



**Grant Thornton**

An instinct for growth™

Report by Simon Sheaf FIA FSAI, Independent  
Expert, on the Proposed Transfer of a Portfolio of  
Policies from Aviva Insurance Limited to Aviva  
Insurance Ireland Designated Activity Company

23 August 2018

# Contents

|           |  |           |
|-----------|--|-----------|
| <b>1</b>  | <b>Introduction</b>  | <b>3</b>  |
|           | Layout of this report  | 4         |
|           | Professional experience  | 4         |
|           | Independence   | 4         |
|           | Use of this report   | 5         |
|           | Professional guidance  | 6         |
| <b>2</b>  | <b>Executive Summary</b>   | <b>7</b>  |
|           | Overview of the Scheme   | 7         |
|           | My approach  | 9         |
|           | Findings   | 10        |
|           | Conclusion   | 12        |
| <b>3</b>  | <b>Scope</b>   | <b>13</b> |
| <b>4</b>  | <b>Methodology</b>   | <b>16</b> |
| <b>5</b>  | <b>Background</b>  | <b>19</b> |
|           | History and background of AIL  | 19        |
|           | History and background of AIIDAC   | 23        |
|           | Background and purpose of the Scheme                                     | 24        |
|           | Overview of structure  | 26        |
| <b>6</b>  | <b>Regulatory background</b>   | <b>28</b> |
|           | Solvency II  | 28        |
|           | UK   | 29        |
|           | Ireland  | 31        |
| <b>7</b>  | <b>Claims reserves</b>   | <b>34</b> |
|           | Best estimate reserves   | 34        |
|           | Solvency II technical provisions   | 45        |
| <b>8</b>  | <b>Capital requirements</b>  | <b>49</b> |
|           | AIL  | 49        |
|           | AIIDAC   | 59        |
| <b>9</b>  | <b>Policyholder security</b>   | <b>70</b> |
|           | Impact of the Scheme on the balance sheets of the affected companies     | 70        |
|           | Impact of the Scheme on the solvency positions of the affected companies | 72        |
| <b>10</b> | <b>Other financial considerations</b>                                    | <b>78</b> |
|           | Investment strategy implications   | 78        |
|           | Implications of the Scheme on ongoing expense levels                     | 79        |
|           | Implications under insolvency  | 80        |
|           | Impact on compensation   | 82        |
|           | Liquidity position   | 84        |
|           | Tax implications   | 84        |
|           | Pension arrangements   | 84        |

|           |   |            |
|-----------|---|------------|
|           | Impact on existing reinsurers   | 85         |
|           | Impact of new business strategy   | 86         |
|           | Impact on existing guarantees   | 86         |
| <b>11</b> | <b>Other non-financial considerations</b>   | <b>87</b>  |
|           | EEA business remaining with AIL following the Scheme  | 87         |
|           | Impact of changes in regulatory jurisdiction  | 89         |
|           | Claims handling   | 89         |
|           | Policy servicing  | 90         |
|           | Complaints  | 91         |
|           | 'Brexit'  | 92         |
|           | Governance and management framework   | 93         |
|           | Should the Scheme not become effective  | 96         |
|           | Should the application for the AIIDAC UK Branch to convert to a third country branch following Brexit not be successful | 96         |
|           | Policyholder notifications  | 97         |
|           | Reinsurer notifications   | 102        |
| <b>12</b> | <b>Reliances and limitations</b>  | <b>103</b> |
|           | Events following the modelling date   | 103        |
|           | Reliance on other parties   | 103        |
|           | Other   | 104        |
| <b>13</b> | <b>Conclusions</b>  | <b>105</b> |

## Appendices

|          |  |            |
|----------|--|------------|
| <b>A</b> | <b>Information Received</b>                                      | <b>107</b> |
| <b>B</b> | <b>Definitions</b>   | <b>110</b> |
| <b>C</b> | <b>Abbreviations</b>   | <b>115</b> |
| <b>D</b> | <b>Checklist against the PRA's Statement of Policy and SUP18</b> | <b>117</b> |
| <b>E</b> | <b>Checklist against the FCA's guidance</b>                      | <b>122</b> |
| <b>F</b> | <b>My experience</b>   | <b>133</b> |
| <b>G</b> | <b>Extract from Statement of Work</b>                            | <b>135</b> |

# 1 Introduction

- 1.1 Section 109 of Financial Service and Markets Act 2000 (“FSMA”) requires that a scheme report must accompany an application to the Court of Session in Scotland (“the Court”) to approve an insurance business transfer scheme. This scheme report should be produced by a suitably qualified independent person (the “Independent Expert”) who has been approved by the Prudential Regulation Authority (“PRA”), in consultation with the Financial Conduct Authority (“FCA”). The scheme report should address the question of whether any policyholders impacted by the insurance business transfer are adversely affected to a material extent.
- 1.2 Aviva Insurance Limited (“AIL”) and Aviva Insurance Ireland Designated Activity Company (“AIIDAC”) have jointly nominated Simon Sheaf (“I”, “me”) of Grant Thornton UK LLP (“Grant Thornton”, “we”, “us”) to act as the Independent Expert for the proposed insurance business transfer scheme (“the Scheme”) of the insurance business of AIL to AIIDAC. The Scheme is intended to be effected at 00:01 on Friday 1 February 2019 (“the Effective Time”).
- 1.3 This nomination has been approved by the PRA in consultation with the FCA.
- 1.4 AIL is an insurance company primarily transacting general and health insurance business in the UK and Ireland. AIL is authorised by the PRA and regulated by the PRA and the FCA.
- 1.5 AIIDAC is established as a wholly owned subsidiary of AIL domiciled in Ireland. AIIDAC is authorised to conduct insurance business by the Irish regulator, the Central Bank of Ireland (“CBI”).
- 1.6 The majority of the insurance business currently underwritten by AIL on a Freedom of Services or a Freedom of Establishment basis in European Economic Area (“EEA”) countries other than the UK will be assumed by AIIDAC at the Effective Time of the transfer. The liabilities relating to such policies sold before the Effective Time (“the Transferring Portfolio”) will be transferred to AIIDAC under the Scheme. The intention is for new general insurance business and renewals in non-UK EEA countries occurring after that date that would previously have been underwritten by AIL to instead be underwritten by AIIDAC. The scope of the policies transferring under the Scheme is described in more detail in paragraphs 5.10 to 5.24.
- 1.7 The terms of my engagement are set out in a Statement of Work that was signed by AIL on 24 July 2017 and by Grant Thornton on 4 August 2017. The Statement of Work is under a Consultancy and Secondment Services Master Framework Services Agreement dated 10 August 2016 between Grant Thornton and Aviva Central Services UK Limited. An extract of the Statement of Work setting out the scope of my work is included in Appendix G.
- 1.8 The Aviva Group will be bearing the costs of producing this report.

- 1.9 Appendices B and C to this report contain definitions of technical terms and explanations of abbreviations used in this report respectively.

### **Layout of this report**

1.10 My report is structured as follows:

- This section sets out an introduction to the Scheme and to this report.
- Section 2 is an executive summary, which summarises the Scheme and the various analyses conducted and describes my conclusion.
- Section 3 sets out the scope of this report.
- Section 4 provides a summary of the methodology I have employed in order to assess the Scheme.
- Section 5 describes the background to the entities involved, the purpose of the Scheme and a description of the Transferring Portfolio.
- Section 6 describes the regulatory background.
- Section 7 describes the work that I have carried out to assess the claims reserves of AIL and AIIDAC.
- Section 8 describes the work that I have carried out to assess the capital requirements of AIL and AIIDAC.
- Section 9 provides my assessment of the policyholder security considerations.
- Section 10 provides my assessment of other financial considerations.
- Section 11 provides my assessment of other non-financial considerations.
- Section 12 sets out the reliances and limitations that apply to my analysis and this report.
- Section 13 sets out my conclusions on the Scheme.

### **Professional experience**

- 1.11 I am a Fellow of the Institute and Faculty of Actuaries (“IFoA”) and a Fellow of the Society of Actuaries in Ireland. I currently hold a Chief Actuary (Non-life with Lloyd's) Practicing Certificate and a Lloyd's Syndicates Practicing Certificate. In addition, I have previously held an Irish Signing Actuary Practicing Certificate and have previously been recognised as a Responsible Actuary by the financial regulator in Liechtenstein.
- 1.12 I joined Grant Thornton's Financial Services Group as General Insurance Practice Leader in 2006. My current job title is Head of General Insurance Actuarial and Risk and I lead the provision of actuarial and risk consulting services to the general insurance sector. Prior to joining Grant Thornton, I held senior roles at Tillinghast – Towers Perrin (now part of Willis Towers Watson) and Travelers Insurance Company Limited.
- 1.13 I have experience in all areas of general insurance actuarial work (including reserving, capital, pricing, transactions, etc.), and have previously acted as Independent Expert for five other insurance business transfer schemes.
- 1.14 Full details of my experience can be found in Appendix F.

### **Independence**

- 1.15 I currently hold a personal motor insurance policy issued by AIL. I do not believe that this policy impairs my independence to fulfil the role of Independent Expert for this Scheme. Further, prior to accepting the role of Independent Expert, I disclosed this relationship to AIL, AIIDAC, the PRA and the FCA to consider whether they believed that the policy could impair my independence or creates a conflict of interest. None of

these parties considered this insurance policy to impair my independence to fulfil the role of Independent Expert on this Scheme.

- 1.16 Apart from my motor insurance policy as mentioned in paragraph 1.15 above, I have no financial interest in AIL or the group of companies to which AIL belongs. I have been involved in a number of projects advising AIL and the group of companies to which AIL belongs in a professional capacity; however, I do not believe these previous assignments impair my independence to act as the Independent Expert on the Scheme. These previous assignments were disclosed to the PRA and the FCA, prior to my approval as the Independent Expert for the Scheme.
- 1.17 I have no financial interest in, nor have I previously advised in a professional capacity, AIIDAC.

### **Use of this report**

- 1.18 The purpose of this report is to inform the Court of the likely effect of the Scheme upon policyholders. This report is not necessarily suitable for any other purpose.
- 1.19 This report is provided for the use of the Court, the AIL Board, the AIIDAC Board, AIL's policyholders, the PRA, the CBI, the FCA and any other relevant regulator for the sole purpose of considering the impact of the Scheme on the affected policyholders.
- 1.20 In addition, draft and final versions of this report may be distributed to AIL's legal advisers, AIIDAC's legal advisers, and companies within the group to which AIL and AIIDAC belongs as necessary in connection with the transaction. Should this report be distributed to any of the entities listed in the previous sentence, no reliance should be placed on this report by these entities, and we do not assume any liability to these entities or any other third parties that choose to rely on this report. In addition, AIL shall be responsible for any confidentiality breach that arises from the distribution of this report to AIL's legal advisers, to companies within the group to which AIL belongs or to any other entities to which it releases this report. Similarly, AIIDAC shall be responsible for any confidentiality breach that arises from the distribution of this report to AIIDAC's legal advisers, to companies within the group to which AIIDAC belongs or to any other entities to which it releases this report.
- 1.21 Copies of the final version of this report may be made available for inspection by policyholders and copies may be provided to any person requesting the same in accordance with legal requirements. The final version of this report may also be made available at <https://transfer.aviva.com>, a webpage which has been developed in connection with the Scheme.
- 1.22 I also consent to the final versions of my Summary Report and Supplementary Report being made available at <https://transfer.aviva.com>.
- 1.23 However, Grant Thornton does not accept any liability to any party other than AIL, AIIDAC, or the Court who chooses to act on the basis of any of our reports.
- 1.24 Judgements about the conclusions drawn in this report should only be made after considering the report in its entirety as any part or parts read in isolation may be misleading.

- 1.25 The underlying figures in this report are calculated to many decimal places. In the presentation of the figures in the various tables, there may be reconciliation differences due to the effect of rounding.

### **Professional guidance**

- 1.26 As an Independent Expert reporting to the Court, I am required to act in accordance with the rules of Scots law which are, in functional terms, the broad equivalent of Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Guidance for the Instruction of Experts in Civil Claims. Accordingly, this report is prepared for the assistance of the Court and I confirm that I understand my duty to the Court and have complied with that duty.
- 1.27 This report has been prepared under the terms of the Statement of Policy produced by the PRA in April 2015, namely "The Prudential Regulation Authority's approach to insurance business transfers" and the guidance set out in Chapter 18 of the Supervision Manual ("SUP18") contained in the FCA Handbook of Rules and Guidance to cover scheme reports on the transfer of insurance business. In addition, in May 2018, the FCA published a guidance paper, entitled "The FCA's approach to the review of Part VII insurance business transfers", which the FCA requires to be considered in addition to SUP18. This report has also been prepared in line with this guidance.
- 1.28 In my opinion, this report has been produced in line with the requirements of the Technical Actuarial Standards ("TASs") issued by the Financial Reporting Council ("FRC"). In particular, this report has been prepared in accordance with TAS 100: Principles of Technical Actuarial Work and TAS 200: Insurance.
- 1.29 This report has also been produced in line with the requirements of APS X3: The Actuary as an Expert in Legal Proceedings, issued by the Institute and Faculty of Actuaries.
- 1.30 In addition, this report has been internally peer reviewed in line with the requirements of APS X2: Review of Actuarial Work, issued by the Institute and Faculty of Actuaries.
- 1.31 I confirm that I have made clear which facts and matters referred to in this report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions that I have expressed and conclusions that I have drawn represent my true and complete professional opinions on the matters to which they refer.

## 2 Executive Summary

### Overview of the Scheme

- 2.1 This report considers the impact of the proposed transfer of the Transferring Portfolio to AIIDAC. The transferring policyholders have policies written in the EEA on a Freedom of Services or a Freedom of Establishment basis.
- 2.2 The business being transferred is all of the following risks except for those set out in paragraph 2.3 :
- General insurance risks written by the Ireland GI branch and situated in the EEA (excluding the UK), comprising both personal and commercial lines risks
  - General insurance risks written by the Ireland GI branch and situated in the UK, comprising both personal and commercial lines risks (“Reverse Flow Business”)
  - Retail policies written on a FOS basis comprising of holiday home, creditor and mobile device insurance (“MDI”) policies
  - Commercial policies covering risks situated in the EEA (excluding the UK) written on a FOS basis
  - French hospitalisation policies
  - French construction bond policies including construction inwards reinsurance risks ceded by pools
  - Belgian hospitalisation policies
- 2.3 It should be noted that the creditor business above is comprised of payment protection insurance policies.
- 2.4 Certain policies written on a FOS basis will remain with AIL following the Scheme. The policies with EEA risks that are not included in the Scheme fall under one of the following categories:
- Inwards reinsurance business other than French construction inwards reinsurance risks
  - Policies from portfolios of insurance business in respect of EEA risks that are in run-off and where AIL’s reserving experts have concluded that no further claims are expected
  - Policies written by AIL on a FOS basis which will either have expired shortly before Brexit or where the continued periods of cover are for a very short time following Brexit, and, in either case, where all resulting claims are expected to have been notified within a relatively short period following Brexit
  - EEA risks from certain global policies where it is not possible to separate out the EEA elements from the UK or wider global elements
- 2.5 Generally speaking, inwards reinsurance is not included in the scope of the Scheme, as AIL expects to be able to continue providing reinsurance to EEA insurers following Brexit. However, French construction inwards reinsurance risks have been included in the Scheme. I understand from AIL that this is because its French branch is closed and,

as a result, including these policies in the Scheme simplifies things from a logistical perspective.

- 2.6 As indicated in paragraph 2.3, there are also a number of portfolios of insurance business in respect of EEA risks that are in run-off and where AIL's reserving experts have concluded that no further claims are expected. Nevertheless, there remains a non-zero possibility that claims may arise under these policies after the date of Brexit. However, I understand from AIL that these policies have been excluded from the scope of the Scheme as the cost and complexity of transferring these policies would be disproportionate to the likelihood of claims being reported under them.
- 2.7 In addition, there are a small number of policies excluded from the transfer which will either have expired shortly before Brexit or which will have continued periods of cover for a very short period following Brexit but where, in either case, all resulting claims are expected to have been notified within a relatively short period following Brexit. These policies will remain with AIL and insurance cover may continue to apply to these policies and claims may be payable under them after the date of Brexit.
- 2.8 Also, there are a small number of policies excluded from the transfer because they form part of global policies where it is not possible to separate out the EEA elements from the UK or wider global elements. These policies will remain with AIL and insurance cover may continue to apply to these policies and claims may be payable under them after the date of Brexit.
- 2.9 I discuss the materiality of these policies and my analysis of whether it is reasonable to exclude them from the scope of the Scheme in paragraphs 11.2 to 11.12.
- 2.10 There are no existing policyholders of AIIDAC as the company has been established for the purpose of the Scheme.
- 2.11 AIIDAC has recently received permissions from the CBI to transact all of the classes of insurance business being transferred into it.

