL, by writing off only 10% of the reinsurance asset (primarily with TICL). This allowance can be considered very conservative inasmuch that it is very unlikely that there would be any write-off of the reinsurance asset associated with the 80% whole account quota share (and stop-loss) reinsurance contracts provided by TICL to TIDAC because of the operation of the SPFMG.

- 25% reduction in the value of bonds – TIDAC's business plan shows investments to be held mainly in government and corporate bonds. It is also assumed that TIDAC will hold a moderate amount of cash. As at 31 December 2019 it is assumed that cash will represent 6% of investable assets and bonds 94%. Cash is assumed to become slightly less significant over time representing 5% as at 31 December 2021 and bonds 95%. The risks associated with these investments is therefore expected to be low. In particular, the SCR projections assume a well diversified portfolio with each bond holding having a credit rating of 'A' or better. A reduction in value of these bonds could be associated with a downgrading of the credit worthiness of the issuers (corporate and/or government), and/or with an increase in inflation expectations. For the purposes of the stress I have assumed a 25% reduction in the value of the bonds. The effect of this would be a reduction in own funds of around 45% across the projection period 2019 – 2021. I estimate that this stress scenario would have a limited impact on the SCR itself because a high proportion of the investments are assumed to be held in government bonds which in turn are assumed to be risk free in the standard formula methodology. It follows, therefore, that while own funds (augmented, as appropriate, by the recoveries under the stop-loss reinsurance arrangement) remain positive (i.e. assets greater than liabilities) under this stress scenario the SCR coverage ratio would drop below the company's 125% risk appetite level (but at the same time remain at around 100%) for all years (2019 – 2021). I have therefore estimated the additional capital required to bring TIDAC back to a 125% Capital Cover Ratio across all years (2019 – 2021) assuming that the SCR would be broadly unchanged under this scenario. Once again the amount is significantly less than the amount of capital held in TIDAC's immediate parent and so a capital injection should be a feasible mitigant in this scenario (and could be actioned so that both TICL and TIDAC can continue trading).

6.82 As described in paragraph 6.81 above, each stress, when considered in isolation, is not expected to cause TIDAC to become insolvent, i.e. assets are greater than liabilities and hence own funds (the difference between assets and liabilities using Solvency II terminology) remain positive (greater than zero) over the 2019 – 2021 projection period. Thus, TIDAC would be expected to meet its policyholder obligations (including those of the Transferring Policyholders) in full post-Scheme. This helps provide comfort that the capital requirement (SF SCR) calculations provided by TIDAC are at a reasonable level, and that the reduction in capital coverage for policyholders of TIDAC (including the Transferring Policyholders) post-Scheme is not so large (as described in sub-paragraph 2.14.7 above) that there is a material risk that their claims will not be met in full. If any of these stress scenarios were to occur in combination, within a short period of time, TIDAC's solvency would be more likely to be compromised, although such scenarios are more remote (because they compound two or more stress events such scenarios must have a lower likelihood than that of a contributory single stress event considered in isolation). Based on my findings in relation to the stress tests above, I consider the likelihood of TIDAC's own funds being exhausted to be remote and beyond the 1-in-200 event likelihood.

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### Own Risk Solvency Assessment

- 6.83 The ORSA report for TIDAC (submitted as part of the CBI authorisation application process) identifies and discusses the key risks to which TIDAC will be exposed. The key risks categories considered are underwriting and reserving risk, asset liability management, investment risk, liquidity and concentration risk, operational risk and reinsurance and other risk mitigation techniques, which embrace the stress scenarios I have considered in paragraph 6.81 above.
- 6.84 TIDAC has examined various stress scenarios within its ORSA to examine the robustness of its capital base. The stress scenarios cover a wide range of risks to which TIDAC is exposed, including:
- (1) Operational Risk from a disputed reinsurance recovery. Results are considered with and without management actions. An ancillary scenario considers the default of largest external reinsurer in the case of a €50m property loss. The risk is mitigated by the whole account quota share, which will cover such scenarios. Also, the scenario considers “a post management action” scenario in which the leverage of the wider Travelers Group induces the reinsurer to pay, and further mitigates the risk;
  - (2) The Scheme is not completed on time. This covers regulatory/legislative risk. The main risk to TIDAC from a financial point of view is the loss of investment income in the early days on reserves expected to transfer as part of the arrangement;
  - (3) A 1-in-20 year operating loss. This is essentially a reserve and premium risk test, which mainly considers a gross (of whole account quota share) operating loss of €28 million, due primarily to adverse prior year development of employers’ liability and public liability, and to a lesser extent property (noting that TICL experienced operating losses in 2015-2017 totalling €16 million, pre whole account quota share, due to a period of severe claims inflation in the Irish market). A knock on impact of this scenario is the requirement to hold higher SCR in view of the increases reserves;
  - (4) A 5% increase in interest rates: This scenario highlights TIDAC’s vulnerability to the most material market risk shock. The instantaneous 5% increase in risk free rates would represent an extreme investment scenario; nevertheless it demonstrates the interest rate sensitivity of TIDAC;
  - (5) The impact of substantial rating downgrade of TICL from A to B++. This would trigger a substantial increase in regulatory capital requirements as, in this case, TICL would move from Credit Quality Step 2 to Credit Quality Step 3 under the Standard Formula. This is an extreme downgrade over a one year time horizon, but nevertheless captures a potential risk to TIDAC in view of the dependency on recoveries in TICL through the internal whole account quota share (reflected both through the expected default risk on the balance sheet recoverable and the risk mitigation impact in the SCR calculation); and
  - (6) The quantitative reverse stress looks at a potential point of failure of the business. This is seen as a combination of the 1 in 20 year event (considered in scenario 3 above) with a hard Brexit scenario in which a rapid and very sharp decline in Irish GDP gives rise to a very adverse business environment for TIDAC, potentially making the going concern basis for TIDAC unviable. In my view, this represents an extreme scenario, both from a losses point on view and the impact of Brexit. Nevertheless, it is useful and valid as a scenario to identify potential sources of threat to the TIDAC business model and overall the reverse stress testing framework is a useful exercise for identifying potential causes of failure of the business model.
- 6.85 Overall, I believe the above scenarios stress the key risks to TIDAC and highlight scenarios where TIDAC has resilience (either through low exposure to the risk or effective risk mitigation), and are in-keeping with the stress tests I have examined as described in paragraph 6.81 above. In general, the output of the stress tests documented in the ORSA report for TIDAC (as part of the CBI authorisation application process) identify that the primary risk is insurance risk, particularly reserve risk deterioration (driven for example by claims deterioration) which have the capability to induce poor experience across both current and prior year results.

- 6.86 I note that the ORSA report for TIDAC also identifies other loss drivers (In line with my expectations):
- Premium risk, potentially propelled through high loss frequency, although the impact should be mitigated more effectively through management actions (e.g. monitoring and re-rating);
  - Large loss and CAT events that can induce losses, but whose capacity to breach the SCR is limited through the use of reinsurance; and
  - Qualitative risk stress tests highlighting events that could have an impact on the smooth operation of the TIDAC business model and in extreme cases might threaten the viability of the model; but whose financial impact is harder to quantify.

**Conclusion**

- 6.87 ***Based on my review of the excess assets of TIDAC as described above I believe that TIDAC will be a more than sufficiently capitalised company at the Effective Date and is expected to continue to be so in the near term thereafter (in line with TIDAC's financial projections over the 3-year period 2019 – 2021).***

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

- 6.88 I have concluded above, based on my review of excess assets<sup>35</sup> held relative to Solvency II capital requirements, that:
- TICL is a well-capitalised company and forecast to be a well-capitalised company on the Effective Date following the implementation of the Scheme, and this status is projected to continue in the near term thereafter (i.e. 2019 – 2021);
  - TIDAC is expected to be a more than sufficiently capitalised company (close to the boundary of well-capitalised) on the Effective Date following the implementation of the Scheme, and this status is forecast to continue in the near term thereafter (i.e. 2019 – 2021).
- 6.89 The Transferring Policyholders will therefore be transferring to a company (i.e. TIDAC) with a similar (albeit reduced) level of capital coverage to that of their existing insurer. Nonetheless, as I note in paragraph 6.82 above, this reduction in capital coverage for policyholders of TIDAC (including the Transferring Policyholders) post-Scheme is not so large that there is a material risk that their claims will not be met in full.
- 6.90 While the Transferring Policyholders will be moving from a medium-sized company (with direct financial support via the SPFMG) to a relatively small company that has only just been established, it should be borne in mind that TIDAC (like TICL) is part of the Travelers Group, and ultimate policyholder security falls to companies in the Travelers Group both before and after the implementation of the Scheme. As a result, I consider that the risk of adverse consequences for the Transferring Policyholders is low.
- 6.91 Furthermore, the policyholders of TIDAC (including the Transferring Policyholders) will receive the indirect benefit of the SPFMG post-Scheme (to the extent of 80% of the risk) since the TIDAC business (including the Transferring Business) will be 80% reinsured back into TICL (via the whole account quota share reinsurance arrangement as outlined in paragraph 4.16 above). Therefore, the policyholders of TIDAC (including the Transferring Policyholders) will benefit indirectly (to the extent of 80% of the risk) from the SPFMG, because all claims under (re)insurance policies issued by TICL are within the scope of the SPFMG, which essentially removes the risk that the aforesaid whole account quota share contract(s) will have any shortfall.

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<sup>35</sup> It should be noted that I have not taken any explicit account of the benefit to policyholders of the SPFMG in my analysis of Excess Assets as discussed in Sections 6 and 7 of the Report, but have done so in considering the wider chain of security protecting policyholders pre- and post-Scheme.

- 6.92 If TICL were unable to meet its obligations after the Scheme were implemented this could impact the solvency position of TIDAC given the significance of the whole account quota share reinsurance asset (provided by TICL) on TIDAC's balance sheet. However, as discussed in paragraph 6.62 above, given the financial strength of TICL and the guarantee in place with SPF&M, this scenario would appear to be remote.
- 6.93 In the period<sup>36</sup> from the Effective Date through to the end of the Brexit Transition Period or expiry of any temporary permissions regime, TIDAC will operate with a UK branch (founded on an FoE basis) and will therefore be a "firm" for the purposes of the FSCS. As such, the Transferring Policyholders will have the same access to the FSCS during this period that they enjoyed prior to the Effective Date. However, as indicated in paragraph 5.27 above, the Transferring Policyholders might lose access to the FSCS (after the Brexit Transition Period or expiry of any temporary permissions regime) if TIDAC fails to get prior authorisation of its UK (third country) branch by the PRA. Nevertheless, as the likelihood of the insolvency of TIDAC appears remote and the security of the Transferring Policyholders will be indirectly supported by the SPFMG (to the extent of 80% of the risk), I do not consider that the potential loss of access to the FSCS will materially adversely affect the security afforded to the Transferring Policyholders.
- 6.94 Further, in relation to any potential loss of FSCS rights, I note that Travelers/TICL are not taking any mitigation steps to offset (at least in part) the loss of such rights. I have considered this approach taking account that: (1) those policyholders pre-Scheme that were eligible for FSCS are not expected to undergo any change in access to the FSCS as a result of the Scheme (see sub-paragraph 2.14.8 above); (2) TIDAC is forecast to be a more than sufficiently capitalised company (close to the boundary of well-capitalised) and thus its insolvency appears remote; and (3) TIDAC is part of the Travelers Group (with attendant support, including the Reinsurance Contracts available to it and their direct backing from the SPFMG) and thus recourse to FSCS appears remote. I have therefore concluded that the Travelers/TICL approach of not undertaking any mitigation steps is not unreasonable.
- 6.95 I note that there are differences in the winding-up provisions between the UK and Ireland as set out in Section 3 above (in particular, the scope of the assets available to meet the valid claims of policyholders). As the policies of the Transferring Business are direct insurance contracts, the Transferring Policyholders will have preferential access to any remaining funds in the company in the event of the insolvency of TICL pre-Scheme and TIDAC post-Scheme. However, owing to the 80% whole account quota share reinsurance of the business of TIDAC by TICL (see paragraph 4.16 above), there will be a post-Scheme indirect impact on the Transferring Policyholders. This is because as a reinsurance policyholder, TIDAC will rank behind most of the Non-Transferring Policyholders since the latter are mostly direct policyholders. In order to mitigate this effect (at least in part), the assets reinsured from TIDAC by TICL will be held by TIDAC in a designated collateral account for the added security of TIDAC's policyholders. This means that:
- If TICL becomes insolvent, the funds held in the collateral account will revert to TIDAC to first settle the premium and claim liabilities of TIDAC. Further, in this scenario, the operation of the SPFMG will essentially remove the risk that there will be any shortfall on the policies issued by TICL, including the 80% whole account quota share (and stop-loss) reinsurance contracts protecting the business of TIDAC;
  - If TIDAC becomes insolvent, the funds held in the collateral account will remain available to meet claims from its policyholders in advance of other creditors. Further, in this scenario where TICL remains solvent, it will continue to meet its obligations under the 80% whole account quota share (and stop-loss) reinsurance contracts protecting the business of TIDAC; and
  - If both TICL and TIDAC become insolvent, the funds held in the collateral account will revert to TIDAC to first settle the premium and claim liabilities of TIDAC. Further, in this scenario, the operation of the SPFMG will essentially remove the risk that there will be any shortfall on the policies issued by TICL, including the 80% whole account quota share (and stop-loss) reinsurance contracts protecting the business of TIDAC.

<sup>36</sup> If the Effective Date is after the Brexit Transition Period or expiry of any temporary permissions regime then the eligible Transferring Policyholders will continue to have the same access to the FSCS during the period from the end of the Brexit Transition Period or expiry of any temporary permissions regime through to the Effective Date, but at the same time be at risk that TICL may be unable to service some of these policyholders.

- 6.96 Overall, I have concluded that there will be changes to the position of Transferring Policyholders on wind-up priorities pre- and post-Scheme. Nevertheless, for the Transferring Policyholders, the operation of the collateral account (and, if necessary, the SPFMG) serve to mitigate any weakening in their positions pre- and post-Scheme in the event of the insolvency of TICL and/or TIDAC. Furthermore, as the insolvency of either TICL or TIDAC appears remote I do not believe that differences in winding-up provisions between the UK and Ireland will materially adversely affect the Transferring Policyholders.

**Conclusion**

- 6.97 ***I am therefore satisfied that the policyholders of the Transferring Business will not be materially adversely affected due to relative differences in the financial strength of TIDAC post-Scheme to those of TICL pre-Scheme.***

**CHANGES IN RISK EXPOSURES**

- 6.98 The policyholders of the Transferring Business are currently (i.e pre-Scheme) exposed to the liabilities of TICL. If the Scheme is sanctioned, the Transferring Policyholders will become exposed to those existing within TIDAC, albeit that, at the Effective Date, no business is planned to have been written by TIDAC.
- 6.99 The portfolio to be transferred under the proposed Scheme consists predominantly of commercial lines business presently written by the Irish branch of TICL, and also the claims, principally related to medical malpractice risks, arising on the run-off businesses of the Dutch, German and French branches of TICL.
- 6.100 If the Scheme is sanctioned the policyholders of the Transferring Business will remain substantially exposed to the business written by TICL, because of TIDAC's whole account quota share reinsurance arrangements with TICL (see paragraph 4.16 above).
- 6.101 As the security of the Transferring Business will be indirectly augmented by the SPFMG via the 80% whole account quota share reinsurance by TICL of the business of TIDAC (including the Transferring Business), it is the other risk exposures within SPF&M that are also pertinent to the policyholders of the Transferring Business. These existing risk exposures will essentially be unchanged as a result of the Scheme (because SPF&M is already exposed to the Transferring Business via the guarantee it has given to TICL).
- 6.102 Based on my analysis of changes in risk exposures as outlined above, given the financial strength of TIDAC (and the indirect benefit of the SPFMG enjoyed by the Transferring Policyholders post-Scheme – to the extent of 80% of the risk) as discussed above, I do not consider that the Transferring Policyholders will be materially adversely affected by the changes in risk exposures.

**Conclusion**

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

**POLICY SERVICING**

- 6.104 The administration (including systems, policy servicing and claims handling) of the Transferring Business is currently outsourced to TML, who will continue to administer this business in the same way whether the Scheme is sanctioned or not, since TIDAC will also out-source the administration to TML (on essentially the same terms as TICL's outsourcing agreement). Therefore, the Scheme should not have any effect on the policy administration arrangements (including systems, policy servicing and claims handling) for the Transferring Business, while noting the impact of Brexit as described in paragraphs 6.117 and 6.118 below.

6.105 As described in paragraph 6.118 below, TIDAC is to establish a regulated (third country) UK branch (subject to the approval of the PRA/FCA) on or ahead of the end of the Brexit Transition Period (or expiry of any temporary permissions regime) in order that those Transferring Policies that involve exposures across both the UK and the rest of the EU (and possibly the EEA) can be administered and meet relevant regulatory requirements (in the UK and the rest of the EEA). I am therefore satisfied that the administration (including policy servicing and claims handling) of the Transferring Business that involves exposures across both the UK and the rest of the EU (and possibly the EEA) would not be materially adversely affected as a result of the Scheme and Brexit.

6.106 I therefore have no reason to believe that there will be any materially adverse change to the administration arrangements, including systems, policy servicing and claims handling, resulting from the Scheme.

### **Conclusion**

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

## **DISPUTE RESOLUTION**

6.108 In order to assess whether any loss of access to the FOS will materially adversely affect Transferring Policyholders, I asked TICL to provide me with statistics concerning the number of Transferring Policyholders that are private policyholders, or “small businesses” or “micro enterprises”; the number of complaints raised historically both in general and with the FOS by policyholders of TICL; and the number of claims and complaints made by policyholders situated in TICL branches.

6.109 The statistics provided to me for TICL show that the number of complaints received each year in relation to the Transferring Business is a small number, i.e. 6 in 2016 (1 of which was referred to the FSPO, formerly the IFSO); 4 in 2017 (none of which were referred to the FSPO, formerly the IFSO); and 1 complaint in the 8 month period to 31 August 2018 (which has not been referred to the FSPO, formerly the IFSO). I note that (at the time of writing this Report) of the complaints made in 2016, 2017 and 2018 all have been resolved with letters issued to the clients.

6.110 Having considered the situation, I have concluded that any loss of access to the FOS as a result of the Scheme will not materially adversely affect the policyholders of the Transferring Business for the following reasons:-

- Very few complaints in general have been referred to TICL historically.
- Any access to dispute resolution schemes that Transferring Policyholders may have in their home country will not be affected by the Scheme.
- FOS compulsory jurisdiction covers complaints about the activities of a firm in the UK. This includes the UK branch activities of a pass-porting EEA insurer, so there should be no change as a result of the Scheme. Activities carried on in an EEA establishment outside the UK are not covered by FOS before or after the Scheme. Activities carried on by an establishment in the UK (whether through a head office or branch of a firm) are covered by FOS both before and after the Scheme. In the event that there were an intention to shift activities that may become the subject of a complaint from the UK to outside the UK, policyholders may be able to bring complaints to the FSPO (formerly the IFOS) as described in paragraph 3.24 above.

6.111 I further note that Travelers/TICL are not taking any mitigation steps with respect to any potential loss of FOS rights. I have considered this approach taking account that: (1) those policyholders pre-Scheme that were eligible for the FOS are not expected to undergo any change in access to the FOS as a result of the Scheme (see sub-paragraph 2.14.8 above); (2) FOS compulsory jurisdiction covers complaints about the activities of a firm in the UK (which would thus include TIDAC's activities); (3) the very small number of complaints referred to dispute resolution mechanisms (see paragraph 6.109 above); and (4) policyholders may be able to bring the complaints to other local dispute schemes such as the FSPO. I have therefore concluded that the Travelers/TICL approach of not undertaking any mitigation steps is not unreasonable.

### Conclusion

- 6.112 ***Based on my review of the potential loss of access to the FOS as a result of the Scheme as described above, I believe that the Scheme will not materially adversely affect the Transferring Policyholders.***

### BREXIT

- 6.113 As noted in paragraph 3.39 above, the process by which the UK exits the EU has begun and, unless otherwise agreed by the UK and all of the remaining EU Member States, will have concluded on or before 29 March 2019.
- 6.114 The final terms of Brexit are subject to negotiation and it is unlikely that those terms will be known publicly until shortly before the exit. Therefore, it is difficult to anticipate the effects of Brexit without resorting to speculation. However, in the context of the Scheme, there are some themes that should be considered. In particular, a key purpose of the Scheme is to mitigate the risk that TICL might not be able to service some of the Transferring Policyholders following Brexit. I therefore need to consider this matter and other expected effects of the Scheme on the Transferring Policyholders. I note that the Transferring Business will be transferred from a company (TICL) that it is expected will, from 29 March 2019, no longer reside within the EU (and which might also then reside outside the EEA) to TIDAC that is and will remain within the EU.
- 6.115 Post Brexit, TICL would continue to be regulated by the PRA and FCA, and TIDAC would to be regulated by the CBI.
- 6.116 The Non-Transferring Business will continue to be administered according to UK regulations post-Scheme. I therefore believe that Brexit will have no material adverse impact on the ability of TICL to service the Non-Transferring Business.
- 6.117 As discussed in paragraph 4.107 above, TML will provide services to TIDAC, including the consideration and adjustment of claims. TIDAC management will ultimately decide whether liability should be accepted, claims should be settled and the appropriate level of reserves to maintain. Therefore, TML will provide no services that are subject to regulation. TIDAC intends that, if the Scheme is sanctioned by the Court, the management of, and decision-making relating to, claims will take place at its head office in Ireland and, notwithstanding any future departure of the UK from the EU, the administration of the Transferring Business will be outsourced to TML post-Scheme. I therefore believe that Brexit will have no material adverse impact on the servicing of the Transferring Business, noting the operation of the UK branch (of TIDAC) as described in paragraph 6.118 below.
- 6.118 As TICL's business presently contains some policies that involve exposures across both the UK and the rest of the EU (and possibly the EEA), TIDAC plans to establish a regulated (third country) UK branch (subject to the approval of the PRA/FCA) as outlined in paragraph 4.68 above. In the absence of any political or regulatory barriers, the UK branch (of TIDAC) will be able to service the UK component of such policies, including claims adjustment, claims settlement, and set the appropriate level of reserves to maintain (in each case subject to TIDAC's internal guidelines). I am therefore satisfied that, subject to the approval of the TIDAC's UK (third country) branch by the PRA/FCA on or ahead of the end of the Brexit Transition Period or expiry of any temporary permissions regime, the policy servicing of any renewed policies with EEA exposures currently written by TICL would not be materially adversely affected by Brexit. I further note that, if (for whatever reason) approval of the TIDAC's UK (third country) branch by the PRA/FCA is not forthcoming on or before the end of any transition period or the expiry of any temporary permissions regime, the Scheme is planned to continue.

### Effect on Balance Sheets

- 6.119 Immediately following the referendum, the value of Sterling on the currency exchange market dropped sharply, but has subsequently stabilised against the Euro and appreciated against the USD. This was largely balanced by rises in the UK equity markets, which at the time of writing this Report have reached or are near to record highs.

6.120 It is unclear what will happen to Sterling and to UK asset values over the period of the Brexit negotiation and following Brexit itself. However, it is likely that there will be some instability, especially as rumours and speculation emerge regarding the progress of those negotiations, and the associated votes for approval (or otherwise) by the UK parliament and the EU. Any such instability would affect the balance sheets of companies with assets and/or liabilities in multiple currencies including Sterling, although the impact could be mitigated by the matching of assets and liabilities by currency. I note that TIDAC's assets and liabilities will be predominantly in Euros and so its balance sheet should be largely immunised against the effects of currency exchange rate movements. For TICL, fluctuations in non-Sterling denominated currencies, in which TICL presently operates, are managed by TICL periodically buying and selling non-Sterling denominated currencies or investment securities in an attempt to match non-Sterling assets and liabilities. Therefore, while Brexit may lead to general economic uncertainty I do not have reason to believe that TIDAC would be impacted to any greater extent by such uncertainty than TICL.