### **Background to the companies**

- 2.12 AIL was incorporated in Scotland on 23 February 1891 as General Accident Assurance Corporation. The company changed its name to General Accident Fire and Life Assurance Corporation Limited on 2 March 1906. The company re-registered as General Accident Fire and Life Assurance Corporation Public Limited Company on 4 February 1982. On 1 October 1999 the company changed its name to CGU Insurance plc after the merger between General Accident plc and Commercial Union plc. The company subsequently changed its name to Aviva Insurance Limited on 1 September 2006.
- 2.13 In 2011, Aviva plc consolidated most of its UK non-life insurance business by transferring non-life insurance business from nine companies to AIL via Part VII transfers. The transfers covered most of Aviva plc's UK non-life insurance and health insurance business.
- 2.14 AIL transacts and underwrites general and health insurance business in the UK and Ireland with its major classes of business being personal lines, health lines and commercial lines.
- 2.15 Specifically, AIL writes the following types of business:

- Personal lines – Motor, home, creditor, specialty, mobile devices and other lines
  - Commercial lines – Motor, property, liability and other lines
  - Health lines.
- 2.16 AIL is a wholly owned subsidiary of Aviva plc, a public limited company incorporated under the laws of England and Wales. Aviva plc is the ultimate holding company of a group of companies (“the Aviva Group”).
- 2.17 AIIDAC was established in 2017 and is a wholly owned subsidiary of AIL.
- 2.18 In June 2016, the UK voted to leave the European Union raising the possibility that AIL may lose passporting rights to insurance business in the European Union once the UK leaves.
- 2.19 If the Scheme goes ahead, AIIDAC will write direct business in the Republic of Ireland and certain Freedom of Services (“FOS”) business within the European Union which, prior to the Scheme, would have been written by AIL. AIIDAC will also establish an insurance branch in the UK under current EU regulations (the “AIIDAC UK Branch”). The following business will be allocated to the AIIDAC UK Branch:
- Reverse Flow Business
  - Retail policies covering risks situated in the EEA (excluding the UK) written on a FOS basis, comprising holiday home and creditor policies
  - Commercial policies covering risks situated in the EEA (excluding the UK) written on a FOS basis
  - French hospitalisation policies
  - French construction bond policies including construction inwards reinsurance risks ceded by pools
  - Belgian hospitalisation policies.
- 2.20 Following Brexit AIIDAC will be required to apply for the AIIDAC UK Branch to convert to a third country branch in the UK.

### **My approach**

- 2.21 My approach to assessing the likely effects of the Scheme on policyholders is to:
- Understand the nature and structure of the Scheme
  - Identify the groups of policyholders that would be affected
  - Assess the financial positions of the companies involved
  - Consider the implications of the Scheme on the level of security provided to the affected policyholders
  - Consider the potential impact on levels of customer service
  - Consider other factors that might affect policyholders
  - Consider the implications of the Scheme on reinsurers.
- 2.22 In order to consider the effect of the proposed Scheme on each of the entities and groups of policyholders concerned, I have been provided with a range of published and internal documentation for each legal entity. A listing of the documents provided to me is shown in Appendix A.

- 2.23 I will issue a Supplementary Report containing the most up to date information available to me prior to the second Court hearing.
- 2.24 In forming my opinion, I have conducted a number of interviews with key personnel responsible for core functions in AIL and AIIDAC and have also placed reliance on AIIDAC's non-life insurance application submitted to CBI in June 2017.
- 2.25 In addition, I have also placed reliance on estimates of the capital required by each of AIL and AIIDAC. In section 8, I describe what information I have relied on in relation to the capital requirements of AIL and AIIDAC and the analyses I have undertaken to assure myself that it is reasonable to rely on that information.
- 2.26 In order to form an opinion based on this information, I have considered:
- The appropriateness of the methods used by each of AIL and AIIDAC to calculate the estimates of capital requirements
  - The appropriateness of the methods used by each of AIL and AIIDAC to calculate the reserves for the Transferring Portfolio
  - The relative capital strength of the two companies
  - The absolute capital strength of each of the two companies.
- 2.27 In forming my opinion, I have only considered the terms of the Scheme presented to me, and am not required to consider any alternative arrangements.

## **Findings**

- 2.28 The findings of my report are summarised in this section. The detailed explanation behind these conclusions follows in the body of this report.
- 2.29 I have identified two distinct groups of policyholders. These are:
- The transferring AIL policyholders ("the Transferring Portfolio")
  - The policyholders remaining in AIL ("the Remaining Portfolio").
- 2.30 I conclude that the Scheme will not have a material adverse impact on the security of the policyholders within the Transferring Portfolio. Note that this conclusion is subject to AIL honouring its intention to provide financial support to AIIDAC should AIIDAC's coverage ratio against its SCR fall below a specified threshold, as discussed in paragraph 9.26. (The limitations of AIL's aforementioned intention and my opinion in respect of the security that this provides to AIIDAC are discussed in paragraphs 9.26 and 9.27.) Although the transferring policyholders would be moving to a smaller entity with less capital, following the Scheme, AIIDAC will have reasonable coverage over both its regulatory and ORSA capital requirements. Furthermore, in my opinion it is highly likely that the transferring policyholders will have the benefit of AIL's aforementioned intention (discussed further in paragraphs 9.26 and 9.27). In addition, the terms of the security in connection with the AIIDAC-AIL Quota Share arrangement have the effect of aligning the transferring policyholders and the policyholders that remain with AIL in relation to a distribution of the assets of AIL in the event of AIL's insolvency. As a result, the transferring policyholders will still retain reasonable access to the security offered by AIL's capital base.
- 2.31 With respect to the Remaining Portfolio, I do not expect any material adverse impact on policyholder security as a result of the Scheme. Given the materiality of the Scheme in

the context of AIL's overall portfolio, the Scheme will not materially affect AIL's capital base or coverage over both its regulatory and ORSA capital requirements. In addition, I am satisfied that the terms of the AIIDAC-AIL Quota Share arrangement will not reduce the level of security available to the policyholders remaining in AIL.

- 2.32 There will be no substantial change in the standards of service experienced by either group of policyholders. For the Transferring Portfolio, claims handling and policy administration services will continue to be outsourced to the same service providers. For the Remaining Portfolio, there will be no changes.
- 2.33 I do not expect any material adverse impact to either group of policyholders as a result of a different investment strategy following the Scheme.
- 2.34 I do not expect any material adverse impact to either group of policyholders resulting from changes in ongoing expense levels as a result of the Scheme.
- 2.35 I do not anticipate that tax implications arising as a result of the Scheme will create any material adverse impact on either group of policyholders.
- 2.36 In the event of insolvency, I expect that some of the transferring policyholders will be in a worse position in respect of access to a compensation scheme following the Scheme. However, in my opinion, to the extent that the Scheme does create an adverse impact on the transferring policyholders' access to compensation, this will be less detrimental to them than the impact should the Scheme not go ahead. Summaries of the coverage provided by the UK and Irish compensation schemes are provided in paragraphs 6.21 to 6.24, and paragraphs 6.39 and 6.40, respectively, and my reasons for reaching my conclusion are discussed in paragraphs 10.31 to 10.41.
- 2.37 For the remaining policyholders, there will be no change to the access to a compensation scheme.
- 2.38 I expect that some of the transferring policyholders will have access to the Financial Services and Pensions Ombudsman in Ireland, discussed in paragraph 6.26, following the Scheme. This is an adequately funded and equivalent body to the Financial Ombudsman Service in the UK. However, I expect that some transferring policyholders who currently have access to the Financial Ombudsman Service will not have access to the Financial Services and Pensions Ombudsman. In this respect, they will be worse off. However, in my opinion, this will be less detrimental to them than the impact should the Scheme not go ahead. For the policyholders remaining in AIL, there will be no change.
- 2.39 I do not expect any material adverse impact to the transferring policyholders as a result of a different financial regulatory environment following the Scheme.
- 2.40 There will be no change in the pension arrangements for affected employees as a result of the Scheme.
- 2.41 In my opinion, the management and governance framework of AIIDAC is proportionate to the size and complexity of the Transferring Portfolio. I have not identified any material adverse impacts to of the transferring policyholders in relation to the management and governance framework as a result of the Scheme.
- 2.42 There will be no change to the management and governance framework of AIL as a result of the Scheme. AIL's management and governance framework is proportionate to

the size and complexity of the Remaining Portfolio. As a result, the Remaining Portfolio will not be impacted by the Scheme from this perspective.

- 2.43 I expect no material adverse impact on the current and historic reinsurers of AIL as a result of the Scheme.

**Conclusion**

- 2.44 I conclude that I do not expect any group of policyholders or reinsurers to be materially adversely affected by the Scheme and therefore I see no reason why the Scheme should not proceed.

## 3 Scope

- 3.1 I am required as Independent Expert to consider the likely effects of the Scheme on policyholders, including whether the Scheme will result in material detriment to any policyholders affected by the Scheme, relative to their current situation. The purpose of this report is to set out my considerations. For the purposes of this report, policyholders include existing and future claimants.
- 3.2 Material detriment in the context of this report means any material adverse effect on:
- the security of policyholders' contractual rights
  - the levels of service provided to policyholders.
- 3.3 My report considers the effect on the following groups of policyholders:
- the Transferring Portfolio
  - the Remaining Portfolio.
- 3.4 AIIDAC does not currently write any insurance business and has not written insurance business in the past. I understand from AIL that, prior to the Scheme of AIL's business to AIIDAC, AIIDAC will not have any existing policyholders, insurance liabilities or outwards reinsurance contracts. As a result, I have not needed to analyse the impact of the Scheme on AIIDAC's existing policyholders or reinsurers in this report.
- 3.5 The Scheme provides for the possibility of one or more policies included in the scope of the Scheme not being successfully transferred at the Effective Time. Should there be any such residual policies following the second Court hearing, these policies will remain the responsibility of AIL but will be reinsured to AIIDAC, until the successful novation of these contracts.
- 3.6 I believe the likelihood of any policies not being successfully transferred are remote for the following reasons:
- The transferring policies cover risks that are located in EEA countries and are transferring to an authorised insurer within the EEA
  - The policies would be transferring into another entity in the same group.
- 3.7 However, following the policyholder notification process, I will know whether there is a risk that there will be any residual policies and, if so, I will comment further on these policyholders in my Supplementary Report.
- 3.8 I have not considered the impact of the Scheme on any policyholder that subsequently takes out a policy with either AIL or AIIDAC.
- 3.9 I have also considered the impact of the Scheme on any reinsurance contracts transferring, and any existing reinsurance contracts remaining in AIL. As mentioned in

paragraph 3.4 above, AIIDAC will not have any reinsurance contracts in place prior to the Scheme.

- 3.10 I am not aware of any alternative scheme or proposal, so I have not considered it necessary to discuss alternative proposals within this report.
- 3.11 Shortly before the date of the Court hearing at which an order sanctioning the Scheme will be sought, I will prepare a Supplementary Report covering any relevant matters which have arisen since the date of this report.

#### **Future changes of ownership**

- 3.12 I have not considered any future changes of ownership in either AIL or AIIDAC. I am not aware of any proposals to change ownership at the time of writing this report.

#### **Exchange rates**

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

- £1 = €1.1270.

This is the Bank of England rate as at 29 December 2017. Note that there is not a Bank of England rate available as at 31 December 2017 as this was not a business date. We have therefore used the exchange rate as at the closest business date prior to 31 December 2017.

#### **Reliance on data**

- 3.14 A summary of the data provided to me can be found in Appendix A.
- 3.15 I have not audited nor have I independently verified the data and information supplied to me. However, I have reviewed it for reasonableness and for internal consistency.
- 3.16 I have checked that all of the information I have been provided with has been supplied by persons appropriately qualified to provide such information and I am satisfied that it is reasonable for me to rely on this information.
- 3.17 A number of the items received are of a commercially sensitive or confidential nature. All relevant information received has been used to inform the conclusions set out in this report, whilst taking care to respect the confidentiality of the entities involved. It should be noted that there are no instances where I have omitted implications of the documentation received from this report for the sake of respecting confidentiality. Therefore, in my opinion it is not necessary to produce a separate document exclusively for the Court providing further details of these data items.
- 3.18 I have been provided with all the information that I have requested.

#### **Peer review process**

- 3.19 In accordance with the Institute of Actuaries Guidance APS X2 on the Review of Actuarial Work and the internal control process of Grant Thornton, the work documented in this report has been peer reviewed by a suitably qualified person (an Actuary within my own firm who has considerable experience working on Part VII transfers as well as capital modelling and reserving in the general insurance market). The

peer review process has included a review of the methodology and key assumptions used and discussion of the key elements of the analysis.

## 4 Methodology

4.1 In this section, I describe my approach to assessing the Scheme.

4.2 My conclusions have been drawn by undertaking the following activities:

- Review of documentation received from AIL and AIIDAC
- Discussions with key personnel at both AIL and AIIDAC
- Undertaking my own analysis, where necessary.

4.3 In particular:

- My view on the insurance liabilities of AIL is based upon my review of the documentation provided to me by AIL and discussions with the relevant individuals at AIL.
- My view on the capital assessments for AIL is based upon my review of the calculations and documentation provided to me by AIL and discussions with the relevant individuals at AIL.
- My view on the insurance liabilities for AIIDAC is based upon my review of the calculations and documentation provided to me by AIIDAC, and discussions with the relevant individuals at AIIDAC.
- My view on the capital assessments for AIIDAC is based upon my review of the calculations and documentation provided to me by AIIDAC, discussions with the relevant individuals at AIIDAC and high-level calculations that I have undertaken.

4.4 My approach to assessing the Scheme has been to perform the following specific activities:

- Understand the nature and structure of the Scheme and identify the groups of policyholders that would be affected
- Assess the financial positions of AIL and AIIDAC
- Consider the implications of the Scheme for the level of security being offered to each group of policyholders
- Consider the potential impact on levels of customer service
- Consider other factors that might affect policyholders
- Consider the implications of the Scheme for reinsurers.

4.5 I provide additional details for each of the activities listed above in the remainder of this section below.

### **Understand the nature and structure of the Scheme and identify the groups of policyholders that would be affected**

4.6 I have discussed the nature and the structure of the Scheme with AIL and AIIDAC, and reviewed the documentation I have received.

#### **Assess the financial positions of AIL and AIIDAC**

- 4.7 The level of security provided to policyholders of an insurance company depends on the available capital of the company and, in particular, the probability that this level of capital is sufficient to make claim payments as they fall due.
- 4.8 Insurers are subject to capital requirements imposed by regulators, the PRA in the case of AIL and the CBI in the case of AIIDAC. These capital requirements are discussed in more detail in paragraphs 6.4 to 6.7. The level of available capital compared to regulatory capital requirements is a measure of the security provided to the policyholders.
- 4.9 Insurers are also required to undertake an assessment of their own risks and solvency needs. Another measure of the security provided to policyholders is the level of available capital compared to the insurer's view of required capital.
- 4.10 I have considered the balance sheet of AIL and the hypothetical balance sheet of AIIDAC, on both accounting and regulatory bases, as part of my assessment of their relative financial strength, including the net assets and level of capital.
- 4.11 I have compared AIL's balance sheet based on data as at 31 December 2017 to AIIDAC's hypothetical balance sheet, as at 31 December 2017, assuming that the Scheme had become effective on this date.

#### **Assess the claims reserves of AIL and AIIDAC**

- 4.12 An important part of the security provided to policyholders is the strength of the claims reserves - the amount of money the insurer will have to make future claim payments in respect of policies already sold. The claims reserves generally form the largest part of the liabilities for a non-life insurer.
- 4.13 I have therefore considered the claims reserves included on the balance sheet for each of AIL and AIIDAC. This is discussed in detail in section 7.

#### **Assess the capital modelling undertaken and the capital positions of AIL and AIIDAC**

- 4.14 To further review the financial strength of AIL and AIIDAC, I have reviewed the modelling undertaken to assess the required regulatory capital.
- 4.15 In addition, I have reviewed the modelling undertaken by AIL and AIIDAC to form a view on their own estimates of the capital required.
- 4.16 These reviews are discussed further in section 8.

#### **Consider the implications of the Scheme for the level of security being offered to each group of policyholders**

- 4.17 I have considered each group of policyholders both before and after the Scheme and the relative level of security available to them. This is discussed further in section 9.

#### **Consider the potential impact on levels of customer service**

- 4.18 I have considered how the level of customer service, specifically claims handling and policy servicing, experienced by each group of policyholders could change following the Scheme. This is discussed in paragraphs 11.20 to 11.29.

**Consider other financial factors that might affect policyholders**

4.19 Through my discussions with AIL and AIIDAC and reviews of documentation, I have also considered various other financial factors that might affect policyholders, including the following:

- Investment strategy implications
- Implications of the Scheme on ongoing expense levels
- Implications under insolvency
- Impact on Compensation
- Liquidity position
- Tax implications
- Impact of changes in employee pension arrangements.

4.20 These issues are discussed in section 10 of this report.

**Consider other factors that might affect policyholders**

4.21 Through my discussions with AIL and AIIDAC and reviews of documentation, I have also considered various other non-financial factors that might affect policyholders, including the following:

- EEA business remaining with AIL following the Scheme
- Impact of changes in regulatory jurisdiction
- Complaints
- 'Brexit'
- Governance and management frameworks
- Should the Scheme not become effective
- Policyholder notifications
- Reinsurer notifications.