**Conclusion**

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

**CONCLUSION FOR THE POLICYHOLDERS OF TICL TRANSFERRING UNDER THE SCHEME**

6.122 ***I am satisfied that the proposed Scheme does not affect in a materially adverse way either the security or the policy servicing levels of the Transferring Policyholders.***

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

- 7.1 In this Section of the Report I consider the impact of the Scheme on those policyholders whose policies will not be transferred to TIDAC, but which will remain within TICL after the Effective Date.
- 7.2 The net effect of moving the Transferring Business out of TICL in conjunction with the whole account quota share arrangements (see paragraph 4.16 above) is projected to represent a small part of TICL's pre-Scheme portfolio at the Effective Date (circa 4% of the expected net Technical Provisions, or circa £27 million, as at 31 December 2018, for illustration purposes). The proposed Scheme will therefore result in a small decrease to the liabilities of TICL and with a *de minimis* net effect on the capital (and regulatory capital position) of TICL.
- 7.3 In my opinion the financial effect of the proposed Scheme on the security of the Non-Transferring Policyholders will be *de minimis* and their security levels are effectively unchanged on both the pre-Scheme position and the post-Scheme position.
- 7.4 I also note that for the Non-Transferring Policyholders, the additional security (over and above the excess assets of TICL, as described in Section 6) they enjoy under the SPFMG will continue post the Effective Date.
- 7.5 In the unlikely event of TICL becoming insolvent prior to the Effective Date, the Direct (Non-Transferring) Policyholders would have priority over any Assumed Reinsurance (Non-Transferring) Policyholders in accessing the remaining assets of TICL.
- 7.6 Were TICL to become insolvent after the Effective Date, the Direct (Non-Transferring) Policyholders (who form the vast majority of TICL's policyholders) would see their position improve compared to that pre-Scheme, owing to the impact of their having priority over TIDAC as a reinsurance policyholder (although the benefit of this will be limited by the earmarking, via the funds held in a collateral account, of the assets backing the reinsured liabilities of TIDAC). Post-Scheme, the Assumed Reinsurance (Non-Transferring) Policyholders (and TIDAC as a reinsurance policyholder) would rank behind the Direct (Non-Transferring) Policyholders in accessing the remaining (non-earmarked) assets of TICL in the event of a wind-up, and therefore see their position essentially unchanged to that pre-Scheme. I am therefore satisfied that the changes in the wind-up priorities of the Non-Transferring Policyholders that would be caused by the Scheme will have no material impact on the security of benefits of the Non-Transferring Policyholders. Furthermore, I have concluded above (see Section 6) that, post-Scheme, the Non-Transferring Policyholders will be in a well-capitalised company. This means that I consider the risk of insolvency of TICL post-Scheme to be low and therefore the likelihood of any changes to priorities on wind-up to be low.
- 7.7 After the implementation of the Scheme, as with all other insurance companies with an establishment in the UK, TICL will continue to be required to participate in the FSCS. Therefore, to the extent that FSCS protection is currently available to eligible holders of the Non-Transferring Policies, they will continue to be protected by the FSCS if the Scheme is sanctioned. Likewise, since TICL is subject to the compulsory jurisdiction of the FOS, the Scheme will have no effect on the eligibility of the holders of Non-Transferring Policies to bring complaints to the FOS. If they are currently able to bring complaints to the FOS, this will remain the case after the implementation of the Scheme. If they are currently not eligible to complain to the FOS this will also remain the case after the implementation of the Scheme.
- 7.8 The policy servicing of the Non-Transferring Business will be unchanged by the proposed Scheme.
- 7.9 As noted in paragraph 5.36 above, it is possible that, at the time that the Scheme is sanctioned, there might remain in TICL some policies of the Transferring Business that could not be transferred under the Scheme (the "Excluded Policies"). As also mentioned in paragraph 5.36 above, I understand that it is highly unlikely that there will be any such Excluded Policies, but I will comment on this point in my Supplemental Report. In the event that any such Excluded Policies do arise then the liability for these will remain with TICL, but TICL will be fully indemnified by TIDAC for any such liabilities (pursuant to the Scheme). In this situation, the security of the holders of such Excluded Policies would be similar to that had they transferred under the Scheme. There would also be no changes to the policy servicing or administration of the Excluded Policies (in the period prior to their eventual transfer).

***Conclusion for the policyholders of TICL not transferring under the Scheme***

- 7.10 ***I am satisfied that the non-transferring policyholders of TICL would not be materially adversely affected by the Scheme.***

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## 8. OTHER CONSIDERATIONS

### ASSETS OF TICL AND TIDAC

- 8.1 In assessing the impact of the Scheme, I have considered the nature of the assets within each of TICL and TIDAC before and after the Scheme occurs (as illustrated in Tables 5.1 and 5.2 above). The assets of each of TICL and TIDAC available to meet policyholder obligations can be classified into three broad categories:
- 8.1.1 Investments and Cash – Financial investments held by TICL and TIDAC are held in bonds and cash. The investment policies pursued by TICL and TIDAC (as described in Section 4) are conservative in nature, with investments made in a broad mix of short to medium-term government bonds and corporate bonds (the latter predominantly comprising bonds issued by corporations which are considered highly secure by public rating agencies);
  - 8.1.2 Reinsurance assets (made up of ceded reserves for unearned premiums and outstanding claims, and reinsurance recoveries on paid claims) – Subject to the specific terms of the relevant reinsurance contracts, reinsurance assets have the capacity to absorb losses arising from the underlying reinsured insurance liabilities thereby reducing financial risk. I note that TIDAC has a material reliance on reinsurance, in particular from the whole account quota share arrangements (see paragraph 4.16 above). However, the nature and level of utilisation of such arrangements is in line with my expectations given the reinsurance strategies of each of TICL and TIDAC (as described in Section 4); and
  - 8.1.3 Premium and Other Debtors – sundry assets arising in the normal course of business such as accounts due from intermediaries, policyholders and suppliers, and intercompany balances due from other members of the Travelers Group largely arising as a consequence of recharges of expenses between group companies. These balances are in line with my expectations for a business of this nature.
- 8.2 I do not identify any matter arising from the balance sheet assets held by TICL and TIDAC that would cause me to perform specific further analysis. I note that no change in the overall asset composition of TICL and TIDAC (available to meet policyholder obligations) will arise as a direct result of the Scheme.
- 8.3 The Court has the power to order (and the Scheme provides for) the transfer to TIDAC, of TICL's relevant outwards reinsurance contracts in respect of the Transferring Business. On the basis that TICL's relevant outwards reinsurance contracts (modified as described in paragraphs 8.13 to 8.15 below) are transferred as part of the Scheme, the net (of reinsurance) positions of TIDAC and TICL will not be materially adversely impacted as a result of the Scheme.
- 8.4 As outlined in sub-paragraph 8.1.1 above, TICL and TIDAC will hold in their investment portfolios short to medium-term government and corporate bonds, and cash. Such assets are sufficiently liquid to meet liabilities as they fall due, both before and after the Scheme. As a result, I do not anticipate that the Scheme will create any material adverse impact with respect to liquidity for the Transferring Policyholders, the Non-Transferring Policyholders or the current TIDAC Policyholders.

### OPERATIONAL PLANS AND CHANGES IN ASSETS AND LIABILITIES UP TO THE EFFECTIVE DATE

- 8.5 The balance sheet I have reviewed for TICL show amounts as at 31 December 2017. I have chosen this date because it is the latest date for which audited financial information is available.
- 8.6 I expect that the current activities of TICL to have continued, and will continue, between 31 December 2017 and the Effective Date (and, as appropriate, after the Effective Date). TICL has continued, and will continue, to write new business, settle claims and reassess reserves in the light of experience. I do not consider that any material additional risk to any group of affected policyholders will emerge as a result of the continuation of normal business.
- 8.7 Further to considering the continuation of normal business, I have discussed with TICL the possibility of management actions, other than the proposed Scheme, as considered in this Report, that could affect the financial position of TICL (such as significant changes in new business strategy or operational plans). I have been informed that: TICL has no planned activities that would have a material effect on the security of TICL's policyholders.

- 8.8 I believe that it is unlikely that any events occurring between 31 December 2017 and the Effective Date would affect any conclusion that I have reached based on my review as at 31 December 2017 (and subsequent updates to projections).
- 8.9 A short time before the final Court hearing, I will consider the extent to which actual changes in assets and liabilities have been in line with expectations (relative to the position as at 31 December 2017, and subsequent updates to projections) and hence whether there have been any changes (including those associated with current economic conditions) that would affect my overall opinion, and, if necessary, I will report on these separately in my Supplemental Report.

## MIS-SELLING LIABILITIES

- 8.10 In her judgement regarding the recent case of PA(GI) Limited v (1) GICL 2013 Limited (2) Cigna Insurance Services (Europe) Limited (2015), Mrs Justice Andrews DBE said that “..an intention to make provision for the transfer of mis-selling liabilities would quantify as an unusual feature which might have a material financial impact on the scheme, and which one would therefore expect to be expressly disclosed in the context of an application for a transfer under a Part VII scheme.” ...
- 8.11 TICL is not aware of any actual or potential mis-selling liabilities within its predominantly commercial business. I note that commercial (re)insurance business which tends to involve larger corporate policyholders is by its nature unlikely to give rise to any mis-selling liabilities in relation to the Transferring Business. In any event, it is intended that the Scheme will transfer any such liabilities, should they arise in relation to the Transferring Business, from TICL to TIDAC. Any mis-selling liability that arises within TICL that is not related to the Transferring Business would not be transferred from TICL to TIDAC as part of the Scheme. I have not considered it necessary to comment further on this matter in the Report.

## THE LIKELY EFFECTS OF THE SCHEME UPON REINSURERS OF TICL

- 8.12 In accordance with the PRA Statement of Policy and SUP18, I have considered the likely effects of the Scheme on the reinsurers whose reinsurance contracts cover those parts of the business to be transferred by the Scheme from TICL to TIDAC.
- 8.13 Travelers intends to modify certain of the outwards reinsurance contracts that currently provide reinsurance protection to the business written by TICL. This means that Travelers will reach agreement with each reinsurer that the reinsurance that they each provide will continue to apply to all of the Transferring Business that transfers to TIDAC. Therefore, after the modification of reinsurance is completed there would be no material change to the reinsurance protecting the business written by TICL, because:
- Travelers will add TIDAC along with TICL as a named insured on any intra-group treaties, and relevant treaties with external reinsurers;
  - The risk profiles of the transferring reinsurance contracts will not be changed as a result of the Scheme;
  - While any aggregate limitation or attachment point shall continue to be applicable to each transferring reinsurance contract as a whole, I am informed that Travelers, which already has in place and runs an operational protocol as the application of aggregate limits and/or attachment points in relation to all the companies of the Travelers Group, will continue to apply such protocols on and after the Effective Date; and
  - Likewise, while any excess or deductible shall continue to be applicable to each transferring reinsurance contract as a whole, I am informed that Travelers, which already has in place and runs an operational protocol as the application of excess levels and/or deductibles in relation to all the companies of the Travelers Group, will continue to apply such protocols on and after the Effective Date.

- 8.14 I am informed that Travelers has already reached an internal agreement in principle to proceed with modifications with those reinsurers of TICL that are part of the Travelers Group. There are a number of reinsurers of TICL external to the Travelers Group, and Travelers is currently carrying out a project to identify such reinsurance contracts of TICL and to reach an agreement with the providers of those reinsurance contracts by 1 March 2019. I anticipate providing an update in my Supplemental Report on the progress made by Travelers in modifying the outwards reinsurance agreements as described above.
- 8.15 I understand that all necessary modifications of both internal and external reinsurance treaties of TICL are expected to be completed by 1 March 2019 (i.e. prior to the Effective Date). My conclusion in this Report is based on the assumption that the transferring reinsurance will be modified as described above prior to the Effective Date.
- 8.16 I have considered whether the Scheme is likely to lead to any changes in the rights of set-off for creditors or debtors of TICL or TIDAC. 'Set-off' is a right that allows parties to cancel or offset mutual debts with each other by subtracting one from the other, and paying only the balance. Since the Transferring Business has external reinsurance, there is the slight possibility of changes in the right of set-off on the insolvency of TIDAC post-Scheme. The chances of insolvency of TIDAC are, however, remote (particularly in the near-term). As such, I do not believe the right of set-off affects my conclusions on the impact of the Scheme on reinsurers.
- Conclusion for the reinsurers of TICL whose contracts of reinsurance are to be transferred by the Scheme***
- 8.17 ***For the reasons discussed above, I am satisfied that the Scheme will not have a materially adverse effect on the reinsurers of TICL whose contracts of reinsurance are to be transferred to TIDAC by the Scheme (subject to the necessary modifications of both internal and external reinsurance treaties of TICL being completed prior to the Effective Date).***

## THE APPROACH TO COMMUNICATION WITH POLICYHOLDERS

- 8.18 Regulations made under the FSMA require a communication regarding the proposed Scheme to be sent to every policyholder of the Companies. However, consideration may be given to the practicality and costs of sending notices against the likely benefits for policyholders of receiving such communications. In order to comply with both paragraph 2.53 of the Policy Statement and paragraph 2.46G of SUP18, the Companies would be expected to notify the policyholders, or interested persons, at least six weeks before the date of the Court hearing at which the application to sanction the Scheme will be heard.
- 8.19 I set out my understanding of the Companies' proposed approach to communicating the Scheme to affected policyholder groups below:
- EU Branches in the Netherlands, France and Germany – Active claimants
  - EU Branches in the Netherlands, France and Germany – Run-off business, long-tail
  - Irish Branch – Live policyholders
  - Irish Branch – New policyholders after Directions Hearing but before the Scheme is implemented
  - Irish Branch – Active claimants
  - Irish Branch – Run-off business, long-tail
  - Irish Branch – Run-off business, short-tail
  - Non-transferring TICL policyholders.
- EU Branches in the Netherlands, France and Germany – Active claimants***
- 8.20 For all active claimants, Travelers will contact them directly to inform them of the Scheme.

*EU Branches in the Netherlands, France and Germany – Run-off*

- 8.21 This book of business has been in run-off since 2000/2001 and was all produced to Travelers by local brokers and Travelers does not hold details of policyholders in its records. It is believed that hard copy underwriting records may exist in off-site local storage, but this is not easily accessible (indeed Travelers does not know where all off-site storage is located) and Travelers does not propose that it is proportionate for it to visit or find these locations in order to determine what, if anything, is held there.
- 8.22 The business written by these branches was mainly Medical Malpractice and therefore has a long-tail. I also note that the Dutch book contains asbestos disease claims, and that the legal system in France means that if injuries worsen, new claims can be made on the French book. As such, further new claims are possible, but I note that the recent claims volume is low.
- 8.23 When claims are made on this book, the claimants come to Travelers via their broker, who provides the information on the insured and the policy. Claims handling for this book is currently undertaken by a Third Party Administrator (Advent Insurance Management Limited – “TPA”) in advance of the anticipated move of this book of business under a separate portfolio transfer (to be implemented after the Scheme).
- 8.24 While there is a possibility of further claims on this book, Travelers does not have contact details for the policyholders, nor is it able to obtain them. Therefore, it is not possible for Travelers to contact policyholders individually. Therefore, where Travelers has broker information (e.g. brokers who have contacted Travelers about claims in the past) Travelers will notify these brokers and ask that they inform policyholders. Travelers will also place notices in local papers and the trade publication “Insurance Day” in order to raise awareness among potential policyholders/claimants/brokers.

*Irish Branch – ‘live’ policyholders*

- 8.25 The ‘live’ book of Irish business is primarily a mix of EL/PL/Property and Motor business. EL makes up approximately 17% of the business, even though the book is very Property biased. Premium sizes range from €1,500 to €1.4 million and all policyholders are commercial businesses; but the majority of the book (approximately 95%) is defined as consumer business under Irish law. At the date of this Report, there are circa 5,530 active policies in the Irish book.
- 8.26 Travelers does hold individual policyholder data for the ‘live’ book and will contact policyholders directly using the latest address details available to it. Travelers will also send notices to Irish brokers for completeness.
- 8.27 In order to raise awareness of the Scheme among the community in Ireland Travelers will also place notices in national newspapers.

*Irish Branch – New policyholders after the Directions Hearing but before the Scheme is implemented*

- 8.28 Travelers will directly contact all new policyholders whose policies incept in the period between the Directions Hearing and the Scheme being implemented by sending information on the Scheme together with their policy documentation.

*Irish Branch – Run-off business, long-tail*

- 8.29 The back book of the Irish branch contains a number of classes of business with long-tail liability. In particular, this includes:
- EL business which has a reasonably long-tail and has generated claims in recent years;
  - Solicitors and Professions, in particular the SMDF (Solicitors Mutual Defence Fund). These books of business are in run-off, but TICL is still dealing with claims;
  - In the late 1990s and early 2000s, Medical Malpractice was written on this book; and
  - Personal lines motor book. This was placed in run-off in 2011 but involves individual customers. There are still some claims on this book and they have a long-tail (bodily injury).

- 8.30 Despite the long-tail of this business, it is the opinion of the Travelers in-house actuaries that all business written in 2010 and prior is likely to experience only minimal movement on associated claims. There are outstanding claims on this business (especially bodily injury and solicitors claims, which take longer to settle) but while it is possible, it is not considered likely that there will be new claims on this business.
- 8.31 Travelers does hold individual policyholder data for most of the Irish back book. However, the estimated cost of contacting all policyholders back to 1993 is considered disproportionate to the benefit. Travelers would need to sort the data to determine that which is long/short-tail, which would take up significant actuarial time, and contacting each of the policyholders would be a costly exercise given the large volumes of policyholders in this category (in particular personal lines motor). A basic estimate of cost (using total policyholders minus active policyholders) gives a policy count of circa 620,000 and a cost (based on a £3 per letter) of circa £1.9 million. Travelers believe that this is a disproportionate cost and effort in relation to the impact on policyholders.
- 8.32 As all of this business was intermediated, Travelers plans to contact policyholders via their broker.
- 8.33 In order to raise awareness of the Scheme among the community in Ireland and in particular any personal lines policyholders or commercial policyholders for whom Travelers does not have broker information, Travelers also plans placing notices in national newspapers and “Insurance Day”.

*Irish Branch – Run-off business, short-tail*

- 8.34 Short-tail run-off business in the Irish book consists primarily of Property business on which further claims are not anticipated. Therefore, Travelers does not plan to contact these policyholders to inform them of the Scheme.
- 8.35 It is considered likely that a number of these policyholders may have renewed their policy with Travelers or have a claim and will be advised directly as either an active policyholder or claimant; or if they have not, the notices placed in local newspapers/trade publications will also reach this group of policyholders.

*Irish Branch – Active claimants*

- 8.36 Travelers will contact all active claimants directly to inform them of the Scheme.

*Non-transferring TICL policyholders*

- 8.37 Travelers does not plan to contact any of the non-transferring TICL policyholders about the Scheme. The Irish book of business represents a small proportion of the total TICL book – in 2017, the Irish book total premium was circa €39 million out of circa £242 million for TICL overall, and therefore the impact on these policyholders is considered by Travelers to be minimal.

*Reinsurers of TICL*

- 8.38 TICL will also send a letter to each reinsurer of a transferring TICL outwards reinsurance contract for whom they have records (essentially reinsurance incepting after 2005) informing them of the intention to transfer such contracts.

*Monitoring broker mailings*

- 8.39 In relation to the broker mailings I am informed by Travelers (via its legal advisors in relation to the Scheme) that:
- TICL will follow-up these brokers with an e-mail (a frequent communication approach used with brokers) to check safe receipt (items such as failed delivery will be managed by TICL) and whether they have any questions, but also traditional post (if no e-mail is available) to ensure an all-inclusive approach is adopted; and
  - Should any person or persons affected by the Scheme object to the Scheme, the mailed materials will state to whom any such objections should be sent – therefore, there is no reason why brokers themselves should receive or handle any objections to the Scheme.

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*Review of the proposed approach to notifications of policyholders*

- 8.40 It will ultimately be for the Court to decide what notifications are required. This will be decided at a court hearing after this Report is finalised and will be subject to any amendments required by the Court. It is possible, therefore, that the actual approach to policyholder notification may differ in some respects from that proposed and outlined above. If the proposed notifications are amended, I will comment on whether there are any changes to my conclusions in my Supplemental Report.
- 8.41 For those policyholders within the policyholder groups identified above for whom Travelers approach is not to directly notify them (i.e. all policyholders other than active claimants, 'live' Irish branch policyholders and new policyholders after the Directions Hearing but before the Scheme is implemented) Travelers is seeking a waiver from the notification requirements.
- 8.42 I also note here that my comments in this sub-section are based on my general industry experience and on my understanding of the policyholders affected (as described above), rather than on specific expertise in the area of policyholder communication.
- 8.43 When evaluating the proposed approach to notifications, I have considered a number of factors, including whether the policyholders in TICL are likely to be interested in being informed of the proposed Scheme. In this context, I believe that the approach to policyholder notifications needs to consider the likelihood of a policyholder having a claim, whether the policyholder's policy is transferring and the impact of the Scheme on security. I have therefore weighed these issues up against the risk of policyholder notifications causing confusion or annoyance in relation to an issue that policyholders may consider to be insignificant, and against the practicability of notifying policyholders, as follows:
- 8.43.1 Ultimate policyholder security falls to companies in the Travelers Group both before and after the implementation of the Scheme. As a result, I consider that the risk of adverse consequences for policyholders or third-party claimants who do not receive notification is low;
- 8.43.2 All the policies written by TICL that comprise the Transferring Business were effected through brokers, and as such all contact (save for claims) is via brokers;
- 8.43.3 For the policyholders located in one of the branches in the Netherlands, France or Germany (all in run-off) the impact of the Scheme is limited. The local contacts (brokers) in the respective countries will stay the same. The current TPA will stay the same, and the Travelers team assisting the TPA will stay the same (working for TIDAC through its UK branch). Therefore, in the event that policyholders use the current contact details, they will be processed by the same team. Nonetheless, for those policyholders located in one of the branches in the Netherlands, France or Germany with active claims, Travelers will contact them directly using the latest address details available to it. I consider the proposed arrangements to be reasonable;
- 8.43.4 For Irish branch run-off business, long-tail policyholders, and Irish branch run-off business, short-tail policyholders the impact of the Scheme is limited. I also observe that writing to all of aforesaid policyholders would incur significant costs, disproportionate to any benefit derived. Further, in each case, the local contacts (brokers) will stay the same, as will the Ireland-based Travelers underwriting and claims team. The office location in Dublin is also the same. Therefore, in the event that policyholders use the current contact details, they will be processed by the same team. Nonetheless, for those Irish branch policyholders with active claims as well as 'live' Irish policyholders, Travelers will contact them directly using the latest address details available to it. I consider the proposed arrangements to be reasonable;
- 8.43.5 For the non-transferring TICL policyholders, my financial analysis has indicated that the impact on their position will be negligible. Therefore writing to all of TICL's non-transferring policyholders would incur significant costs, disproportionate to any benefit derived. I therefore think the proposed approach is reasonable for these policyholders;
- 8.43.6 Travelers (via its legal advisors in relation to the Scheme) has shown me the wording in the Policyholder Statement to be sent directly to certain policyholders TICL (which is to have enclosed with it a short document containing the terms of the Scheme, and the Summary). I believe that this document will make the aforesaid policyholders aware of the Scheme and its impact on their position;

8.43.7 Travelers proposes to publicise the Scheme in notices for the Scheme in Ireland, France, Germany and the Netherlands. I consider that the publicity arrangements for the Scheme are reasonable and will help reduce the risk of there being transferring policyholders affected who will not be aware of the Scheme;

8.43.8 For the Scheme, TICL is to send a letter to each reinsurer of the transferring TICL outwards reinsurance contract (on the basis set out in paragraph 8.38 above) informing them of the intention to transfer such contracts. I consider that such an approach is appropriate.

8.44 ***Based on my considerations (as outlined above), I believe the proposed approach to communication with policyholders and reinsurers (as the case may be) including the dispensations sought to be both proportionate and reasonable. In making this statement, I reiterate that it is for the Court to approve the notification arrangements.***

## CHANGE IN REGULATORY STANDARDS

8.45 In this sub-section I analyse (at a high-level) the change in regulatory regimes as a result of the Scheme, under the categories of prudential supervision and conduct supervision.

### *Prudential Supervision*

8.46 For the Non-Transferring Policyholders there will be no change to the lead prudential supervisory authority of TICL; this will remain as the PRA.

8.47 Prudential supervision for the Transferring Policyholders may change following the Scheme. Pre-Brexit, I anticipate that the PRA will act as the lead prudential supervisor for TICL and TIDAC together, working closely with the CBI under the Solvency II regulatory arrangements. Post-Brexit, the supervisory position will depend upon the exit terms negotiated between the UK and the EU. Nonetheless, I would expect that the CBI will take over responsibility as sole prudential supervisor for TIDAC and prudential supervisor for its proposed UK branch. Further, in either scenario (pre- or post-Brexit), I would expect that the PRA and the CBI will seek to co-operate with one another.

8.48 Solvency II has essentially harmonised prudential supervision across the EU. As such, I consider that the prudential regulatory regime in Ireland to be substantively similar to that operating in the UK.