These issues are discussed in section 11 of this report.

**Consider the implications of the Scheme for reinsurers.**

4.22 I have considered the implications of the Scheme on any reinsurers transferring, and any existing reinsurers of both AIL and AIIDAC. This is discussed in paragraphs 10.53 to 10.60.

## 5 Background

### **History and background of AIL**

- 5.1 AIL is authorised by the PRA to conduct insurance business in the UK and is regulated by the PRA and the FCA.
- 5.2 AIL is a wholly owned subsidiary of Aviva plc, a public limited company incorporated under the laws of England and Wales, which is the ultimate holding company of the Aviva Group.
- 5.3 AIL was incorporated in Scotland on 23 February 1891 as General Accident Assurance Corporation. The company changed its name to General Accident Fire and Life Assurance Corporation Limited on 2 March 1906. The company re-registered as General Accident Fire and Life Assurance Corporation Public Limited Company on 4 February 1982. On 1 October 1999 the company changed its name to CGU Insurance plc after the merger between General Accident plc and Commercial Union plc. The company subsequently changed its name to Aviva Insurance Limited on 1 September 2006.
- 5.4 In 2011, Aviva plc consolidated most of its UK non-life insurance business by transferring non-life insurance business from nine companies to AIL via Part VII transfers. The transfers covered most of Aviva plc's UK non-life insurance and health insurance business.
- 5.5 Until 2012, Aviva Group's Irish non-life insurance business operated through a locally incorporated subsidiary, Aviva Insurance Europe SE. In 2012 the existing Irish business was transferred to AIL and continues to be written by a branch of AIL (the "Ireland GI branch") on a Freedom of Establishment basis.
- 5.6 AIL's total gross written premium in 2017 was approximately GBP 5.3 billion. It transacts and underwrites general and health insurance business in the UK, Ireland and wider EEA countries. AIL writes the following types of business:
  - Personal lines – Motor, home, creditor, specialty, mobile devices and other lines
  - Commercial lines – Motor, property, liability and other lines
  - Health lines.
- 5.7 In addition, AIL also writes a portfolio of MDI business operated through a number of binding authorities in the UK and several other EEA countries. AIL has informed me that its MDI business in countries other than UK and Ireland will be in run-off by the Effective Time of the Scheme. In other words, no new MDI business will be written in these countries after the Effective Time of the Scheme.

5.8 An analysis of AIL's gross earned premium in 2017 by Solvency II class of business is shown in the table below:

**Table 1: Class of business breakdown of AIL's gross earned premium by Solvency II class of business in 2017**

| Solvency II line of business                | Gross Earned Premium (£m) | Percent of total |
|---|---------------------------|------------------|
| Medical expense insurance                   | 567.5                     | 10.9%            |
| Income protection insurance                 | 89.1                      | 1.7%             |
| Motor vehicle liability insurance           | 1,540.9                   | 29.6%            |
| Other motor insurance                       | 385.2                     | 7.4%             |
| Marine, aviation and transport insurance    | 39.3                      | 0.8%             |
| Fire and other damage to property insurance | 2,038.0                   | 39.1%            |
| General liability insurance                 | 422.6                     | 8.1%             |
| Credit and suretyship insurance             | 27.2                      | 0.5%             |
| Assistance                                  | 39.6                      | 0.8%             |
| Miscellaneous financial loss                | 61.3                      | 1.2%             |
| <b>Total</b>                                | <b>5,210.6</b>            | <b>100.0%</b>    |

5.9 A breakdown of AIL's gross and net Solvency II technical provisions as at 31 December 2017 is shown in the table below:

**Table 2: Class of business breakdown of AIL's gross and net Solvency II technical provisions (including Solvency II Risk Margin) by class of business as at 31 December 2017**

| Solvency II line of business                         | Gross (£m)     | Percent of total | Net (£m)       | Percent of total |
|--|----------------|------------------|----------------|------------------|
| Medical expense insurance                            | 80.3           | 1.2%             | -38.6          | -1.9%            |
| Income protection insurance                          | 34.3           | 0.5%             | 5.0            | 0.2%             |
| Motor vehicle liability insurance                    | 2,879.3        | 44.1%            | 1,313.6        | 64.0%            |
| Other motor insurance                                | 207.6          | 3.2%             | 51.3           | 2.5%             |
| Marine, aviation and transport insurance             | 49.9           | 0.8%             | 13.8           | 0.7%             |
| Fire and other damage to property insurance          | 473.9          | 7.3%             | -56.3          | -2.7%            |
| General liability insurance                          | 1,972.4        | 30.2%            | 595.1          | 29.0%            |
| Credit and suretyship insurance                      | 18.4           | 0.3%             | 6.6            | 0.3%             |
| Assistance   | 25.3           | 0.4%             | 10.2           | 0.5%             |
| Miscellaneous financial loss                         | 32.1           | 0.5%             | 9.6            | 0.5%             |
| Non-proportional reinsurance                         | 0.8            | 0.0%             | 0.4            | 0.0%             |
| Annuities stemming from non-life insurance contracts | 758.5          | 11.6%            | 141.7          | 6.9%             |
| <b>Total</b>   | <b>6,532.7</b> | <b>100.0%</b>    | <b>2,052.4</b> | <b>100.0%</b>    |

### The Transferring Portfolio

5.10 The Transferring Portfolio forms a subset of the existing AIL business and comprises business written by the existing AIL Ireland GI branch as well as risks written by AIL in the EEA on a Freedom of Services and Freedom of Establishment basis. More specifically, the business being transferred comprises:

- General insurance risks written by the Ireland GI branch and situated in the EEA (excluding the UK), comprising both personal and commercial lines risks
- General insurance risks written by the Ireland GI branch and situated in the UK, comprising both personal and commercial lines risks (“Reverse Flow Business”)
- Retail policies written on a FOS basis comprising of holiday home, creditor and mobile device insurance (“MDI”) policies
- Commercial policies covering risks situated in the EEA (excluding the UK) written on a FOS basis
- French hospitalisation policies
- French construction bond policies including construction inwards reinsurance risks ceded by pools
- Belgian hospitalisation policies

5.11 It should be noted that the creditor business above is comprised of payment protection insurance policies.

5.12 The table below shows an analysis of the number of policies in AIIDAC by class of business. Note that this is the hypothetical position assuming that the Scheme had become effective on 31 December 2017.

**Table 3: Number of policies in AIIDAC by class as at 31 December 2017**

| <b>Class</b>                            | <b>Number of policies</b> |
|---|---------------------------|
| Ireland Personal Motor                  | 399,402                   |
| Ireland Personal Property               | 215,704                   |
| Ireland Commercial Motor                | 34,027                    |
| Ireland Commercial Property & Liability | 49,175                    |
| Ireland Commercial Specialty            | 10,310                    |
| <b>Ireland GI Total</b>                 | <b>708,618</b>            |
| UK FOS MDI Business                     | 686,980                   |
| UK FOS Commercial Property              | 203                       |
| UK FOS excl MDI and Commercial Property | 894                       |
| <b>UK FOS Total</b>                     | <b>688,077</b>            |
| <b>Total</b>                            | <b>1,396,695</b>          |

5.13 Generally speaking, inwards reinsurance is not included in the scope of the Scheme, as AIL expects to be able to continue providing reinsurance to EEA insurers following Brexit. However, French construction inwards reinsurance risks have been included in the Scheme. I understand from AIL that this is because its French branch is closed and, as a result, including these policies in the Scheme simplifies things from a logistical perspective.

- 5.14 For simplicity, the Commercial policies written on a FOS basis, holiday home policies, creditor policies, French and Belgian policies within the scope of the Scheme are collectively referred to as “the Other FOS business” in the remainder of this report.
- 5.15 There will be small numbers of policies written on a FOS basis that will not be included in the Transferring Portfolio. These policies will remain with AIL and insurance cover may continue to apply to these policies and claims may be payable under them after the date of Brexit. I understand from AIL that these policies are not included in the Scheme either because the continued periods of cover are for a very short period following Brexit or because they form part of global policies where it is not possible to separate out the EEA elements from the UK or wider global elements.
- 5.16 There are also a number of portfolios of insurance business in respect of EEA risks that are in run-off and where AIL’s reserving experts have concluded that no further claims are expected. Nevertheless, there remains a non-zero probability that claims may arise under these policies after the date of Brexit. However, I understand from AIL that these policies have been excluded from the scope of the Scheme as the cost and complexity of transferring them would be disproportionate to the likelihood of claims being reported under these policies following Brexit.
- 5.17 I discuss my analysis of whether it is reasonable to exclude these EEA policies from the scope of the Scheme in paragraphs 11.2 to 11.12.
- 5.18 AIIDAC has informed me that it will also establish an insurance branch in the UK and that the Reverse Flow business and the Other FOS business will be allocated to the AIIDAC UK Branch. Following Brexit AIIDAC will be required to apply for the AIIDAC UK Branch to convert to a third country branch in the UK.
- 5.19 Breakdowns of the reserves for the Transferring Portfolio on gross and net of insurance bases are included in paragraph 7.53 of this report.
- 5.20 AIL’s systems are able to separately identify the individual affected policyholders in the Transferring Portfolio in respect of the following policy cohorts:
- General insurance risks written by the Ireland GI branch situated in the EEA, comprising both personal and commercial lines risks
  - MDI business written in the EEA on an FOS basis
  - Certain subgroups of Commercial policies on risks situated in the EEA written on a FOS basis, in particular policies in respect of small and medium enterprises
  - French and Belgian policies.
- 5.21 In respect of the remaining Commercial policies on risks situated in the EEA written on a FOS basis not covered by paragraph 5.20 above, I understand that, for some of these policies, there is currently insufficient data available to identify EEA risks within individual policies. As at May 2018, only 973 policies were impacted by this issue, which is an immaterial number of policies in the context of the Transferring Portfolio.
- 5.22 I understand from AIL that it is currently in the process of enhancing its policy data systems so that all policies with EEA risks can be identified. AIL has informed me that an initial process has already been undertaken and it will undertake a more detailed exercise to refine this further during the fourth quarter of 2018 and January 2019 prior to the Effective Date of the Scheme. Following this, AIL will continue to check and monitor the data quality on the policy systems until the Effective Time of the Scheme to

ensure that EEA risks are being appropriately identified. I will provide an update on AIL's work to identify the transferring FOS policyholders in my Supplementary Report which will be issued prior to the second Court hearing.

- 5.23 I understand from AIL that it is also not currently able to split out its actuarial claims data in respect of the Other FOS business within the Transferring Portfolio, with the exception of actuarial claims data in respect of its French and Belgian policies. AIL has therefore applied assumptions to split out the reserves relating to this business. I discuss this in more detail in paragraph 7.47.
- 5.24 I have calculated that the reserves that AIL has estimated in respect of the Other FOS business for which it cannot split out its claims data only represent 4% of the total reserves that are expected to transfer net of primary reinsurance. It follows that these reserves are not material in the context of the total reserves for the Transferring Portfolio.

### **History and background of AIIDAC**

- 5.25 AIIDAC was incorporated under the Irish Companies Act 2014 as a designated company on 9 June 2017 and is a wholly owned subsidiary of AIL. A simplified view of AIIDAC's position within Aviva plc following the Scheme is shown in figure 2 under paragraph 5.46.
- 5.26 AIIDAC does not currently sell any insurance business and has not sold insurance business in the past. I understand from AIL and AIIDAC that, prior to the Scheme, AIIDAC will not have any existing policyholders or insurance liabilities. As a result, I have not analysed the impact of the Scheme on AIIDAC's existing policyholders in this report.
- 5.27 AIIDAC is authorised to write direct insurance business in the Republic of Ireland and, consequently, AIIDAC benefits from passporting rights enabling it to write insurance business in other EEA countries. Under Solvency II, AIIDAC is required to notify the CBI of its intention to exercise those rights.
- 5.28 I understand from AIL and AIIDAC that the Transferring Portfolio does not include business operated on a Freedom of Establishment basis other than the Ireland GI branch business.
- 5.29 AIIDAC has received permissions to write the following classes of business:
- Accident (including industrial injury and occupational diseases)
  - Sickness
  - Land vehicles (other than railway rolling stock)
  - Railway rolling stock
  - Ships (sea, lake and river and canal vessels)
  - Goods in transit (including merchandise, baggage, and all other goods)
  - Fire and natural forces
  - Other damage to property
  - Motor vehicle liability
  - Liability for ships (sea, lake and river and canal vessels)
  - General liability
  - Suretyship

- Miscellaneous financial loss
- Legal expenses
- Assistance.

5.30 As a result, AIIDAC has permission to transact all of the classes of insurance business within the Transferring Portfolio.

### **Background and purpose of the Scheme**

- 5.31 The purpose of the Scheme is to ensure that the Aviva Group retains the ability to service all of its general insurance policyholders following the UK's departure from the EU ("Brexit").
- 5.32 The UK voted to leave the EU on 23 June 2016. On 29 March 2017, the UK officially notified the European Commission of its intention to withdraw from the EU. Under the current terms of UK's withdrawal, the UK will cease to be a member of the EU on 29 March 2019.
- 5.33 A key area of concern for AIL is the potential loss of insurance passporting rights after 29 March 2019. A significant proportion of AIL's insurance portfolio comprises policyholders in EEA countries. These policies are transacted under an EU Freedom of Establishment or Freedom of Services passport.
- 5.34 To ensure that the Aviva Group retains the ability to transact general insurance business and service insurance policies in the EEA following the UK's departure from the EU, AIL has established AIIDAC as a wholly owned subsidiary domiciled in Ireland. AIIDAC is authorised to conduct insurance business by the CBI.
- 5.35 AIIDAC will provide the Aviva Group with the ability to write insurance business in the Republic of Ireland and certain Freedom of Services business within the European Union.
- 5.36 The purpose of the Scheme is to transfer certain policies of AIL transacted under EU Freedom of Establishment and Freedom of Services passports to AIIDAC prior to the UK's departure from the EU and ensure the Aviva Group and AIIDAC's ability to continue to provide services to the relevant policyholders.
- 5.37 I understand from AIL that the employees that service AIL's Ireland GI branch are employed by Aviva Group Services Ireland Limited ("AGSIL") and are assigned to AIL to perform roles and activities in respect of the Ireland GI branch. Following the Scheme, AIL and AIIDAC have informed me that they do not anticipate any material changes in the staffing requirements of AIIDAC in comparison to the current staffing requirements in AIL's Ireland GI branch. The AGSIL employees that currently service AIL's Ireland GI branch will be assigned to AIIDAC to perform the same roles.

### **Reinsurance**

- 5.38 Historically, the Transferring Portfolio benefited from a combination of both internal and external reinsurance arrangements, as part of the Aviva Group's wider reinsurance strategy. In particular, the Irish business, which forms the vast majority of the Transferring Portfolio, is currently reinsured with a wide variety of reputable reinsurers.
- 5.39 AIIDAC will participate in the Aviva Group's existing reinsurance programme, which is designed to protect the Aviva Group's entities against extreme risks. Specifically, the

group has purchased substantial Excess of Loss reinsurance to protect its property, motor and liability lines of business.

5.40 Following the Scheme, AIL will provide proportional reinsurance to AIIDAC (the “AIIDAC-AIL Quota Share arrangement”) as follows:

- 85% quota share arrangement in respect of the transferring Ireland GI branch risks that are situated in the EEA (excluding the UK) and European MDI business; and
- 100% quota share arrangement covering all other transferring business.

5.41 AIIDAC will therefore retain 15% of the risk in respect of the Ireland GI branch EEA (excluding UK) and European MDI business, which accounted for approximately 84% and 13% of the Transferring Portfolio’s gross business in 2017 (by GWP). These two portfolios are expected to account for similar proportions of AIIDAC’s business following the Scheme.

5.42 I have reviewed AIL’s and AIIDAC’s Petition to the Court of Session in Scotland which includes the AIIDAC-AIL Quota Share as a part of the Scheme. As a result, the Scheme will not be able to proceed without the AIIDAC-AIL Quota Share arrangement being in place prior to the Effective Time of the Scheme.