8.49 Thus, I have concluded that, while Transferring Policyholders may experience a change in the prudential supervisor (of their insurer) as a result of the Scheme, the effects of any of these changes are unlikely to impact adversely the Transferring Policyholders to a material degree. Nevertheless, I anticipate including in my Supplemental Report any update to the position regarding prudential supervision of TIDAC.

### *Conduct Supervision*

8.50 In general, conduct regulation is performed by the regulator in the country in which the risk is located and/or the location in which the regulated activities are carried out. As such, for the Transferring Policyholders with policies written on a FoE basis, since neither the location of the risk nor the location of the regulated activities is changing (because they all remain policyholders of a branch operation located in the same EEA-state pre- and post-Scheme), the applicable conduct regime will remain unchanged by the Scheme. Thus, I have concluded that the Transferring Policyholders with policies written on a FoE basis are unlikely to be materially adversely affected by the change in conduct regulatory regime.

8.51 In the case of Transferring Policyholders with policies written on a FoS basis, although the location of the risk is not changing the location in which the regulated activities are carried out might change from the UK to Ireland (although I note that TICL's preference, subject to applicable regulatory consents, is to service claims in respect of such Transferring Policyholders from the UK branch of TIDAC, which would mean that the UK conduct regulatory regime would continue to apply in respect of activities carried out from the UK branch).

- 8.52 Nonetheless, it is possible that the Irish conduct regime, rather than the UK conduct regime, will apply post-Scheme to Transferring Policyholders with policies written on a FoS basis. I anticipate that there will be differences in the manner in which the FCA and the CBI discharge their respective conduct responsibilities, but I do not have any reason to believe that there will be a fundamental difference in their aims (i.e. the need to ensure the honest and equitable treatment of financial consumers and the integrity of the financial markets) and therefore in the outcomes arising for such policyholders.
- 8.53 As such, I do not consider that the Transferring Policyholders are likely to be materially adversely affected by any change in conduct regime as a result of the Scheme. Nevertheless, I anticipate including in my Supplemental Report any update to the position regarding conduct supervision of TIDAC.
- 8.54 Further, for the Non-Transferring Policyholders there will be no change to the conduct supervisory authority of TICL; this will remain the FCA. Thus, there is unlikely to be a materially adverse impact on such policyholders as a result of the Scheme.

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

- 8.55 If the Scheme were not to proceed then:
- 8.55.1 The TICL transferring business would remain with TICL. There would in effect be no change from the current situation, although the parties to the Scheme would revisit the contractual arrangements that are in place in relation to the TICL transferring business to ensure they remain appropriate, in particular post-Brexit. This situation would not provide the regulatory split between EEA (excluding UK) and UK (and non-EEA) risks that TICL seeks in respect of this business, and there is a risk that post-Brexit, were it to continue to service its EEA (excluding UK) policies in line with its contractual obligations, TICL would be breaching regulatory rules;
- 8.55.2 TIDAC would remain a vehicle for writing EEA (excluding UK) business within the Travelers Group, including the new and renewing EEA (excluding UK) business of TICL from the Effective Date. This mode of operation would not change as a result of Brexit.
- 8.56 As indicated in paragraph 8.55 above, in the absence of the proposed Scheme there is a risk that TICL will not be able to service policies (including the settlement of claims) in line with regulatory rules as a result of Brexit. In particular, were the Scheme not to proceed then, following Brexit, TICL has estimated that, at the date of the Report, there will be: 748,000 Irish Transferring Policies (made up of around 1,000 policies with case reserves and an additional 5,500 policies from the in-force portfolio that are not duplicates) that TICL might no longer be authorised to service.

## PENSION SCHEME OBLIGATIONS

- 8.57 There are no pension liabilities in TICL or TIDAC. The staff are employed by TML (servicing the business of TICL and TIDAC) and employee pension benefits are provided by TML. These pension arrangements are in place, and will not change after the Scheme. Given that there will be no pension liabilities in TICL or TIDAC at the Effective Date, I do not believe that these pension arrangements affect my conclusion on the Scheme.

## COSTS AND TAX EFFECTS OF THE SCHEME

- 8.58 The external costs of the Scheme (estimated to be about £231,500, based on the Scheme and planned communication with policyholders as outlined above) will be met by TICL. While these costs are not insubstantial, they are one-off in nature and not material in the context of the available capital of TICL as at 31 December 2017 (and forecast over the period 2018 – 2021).
- 8.59 I am informed by Travelers that the Scheme is not expected to have tax implications that would have a material effect on any of the Companies or any of the groups of policyholders identified in paragraph 2.10 above. I have not identified any reasons for a material tax liability to be incurred and, on that basis, I have no reason to disagree with the conclusion reached by Travelers that there are no material tax implications as a result of the Scheme.
- 8.60 I do not believe that the cost or tax effects of the Scheme will have a materially adverse impact on the policyholders affected by the Scheme (as identified in paragraph 2.10 above).

## 9. CONCLUSIONS

9.1 In summary, in my opinion:

- The security of benefits to policyholders of TICL and TIDAC will not be materially adversely affected by the implementation of the Scheme (in conjunction with the Reinsurance Contracts) on the Effective Date; and
- The Scheme (in conjunction with the Reinsurance Contracts) will not materially adversely impact on service standards experienced by the policyholders of TICL and TIDAC.

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

- I have considered which parties might be affected by the Scheme and in what way. I have documented my findings.
- I have not performed my own modelling, rather I have relied on the results of models developed and operated within TICL and TIDAC. I have reviewed documentation describing the models, describing and justifying the assumptions underlying those models, and explaining the derivation of the data underlying the models and assumptions, in particular explaining how its accuracy, completeness and relevance has been verified.
- To the best of my knowledge there are no beneficiaries for whom the impact of the Scheme has not been considered.
- I have considered how the Scheme might lead to any changes in the material risks to the benefits of the different interested parties.
- I have considered the impact on the actuarial information provided to me of TICL and TIDAC having adopted alternative plausible assumptions.



Gary Wells / 10 December 2018

Fellow of the Institute and Faculty of Actuaries

## APPENDIX A DEFINITIONS

2017 TICL ORSA Report	The ORSA Report prepared in respect of TICL and dated 13 December 2016.
2018 TIDAC ORSA Report	The ORSA Report prepared in respect of TIDAC for the application for authorisation to the CBI and dated 01 May 2018.
Actuarial Central Estimate (“ACE”)	An ACE represents an expected value over the range of reasonably possible claims outcomes. As the range of reasonably possible outcomes does not include all possible outcomes, e.g. it does not include conceivable extreme events where the contribution of such events to an expected value is not reliably estimable, it is not the result of a probability distribution or a statistical analysis.
Actuarial Function (“AF”)	The AF is a key function under Article 48 of the Solvency II Framework Directive, having responsibilities for Technical Provisions, Underwriting, Reinsurance and Risk Management.
APH	Asbestos, pollution and health hazard.
APS	Actuarial Profession Standard, as issued by the Institute and Faculty of Actuaries.
Assumed Reinsurance Policyholder	A policyholder (or a prospective policyholder) who enters in to a contract of reinsurance that is assumed by (or written by) an insurance undertaking (as distinct from outwards reinsurance that is ceded to a reinsurer). I refer to policies issued to Assumed Reinsurance Policyholders as Assumed Reinsurance Policies.
BBNI	Bound but not incepted, i.e. policies that have been written but have not yet incepted at the valuation date.
Best estimate	This term is used in this Report in reference to outstanding claim reserves and is intended to represent the arithmetic mean of the perceived distribution of all possible claims outcomes. A best estimate reserve will therefore normally be designed to include no margins for caution or optimism.
B/F Method	Bornhuetter-Ferguson method, a means of projecting claims data to its ultimate value. It is effectively a mixture of the chain ladder method and the initial expected loss approach, the results being a weighting of the results of these two other methods, the weighting being increasingly towards the results of the chain ladder method the greater the time since the date of the underlying claim, or of the underwriting year (depending on the underlying data).
Brexit	“Brexit” is an abbreviation of “British Exit” which refers to the impending exit of the UK from the EU, following the referendum on continuing membership held in the UK in June 2016. The UK government began the formal process for negotiating the terms of the UK’s exit in March 2017 by triggering Article 50 of the Lisbon Treaty. The negotiation process is likely to take at least two years, and at the time of drafting this Report, the terms of Brexit were unknown.
Brexit Transition Period	The transition period is for 21 months after Brexit (i.e. to 31 December 2020) within which the UK will leave the EU but remain within the single market and customs union.

CBI	Central Bank of Ireland (the “CBI”) is the Ireland regulator for financial services. Since 1 January 1972 the CBI has been the banker of the Government of Ireland in accordance with the Central Bank Act 1971.
Capital Cover Ratio	The ratio of Available Capital to Required Capital. This is a measure of the capital strength of the insurer – the higher the ratio, the stronger the company.
Chain Ladder Method	The Chain Ladder method is an actuarial method commonly used to estimate claim reserve amounts. The method considers the historical development of reported paid and incurred claims and then extrapolates this historical claim development into the future to estimate future claim development. An important assumption in this method is that it expects the future development of claims to be similar to the historical average. The method involves some actuarial judgement in determining the assumption for the pattern of future claims from the historical data.
CBM	Cross Border Merger (“CBM”) is a mechanism whereby at least two companies from different EU member states can effect mergers in which all the assets and liabilities of the transferor company (including employees) are automatically transferred to the transferee company and the transferor company ceases to exist without needing to be put into liquidation.
The Companies	The collective term for TICL and TIDAC.
Correlation	Correlation (in the context of the Report) is a number that describes the statistical relationship between two variables (e.g. equity prices and interest rates).
The Court	The High Court of Justice of England and Wales
Direct Policyholder	A policyholder (or a prospective policyholder) who makes arrangements for him/her to enter in to a contract of insurance (directly or through an agent) with an insurance undertaking. I refer to policies issued to Direct Policyholders as Direct Policies.
ECM	Economic Capital Model.
EEA	The European Economic Area (“EEA”) was established by the EEA Agreement on 1 January 1994. The EEA unites the 28 EU Member States with Iceland, Liechtenstein, and Norway into an internal market governed by the same basic rules. These rules aim to enable goods, services, capital, and persons to move freely about the EEA in an open and competitive environment, a concept referred to as the four freedoms.
Effective Date	The date on which the Scheme shall become operative (expected to be 31 March 2019).
EIOPA	The European Insurance and Occupational Pensions Authority (“EIOPA”) was established in consequence of the reforms to the structure of supervision of the financial sector in the EU, with the goals of: better protecting consumers and rebuilding trust in the financial system; ensuring a high, effective and consistent level of regulation and supervision taking account of the varying interests of all Member States and the different nature of financial institutions; greater harmonisation and coherent application of rules for financial institutions & markets across the EU; strengthening oversight of cross-border groups; and promoting coordinated EU supervisory responses.

ELTO	Employers' Liability Tracing Office, which is an independent, not-for-profit UK company limited by guarantee and funded by a levy, and which aims to help claimants suffering from a disease/injury caused at work to find the insurer of their former employer.
ENID	In estimating the technical provisions under Solvency II, insurers must make allowance for events not in data ("ENID"), i.e. those possible future events or developments that have not been seen in the historic claims experience of the insurer.
EOF	Eligible Own Funds, which is that element of the Own Funds that can count towards meeting the SCR (or MCR).
ERM	Enterprise Risk Management, which is the process of planning, organising, leading, and controlling the activities of an organisation in order to minimize the effects of risk on an organisation's capital and earnings.
EU	The European Union.
Excluded Policy	A contract of insurance or reinsurance (if any) written or assumed by by TICL under which any liability remains unsatisfied or outstanding as at the Effective Date and which, for any reason, is not transferred by order of the Court pursuant to Part VII of FSMA on the Effective Date.
Funds at Lloyd's ("FAL")	FAL are assets (not being the syndicate assets) provided by or on behalf of a member (Travelers in the context of the Report) to meet the liabilities arising from the member's insurance business at Lloyd's that are held in a Lloyd's Trust Fund and managed by the Society of Lloyd's as trustee.
FCA	The Financial Conduct Authority ("FCA") is the UK regulatory agency that focuses on the regulation of conduct by retail and wholesale financial services firms. The FCA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
FoE	Freedom of Establishment, which is a form of EEA passport rights whereby an EEA domiciled firm can set-up and operate as a branch in another EEA state.
FoS	Freedom of Services, which is a form of EEA passport rights whereby an EEA domiciled firm can provide cross-border services or advice in other EEA states (from its home EEA state).
FOS	Set up by the UK Parliament, the Financial Ombudsman Service ("FOS") is the UK's official expert in sorting out problems with financial services.
FRC	Financial Reporting Council, the body that oversees the actuarial profession in the UK and which is responsible for the issuance of all professional guidance to UK actuaries.
FSA	The Financial Services Authority ("FSA") was the UK regulator for financial services until 2012. Its responsibilities were then taken over by and divided between the PRA and the FCA.
FSCS	The Financial Services Compensation Scheme ("FSCS") is the compensation fund of last resort for customers of UK authorised financial services firms.
FSMA	Financial Services and Markets Act 2000, the legislation under which Part VII governs the transfer of (re)insurance business between (re)insurance undertakings.

FSMA Report	A report on the terms of a transfer under Part VII of FSMA, to be prepared by an independent person. The FSMA Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.
GAAP	Generally accepted accounting principles (“GAAP”) form the standard framework of guidelines for financial accounting used in any given jurisdiction.
Gross	Excluding the effect of reinsurance arrangements, e.g. “gross insurance liabilities” refers to insurance liabilities before taking into account any offsetting of reinsurance assets.
Holding company	A holding company is a company established for the sole or main purpose of holding shares in subsidiary companies.
IBNR reserves	These are reserves in respect of claims which relate to claim events that have occurred before the valuation date but which were still to be reported to the insurer as at that date. For the purposes of this Report they also include reserves in respect of any perceived shortfall between the projected ultimate costs and the case estimates for claims already notified.
IDD	The Insurance Distribution Directive (EU) 2016/97 of the European Parliament and of the Council.
IELR	An Initial Expected Loss Ratio (“IELR”) is generally based on a review of previous accident (or underwriting) year ultimate loss ratios and the relevant ultimate loss ratios used in the company’s business plan.
ILU	Institute of London Underwriters.
Independent Expert	The Independent Expert prepares the FSMA Report and provides it to the Court in order that it may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question. In the case of the Scheme, I have been appointed as the Independent Expert.
Independent Peer Review	Work Review undertaken by one or more individual(s) who is, or are, not otherwise involved in the work in question and who would have had the appropriate experience and expertise to take responsibility for the work themselves.
IFRS	International Financial Reporting Standards (“IFRS”) form a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
Jurisdiction	The concept that a court or government authority or regulator may exercise control over a person or property because of the location of the property, the activities of a person within a geographic area, or a person’s request for assistance from that authority, thereby voluntarily subjecting themselves to jurisdiction.
Liability	A claim against the assets, or legal obligations of a person or organisation, arising out of past or current transactions or actions.
LOC	Letter of credit.
LMX	Excess of Loss reinsurance business written in the London Market.

MCR	The Solvency II Minimum Capital Requirement (“MCR”) is lower than the SCR, and defines the point of intensive regulatory intervention. The MCR calculation is less risk sensitive than the SCR calculation and is calibrated to a confidence level of 85% over one year (compared to 99.5% for the SCR).
MI	Management information.
Milliman	Milliman LLP
MTPL	Motor third party liability.
Net	Including the effect of reinsurance arrangements, e.g. “net insurance liabilities” refers to insurance liabilities after deducting any offsetting reinsurance assets from the gross insurance liabilities.
NIHL	Noise induced hearing loss.
Non-Transferring Policyholders	Policyholders of TICL that are not to be transferred to TIDAC under the Scheme.
NWA	Net Worth Agreement, which, in the context of the Travelers Group, is an agreement by which one Travelers Group company (e.g. SPMFIC) agrees to cause another Travelers Group company (e.g. TICL) to have capital resources (to at least meet applicable regulatory capital requirements) and sufficient cash funds (to pay valid claims and other obligations).
Ogden Rate	The colloquial term given to the discount rate applied when calculating lump sum payments in respect of personal injury claims.
Own Funds	In Solvency II terminology, the amount of capital or excess assets of an insurance company. Own funds are divided into basic own funds and ancillary own funds (e.g. unpaid share capital), which require regulatory approval.
ORSA	The Own Risk Solvency Assessment (“ORSA”) is a fundamental set of processes under Solvency II constituting a tool for decision-making and strategic analysis. It aims to assess, in a continuous and prospective way, the overall solvency needs related to the specific risk profile of the insurance company.
Parameter	A numerical input which affects the result of a calculation.
Periodic Payment Orders (“PPOs”)	A method of setting catastrophic injury claims where compensation is paid to claimants at regular intervals rather than a single lump sum.
POG	Product oversight and governance arrangements (in relation to the IDD).
The Policy Statement	The Statement of Policy issued by the PRA entitled <i>The Prudential Regulation Authority’s approach to insurance business transfers</i> , issued in April 2015.
Policyholder Obligation	The contractual obligation of an insurer to its policyholders.
Policyholder Statement	A statement be sent to policyholders of TIDAC and TICL (which is to have enclosed with it a short document containing the terms of the Scheme, and the Summary).

PRA	The Prudential Regulation Authority (“PRA”) is part of the Bank of England and carries out the prudential regulation of financial firms in the UK, including banks, investment banks, building societies and insurance companies. The PRA operates as part of the regulatory framework implemented under the Financial Services Act 2012.
PRA Returns	Accounts, balance sheets, abstracts and statements relating to the business of an insurance company required under PRA rules to be submitted periodically to the PRA. Prior to May 2013, companies were required to submit this information to the FSA.
QS	Quota Share, a form of proportional reinsurance in which the insurer and reinsurer share premiums and losses according to a fixed percentage.
QRTs	Quantitative Reporting Templates, which are reporting templates that must be completed by insurers and submitted to the regulator on a regular basis in accordance with Solvency II. The QRTs cover a wide range of quantitative financial information about the insurer including details of its balance sheet, capital requirements and reserves.
RAO	Part 1 of Schedule 1 of FSMA (Regulated Activities) Order 2001.
Required Capital	The amount of capital an insurer must hold in order to meet its regulatory capital requirements (for example the SCR).
Reinsurance	An arrangement with another insurer whereby risks are shared (or passed on). If reinsurance is termed as being “inwards” then the reinsurer in question has accepted risk from an(other) (re)insurer; if reinsurance is termed as being “outwards” then the (re)insurer in question has passed risk to a(nother) reinsurer.
The Report	References to the “Report” refer to this report as produced by the Independent Expert.
Risk Margin	The risk margin under Solvency II is designed to ensure that the value of TPs is sufficient for another insurer to take-over and meet the insurance obligations. It is calculated by determining the cost of providing an amount of EOF equal to the SCR necessary to support the obligations over their lifetime based currently on a 6% cost-of-capital rate.
Run-off	An insurer that is in run-off is not writing any new (or renewal) business, but will continue to administer and pay claims for existing policies.
The Scheme	In the context of this Report, the proposal that the EEA (excluding UK) related business of TICL be transferred to TIDAC, under the provisions of Part VII of FSMA.
Scheme Document	This document sets out the terms of the Scheme.
SFCR	Each insurer is expected to publish a Solvency Financial Condition Report (“SFCR”) annually which will contain certain qualitative and quantitative information, the quantitative information being in the format of certain prescribed QRTs.
SF	Standard Formula, which is the basis prescribed under Solvency II for the calculation of capital requirements where an internal model has not been approved. The SCR estimated using the SF has been calibrated to meet the general requirements of firms across the EU.
SME	Small medium enterprise (“SME”) is (in a European context) an enterprise that employ fewer than 250 persons and has an annual turnover not exceeding €50 million (and/or an annual balance sheet total not exceeding €43 million).

Solvency II	The system for establishing (among other things) minimum capital requirements for EU (re)insurers under the Solvency II Directive 2009/138/EC.
Solvency Capital Requirement (“SCR”)	The SCR under Solvency II is the amount of capital required to ensure continued solvency over a one-year trading time frame with a likelihood of 99.5%.
Stop-Loss Reinsurance	Aggregate stop-loss reinsurance is a form of non-proportional reinsurance in which the reinsurer caps the aggregate amount of losses for which a ceding company is responsible. This cap only applies to the aggregate value of claims occurrences above the attachment point and up to a specified limit.
The IE Summary	A summary of the Report I will prepare in advance of the Court hearing at which the judge gives 'directions' to the parties in relation to the Scheme.
SUP18	Section 18 of the FCA Supervision Manual.
Supplemental Report	A report I will prepare in advance of the Court hearing to sanction the Scheme covering any relevant matters that might have arisen since the date of the Report.
TAS	Technical Actuarial Standards issued by the Financial Reporting Council.
TCF	The TCF ('treating customer fairly') principle aims to raise standards in the way firms carry on their business by introducing changes that will benefit consumers and increase their confidence in the financial services industry. Specifically, TCF aims to: help customers fully understand the features, benefits, risks and costs of the financial products they buy; and minimise the sale of unsuitable products by encouraging best practice before, during and after a sale.
TCSCE Transfer	The transfer of the insurance business of TCSCE to TICL under Part VII of FSMA. The TCSCE Transfer has gone through its Directions Hearing and is scheduled to complete on 28 February 2019.
TICL	Travelers Insurance Company Limited, which is a wholly owned subsidiary of Travelers and a member of the Travelers Group.
TICL Policyholder	A policyholder of TICL.
TIDAC	Travelers Insurance DAC. An Irish regulated insurer and wholly owned subsidiary of TICL, and a member of the Travelers Group (subject to authorisation by the CBI).
TIDAC Policyholder	A policyholder of TIDAC.
TML	Travelers Management Limited, a member of the Travelers Group.
TPs	Technical Provisions, which are the value of the liabilities as determined for regulatory purposes under Solvency II. In particular, the provisions for the ultimate costs of settling all claims arising from events which have occurred up to the balance sheet date, including provision for claims incurred but not yet reported, less any amounts paid in respect of these claims; plus the provisions for future claims (and premiums) arising on unexpired periods of risk (see Appendix G for further details).
Transferee(s)	The insurer(s) to which business is being transferred – in the case of the Scheme it is TIDAC.

Transferor(s)	The insurer(s) from which business is being transferred – in the case of the Scheme it is TICL.
Transferring Business	The business of TICL, which is to be transferred to TIDAC under the Scheme. I have referred separately to a policy that is part of such transferring business as a Transferring Policy, and a holder of a Transferring Policy as a Transferring Policyholder.
Travelers	The Travelers Companies, Inc. a US company, which is the ultimate holding company of the Travelers Group.
Travelers Casualty and Surety Company of Europe Limited	Travelers Casualty and Surety Company of Europe Limited (“TCSCE”) is a UK insurer and a member of the Travelers Group.
Travelers Group	A collective term for Travelers and its direct and indirect subsidiaries.
TUPE	Transfer of Undertaking (Protection of Employment) Regulations 2006 and as subsequently amended.
ULAE	Unallocated loss adjustment expenses, i.e. claim-related costs that cannot be allocated specifically to individual claims, such as the costs of running a claims team.
UPR	Unearned Premium Reserve, which is the premium corresponding to the time period remaining on an insurance policy at a valuation date. The UPR is typically proportionate to the unexpired portion of the insurance and appears as a liability on an insurer’s balance sheet.
Underwriting Year	The year to which a claim is allocated based on the date the policy was written.
USP	Undertaking Specific Parameters used, subject to prior approval from the local regulator, in the SF.
Value at Risk (“VaR”)	For example, the SCR under Solvency II is the amount of capital required to ensure continued solvency over a one-year trading time frame with a VaR of 99.5%, i.e. the amount of capital required by an insurer over a one-year period to meet expected losses on 199 years out of 200 years (because of 99.5% probability).
Winding-up	A process that entails liquidating all the assets of a business entity, paying off creditors, distributing any remaining assets to the principals, and then dissolving the business.
Work Review	Process by which a piece of actuarial work is considered by at least one other individual for the purpose of providing assurance as to the quality of the work in question.
XL	Excess of loss (“XL”), which is a form of non-proportional reinsurance in which the reinsurer indemnifies the insurer for losses that exceed an attachment point up to a specified limit.