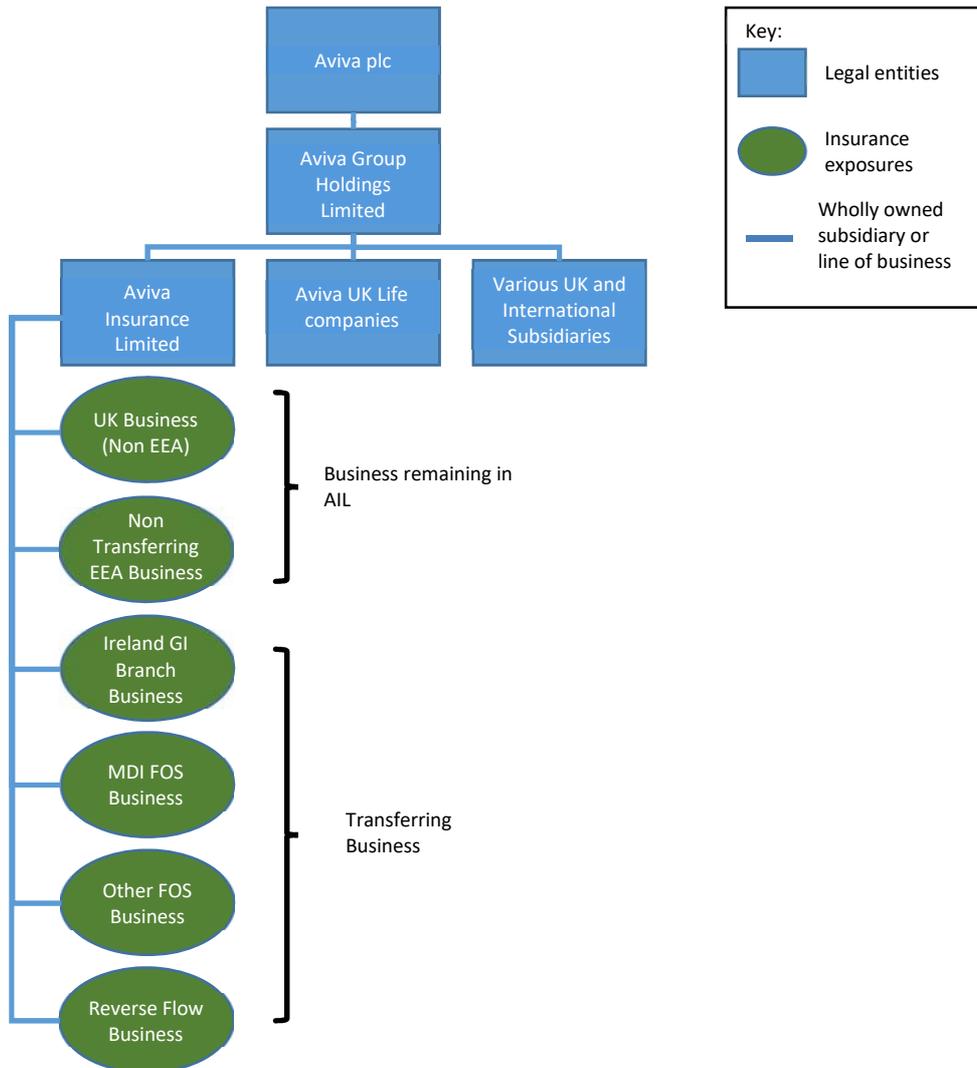
5.43 I understand from AIL and AIIDAC that this reinsurance arrangement will take effect immediately following the Scheme and will apply to both existing and future business.

## Overview of structure

### Overview of structure prior to the Scheme

5.44 The diagram below illustrates the structure of the businesses prior to the Scheme.

Figure 1: Simplified structure of businesses prior to the Scheme (showing main relevant entities only)

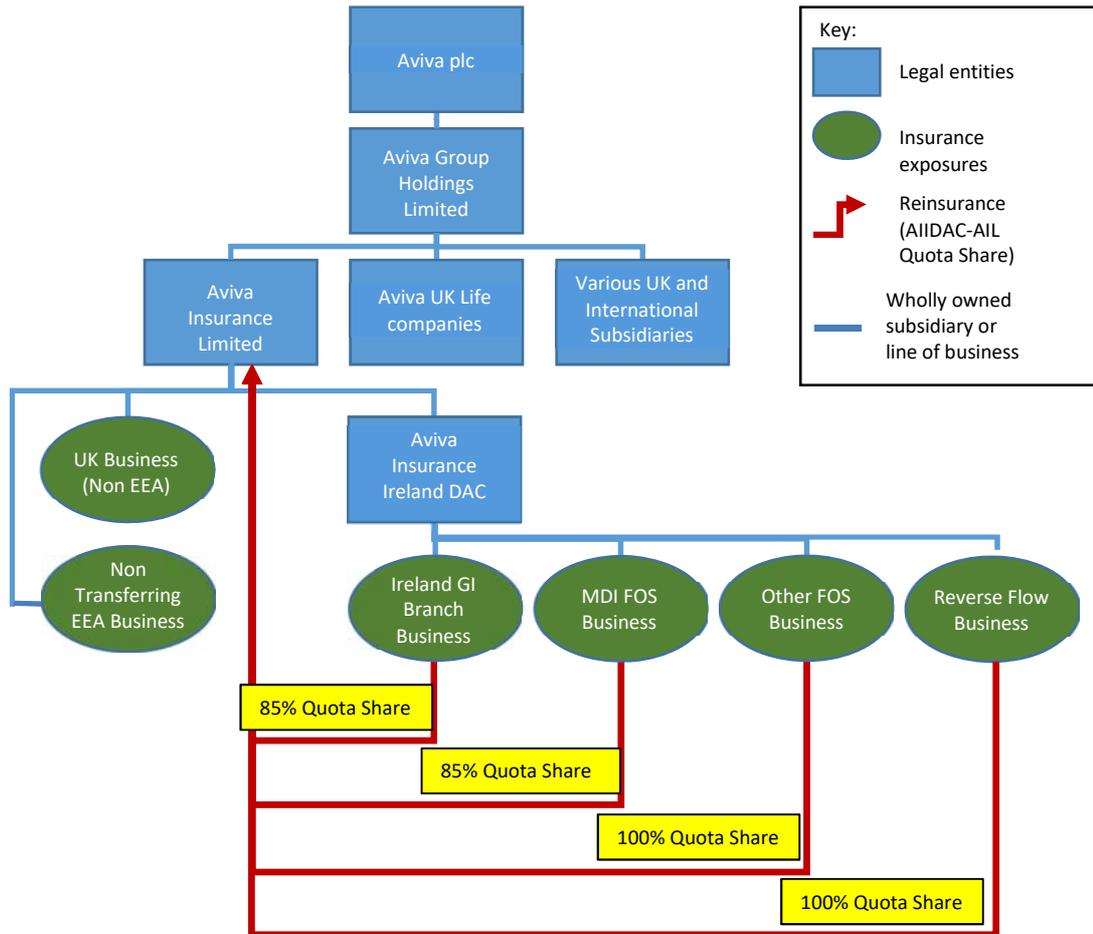


**Overview of structure following the Scheme**

5.45 Following the Scheme, AIIDAC will exist as a wholly owned subsidiary of AIL.

5.46 The diagram below illustrates the proposed structure of the businesses following the Scheme.

**Figure 2: Simplified structure of businesses following the Scheme (showing main relevant entities only)**



## 6 Regulatory background

6.1 In this section, I provide some background on the regulatory requirements in the UK and Ireland. The impact of changes in regulation for any of the groups of policyholders are discussed in section 11. However, as discussed in paragraph 13.9, the opinions contained in this report are based on my own analysis and not based on regulators' views of the companies involved.

### **Solvency II**

6.2 Insurance regulation in Europe has recently undergone a major overhaul. Since 1 January 2016, all EU insurers are now required to meet a new common set of requirements developed by the European Commission ("Solvency II").

6.3 Solvency II is a principles-based regime set around three pillars:

- Pillar 1 – quantitative requirements
- Pillar 2 – qualitative requirements
- Pillar 3 – reporting and disclosure requirements.

6.4 Under Solvency II, there are two sets of capital requirements to allow for different levels of supervisory intervention.

6.5 The usually higher of these two is the Solvency Capital Requirement ("SCR"). This is the amount of capital required in excess of liabilities in order to ensure continued solvency over a one year time frame in 99.5% of cases.

6.6 The SCR can be calculated using one of four approaches; the Standard Formula, the Standard Formula with undertaking specific parameters, an Internal Model, or a Partial Internal Model:

- the Standard Formula approach uses a prescribed set of formulae and parameters in order to work out the SCR.
- within the Standard Formula framework, entities are able to use undertaking specific parameters ("USPs") in order to refine certain parameters, subject to regulatory approval.
- the Internal Model approach involves the entity using its own capital model to calculate the SCR. The model requires regulatory approval.
- the Partial Internal Model approach is a combination of the Internal Model and Standard Formula approaches. An approved Internal Model is used to calculate parts of the SCR and the Standard Formula is used to calculate the remaining parts of the SCR.

6.7 The Minimum Capital Requirement ("MCR") defines the point of severe supervisory intervention.

6.8 I have been provided with details of the approaches taken to calculating the SCR and MCR by both AIL and AIIDAC.

- 6.9 Further to calculating the SCR, insurers are required to calculate the level of capital ("Own Funds") available to meet the SCR and the MCR. This requires the calculation of a balance sheet according to Solvency II requirements. The Own Funds are then assessed and allocated into tiers depending on their eligibility to meet the SCR and MCR.
- 6.10 It is important to note that even if an insurer does not have sufficient Own Funds to meet its SCR, then this does not necessarily mean that it would not be able to settle all of its claims in full.
- 6.11 An additional requirement for Solvency II is that each year, every insurer must undertake an Own Risk and Solvency Assessment ("ORSA"). This sets out its current and future risk profile and its assessment of the level of capital it will require over the next three to five years.

## **UK**

### **Overview of regulation**

- 6.12 UK insurers are regulated by both the PRA and FCA. The PRA and FCA are statutory bodies set up under the Financial Services Act 2012. Prior to 1 April 2013, all regulation of financial services institutions was undertaken by the Financial Services Authority ("FSA"). All regulatory responsibility was transferred from the FSA to the PRA and/or FCA on 1 April 2013.
- 6.13 The PRA is part of the Bank of England and is responsible for prudential regulation of:
- banks
  - building societies
  - credit unions
  - insurance companies
  - major investment firms.
- 6.14 Its three statutory objectives, as applicable to insurance companies, are:
- to promote the safety and soundness of the firms which it regulates
  - to contribute to the securing of an appropriate degree of protection for those who are or may become policyholders
  - to facilitate effective competition.

The third objective above is secondary to the first two.

- 6.15 The FCA is a separate organisation and its strategic objective is to ensure that the relevant markets function well.
- 6.16 To support this, it has three operational objectives:
- to secure an appropriate degree of protection for consumers
  - to protect and enhance the integrity of the UK financial system
  - to promote effective competition in the interests of consumers.

### **Current capital requirements**

- 6.17 Since 1 January 2016, most insurance companies in the UK are required to maintain capital in line with the Solvency II requirements as discussed in paragraphs 6.2 to 6.11.

### **Capital extraction**

6.18 Insurers that are not in run-off are able to extract capital from the business without the PRA's prior approval. However, the PRA expects insurers to maintain an adequate level of capital above the SCR.

### **FCA conduct principles**

6.19 The FCA has set out its Principles for Businesses, the general statements of the fundamental obligations of firms under its regulatory system. These principles include the following that relate to the fair treatment of customers:

- Principle 6: A firm must pay due regard to the interests of its customers and treat them fairly
- Principle 7: A firm must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading
- Principle 8: A firm must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client
- Principle 9: A firm must take reasonable care to ensure the suitability of its advice and discretionary decisions for any customer who is entitled to rely on its judgement.

### **Security under wind up**

6.20 The winding up of an insurance undertaking is governed by the Insurers (Reorganisation and Winding Up) Regulations 2004 in the UK. Under these regulations, insurance claims take precedence over other claims on the insurance undertaking with the exception of certain preferential claims (e.g. claims by employees, rights in rem etc.). Therefore, direct policyholders rank equally and above inwards reinsurance policyholders and all other unsecured or non-preferential creditors in the event that an insurer is wound up.

### **Financial Services Compensation Scheme**

- 6.21 The Financial Services Compensation Scheme ("FSCS") is the compensation fund of last resort for customers of authorised financial services firms.
- 6.22 Most private policyholders, small businesses and charities are eligible for protection from the FSCS in the event that an insurer is unable to meet its liabilities.
- 6.23 The FSCS will pay 100% of any claim incurred for compulsory insurance (e.g. motor third party liability insurance) and 90% of the claim incurred for non-compulsory insurance without any limit on the amount payable. The FSCS is funded by levies on firms authorised by the PRA. No protection is available for Goods in Transit, Marine, Aviation and Credit Insurance and contracts of reinsurance are also not protected.
- 6.24 As well as providing cover for risks situated in the UK written by UK authorised insurance companies, it also provides cover for risks situated in other EEA states written by an insurer authorised in the UK.
- 6.25 The FSCS is discussed further in paragraphs 10.31 to 10.40.

### **Financial Ombudsman Service**

6.26 The Financial Ombudsman Service ("FOSUK") was set up as an independent public body. Its job is to resolve individual disputes between consumers and financial services businesses. In order to access FOSUK, it is necessary for the insurance policy to have been administered from within the UK.

6.27 Eligible claimants are defined to be:

- Consumers, which for these purposes means natural persons acting for purposes outside their trade, business or profession;
- Micro-enterprises, which means any enterprise (being a person, irrespective of legal form, engaged in an economic activity) which employs fewer than 10 persons and has a turnover or annual balance sheet that does not exceed €2 million.
- Charities which have an annual income of less than £1 million; and
- Trustees of a trust which has a net asset value of less than £1 million.

6.28 FOSUK is discussed further in paragraphs 11.30 to 11.43.

### **Impact of EU referendum ('Brexit')**

6.29 On 23 June 2016, the UK voted to leave the EU. On 29 March 2017, the UK officially notified the European Commission of its intention to withdraw from the EU. At this stage, it is unclear what will happen as a result of this vote. What is clear is that both AIL and AIIDAC are currently subject to regulatory regimes implementing the same EU framework (i.e. Solvency II). Solvency II is likely to continue to form the basis of the regulatory regime in the UK at least until 29 March 2019.

6.30 The developments in the regulatory regime in the UK will ultimately be determined by the PRA, the FCA and UK lawmakers. However, what will happen and when it may happen are not yet known.

6.31 This issue is discussed further in paragraphs 11.44 to 11.46

## **Ireland**

### **Overview of regulation**

6.32 Irish insurers are regulated by the CBI. The Central Bank Reform Act 2010 created the new single unitary body, the CBI, which replaced the previous related entities, the Central Bank and the Financial Services Authority of Ireland and the Financial Regulator.

6.33 Its mission statement is 'Safeguarding Stability, Protecting Consumers' and its strategic responsibilities are as follows:

- Eurosystem effectiveness and price stability
- stability of the financial system
- protection of consumers of financial services
- regulatory policy development
- efficient and effective payment and settlement systems and currency services
- independent economic advice and high quality financial statistics
- recovery and resolution of financial institutions.

### **Current capital requirements**

6.34 From 1 January 2016, insurance companies in Ireland are required to maintain capital in line with the Solvency II requirements as discussed in paragraphs 6.4 to 6.7.

### **Capital extraction**

6.35 For insurers that continue to sell policies and are a going concern, there is no requirement placed on the insurer by the CBI with regards to capital extraction, other

than that it must maintain its SCR. However, it is commonplace for insurers to hold a buffer above its SCR.

### **Consumer protection**

- 6.36 The CBI has a role in ensuring that the best interests of consumers of financial services are protected.
- 6.37 One of its objective is to have a financial services industry where consumers' interests are protected. This means that:
- consumers should be provided with , 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
  - consumers should receive a high standard of follow-up services, e.g., when making a claim, making a complaint, switching product, dealing with errors, renewing a policy, obtaining follow-up advice on investments/pensions, etc.

### **Security under wind up**

- 6.38 In Ireland, the winding up of an insurance undertaking is governed by the European Union (Insurance and Reinsurance) Regulations 2015. Under these regulations, insurance claims take precedence over other claims on the insurance undertaking with respect to the assets representing the technical provisions.

### **Compensation**

- 6.39 The Insurance Compensation Fund ("ICF") is a fund of last resort in Ireland. The ICF is primarily designed to facilitate payments to policyholders in relation to risks situated in Ireland where an Irish authorised non-life insurer or a non-life insurer authorised in another European Member State goes into liquidation. It does not cover risks written by an insurer regulated by the CBI that are situated in another EEA state. Note that any payments from the ICF are subject to approval from the High Court and not all policyholder liabilities are covered by the ICF.
- 6.40 Payments made by the ICF are limited to the lesser of 65% of the sum due to the policyholder and €825,000. Note that commercial policyholders are not covered by the ICF unless the claim is in respect of a liability to an individual.
- 6.41 It should be noted that, at the time of writing, there is currently a bill going through the Oireachtas which, once effected, will impact the compensation coverage offered by the ICF. The Insurance (Amendment) Bill 2018 ("the Bill") provides for the following:
- the transfer of the operation of the ICF to the Central Bank from the Office of the Accountant of the High Court
  - an increase in payments potentially due from the ICF. These are currently limited to the greater of 65% or €825,000 but, under the bill, the ICF will pay the full cost of personal injury claims and will pay claims in respect of property damage arising from third party motor claims up to the amount specified in the Road Traffic Acts (currently €1.22m)
  - the establishment of a new Motor Insurers' Insolvency Compensation Fund to be held by the Motor Insurers Bureau of Ireland and funded by a new 2% levy on motor insurers' gross written premium with amounts paid out of the ICF over and above the previous 65% limit to be recouped to the ICF by a payment out of the Motor

Insurers' Insolvency Compensation Fund.

**Financial Services and Pensions Ombudsman**

6.42 Complaints against a financial services firm in Ireland can be made through the Financial Services and Pensions Ombudsman ("FSPO"). The FSPO is a statutory officer who deals independently with unresolved complaints from consumers about their individual dealings with all financial service providers. The financial services provider must be registered and authorised by the CBI.