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## APPENDIX B LIST OF PREVIOUS TRANSFERS FOR WHICH GARY WELLS HAS ACTED AS THE INDEPENDENT EXPERT

- 2004: Transfer of the business of the Continental Reinsurance Company (UK) Limited to Continental Management Services Limited
- 2005: Transfer of the business of the UK branch of the Continental Insurance Company to Continental Management Services Limited
- 2006: Transfer of the IGI portfolio of CX Reinsurance Company Limited to CNA Insurance Company Limited
- 2008: Transfer of the Irish branch business of Royal & Sun Alliance Insurance plc to Europa General Insurance Company Limited
- 2009: Transfer of the business of Arran Insurance Company Limited to Chevanstell Limited
- 2010: Transfer of the business of Euler Hermes Guarantee plc to Euler Hermes UK plc
- 2011: Transfer of the business of Euler Hermes UK plc to Euler Hermes Credit Insurance Belgium SA (NV)
- 2011: Transfers of the business of PA(GI) Ltd to Royal & Sun Alliance Insurance plc and Marine Insurance Company Limited
- 2011: Rationalisation of 22 UK regulated entities of Royal & Sun Alliance Insurance plc to 5 UK companies via 3 Part VII transfer schemes (effective 1 January 2012)
- 2013: Transfer of certain business of the Italian branch of Sampo Japan Insurance Company of Europe Limited to Berkshire Hathaway International Insurance Limited.
- 2013: Transfer of the business of Arbor Property & Casualty Ireland Limited to AIG Europe Limited (portfolio transfer under Irish legislation)
- 2013: Transfer of the European branch business of Mitsui Sumitomo Insurance Company (Europe) Limited to MSIG Insurance Europe AG.
- 2013: Transfer of the business of Chevanstell Limited to R&Q Insurance (Malta) Limited
- 2015: Transfer of the business of Nipponkoa Insurance Company (Europe) Limited to Sampo Japan Nipponkoa Insurance Company of Europe Limited
- 2015: Transfer of the Italian branch business of the RSA Group to ITAS Mutua
- 2016: Transfer of the UK branch business of Sampo Japan Nipponkoa Insurance Inc. to Transfercom Limited
- 2016: Transfer of the business of Cardrow Insurance Limited to Tenecom Limited
- 2017: Transfer of the 1992 and prior insurance business of Markel International Insurance Company Limited to RiverStone Insurance (UK) Limited.
- 2017: Transfer of the Czech, Hungarian and Slovakian branches of QBE Insurance (Europe) Limited to Colonnade Insurance S.A.
- 2017: Transfer of the UK branch of Nisshin Fire & Marine Insurance Co., Ltd. to Rombalds Run-off Limited.
- 2018: Transfer of the EEA businesses of Sampo Japan Nipponkoa Insurance Company of Europe Limited and Endurance Worldwide Insurance Limited to SI Insurance (Europe), SA; and the non-EEA business of Sampo Japan Nipponkoa Insurance Company of Europe Limited to Endurance Worldwide Insurance Limited.

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## APPENDIX C SCOPE OF THE WORK OF THE INDEPENDENT EXPERT IN RELATION TO THE SCHEME

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

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

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

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

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

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

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

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

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

## APPENDIX D KEY SOURCES OF DATA

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

- Draft Scheme Document.
- Draft Witness Statement for the Companies.
- Draft Communication Plan.

### TICL

- The audited financial statements as at 31 December 2017.
- Solvency and Financial Condition Report for the year-ended 31 December 2017 (containing certain QRTs as at 31 December 2017).
- ORSA – annual report (2016) and interim ORSA update report (2017).
- Actuarial Function Report for year-end 2017, dated May 2018.
- Quarterly reserving memorandums.
- Documents summarising the 2018 outwards reinsurance programmes.
- Copy of Guarantee between SPF&M and TICL, dated 19 March 2003.
- Documents relating to the additional layer (£40m xs £10m) of intra-group property catastrophe reinsurance purchased by TICL (on 30 April 2018) from Travelers Property Casualty Company of America, including the impact on the regulatory capital requirements.
- Financial projections over the period 2018 – 2021 on pre- and post-Scheme bases.
- Term sheets for the whole account quota share reinsurance arrangement between TICL and TIDAC (whereby 80% of TIDAC's business is reinsured to TICL); and the stop-loss reinsurance arrangement between TICL and TIDAC (to protect TIDAC's compliance with its regulatory capital requirements).
- Documents relating to the collateral account arrangement (and escrow agency agreement) between TICL and TIDAC to be operated in conjunction with the proposed 80% whole account quota share reinsurance agreement between TICL and TIDAC.

### TIDAC

- Application File to CBI, dated 02 May 2018, including documents supporting the Application.
- ORSA for the period 2019 – 2021 inclusive (submitted to the CBI as part of the authorisation process).
- Report by Proposed HoAF (submitted to the CBI as part of the authorisation process).

D.2. Information relating to the items listed above was also gathered during discussions and e-mails with staff of TICL and TIDAC.

## APPENDIX E COMPLIANCE WITH THE PRA POLICY STATEMENT

The table below indicates how I have complied with the provisions of the PRA Policy Statement (“*The Prudential Regulation Authority’s approach to insurance business transfers*”, dated April 2015) that pertain to the form of the Report.

PRA Policy Statement Reference	Requirement	Scheme Report paragraph reference
2.30 (1)	Who appointed the Independent Expert and who is bearing the costs of that appointment	Paragraphs 1.12 and 1.17
2.30 (2)	Confirmation that the independent expert has been approved or nominated by the appropriate regulator.	Paragraph 1.12
2.30 (3)	A statement of the independent expert’s professional qualifications and (where appropriate) descriptions of the experience that fits him for the role.	Paragraph 1.12 and Appendix B
2.30 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest.	Paragraphs 1.13 and 1.14
2.30 (5)	The scope of the report.	Paragraphs 1.19 – 1.29
2.30 (6)	The purpose of the scheme.	Paragraphs 2.7 – 2.9 and paragraphs 5.1 – 5.5
2.30 (7)	A summary of the terms of the scheme in so far as they are relevant to the report.	Paragraphs 1.8 – 1.11, paragraph 2.5 and paragraphs 5.6 – 5.22
2.30 (8)	What documents, reports and other material information the independent expert has considered in preparing his report and whether any information that he requested has not been provided.	Appendix D
2.30 (9)	The extent to which the independent expert has relied on:  (a) information provided by others; and  (b) the judgment of others	Paragraphs 1.32 – 1.46  Paragraphs 1.23, 1.44 and 9.2
2.30 (10)	The people on whom the independent expert has relied and why, in his opinion, such reliance is reasonable	Paragraphs 1.32, 1.33 and 1.34
2.30 (11)	His opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between:  (a) transferring policyholders;  (b) policyholders of the transferor whose contracts will not be transferred; and  (c) policyholders of the transferee	Paragraphs 2.13 and 2.14 and Section 6 Paragraphs 2.15 – 2.17, and Section 7 Not applicable

2.30 (12)	His opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme	Paragraphs 2.22 and 8.12 – 8.17
2.30 (13)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in his opinion, be relevant to policyholders' consideration of the scheme	None of which I am aware.
2.30 (14)	For each opinion that the independent expert expresses in the report, an outline of his reasons.	Paragraphs 2.13, 2.16, 6.23, 6.24, 6.30, 6.36, 6.62, 6.87, 6.97, 6.103, 6.107, 6.112, 6.121, 6.122, 7.10,
2.32 (1)	The summary of the terms of the scheme should include a description of any reinsurance agreements that it is proposed should pass to the transferee under the scheme	Paragraph 5.8
2.32 (2)	The summary of the terms of the scheme should include a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred	Paragraph 5.20
2.33 (1)	The independent expert's opinion of the likely effects of the scheme on policyholders should include a comparison of the likely effects if it is or is not implemented	Paragraphs 8.55 and 8.56
2.33 (2)	The independent expert's opinion of the likely effects of the scheme on policyholders should state whether he considered alternative arrangements and, if so, what	Paragraph 1.20
2.33 (3)	The independent expert's opinion of the likely effects of the scheme on policyholders should, where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences he considers may be material to the policyholders	Paragraphs 2.10 and 2.11
2.33 (4)	The independent expert's opinion of the likely effects of the scheme on policyholders should include his views on:	
	(a) the effect of the scheme on the security of policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer;	Sections 6 and 7
	(b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, expense levels and valuation bases in so far as they may affect:	Paragraphs 8.1 – 8.11, and 8.57
	(i) the security of policyholders' contractual rights;	
(ii) levels of service provided to policyholders; or		
(iii) for long-term insurance business, the reasonable expectations of policyholders; and	Not applicable	
		Paragraphs 8.58 and 8.59

	(c) the cost and tax effects of the scheme, in so far as they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations	
2.35 (1)	For any mutual company involved in the scheme, the report should describe the effect of the scheme on the proprietary rights of members of the company, including the significance of any loss or dilution of the rights of those members to secure or prevent further changes which could affect their entitlements as policyholders	Not applicable
2.35 (2)	For any mutual company involved in the scheme, the report should state whether, and to what extent, members will receive compensation under the scheme for any diminution of proprietary rights	Not applicable
2.35 (3)	For any mutual company involved in the scheme, the report should comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between members with voting rights and those without.	Not applicable
2.36 (1)	For a scheme involving long-term insurance business, the report should describe the effect of the scheme on the nature and value of any rights of policyholders to participate in profits	Not applicable
2.36 (2)	For a scheme involving long-term insurance business, the report should, if any such rights will be diluted by the scheme, how any compensation offered to policyholders as a group (such as the injection of funds, allocation of shares, or cash payments) compares with the value of that dilution, and whether the extent and method of its proposed division is equitable as between different classes and generations of policyholders;	Not applicable
2.36 (3)	For a scheme involving long-term insurance business, the report should describe the likely effect of the scheme on the approach used to determine: (a) the amounts of any non-guaranteed benefits such as bonuses and surrender values; and  (b) the levels of any discretionary charges	Not applicable
2.36 (4)	For a scheme involving long-term insurance business, the report should describe what safeguards are provided by the scheme against a subsequent change of approach to these matters that could act to the detriment of existing policyholders of either firm	Not applicable
2.36 (5)	For a scheme involving long-term insurance business, the report should include the independent expert's overall assessment of the likely effects of the scheme on the reasonable expectations of long-term insurance business policyholders	Not applicable
2.36 (6)	For a scheme involving long-term insurance business, the report should state whether the independent expert is satisfied that for each firm the scheme is	Not applicable

	equitable to all classes and generations of its policyholders	
2.36 (7)	For a scheme involving long-term insurance business, the report should state whether, in the independent expert's opinion, for each relevant firm the scheme has sufficient safeguards (such as principles of financial management or certification by a with-profits actuary or actuarial function holder) to ensure that the scheme operates as presented.	Not applicable

## APPENDIX F GENERAL CONSIDERATIONS OF THE INDEPENDENT EXPERT

### INTRODUCTION

- F.1. I have compiled my Report in accordance with the Policy Statement and with SUP18.
- F.2. Under FSMA, the concept of TCF must be applied. To help ensure that customers are treated fairly in the future it is necessary to understand how they have been treated in the past. From the policyholders' perspective, the acceptability of the Scheme must be on the basis that it will not have a materially adverse effect on their benefits or fair treatment.
- F.3. In order to fulfil my obligations as Independent Expert I have considered the terms of the Scheme generally and how the different groups of policyholders are likely to be affected by the Scheme. In particular, I have considered:
- The likely effects of the Scheme on the security of the policyholders' benefits, including the likelihood and potential effects of the insolvency of the insurer; and
  - The likely effects of the Scheme on policyholder servicing levels (e.g. claims handling).

### Materiality

- F.4. After considering the effects of the Scheme on each of the different groups of policyholders affected by the Scheme (as identified in paragraph 2.10 above), I have drawn conclusions as to whether I believe the Scheme will materially adversely affect that group of policyholders. It should be recognised that the Scheme will affect different policyholders in different ways, and, for any one group of policyholders, there may be some effects of the Scheme that are positive, and others that are adverse. If some effects of the Scheme are adverse, that does not necessarily mean that the Scheme is unreasonable or unfair, as those adverse effects may be insignificant or they may be outweighed by positive effects.
- F.5. In order to determine whether any effects of the Scheme on any group of policyholders are materially adverse it has been necessary for me to exercise my professional judgement in the light of the information that I have reviewed. If the potential impact under consideration is very unlikely to happen and does not have a significant impact, or is likely to happen but has a very small impact, on a group of policyholders then it is not considered to have a material effect on that group of policyholders.
- F.6. My assessment of materiality will also take into account the nature of the potential impact so that, for example, the materiality threshold for a change that could have a direct impact on the financial security of a group of policyholders is likely to be lower than the materiality threshold for a change that does not have a direct financial impact.
- F.7. This is the framework in which I undertake my consideration of materiality in relation to the Scheme.

### SECURITY OF POLICYHOLDER BENEFITS

- F.8. As noted above, I need to consider the security of policyholder benefits, i.e. the likelihood that policyholders will receive their benefits when due.
- F.9. In considering and commenting upon policyholder security I shall consider the financial strength of each entity. Financial strength is provided by the margins for prudence in the assumptions used to calculate the Technical Provisions, by the shareholder capital and by any specific arrangements for the provision of financial support. In considering policyholder security it is also necessary to take into account the potential variability of future experience (including claim frequency and severity). Security is also affected by the nature and volume of future new business.

F.10. The main factors that determine the risks to which a policyholder is exposed are:

- Size of company;
- Amount of capital held, other calls on that capital and capital support currently available to the company;
- Reserve strength;
- Mix of business written; and
- Company strategy – for example, whether it is open or closed to new business.

F.11. I also need to consider the impact on policyholders' security in the event of the default of an insurer (e.g. the role of the FSCS).

### TREATING CUSTOMERS FAIRLY

F.12. As Independent Expert I also need to consider the impact of the Scheme on levels of service provided to policyholders, including those resulting from changes in administration, claims handling and expense levels.

F.13. Further, I have considered the proposals in the context of applicable conduct rules/regulation, e.g. the fair resolution of complaints between an insurer and its customers (policyholders).

### OTHER CONSIDERATIONS

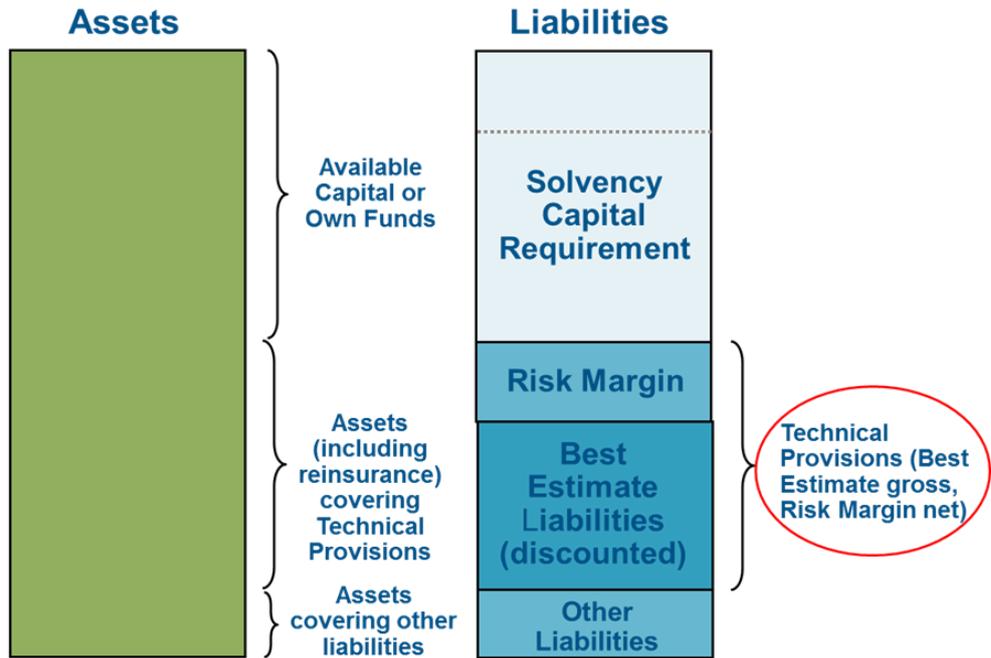
F.14. Paragraph 2.34(4)(b) of the Policy Statement and paragraph 2.36 of SUP18 both require me, as Independent Expert, to consider the likely effects of the Scheme on matters such as investment management, new business, administration, expense levels and valuation bases insofar as they might impact on levels of service to policyholders or on the security of policyholders' benefits.

F.15. I am also required to consider the cost of the Scheme and the tax effects of the Scheme insofar as they might impact on the security of policyholders' benefits.

## APPENDIX G SOLVENCY II BALANCE SHEET

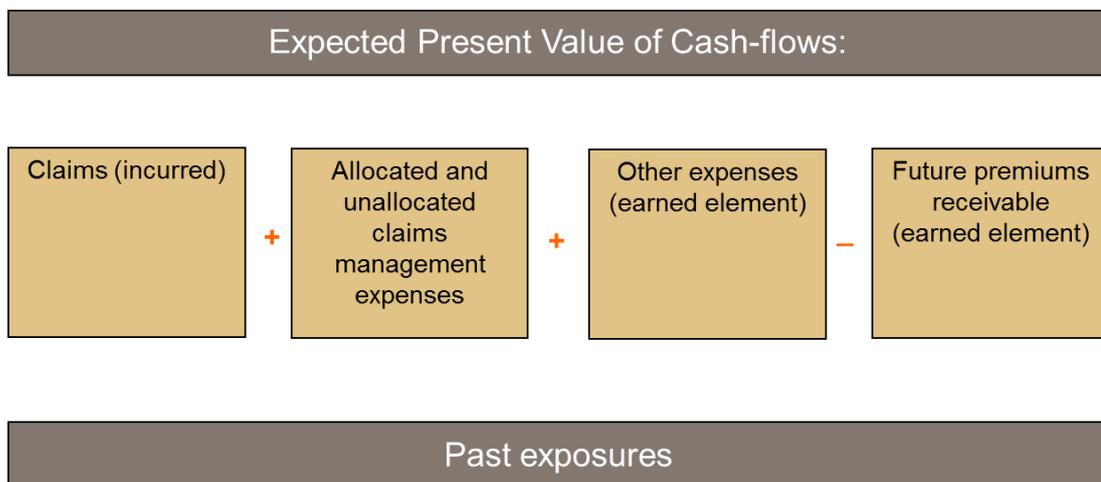
G.1. A simplified illustration of a Solvency II balance sheet is shown in Figure G.1 below.

Figure G.1  
Solvency II balance sheet



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

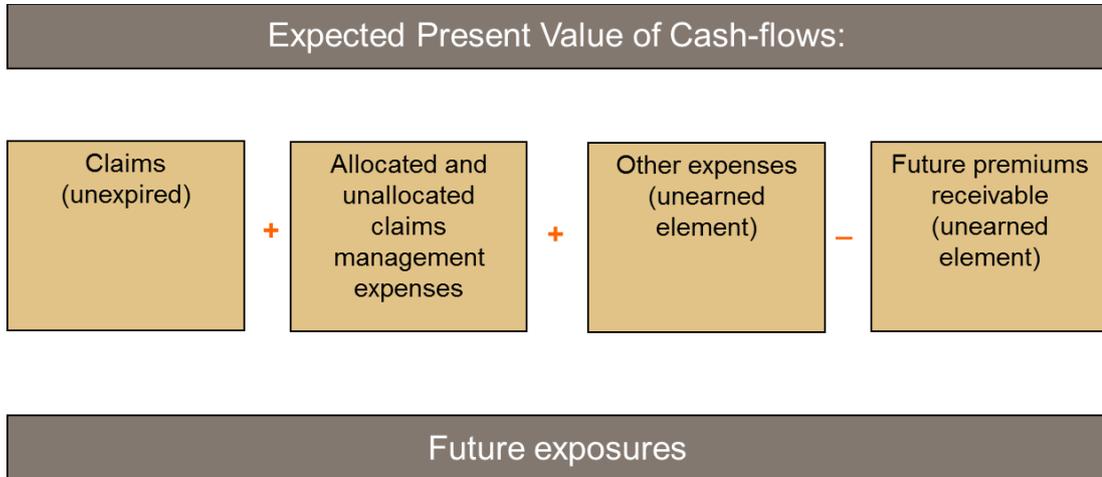
**Figure G.2**  
**Claim Provision**



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

**Figure G.3**

**Premium Provision**



G.8. The risk margin (‘RM’) is intended to be the balance that another (re)insurer taking on the liabilities at the valuation date would require over and above the discounted ‘best estimate’. Under Solvency II, the RM is calculated using a cost-of-capital (‘CoC’) approach (presently employing a 6% CoC parameter as provided by EIOPA). More specifically, the calculation is as follows:

$$RM = CoC \times \sum_{t \geq 0} \frac{SCR(t)}{(1 + r_{t+1})^{t+1}}$$

where:

SCR(t) as employed for the RM formula consists of underwriting risk (with respect to existing business); counterparty risk (e.g. reinsurance); operational risk; and market risk (if unavoidable, i.e. not hedge-able); and

$r_t$  is the risk-free discount rate(s) at time t as provided by EIOPA for all major currencies.

## APPENDIX H KEY DIFFERENCES BETWEEN UK GAAP AND SOLVENCY II TECHNICAL PROVISIONS

A summary of the key differences between UK GAAP reserves and Solvency II TPs is set out in the table below:

Area of change	UK GAAP Reserves	Solvency II Technical Provisions	Balance sheet impact
<b>Earned business</b>	Claims reserve = point estimate within a reasonable range ("not insufficient")	Claims provision = probability weighted average of future cash flows	Reduces liabilities (remove margins)
<b>Unearned business</b>	Unearned premium reserve, net of DAC	Premium provision = probability weighted average of future cash flows	Reduces liability (expected profit)
<b>Risk Margin</b>	n/a	Explicit item, based on cost of capital approach	Increases liabilities
<b>Discounting</b>	Undiscounted	Discounted cash flows	Reduces liabilities
<b>Contract recognition</b>	Policies written	Policies written and legally bound but not incepted policies ("BBNI policies")	Reduces liabilities (due to expected profit on BBNI policies)
<b>Expenses</b>	Claims handling expense reserve	More explicit treatment of expenses	Increases liabilities
<b>Events Not In Data ("ENIDs")</b>	Limited allowance for contingent liabilities	New concept allowance for extreme outcomes (which are "not in the data" used for reserving)	Increase liabilities
<b>Reinsurance Bad Debt Provision</b>	n/a	Explicit provision required for reinsurer bad debt	Increases liabilities

## APPENDIX I KEY DIFFERENCES BETWEEN ACCESS TO FSCS AND/OR FOS PRE- AND POST-SCHEME

A simplified summary of the key differences between access to the FSCS and/or the FOS pre- and post-Scheme by policyholder category is set-out in the table below:

FSCS		FOS	
Policyholder category and access to FSCS pre-Scheme	Policyholder category and access to FSCS post-Scheme	Policyholder category and access to FOS pre-Scheme	Policyholder category and access to FOS post-Scheme
Non-Transferring Policyholder (i.e. a policyholder remaining with TICL) who <b>does</b> have access to FSCS currently	No change in position (access to FSCS remains)	Non-Transferring Policyholder (i.e. a policyholder remaining with TICL) who <b>does</b> have access to FOS currently	No change in position (access to FOS remains)
Non-Transferring Policyholder who <b>does not</b> have access to FSCS currently	No change in position (no access to FSCS)	Non-Transferring Policyholder who <b>does not</b> have access to FOS currently	No change in position (no access to FOS)
Transferring Policyholder who <b>does</b> have access to FSCS currently (broadly, a policyholder will only have access to FSCS if they are a private individual or a small business – see paragraph 3.9 above)	No change anticipated in position (access to FSCS expected to remain)  This is essentially due to the way that TIDAC is intending to operate after the Scheme (i.e. with a UK branch)	Transferring Policyholder who <b>does</b> have access to FOS currently (broadly, a policyholder will only have access to FOS if they are a private individual or "micro-enterprise" – see paragraph 3.10 above)	No change anticipated in position (access to FOS expected to remain)  This is essentially due to the way that TIDAC is intending to operate after the Scheme (i.e. with a UK branch)
Transferring Policyholder who <b>does not</b> have access to FSCS currently	No change in position (no access to FSCS)	Transferring Policyholder who <b>does not</b> have access to FOS currently	No change in position (no access to FOS)

It should be noted that the table above is a simplified summary of the key differences between access to the FSCS and/or the FOS pre- and post-Scheme, by policyholder category. The Report (of which this Appendix is part) contains the reasoning behind my conclusions on this matter, the detail of which is largely omitted from this table. The Report also includes further information regarding TICL and TIDAC that I have also not included within this table. While I am satisfied that this table provides a synopsis of key differences between access to the FSCS and/or the FOS pre- and post-Scheme by policyholder category reliance on this table alone could be misleading.