6.43 Eligible claimants, subject to turnover limitations, are defined to be:

- Private individuals – personal policy or account holders
- Limited companies
- Sole traders
- Trusts
- Clubs
- Charities
- Partnerships

6.44 The FSPO is discussed further in paragraphs 11.30 to 11.43.

## 7 Claims reserves

- 7.1 In this section, I discuss the claims reserve strength of the Transferring Portfolio and Remaining Portfolio. In doing so, I have considered:
- The impact of the Scheme on AIL's and AIIDAC's best estimate reserves at an entity level
  - The Transferring Portfolio's best estimate reserves by class of business
  - The Remaining Portfolio's best estimate reserves by class of business
  - The impact of the Scheme on AIL's and AIIDAC's Solvency II technical provisions at an entity level
  - The adjustments applied to determine AIL's and AIIDAC's Solvency II technical provisions from their respective IFRS booked reserves
- 7.2 Note that the figures quoted in this section of the report are as at 31 December 2017.

### **Best estimate reserves**

#### **Summary of my analysis and conclusions**

- 7.3 AIL operates a well embedded quarterly reserving process which is subject to several layers of internal review.
- 7.4 Overall, AIL demonstrates a reasonably conservative reserving approach for setting the IFRS booked reserves. Best estimate reserves are calculated using an internally developed reserving tool and correspond to AIL's actuarial mean estimate ("AME") reserves. The reserving process also calculates the statistical range of possible reserves and the corresponding probabilities. A reserve margin is then applied in order to book provisions at a predetermined percentile which produces a significantly higher, and therefore more conservative, reserve than the AME.
- 7.5 As part of the existing reserving process operated by AIL, best estimate reserves are calculated separately for most of the component parts of the Transferring Portfolio, which simplifies the process of estimating the post-Scheme reserves considerably. There is however a cohort of transferring policyholders for which reserves are not calculated separately under AIL's reserving process. In my opinion, reasonable assumptions have been made to determine the reserves attributable to this cohort of transferring policyholders.
- 7.6 In my opinion AIL has also given due consideration to ongoing uncertainties in the wider claims environment, in particular the recent change in Ogden discount rate and the passing of the Civil Liability (Amendment) Act 2017 introducing Periodic Payment Orders ("PPOs") in Ireland.
- 7.7 Overall, the reserving processes for the Transferring Portfolio and Remaining Portfolio appear robust and I have no reason to believe that the best estimate reserves lie outside a range of reasonable estimates.

### **My analysis of the reserves**

7.8 I have performed an analysis to satisfy myself that the assessment of the insurance liabilities is consistent with my expectations for insurance business of this nature. This analysis involved:

- A review of the draft reserve report for AIIDAC as at 30 June 2017, provided by AIL's actuaries, in respect of the Transferring Portfolio
- A review of AIL's 31 December 2017 valuation report, provided by AIL's actuaries, in respect of the Remaining Portfolio
- A step through of the methods used to estimate the reserves with the Head of Actuarial Reserving at AIL and a review of these methods compared with industry best practice.
- Discussions and meetings with individuals at AIL to further understand the approach to setting reserves.

### **Total reserves of AIL and AIIDAC**

7.9 Tables 3 and 4 below show the best estimate claims reserves of AIL and AIIDAC, gross and net of reinsurance arrangements, prior to and post the Scheme. The position post the Scheme is the hypothetical position, as at 31 December 2017, assuming that the Scheme had become effective on this date.

7.10 For the avoidance of doubt, the reinsurance arrangements referenced throughout this section of the report are as follows:

- Primary reinsurance - the reinsurance programme of the Aviva Group with external reinsurers, as outlined in paragraph 5.39
- AII reinsurance mixer - AIL has reinsured to Aviva International Insurance Ltd ("AII") on a Quota Share basis 50% of its retrospective and prospective insurance business, with effect from 1 January 2016
- AIIDAC-AIL Quota Share – the proposed reinsurance arrangement between AIL and AIIDAC, as outlined in paragraph 5.40.

- 7.11 The AII reinsurance mixer and AIIDAC-AIL Quota Share reinsurances also receive the benefit of the primary reinsurance i.e. these contracts are in respect of the liabilities net of the primary reinsurance.

**Table 4: Actuarial best estimate claims reserves of AIL and AIIDAC before the Scheme**

| £m   | AIL     | AIIDAC |
|--|---------|--------|
| Gross  | 5,622.8 | 0.0    |
| Net of primary reinsurance                         | 4,233.8 | 0.0    |
| Net of primary reinsurance & AII reinsurance mixer | 2,126.9 | 0.0    |

**Table 5: Actuarial best estimate claims reserves of AIL and AIIDAC after the Scheme**

| £m  | AIL     | AIIDAC |
|---|---------|--------|
| Gross   | 4,885.1 | 737.4  |
| Net of primary reinsurance  | 3,543.9 | 689.6  |
| Net of primary reinsurance & following AIIDAC-AIL Quota Share                               | 4,134.3 | 99.4   |
| Net of primary reinsurance, following AIIDAC-AIL Quota Share & net of AII reinsurance mixer | 2,077.2 | 99.4   |

- 7.12 It should be noted that the best estimate reserves detailed above correspond to AIL's and AIIDAC's AME reserves, excluding any claims handling expense ("CHE") provision. Additions made to the AME reserves to arrive at the IFRS booked provisions are as follows:

- CHE provision
- Management adjustments - adjustments to the Chief Actuary's AME reserves, which are agreed at quarterly Reserve Committee meetings
- Reserve margin - a prudence margin applied to all lines of business

7.13 AIL's and AIIDAC's IFRS booked provisions are detailed below for comparative purposes:

**Table 6: IFRS booked provisions of AIL and AIIDAC before the Scheme**

| £m   | AIL     | AIIDAC |
|--|---------|--------|
| Gross  | 6,188.3 | 0.0    |
| Net of primary reinsurance                         | 4,711.2 | 0.0    |
| Net of primary reinsurance & AII reinsurance mixer | 2,365.6 | 0.0    |

**Table 7: IFRS booked provisions of AIL and AIIDAC after the Scheme**

| £m  | AIL     | AIIDAC |
|---|---------|--------|
| Gross   | 5,398.2 | 789.8  |
| Net of primary reinsurance  | 3,968.9 | 742.0  |
| Net of primary reinsurance & following AIIDAC-AIL Quota Share                               | 4,603.9 | 107.2  |
| Net of primary reinsurance, following AIIDAC-AIL Quota Share & net of AII reinsurance mixer | 2,312.0 | 107.2  |

7.14 There is a limitation upon the accuracy of any estimate of claims reserves in that there is an inherent uncertainty in any estimate of future liabilities. This is due to the fact that the claims will be subject to the outcome of events yet to occur, such as judicial decisions, legislative actions, claim consciousness amongst potential claimants, claims management, claim settlement practices, changes in inflation, and economic decisions. As a result, it should be recognised that future claim emergence will likely deviate, perhaps materially, from any estimate of claims reserves.

7.15 This uncertainty is exacerbated by the announcement from the Ministry of Justice on 27 February 2017 regarding changing the discount rate used for lump sum settlements on personal injury claims ("the Ogden discount rate") from 2.5% to -0.75%. This change has significantly increased the size of UK injury claims that are currently outstanding or yet to be reported, particularly large bodily injury claims. It should be noted that this discount rate is currently under review and expected to be amended, following widespread challenge from the insurance industry with regards to how the rate is calculated. However, the uncertainty as to the amended rate increases the uncertainty attaching to any reserve estimates for affected business.

#### **Overview of AIL's estimation methodology**

7.16 AIL operates a quarterly reserving cycle comprised of two main stages:

- Initially AIL carries out a detailed reserving exercise based on data as at the end of the previous quarter (the "valuation date").
- At the quarter end the reserving team then makes modifications to the reserves to allow for any management adjustments and for the actual versus expected experience in the period between the valuation date and the quarter end.

7.17 I have been provided with two reserving reports, produced during AIL's 31 December 2017 reserving cycle, which correspond to the two stages outlined above. I understand from AIL that these reports are subject to several layers of internal review within the

reserving team and ultimately by the Chief Actuary. I am satisfied that the actuaries at AIL have the necessary experience and expertise to undertake a review of this nature, and for me to rely on this review.

- 7.18 I have also discussed the governance process and controls operated by AIL in respect of its reserving cycle with AIL's Head of Actuarial Reserving. AIL regularly communicates key updates on the reserving process to the wider business, with reports being issued to the Reserve Committee, Audit Committee and the Board on a monthly, quarterly and half-yearly basis, respectively. The majority of AIL's reserve calculations are also subject to an independent recalculation by AIL's external auditor on a yearly basis. Overall, I am comfortable that AIL has a sufficiently robust process in place to ensure that the chosen level of reserves receives an appropriate level of challenge from both internal and external experts.
- 7.19 For the majority of AIL's business, reserves are estimated using widely accepted actuarial reserving methods. AIL has developed its own in-house reserving tool, the Actuarial Insight Model ("the AIM model"), for this purpose, which incorporates a range of Chain Ladder methods. The AIM model is designed to flag cases where past experience may not provide a reliable guide to the future, due to changes in the wider claims environment. The reserving team also maintains an open dialogue with the claims teams to keep abreast of any changes that may affect the reserving process. This allows the actuaries to place more or less weight on experience data, as appropriate.
- 7.20 Once an AME for past experience has been determined using standard Chain Ladder techniques the AIM model is also used to project future experience. The projections are based on recent experience of claim frequency and claim cost, and are also overlaid with forecasts for seasonality, claims inflation and business mix.
- 7.21 In order to gain comfort with the reserving approach and level of reserves, I met with AIL's Head of Actuarial Reserving to step through AIL's process for implementing the AIM model with respect to AIL's most material classes of business. During this meeting we walked through the reserving process in detail. I then undertook a detailed review of AIL's reserving methodology and key assumptions for classes of business which comprise approximately two-thirds of AIL's best estimate reserves. Based on the walkthrough, my review and my extensive experience of reserving for non-life insurers, I am comfortable that this reserving approach is appropriate and in line with market practice, and that the key assumptions are reasonable. As a result, I am comfortable that the resulting reserve estimates are reasonable.
- 7.22 Smaller classes written by AIL have insufficient data to make use of the AIM model described above. For these classes, AIL uses simpler techniques, such as a basic claims ratio approach. Based on my experience, it is my view that this approach is reasonable, and I would expect any inaccuracies arising from these simplified techniques to be immaterial to the overall valuation.
- 7.23 AIL's reserving methodology is carried out at a class and peril level using gross claims data. Separate reinsurance models are then used to allow for the internal and external reinsurance arrangements outlined in paragraph 7.10.
- 7.24 The main exceptions to the valuation process outlined above are latent disease claims and PPOs, for which AIL has informed me that it aims to adopt approaches which reflect the underlying characteristics of the liabilities.

## PPOs

- 7.25 PPO liabilities are projected based on assumptions relating to the life expectancy of PPO claimants, the quantum of the periodic payments, future interest rates and changes in future inflation expectations. The discount rates used for PPOs also include an illiquidity premium, consistent with the approach used by the Aviva Group to discount deferred annuities within its UK Life business. Reserves for PPOs and latent claims are recognised on a discounted basis in AIL's booked provisions.
- 7.26 It should be noted that there is exposure to PPO liabilities both within the Remaining Portfolio and within the Reverse Flow element of the Transferring Portfolio.
- 7.27 In order to gain comfort with the level of reserves held in respect of PPOs I have discussed the reserving methodology for these claims in detail with AIL's Head of Actuarial Reserving. During this discussion, I challenged both the methodology and the key assumptions used in the evaluation of these reserves.
- 7.28 After reviewing the approach, holding the discussion, and considering my experience of reserving for PPOs, it is my opinion that the reserving approach adopted for PPOs is reasonable and that, as a result, the estimated reserves make an appropriate provision for these liabilities.

## Latent claims

- 7.29 AIL's latent claims reserves are calculated by projecting the number of future latent claim notifications and multiplying these by the estimated average cost per claim for each future notification year. The one exception to this approach is in relation to abuse claims, as there can be multiple claimants to one claim, and which are therefore modelled in aggregate.
- 7.30 For asbestos-related claims, industry models are used to project the expected shape of the run-off profile. Projected claims numbers for non-asbestos-related claim types are based on recent claims experience.
- 7.31 Average costs per claim are projected for each notification year based on recent claims experience using standard Chain Ladder methods with adjustments for future inflation expectations.
- 7.32 A payment pattern is applied to the projected notification year reserves to estimate future cash-flows, which are then discounted using prevailing risk-free swap rates.
- 7.33 In order to gain comfort with the level of reserves held in respect of latent claims I have discussed the reserving methodology for these claims in detail with AIL's Head of Actuarial Reserving. During this discussion I challenged both the methodology and the key assumptions used in the evaluation of these reserves.
- 7.34 After reviewing the approach, holding the discussion, and considering my experience of reserving for latent claims, it is my opinion that the reserving approach adopted for these claims is reasonable and that, as a result, the estimated reserves make an appropriate provision for these liabilities.
- 7.35 However, it should be noted that the latent claims liabilities within the Transferring Portfolio are not material in the context of the overall reserves of the Transferring Portfolio.

#### Events Not In Data

- 7.36 AIL's AME reserves include a provision for Events Not In Data ("ENIDs"). ENIDs represent low probability, high impact scenarios which are unlikely to be captured by standard Chain Ladder methods, as these are based on historical data. These scenarios are taken into account to ensure that AIL's best estimate reserves account for the full distribution of possible outcomes. AIL uses ENIDs to cover outcomes which have not occurred in the past ten years and, as such, are generally not considered in the parameterisation of the AIM model. A scenario based approach is used to specify the ENIDs, with a wide range of stakeholders involved in selecting and calibrating the scenarios. The full list of ENIDs included in AIL's reserving process is reviewed on an annual basis and includes scenarios such as legislative changes and changes in the claims handling process. For most ENIDs, a probability of occurrence is assigned to the scenario and a full distribution of monetary impacts is modelled. The AME is impacted by the probability weighted average outcome of each ENID. This methodology is adjusted accordingly for scenarios which are considered certain to occur, or for which a full distribution of costs cannot reasonably be modelled.
- 7.37 In order to gain comfort with the level of reserves held in respect of ENIDs I have discussed the reserving methodology for ENIDs in detail with AIL's Head of Actuarial Reserving. In particular, I have discussed and challenged the approach to deriving the ENID scenarios as well as both the methodology and key assumptions used to model the selected scenarios. I have also discussed the controls and governance in place with regards to the selection and calibration of ENID scenarios.
- 7.38 After holding the discussions, reviewing the approach and key assumptions, and considering my experience of reserving for ENIDs, it is my opinion that the reserving approach adopted for ENIDs is reasonable and that, as a result, the estimated reserves make an appropriate provision for these prospective liabilities.

#### Impact of the Ogden discount rate change

- 7.39 In response to the change in Ogden discount rate, outlined in paragraph 7.15, and the Ministry of Justice's ongoing review of the Ogden discount rate, I understand from AIL that its Reserve Committee instigated an analysis of the full impact on AIL's booked reserves of the various possible outcomes. I understand from AIL that both the Remaining Portfolio and the Reverse Flow element of the Transferring Portfolio are exposed to the Ogden discount rate.
- 7.40 AIL's current approach to managing the ongoing uncertainty around the Ogden discount rate is two-fold. AIL's best estimate reserves are calculated using AIL's own internal assessment of the Ogden discount rate that will be applicable following the conclusion of the Ministry of Justice's review. I understand from AIL that this rate is based on the mean output of an ENID, which was constructed to allow for alternative future discount rate scenarios. In respect of the booked IFRS reserves, AIL also applies a management adjustment over and above its best estimate to allow for the full impact of moving to a -0.75% discount rate. AIL's Solvency II technical provisions also assume a -0.75% discount rate on impacted policies.
- 7.41 It follows that, on both IFRS and Solvency II bases, AIL has calculated its reserves using the current Ogden discount rate. Consequently, I consider AIL's approach to allowing for the Ogden discount rate in reserving to be appropriate.

## **Transferring Portfolio**

### **Splitting out the reserves for the Transferring Portfolio**

7.42 I have been provided with a draft reserve report for AIIDAC as at 30 June 2017, which details the approach used to split out the AIL reserves which are within scope of the Scheme. This report was written by the Head of Actuarial Reporting at AIL and has been subject to internal review. I am satisfied that the actuaries at AIL have the necessary experience and expertise to undertake a review of this nature, and for me to rely on this review.

7.43 The business lines being transferred to AIIDAC are outlined below:

- General insurance risks written by the Ireland GI branch and situated in the EEA (excluding the UK), comprising both personal and commercial lines risks
- Reverse Flow Business
- Retail policies written on a FOS basis comprising of holiday home, creditor and mobile device insurance (“MDI”) policies
- Commercial policies covering risks situated in the EEA (excluding the UK) written on a FOS basis
- French hospitalisation policies
- French construction bond policies including construction inwards reinsurance risks ceded by pools
- Belgian hospitalisation policies

7.44 I understand from AIL that, as part of its quarterly reserving process, the actuaries reserve separately for the total of the first two subsets of business listed above, for the MDI policies, for the French policies and for the Belgian policies, meaning that there are no new material assumptions used to determine the reserves for AIIDAC in respect of these elements of the business. The approach to determining the reserves for AIIDAC in respect of the remaining subsets of the transferring business is detailed in paragraphs 7.47 to 7.51, below.

7.45 The reserving approach in respect of the French and Belgian policies listed above is simpler than the main reserving methodology set out in paragraphs 7.19 and 7.20, as these are small classes of business with very few outstanding claims. In particular, all exposure on the French construction bond policies has now expired. In addition, no new French or Belgian hospitalisation policies are being written, although a small volume of renewals are still being written in these two accounts. However, both the French and Belgian portfolios are immaterial in the context of the Transferring Portfolio, with associated case reserves of approximately £1m each.

7.46 AIL’s reserving approach for the French and Belgian business is simply to take their best estimate reserves as equal to their case reserves. I understand from AIL that these case reserves are reviewed on a half-yearly basis for adequacy. In my view, it would be preferable to consider whether an allowance is needed for IBNR in respect of these liabilities. However, given the magnitude and characteristics of the liabilities and the fact that there is no remaining unexpired exposure in respect of French construction bonds, I do not believe that the absence of such an allowance will have materially distorted AIIDAC’s total reserves.

### **Estimating Freedom of Services reserves (Other than MDI, French and Belgian business)**

7.47 I understand from AIL that AIL is not currently able to split out its actuarial claims data in respect of the Other FOS business within the Transferring Portfolio, with the exception of actuarial claims data in respect of its French and Belgian policies. Additional

assumptions are therefore required in order to split out the reserves relating to this business. However, based on the estimates made, the impacted reserves only account for 4% of AIIDAC's total reserves net of primary reinsurance. It follows that they are not material in the context of the reserves for the Transferring Portfolio.

- 7.48 AIL has estimated these reserves by assessing the proportion of FOS business in impacted classes by premium income, and applying these proportions to the total reserves of each class.
- 7.49 I understand that AIL estimated the reserves on the transferring Other FOS business which it is unable to split out, before the scope of the policies under the Scheme had been finalised. There are some minor differences between the Other FOS business that will actually transfer and what was assumed in AIL's estimate of the transferring reserves. AIL has however investigated these differences and has concluded that these differences do not have a material impact on the estimate of the transferring reserves. AIL has provided me with the details of these differences and I agree with AIL's conclusions.
- 7.50 I also understand from AIIDAC that, following the Scheme, it will no longer need to apply the methodology as described in paragraph 7.48 to split out the Other FOS business within its actuarial claims data as the actuarial data systems are expected to have been updated to be able to provide the required split.
- 7.51 In addition, the actuaries have identified a number of large Commercial Property claims arising from FOS business in 2016 and have included the reserves on these claims in addition to the reserves calculated as described in paragraph 7.48 above.
- 7.52 I consider the approach described in paragraphs 7.42 to 7.51 above to be reasonable and proportionate to the size of the reserves involved.

### Breakdown of the best estimate reserves

7.53 The table below shows the breakdown of the claims reserves of AIIDAC by class of business, both gross and net of the proposed AIIDAC-AIL Quota Share arrangement. Note that this is the hypothetical position assuming that the Scheme had become effective on 31 December 2017.

**Table 8: Actuarial best estimate claims reserves of AIIDAC by class as at 31 December 2017 (£m)**

| <b>Class</b>                            | <b>Net of primary reinsurance (£m)</b> | <b>Net of primary reinsurance &amp; following AIIDAC-AIL Quota Share (£m)</b> |
|---|--|---|
| Ireland Personal Motor                  | 289.8                                  | 43.5  |
| Ireland Personal Property               | 21.4                                   | 3.2   |
| Ireland Commercial Motor                | 85.4                                   | 12.8  |
| Ireland Commercial Property             | 17.2                                   | 2.6   |
| Ireland Commercial Liability            | 238.3                                  | 35.7  |
| Ireland Commercial Specialty            | 7.1                                    | 1.1   |
| <b>Ireland GI Total</b>                 | <b>659.1</b>                           | <b>98.9</b>   |
| UK FOS MDI Business                     | 3.5                                    | 0.5   |
| UK FOS Commercial Property              | 22.0                                   | 0.0   |
| UK FOS excl MDI and Commercial Property | 5.0                                    | 0.0   |
| <b>UK FOS Total</b>                     | <b>30.5</b>                            | <b>0.5</b>  |
| <b>Total</b>                            | <b>689.6</b>                           | <b>99.4</b>   |

7.54 Holiday home policies, creditor policies, and French and Belgian policies within the scope of the Scheme are shown in aggregate as “UK FOS excl MDI and Commercial Property” in the table above.

7.55 Under the AIIDAC-AIL Quota Share, 85% of AIIDAC’s reserves in respect of Ireland GI branch and MDI business, as well as 100% of reserves in respect of all Other FOS business, will be reinsured back to AIL.

7.56 Note that in addition to the best estimate claims reserves detailed above, AIL’s booked reserves (net of primary reinsurance) for the Ireland GI business also include a £52m reserve margin, which is in scope for the Scheme.

7.57 There is also a reserve margin of £167m in respect of AIL’s UK GI book. We would expect the FOS policies within the Transferring Portfolio to be entitled to a share of this reserve margin. However, I understand that AIL does not expect this amount to be material, given the size of the FOS book relative to the UK GI business as a whole. I am comfortable with this rationale.

7.58 I understand from AIL that the Transferring Portfolio is also entitled to a £7m share of AIL’s CHE provision.

7.59 There were no management adjustments applicable to the Transferring Portfolio as at 31 December 2017 and as a result no management adjustments will be included in the transferring booked reserves.

- 7.60 In December 2014, the Dublin High Court ruled that the discount rate used to value a lump sum settlement on a specific large injury case should be reduced from 3% to 1% for future care costs and to 1.5% for future pecuniary loss. Following this ruling, future care costs and pecuniary losses in respect of injury claims in Ireland are now discounted at 1% and 1.5%, respectively.
- 7.61 Further, in November 2017 an Act introducing PPOs in Ireland (the Civil Liability (Amendment) Act 2017) was passed by the Irish Parliament.
- 7.62 The AME reserve associated with the Irish business includes a material ENID scenario in relation to the introduction of settlements based on periodic payments, as well as the interaction with changes in the Irish discount rate used to calculate lump sum settlements.

### Remaining Portfolio

- 7.63 The table below shows the breakdown of the claims reserves of AIL's Remaining Portfolio by class of business, both before and after the proposed AIIDAC-AIL Quota Share arrangement. Note that this is the hypothetical position assuming that the Scheme had become effective on 31 December 2017.

**Table 9: Actuarial best estimate claims reserves of the Remaining Portfolio by class of business as at 31 December 2017 (£m)**

| <b>Book</b>                                  | <b>Net of primary reinsurance (£m)</b> | <b>Net of primary &amp; AII reinsurance mixer (£m)</b> |
|--|--|--|
| UK Personal Motor                            | 1,380.5                                | 690.2  |
| UK Personal Property                         | 115.1                                  | 57.5   |
| UK Personal Specialty                        | 66.0                                   | 33.0   |
| UK Commercial Motor                          | 824.7                                  | 412.3  |
| UK Commercial Property                       | 276.0                                  | 138.0  |
| UK Commercial Liability                      | 738.9                                  | 369.5  |
| UK GI Other                                  | 87.1                                   | 43.6   |
| <b>UK GI Total</b>                           | <b>3,488.4</b>                         | <b>1,744.2</b>   |
| UK Health                                    | 54.2                                   | 27.1   |
| <b>Total before AIIDAC-AIL Quota Share</b>   | <b>3,542.6</b>                         | <b>1,771.3</b>   |
| <b>Ireland GI Total</b>                      | <b>560.3</b>                           | <b>280.1</b>   |
| UK FOS MDI Business                          | 3.0                                    | 1.5  |
| UK FOS excl MDI and Commercial Property      | 27.0                                   | 13.5   |
| <b>UK FOS Total</b>                          | <b>30.0</b>                            | <b>15.0</b>  |
| <b>Default Risk on AII reinsurance mixer</b> | <b>0.0</b>                             | <b>10.0</b>  |
| <b>Total</b>                                 | <b>4,132.9</b>                         | <b>2,076.5</b>   |

- 7.64 Note that, in addition to the best estimate claim reserves detailed above, AIL's booked reserves (net of primary reinsurance) for the Remaining Portfolio also include a £167m reserve margin, a £58m CHE provision and a £258m management adjustment.
- 7.65 After application of the proposed AIIDAC-AIL Quota Share arrangement, the reserves retained by AIIDAC represent only 2.3% of AIL's total pre-Scheme reserves on a net of primary reinsurance basis.

7.66 I have been informed by AIL and AIIDAC that the process and methodology used to calculate the reserves for the Transferring Portfolio will not change following the Scheme.

## Solvency II technical provisions

### Total Solvency II technical provisions

7.67 Tables 10 and 11 below show the Solvency II technical provisions of AIL and AIIDAC, gross and net of reinsurance arrangements, prior to and post the Scheme. The position post the Scheme is the hypothetical position, as at 31 December 2017, assuming that the Scheme had become effective on this date.

**Table 10: Technical provisions of AIL and AIIDAC before the Scheme**

| £m                                     | AIL     | AIIDAC |
|--|---------|--------|
| Gross                                  | 6,290.7 | 0.0    |
| Net of primary & AII reinsurance mixer | 1,809.8 | 0.0    |

**Table 11: Technical provisions of AIL and AIIDAC after the Scheme**

| £m  | AIL     | AIIDAC |
|---|---------|--------|
| Gross   | 5,453.1 | 837.0  |
| Net of primary reinsurance  | 4,099.0 | 789.8  |
| Net of primary reinsurance & following AIIDAC-AIL Quota Share                               | 4,832.5 | 56.5   |
| Net of primary reinsurance, following AIIDAC-AIL Quota Share & net of AII reinsurance mixer | 1,816.3 | 56.5   |

## Overview of estimation methodology

### AIL's Solvency II technical provisions calculation

7.68 AIL calculates its Solvency II technical provisions (excluding the Solvency II risk margin) from its booked IFRS reserves by applying a series of adjustments to the IFRS reserves. Note that the IFRS reserves used as the starting point for this analysis differ slightly from the IFRS booked provisions detailed earlier in this section of the report, as they also include an unearned premium reserve ("UPR"). The adjustments then made to these provisions to derive the Solvency II technical provisions are as follows:

- release any margins for prudence, as Solvency II technical provisions assume no margins over best estimate
- release the UPR and replace with an allowance for expected future claims and expenses on incepted business
- allow for inflows and outflows relating to legally obliged but unaccepted business
- allow for differences in the way reinsurance premiums payable are calculated under IFRS and Solvency II
- allow for discounting to account for the time value of money, calculated using the risk free yield curves published by EIOPA at the relevant date.

- 7.69 It is common industry practice for this series of adjustments to also include an allowance for ENIDs. However, in AIL's case this adjustment is not necessary, as ENIDs are already included in AIL's IFRS booked provisions, as discussed in paragraph 7.36.

#### **Splitting out the Transferring Portfolio**

- 7.70 The draft reserving report mentioned in paragraph 7.42 sets out the approach used by AIL to calculate the Solvency II technical provisions for the Transferring Portfolio.
- 7.71 Solvency II technical provisions are already calculated separately for the French, Belgian and Ireland GI Branch business (including the Reverse Flow Business) as part of the Solvency II valuation of best estimate liabilities and are signed off by the Chief Actuary. As such, there are no new material assumptions used to determine the technical provisions for AIIDAC in respect of this business.
- 7.72 For the remainder of the FOS business written by AIL, similar adjustments to those described in paragraph 7.68 were applied to these reserves in order to arrive at an estimate of Solvency II technical provisions for the transferring business.

#### **Estimating Freedom of Services technical provisions**

- 7.73 As explained in paragraphs 7.47 to 7.52, AIL is not currently able to split out its actuarial data in respect of the Other FOS business within the Transferring Portfolio, with the exception of actuarial data in respect of its French and Belgian business. Therefore AIL has calculated best estimate reserves for this element of the FOS business by estimating the proportion of FOS business in the relevant classes of business. Although this is an approximate approach, based on the relatively small size of the FOS reserves that AIL is unable to split out compared to the Transferring Portfolio as a whole, I would not expect any inaccuracy arising from this estimation to be sufficient to materially impact my conclusions.
- 7.74 The Solvency II adjustments detailed in paragraph 7.68 have then been applied to the IFRS reserves for the FOS business that AIL is unable to split out to derive equivalent Solvency II technical provisions.

#### **My analysis of the process for setting technical provisions**

- 7.75 I am satisfied that AIL's Solvency II technical provisions calculation methodology considers all of the material differences between the best estimate and Solvency II bases applicable to the insurance business under consideration.
- 7.76 As part of the existing Solvency II valuation process operated by AIL, Solvency II technical provisions are calculated separately for most of the component parts of the Transferring Portfolio, which simplifies the process of estimating the post-Scheme technical provisions considerably. There is however a cohort of transferring policyholders for which Solvency II technical provisions are not calculated separately under AIL's reserving process. This cohort comprises Other FOS business except for AIL's French and Belgian business. In my opinion, reasonable assumptions, as detailed in paragraphs 7.73 and 7.74, have been made to determine the Solvency II technical provisions attributable to this cohort of transferring policyholders.
- 7.77 Overall, my view is that the process used to calculate Solvency II technical provisions for the Transferring Portfolio and Remaining Portfolios as at 31 December 2017 appears robust.

### **My analysis of the calculation of technical provisions**

- 7.78 AIL has provided me with copies of the materials submitted to AIL’s reserving committee at which the 31 December 2017 Solvency II Technical Provisions were signed off. In addition, I have also reviewed AIL’s internal paper setting out the overall methodology and key assumptions applied to each of the main components of the Solvency II Technical Provision as at 31 December 2017. The paper also provided a summary of the differences between the Solvency II and IFRS bases and an explanation of the changes to the previous quarter’s Solvency II technical provisions.
- 7.79 In addition, I have also been provided with a copy of the calculations used to determine AIL’s Solvency II technical provisions from its booked IFRS reserves for a material subset of its business. I have performed a high level review of these calculations to verify that the series of adjustments detailed in paragraph 7.68 are being applied appropriately.
- 7.80 I have reviewed the adjustments used by AIL to convert its IFRS booked reserves into Solvency II technical provisions and compared its adjustments to wider industry practice.
- 7.81 Based on this review and my experience of estimating Solvency II technical provisions, my opinion is that the various adjustments are appropriate and in line with market practice and that, as a result, I am comfortable with AIL’s estimates of the Solvency II technical provisions for AIL and AIIDAC. However, I note that there is uncertainty in any estimate of future liabilities, including estimates of Solvency II technical provisions.

### **Risk Margin**

- 7.82 Note that the technical provisions detailed above exclude any associated Solvency II risk margin. The Solvency II risk margins for AIL and AIIDAC as at 31 December 2017 are given in the table below. The post-Scheme figures assume that the AIIDAC-AIL Quota Share is in effect.

**Table 12: Solvency II risk margins of AIL and AIIDAC before and after the Scheme**

| £m          | AIL pre-Scheme | AIL post-Scheme | AIIDAC post-Scheme |
|-------------|----------------|-----------------|--------------------|
| Risk Margin | 242.6          | 241.4           | 10.4               |

- 7.83 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.

### **AIL’s Solvency II risk margin calculation**

- 7.84 The Risk Margin is calculated by AIL by determining the future cost of capital for providing eligible Own Funds equal to the SCR necessary to support the insurance obligations over their lifetime. The calculation is specified in the Solvency II delegated regulations.
- 7.85 A key element is therefore the estimation of future SCRs. AIL achieve this by projecting the future SCRs for each modelled class within each risk, and then aggregating between classes allowing for diversification.
- 7.86 AIL’s projection method then selects between two alternative methods for calculating the run-off pattern of the future SCRs. The first approach assumes that the SCRs by risk and modelled class run-off in line with the best estimate of the reserves for that risk and

class, and the second approach assumes that the rate of risk emergence is linked to the speed of SCR decay.

**My analysis of the risk margin**

7.87 I have been provided with a methodology paper which describes AIL's approach to calculating its risk margin. I have reviewed this methodology and compared AIL's approach to my experience of wider industry practice.

7.88 I understand from AIL that the same methodology has been applied to estimate AHIDAC's risk margin.

7.89 Based on my review of AIL's methodology and my substantial experience of estimating Solvency II technical provisions for non-life insurers, I am comfortable that AIL's approach is appropriate for the classes of business to which it is applied and that it is in line with market practice.

## 8 Capital requirements

8.1 In considering the solvency position, I have considered the following:

- the position of AIL in respect of its regulatory capital requirements before and after the Scheme
- the position of AIL in relation to its ORSA capital requirements before and after the Scheme
- the position of AIIDAC in respect of its regulatory capital requirements before and after the Scheme
- the position of AIIDAC in relation to its ORSA capital requirements before and after the Scheme.

### **AIL**

#### **Capital strategy**

8.2 AIL has informed me that it aims to maintain a minimum capital coverage of its SCR plus a 1-in-5 year stress of its SCR (“AIL’s Capital Coverage Target”) as set out in its 2017 ORSA. If AIL’s capital drops below this level, the Board of AIL is to be informed. In addition, I understand from AIL that it has a recovery plan that contains a number of management actions to improve the capital coverage ratio if required.

#### **Regulatory capital requirements**

8.3 AIL calculates its regulatory capital requirements using a Partial Internal Model. An Internal Model approach is used to calculate the capital requirements for the majority of AIL’s business and accounts for the majority of the Solvency II SCR.

8.4 AIL uses the Solvency II Standard Formula to calculate the capital requirements for the following components of its business:

- Private medical insurance business
- The staff pension fund associated with Aviva Canada Inc (a subsidiary of AIL)
- Inwards household reinsurance business underwritten by Gresham (which is a subsidiary of AIL)
- AIL’s non-insurance participations.

8.5 The Transferring Portfolio is included within the scope of AIL’s Partial Internal Model.

8.6 AIL’s Partial Internal Model has been approved for use by the PRA.

8.7 I have considered AIL’s approach to calculating its regulatory capital requirements through a review of the key documents in respect of AIL’s Partial Internal Model and discussions with key subject matter experts from AIL. I consider AIL’s approach to be reasonable and proportionate to the scale and complexity of its operations.

8.8 The following are the key components modelled within AIL’s Partial Internal Model:

- **Reserve risk** – the risk of the best estimate claims reserves deteriorating i.e. the reserves are insufficient to cover the unpaid claims on earned exposure. Latent and non-latent reserve risks are modelled separately in AIL’s Internal Model.
- **Underwriting premium risk** – the risk that average written premiums achieved over the next 12 months are different to expectations. This allows for changes in the market price of insurance business by modelling the variation in the premium rates achieved for a given volume of exposure.
- **Underwriting claims risk** – the risk of adverse financial impact on business earned over the next 12 months, arising from unforeseen fluctuations in the timing, frequency and severity of insured events relative to initial expectations. This includes business that is already written and not yet earned as well as business expected to be written and earned over the next 12 months. This excludes risks arising from claims caused by natural catastrophes.
- **Catastrophe risk** – the risk of claims arising due to extreme or exceptional natural events affecting multiple insurance policies e.g. floods, windstorms, earthquakes etc.
- **Insurance Events Not In Data** – the risk of losses due to low frequency, high impact events that are not captured or not adequately captured in the past experience data that is used to calibrate insurance risk.
- **Annuity risk** – the risk that claims arising from previously awarded and expected future court awarded periodical payment orders deviate adversely from what is expected. The model considers variability in relation to the propensity of claims to settle as annuities, mortality, longevity and inflation.
- **Expense risk** – the risk of changes in AIL’s net asset value resulting from adverse changes in expenses
- **Reinsurer credit default risk** – the risk of losses due to default or downgrade of reinsurers or due to non-payment of receivables from internal or third party reinsurers
- **Asset risk** – the risk of adverse changes in AIL's net asset value as a result of movements in market risk variables such as interest rates, exchange rates, equity values etc. This risk also includes the exposure to investment credit risk (the risk of default or adverse movements in credit ratings of the assets)
- **Operational risk** – the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
- **Profit commission** – commission paid to intermediaries. When less profit or a loss is made, then profit commission paid out is reduced and modelled losses consider any reduction in profit commission paid out since this would be an off-setting item within the capital requirement. I have been informed by AIL that, although its Partial Internal Model has the functionality to model the variability in respect of profit commission, this functionality is not currently used and the model therefore currently considers the profit commission on a best estimate basis.
- **Loan to Aviva Group Holdings** – the risk of an adverse financial impact as a result of credit risk on the loan to Aviva Group Holdings (“AGH”). As part of the Aviva Group’s restructuring exercise in 2013, AIL has informed me that it provided a loan to AGH. The loan is secured on a number of AGH’s assets including the Aviva Group’s UK life business. The loan balance as at 31 December 2017 was £1,387m. AIL has informed me that the credit risk from this loan is assessed in a separate analysis to ensure that it is sufficiently remote so not to impact on AIL’s SCR calculated using its Partial Internal Model.
- **AII reinsurance mixer** – this is an internal reinsurance arrangement between a number of Aviva’s businesses and Aviva International Insurance Limited (“AII”). This component area covers the reinsurance premiums and recoveries as well as the internal reinsurer credit default risk and credit rating migration risk arising as a result of the AII reinsurance mixer.

- **Aggregation** – the aggregation of the insurance and non-insurance related risks above allowing for risk mitigation and diversification. This includes the aggregation of Internal Model and Standard Formula components of the total SCR.

- 8.9 I note that whilst I have considered the methodology for each element described above, I have not reviewed the calculations in detail. I have considered the final results of the calculation, and I have not identified any reason to believe the calculated SCR materially understates or overstates the capital required by AIL.
- 8.10 I have also gained comfort from the fact that the methodology, governance and validation process in respect of AIL’s Partial Internal Model was reviewed and approved by the PRA as part of AIL’s Internal Model Application Process.
- 8.11 In addition, I have reviewed the independent validation report in respect of the 2017 year end model for the Partial Internal Model. The independent validation report, a requirement for having an approved Partial Internal Model, sets out in detail the validation that has been carried out on the Partial Internal Model in order to ensure the results are appropriate. As is to be expected, there are a number of limitations that have been highlighted in the latest independent validation report. However, there is nothing in the independent validation report that makes me believe that the SCR, as derived by the Partial Internal Model, is materially misstated.
- 8.12 I have also considered the opinion provided by an external consultant (Firm A) in respect of AIL’s Partial Internal Model as at the 2016 year end, This review was undertaken on a private reasonable assurance basis at the request of Aviva plc. I understand that this review has not been repeated as at the 2017 year end and I have therefore relied on the results from Firm A’s assessment of AIL’s Partial Internal Model as at the 2016 year end. The opinion of Firm A has provided me with further comfort on the processes and controls in place, which govern the accuracy and completeness of the data and model used by AIL to calculate its SCR.
- 8.13 The table below shows the MCR and SCR coverage ratios of AIL as at 31 December 2017.

**Table 13: MCR and SCR coverage ratios for AIL as at 31 December 2017 (£m)**

| Item                                      |              |
|---|--------------|
| <b>MCR</b>                                | <b>386</b>   |
| <b>Eligible Own Funds to Meet the MCR</b> | <b>2,271</b> |
| <b>MCR Coverage ratio</b>                 | <b>588%</b>  |
| <b>SCR</b>                                | <b>1,283</b> |
| <b>Eligible Own Funds to Meet the SCR</b> | <b>2,542</b> |
| <b>SCR Coverage ratio</b>                 | <b>198%</b>  |

- 8.14 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.
- 8.15 As can be seen from the table above, AIL currently has substantial Own Funds in comparison to its regulatory capital requirements.

### Stress testing

- 8.16 In order to test the sufficiency of AIL's Own Funds and to support my conclusions, I have undertaken a number of high level stress tests as set out in the paragraphs below.
- 8.17 As shown in the table above, at 31 December 2017, AIL had £2,542m of Eligible Own Funds to meet its SCR of £1,283m. As a result, there is an excess of £1,259m in AIL's Eligible Own Funds on top of its SCR.
- 8.18 I have assessed the resilience of AIL's capital position against a number of scenarios. I have selected the scenarios below based on my review of AIL's business structure and risk profile. The scenarios that I have considered represent, in my opinion, the risks that could most significantly impact AIL's financial and capital strength. The scenarios I have considered in my stress tests are as follows:
- Deterioration of AIL's net best estimate technical provisions
  - Deviation of AIL's underwriting performance from its business plan
  - Default of reinsurance recoverable from AIL's internal and external reinsurance providers
  - Financial losses from significant catastrophe events
  - Deterioration in the value of AIL's investment portfolio
  - Deterioration in the value of AIL's loan to its parent company.
- 8.19 AIL's net technical provisions (excluding the Solvency II risk margin) as at 31 December 2017 is £1,810m. In order to reduce its SCR coverage ratio to 100% or below, AIL would need to experience a deterioration in the region of 69.6% of its net best estimate technical provisions. The probability of AIL experiencing a reserve deterioration in excess of £1,259m over the 12 month period following 31 December 2017 has been calculated by AIL's Partial Internal Model to be less than 0.01%. Given the remoteness of this scenario, I am comfortable that AIL has sufficient Own Funds to cover it against the risk of a reserve deterioration in all but extremely remote circumstances.
- 8.20 In its 2017 Year-End ORSA Report, AIL projected a combined loss ratio of 93.6% for the 2018 accounting year. In order to reduce AIL's SCR coverage ratio to 100% or below, its combined ratio would need to deteriorate to a level around 149.9%. Based on my experience and the historical performance of AIL's business, I consider the likelihood of a deterioration of this magnitude to be remote. In addition, based on outputs from AIL's Partial Internal Model, the probability of AIL experiencing a combined ratio in excess of 149.9% over the 12 month period following 31 December 2017 is less than 0.01%. Given the remoteness of this scenario, I am comfortable that AIL has sufficient Own Funds to protect it against the risk of deterioration in its underwriting performance in all but extremely remote circumstances.
- 8.21 The reinsurance recoverable of AIL as at 31 December 2017 is £4,480m. In order to reduce the coverage ratio to 100% or below, AIL would need to experience a default in the region of 28.1% of its total recoveries. I consider the likelihood of a deterioration of this magnitude to be remote. My reasons for this are set out below in paragraphs 8.22 to 8.27.
- 8.22 AIL holds a well-diversified portfolio of reinsurance assets from a wide range of internal and external reinsurance providers. These include more than twenty external reinsurance companies and a number of subsidiaries within the Aviva Group. As at 31 December 2017, 96.7% of AIL reinsurance assets are held with reinsurers with credit ratings between AA and A.

- 8.23 AIL's largest internal reinsurance exposure arises from a 50% quota share reinsurance programme with Aviva International Insurance Limited ("AII"), which is a sister company of AIL within the Aviva Group and a UK domiciled risk retention vehicle for pooling risk across the Aviva Group. The reinsurance recoveries from AII were estimated to be £2,346m as at 31 December 2017. In order for AIL's SCR coverage ratio to fall below 100%, AII would need to default on more than half of its recoveries owed to AIL.
- 8.24 AII has a credit rating of A+ from Standard & Poor's and, as at 31 December 2017, AII had £1,134m surplus in excess of its Solvency II SCR and an SCR coverage ratio of 142%. Furthermore, a funds-withheld account, which is rebalanced on a quarterly basis, has been set up between AIL and AII to provide additional credit security to AIL. As a result, I consider the risk of default to be remote.
- 8.25 In addition, AIL's MCR coverage ratio will only fall below 100% in the event that AII defaults on 80% or more of the reinsurance recoveries owed to AIL.
- 8.26 AIL's largest external reinsurance credit exposures arise from its outward reinsurance programme with two large multinational reinsurers with total estimated reinsurance recoveries of £1,184m as at 31 December 2017. Together, the expected recoveries due from these two reinsurers account for in excess of 83% of AIL's total expected recoveries from its top ten largest external reinsurance exposures. If both of these reinsurers defaulted on all of the recoveries owed to AIL, AIL would still have sufficient capital to meet its SCR. In addition, AIL held collateral of approximately £206m in relation to the reinsurance programme with its largest reinsurer as at 31 December 2017.
- 8.27 In order to reduce its SCR coverage ratio to 100% or below, AIL would need to experience reinsurance defaults in excess of £1,259m. The probability of AIL experiencing reinsurance defaults in excess of this over the 12 month period following 31 December 2017 has been calculated by AIL's Partial Internal Model to be less than 0.01%. I am comfortable that this is a sufficiently remote scenario.
- 8.28 Therefore, I believe that AIL has sufficient Own Funds to protect it against reinsurance credit defaults in all but extremely remote circumstances.
- 8.29 I have considered AIL's exposure to catastrophe events. AIL's largest catastrophe exposure arises from its exposure to UK windstorms. In AIL's 2017 year end ORSA, AIL assessed the loss arising as a result of a significant catastrophe event, namely a 1-in-500 year UK windstorm coinciding with the loss of the reinsurance recoveries in respect of this event from the external reinsurance party with the largest share of these exposures. The loss estimated in relation to this scenario is £1,125m. An estimated loss of this magnitude still resulted in AIL having an SCR coverage ratio in excess of 100%.
- 8.30 I understand from AIL that it participated in the PRA's General Insurance Stress Testing for 2017. Under this, insurers were required to assess the impact of a number of extreme scenarios on their solvency position. From the scenarios considered, I understand that the most severe catastrophe loss scenario impacting AIL directly, i.e. excluding the impact on AIL's subsidiaries, was the European Windstorm and UK Floods scenario. This scenario assumed two severe windstorms affect Europe and the UK which are followed by two severe floods that affect the UK in a single winter season. Following this scenario, AIL would still have an SCR coverage ratio in excess of its Capital Coverage Target, as discussed in paragraph 8.2. The losses from this scenario are

substantially mitigated by reinsurance. In the event that this scenario is followed by reinsurance defaults, AIL would only breach its SCR capital requirement if it was not able to recover approximately 50% of the reinsurance recovery from this event. Given the credit quality of AIL's reinsurance counterparties, I consider the likelihood of this level of reinsurance default to be remote.

- 8.31 Based on the results of the scenario testing discussed in 8.29 and 8.30, I am comfortable that AIL has sufficient Own Funds to protect it against severe and remote catastrophe events.
- 8.32 The investments held by AIL as at 30 December 2017 amount to £5,328m. As at 31 December 2017, 63.2% of AIL's investment portfolio is in government and corporate debt instruments. 93.8% of these debt instruments have credit ratings between AAA and BBB. In particular, approximately half of AIL's debt investments are in UK government debt, which is generally considered a risk-free investment. The cautious nature of these investments reduces the probability of a significant fall in the value of AIL's portfolio.
- 8.33 In order to reduce AIL's coverage ratio to 100% or below, AIL would need to experience a reduction in the value of its investments in excess of £1,259 or 23.6% of the total value of its investment portfolio. The probability of AIL experiencing investment losses in excess of this over the 12 month period following 31 December 2017 has been calculated by AIL's Partial Internal Model to be less than 0.01%.
- 8.34 Given AIL's relatively cautious investment strategy and the remoteness of the probability calculated by AIL's Partial Internal Model for investment losses to exceed AIL's capital coverage, I believe that AIL has sufficient Own Funds to cover it against the risk of investment losses in all but extremely remote circumstances.
- 8.35 AIL entered into a loan to its parent company Aviva Group Holding ("AGH") in 2013. The outstanding value of AIL's loan to AGH as at 31 December 2017 was £1,369m. In order to reduce AIL's SCR coverage ratio to 100% or below, AIL would need to experience a reduction in the value of this loan in the region of 92.0%. I have been informed by AIL that this loan is fully collateralised, and that the current value of the collateral is in excess of the outstanding value of the loan. In addition, the Aviva Group has been awarded a credit rating of A-(Stable) by S&P and has recently been upgraded to a credit rating of Aa3 (High quality) by Moody's. On the basis of the collateral held and Aviva Group's credit ratings, I consider the likelihood of a reduction of more than 90% of the value of this loan to be remote.
- 8.36 The stress testing that I have undertaken, the results of which I have summarised in the paragraphs above supports my conclusion that AIL has substantial Own Funds in comparison to its regulatory capital requirements.

## IFRS balance sheet, Solvency II balance sheet and Own Funds

### IFRS and Solvency II Balance Sheets

8.37 Table 14 below shows the simplified IFRS and Solvency II balance sheets for AIL as at 31 December 2017, prior to and post the Scheme. The position post the Scheme is the hypothetical position, as at 31 December 2017, assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect on this date.

**Table 14: IFRS and Solvency II balance sheets for AIL as at 31 December 2017 (£m)**

|  | Prior to Scheme |                   | After Scheme  |                   |
|--|-----------------|-------------------|---------------|-------------------|
|  | IFRS basis      | Solvency II basis | IFRS basis    | Solvency II basis |
| <b>Assets:</b>                                   |                 |                   |               |                   |
| Cash   | 485             | 109               | 483           | 107               |
| Investments                                      | 4,803           | 5,219             | 4,976         | 5,007             |
| Loan and mortgage assets                         | 1,864           | 1,922             | 1,864         | 1,922             |
| Reinsurers' share of technical provisions        | 5,151           | 4,480             | 5,161         | 4,370             |
| Investments in group entities and participations | 2,469           | 1,093             | 2,538         | 1,175             |
| Other assets                                     | 3,196           | 714               | 2,793         | 677               |
| <b>Total assets</b>                              | <b>17,968</b>   | <b>13,537</b>     | <b>17,815</b> | <b>13,258</b>     |
| <b>Liabilities:</b>                              |                 |                   |               |                   |
| Technical provisions (excluding risk margin)     | 8,648           | 6,291             | 8,449         | 6,187             |
| Risk Margin                                      | 0               | 242               | 0             | 241               |
| Deposits from reinsurers                         | 3,237           | 3,237             | 3,321         | 3,194             |
| Other liabilities                                | 2,033           | 1,508             | 1,987         | 1,402             |
| <b>Total liabilities</b>                         | <b>13,918</b>   | <b>11,278</b>     | <b>13,757</b> | <b>11,025</b>     |
| <b>Excess of assets over liabilities</b>         | <b>4,050</b>    | <b>2,259</b>      | <b>4,058</b>  | <b>2,234</b>      |
| Subordinated liabilities                         |                 | 283               |               | 283               |
| <b>Solvency II Own Funds</b>                     |                 | <b>2,542</b>      |               | <b>2,517</b>      |

8.38 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.

8.39 From the table above, it can be seen that AIL's assets and liabilities reduce following the Scheme. The changes in AIL's assets and liabilities correspond to the assets and liabilities that transfer to AIIDAC under the Scheme.

- 8.40 I have considered the approach used to calculate the Solvency II balance sheet for AIL, including the technical provisions, and consider the approach and results to be reasonable.
- 8.41 As mentioned in paragraphs 7.3 to 7.7 and 7.75 to 7.81 I am comfortable with AIL's calculation of its IFRS and Solvency II technical provisions.
- 8.42 Given the above, I conclude that the Scheme is small in comparison to AIL's overall business and therefore does not have a significant impact on AIL's balance sheet on an IFRS or Solvency II basis.

#### **Own Funds**

- 8.43 AIL has £2,194m of unrestricted Tier 1 Own Funds. As per Solvency II regulations, Tier 1 Own Funds can be recognised in full to meet the SCR and the MCR capital requirements. The full value of the Tier 1 Own Funds is made up of ordinary share capital and the reconciliation reserve and is classed as unrestricted Tier 1 capital.
- 8.44 AIL has £283m of Tier 2 Own Funds in the form of subordinated liabilities. The subordinated liabilities qualifying as Tier 2 Own Funds can also be recognised in full to meet SCR requirements as they will rank below policyholder liabilities upon default. Under Solvency II regulations, these Tier 2 Own Funds can also be partially recognised to meet the MCR.
- 8.45 AIL has £65m of Tier 3 Own Funds in the form of net deferred tax assets that can also be recognised in full to meet its SCR. Solvency II regulations do not permit Tier 3 Own Funds to be used to meet the MCR.
- 8.46 The table below shows the breakdown of AIL's Eligible Own Funds to meet the SCR and MCR.

**Table 15: Eligible Own Funds for AIL as at 31 December 2017 (£m)**

| <b>Item</b>                     | <b>SCR</b>   | <b>MCR</b>   |
|---------------------------------|--------------|--------------|
| <b>Tier 1</b>                   | 2,194        | 2,194        |
| <b>Tier 2</b>                   | 283          | 77           |
| <b>Tier 3</b>                   | 65           | -            |
| <b>Total Eligible Own Funds</b> | <b>2,542</b> | <b>2,271</b> |

- 8.47 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.
- 8.48 I consider AIL's allocation of Own Funds to the tiers to be reasonable. I also observe that the significant majority of Eligible Own Funds are Tier 1, which is the highest tier of Own Funds.

#### **ORSA**

- 8.49 I have been provided with a copy of a report outlining AIL's ORSA. The document is dated 13 February 2018 and has been approved by AIL's Board. This represents a forward looking assessment of AIL's risk profile and capital requirements.

- 8.50 In this ORSA report, AIL has considered how much capital it believes it requires taking account of the risks that it believes it is currently exposed to. AIL concluded that it should hold a capital amount that covers not only its risk and uncertainty over the following financial year, but also the risk associated with the run-off of its existing business.
- 8.51 Under Solvency II, the SCR is the amount of capital that is required for the insurer to have a 99.5% chance of meeting its obligations over the next year. By definition, this does not take account of the capital required to meet obligations in subsequent years. As a result, the SCR may not reflect the capital required to meet policyholder obligations over the course of the run-off of existing business.
- 8.52 To address this, AIL also estimates the capital required for AIL to meet its obligations over the course of the run-off of the existing liabilities. AIL has used the Risk Margin calculated under the Solvency II regulations as an estimate of the amount of capital required to cover the residual risks beyond the first year.
- 8.53 As a result, AIL takes the sum of the SCR, the Solvency II Risk Margin for AIL (excluding its Canadian subsidiary) and £134m in respect of the Solvency II Risk Margin for AIL's Canadian subsidiary to represent its own view of its capital requirement (the "ORSA capital requirement"). The Solvency II Risk Margin for AIL excluding its Canadian subsidiary is shown as "Risk Margin" in Table 14. The Solvency II Risk Margin in respect of AIL's Canadian subsidiary is accounted for under the "Investments in group entities and participations" item on AIL's Solvency II balance sheet since AIL's holding in the Canadian subsidiary is accounted for as an investment. It follows that this amount is included within Investments in group entities and participations" in Table 14.
- 8.54 I have considered AIL's assessment of its ORSA capital requirement and believe it to be reasonable.
- 8.55 The table below shows the coverage ratio of AIL's Eligible Own Funds against AIL's ORSA capital requirement as at 31 December 2017.

**Table 16: Coverage ratio for AIL as at 31 December 2017 against ORSA capital requirement (£m)**

| Item                     |       |
|--------------------------|-------|
| ORSA capital requirement | 1,659 |
| Eligible Own Funds       | 2,542 |
| Coverage ratio           | 153%  |

- 8.56 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.
- 8.57 As can be seen from the above table, AIL has substantial Own Funds in excess of its own view of the capital requirement.
- 8.58 AIL has conducted various stress and scenario tests within its ORSA to test the robustness of its capital base. AIL believes that the stress and scenario testing it has conducted covers a wide range of risks that AIL is exposed to. The scenarios considered in AIL's stress and scenario testing are summarised as follows:

- Loss of market share
- Cyber attack and data theft event
- Regulatory intervention from the FCA coinciding with high lapse experience
- Significant deterioration in AIL's reserves
- IT failures impacting AIL's underwriting and policy administration
- Significant fall in AIL's Canadian subsidiary's profits
- Market turmoil arising as a result of Brexit
- Loss of recoveries from AII
- Natural catastrophe events following the failure of major external reinsurance credit exposures;
- Impact arising from a plausible war and conflict scenario
- A number of operational risk scenarios focusing on cyber risks, such the loss of customers' data;
- Pandemic leading to reduction in business volume and economic recession.

8.59 AIL has demonstrated that it would still have sufficient capital to meet its SCR in all but two of the scenarios described above. The scenarios under which AIL's capital was insufficient to meet its SCR (before the application of management actions) were a 1 in 500 year windstorm in the UK coinciding with the failure of a major external reinsurance counterparty, and a pandemic event leading to both a reduction in business volume and economic recession. AIL's capital is however sufficient to meet its MCR requirement following these scenarios. I believe that these scenarios are remote and am therefore comfortable that AIL's scenario testing demonstrates that AIL has sufficient capital to withstand extreme loss events.

8.60 Furthermore, AIL has carried out a range of extreme stress and scenario testing at the aggregate level. This aggregate stress and scenario testing demonstrates that:

- Only in more extreme scenarios (with estimated return periods between 1-in-50 years and 1-in-200 years) does it fail to have sufficient capital, before the application of management actions) to meet its Capital Coverage Target.
- Only in scenarios with estimated return periods of around 1-in-200 years or higher does it fail to have sufficient capital to meet its SCR
- Even in those scenarios, it still has sufficient capital to meet its MCR.

8.61 AIL has informed me that it has also developed and agreed a suite of management actions that will be deployed in times of stress. I have reviewed these action and I am satisfied that they will help AIL to improve its capital position over time should the necessity arise.

8.62 I consider the range of stresses and scenarios that AIL has considered and the results it has obtained to be reasonable.

### **AIL's capital requirements following the Scheme**

8.63 AIL has calculated its SCR, MCR and ORSA capital requirement as at 31 December 2017, assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect on that date.

8.64 The SCR and ORSA capital requirements have been calculated using AIL's Partial Internal Model with adjustments to exclude the Transferring Portfolio from the model's input assumptions and to allow for the AIIDAC-AIL Quota Share arrangement.

- 8.65 I believe that AIL’s approach to estimating the capital requirements after the Scheme, as described above, is appropriate.
- 8.66 The table below shows the breakdown of the estimated capital coverage ratios of AIL as at 31 December 2017 assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect.

**Table 17: Capital coverage ratios for AIL as at 31 December 2017 (£m) assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect on that date**

| <b>Item</b>  |              |
|--|--------------|
| <b>MCR</b>   | <b>376</b>   |
| <b>Eligible Own Funds to Meet the MCR</b>                      | <b>2,311</b> |
| <b>MCR Coverage ratio</b>                                      | <b>614%</b>  |
| <b>SCR</b>   | <b>1,291</b> |
| <b>Eligible Own Funds to Meet the SCR</b>                      | <b>2,517</b> |
| <b>SCR Coverage ratio</b>                                      | <b>195%</b>  |
| <b>ORSA capital requirement</b>                                | <b>1,667</b> |
| <b>Eligible Own Funds to Meet the ORSA capital requirement</b> | <b>2,517</b> |
| <b>ORSA Coverage ratio</b>                                     | <b>151%</b>  |

- 8.67 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.
- 8.68 As can be seen from the above table, AIL has substantial Own Funds in excess of its SCR and ORSA capital requirements following the Scheme.
- 8.69 From the table above, and Tables 12 and 15 on AIL’s capital requirements prior to the Scheme, it can be seen that the Scheme does not materially change AIL’s capital position. For this reason, my view is that the conclusions from my analysis of the robustness of AIL’s pre-Scheme capital position in paragraphs 8.16 to 8.36 also apply to AIL’s capital position following the Scheme.

## **AIIDAC**

### **Capital strategy**

- 8.70 I understand from AIIDAC that it will aim to maintain a minimum capital coverage ratio (“AIIDAC’s Capital Coverage Target”) which is broadly equivalent to the level of AIL’s Capital Coverage Target as a percentage of the SCR. If AIIDAC’s capital drops below this level, I understand that the Board of AIIDAC is to be informed. In addition, I understand from AIIDAC that it has a recovery plan that contains a number of management actions to improve the capital coverage ratio if required.

### **Regulatory capital requirements**

- 8.71 AIIDAC is a new entity and has recently been authorised to conduct insurance business by the CBI.

- 8.72 I have been informed by AIL that AIIDAC will not transact any insurance business prior to the Effective Time of the Scheme.
- 8.73 AIIDAC's capital requirements prior to the Scheme will therefore be €3.7m, which is the Absolute Minimum Capital Requirement (AMCR) applicable to the classes of business which AIIDAC has been authorised to transact. Under Solvency II requirements, all authorised insurers are subject to an AMCR and the value of the AMCR depends on the classes of business that an insurer is authorised to transact.
- 8.74 Following the Scheme, I have been informed by AIL that AIIDAC will initially use the Standard Formula approach to calculate its SCR. I have also been informed that AIIDAC will potentially consider applying for Internal Model approval.
- 8.75 AIL has calculated the hypothetical capital requirements under the Standard Formula for AIIDAC as at 31 December 2017 assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect.
- 8.76 The following key risks are modelled within AIIDAC's calculation of the Standard Formula:
- **Reserve risk** – the risk of the best estimate claims reserves deteriorating i.e. the reserves are insufficient to cover the unpaid claims on earned exposure
  - **Underwriting risk** – the risk that claims arising from premium earned over the following 12 months deviate adversely from the expected claims at the beginning of the year
  - **Catastrophe risk** – the risk of claims arising due to natural or man-made catastrophes affecting multiple insurance policies e.g. floods, windstorms, fires etc.
  - **Market risk** – the risk of adverse changes in AIIDAC's net asset value as a result of movements in market risk variables such as interest rates, exchange rates, equity values etc. This risk also includes the exposure to investment credit risk (the risk of default or adverse movements in credit ratings of the assets)
  - **Counterparty default risk** – the risk of losses due to default or downgrade of reinsurers or due to non-payment of receivables from third parties
  - **Operational risk** – the risk of loss resulting from inadequate or failed internal processes, people and systems or from external events.
- 8.77 I note that whilst I have considered the appropriateness of the application of the Standard Formula methodology for each risk area described in paragraph 8.76 above, I have not reviewed the calculations used in detail.
- 8.78 AIIDAC's Solvency II Standard Formula calculations were performed by AIL. Following the Scheme, the responsibility for the Standard Formula calculation will reside with AIIDAC's Finance and Actuarial functions. AIIDAC has informed me that although it will retain leadership over these functions, it will utilise resources within AIL for some aspects, including for the calculation of its Solvency II Standard Formula. As a result, I am comfortable that AIIDAC's calculation of its SCR under the Standard Formula ("AIIDAC's Standard Formula SCR") following the Scheme will be consistent with AIL's calculation of AIIDAC's Standard Formula SCR as at 31 December 2017.
- 8.79 I have considered AIL's approach to calculating the hypothetical regulatory capital requirements for AIIDAC as at 31 December 2017 assuming that the Scheme was in effect, through a review of key documents and discussions with key subject matter

experts from AIL. I consider AIL’s approach to be reasonable and proportionate to the scale and complexity of the business transferring to AIIDAC.

- 8.80 The 2017 ORSA for AIIDAC includes an analysis of the appropriateness of the Standard Formula calculation for the business transferring to AIIDAC. The analysis concludes that the Standard Formula approach is appropriate for calculating AIIDAC’s regulatory capital requirements given the characteristics of its forecasted business mix. I agree with this analysis and its conclusion.
- 8.81 Given the above, I am of the opinion that the hypothetical SCR calculated using the Standard Formula is adequately robust and provides an adequate level of security.
- 8.82 The table below shows the capital coverage ratios for AIIDAC as at 31 December 2017 assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect and that AIIDAC’s SCR were calculated using the Standard Formula approach.

**Table 18: Capital coverage ratios for AIIDAC as 31 December 2017 (£m) assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect**

| Item                                      |             |
|---|-------------|
| <b>MCR</b>                                | <b>17</b>   |
| <b>Eligible Own Funds to Meet the MCR</b> | <b>76</b>   |
| <b>MCR Coverage ratio</b>                 | <b>455%</b> |
| <b>SCR</b>                                | <b>59</b>   |
| <b>Eligible Own Funds to Meet the SCR</b> | <b>90</b>   |
| <b>SCR Coverage ratio</b>                 | <b>151%</b> |

- 8.83 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.
- 8.84 As can be seen from the above table, AIIDAC has substantial Own Funds in excess of its Standard Formula SCR following the Scheme.
- 8.85 This is discussed further in section 9 of this report.

**AIIDAC’s capital requirements calculated using an Internal Model**

- 8.86 AIIDAC does not have an Internal Model that has been formally approved by the CBI, however AIIDAC has estimated its regulatory capital requirements using AIL’s Partial Internal Model, in addition to performing the Standard Formula calculation described above. We refer to this as “AIIDAC’s unapproved Internal Model SCR”. Prior to the Scheme, the Transferring Portfolio is part of AIL’s portfolio and therefore is modelled within AIL’s Partial Internal Model. To calculate AIIDAC’s unapproved Internal Model SCR, AIL’s partial Internal Model was run with adjustments to exclude the Remaining Portfolio from the model’s input assumptions and to allow for the AIIDAC-AIL Quota Share arrangement.
- 8.87 I believe that AIIDAC’s approach to calculating AIIDAC’s unapproved Internal Model SCR, as described above, is appropriate.

8.88 Although AIIDAC does not currently use the Internal Model to calculate its SCR, I believe that it is still appropriate to consider AIIDAC's unapproved Internal Model SCR since it provides an alternative indication of the capital that AIIDAC requires. While the Internal Model has not been approved for use by AIIDAC, I take a level of comfort that it is appropriate from the fact that it has been approved for the use of AIL, of which the Transferring Portfolio was a part. I also note that, as with any insurer, I would expect the Internal Model to reflect the risks that AIIDAC is exposed to more accurately than the Standard Formula since it will be better tailored to AIIDAC and its situation.

8.89 AIIDAC's unapproved Internal Model SCR as at 31 December 2017 is £37.9 million.

**Table 19: Capital coverage ratios for AIIDAC as 31 December 2017 (£m) assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect**

| Item                                      |             |
|---|-------------|
| <b>AIIDAC's Internal Model SCR</b>        | <b>38</b>   |
| <b>Eligible Own Funds to Meet the SCR</b> | <b>90</b>   |
| <b>SCR Coverage ratio</b>                 | <b>237%</b> |

8.90 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.

8.91 As can be seen from the above table, AIIDAC's coverage ratio against its unapproved Internal Model SCR is far higher than that against the Standard Formula SCR. As mentioned above, even though, AIIDAC is not using the unapproved Internal Model to calculate its SCR, I would expect the unapproved Internal Model to reflect the risks that AIIDAC is exposed to more accurately than the Standard Formula. Given this, the higher coverage ratio against AIIDAC's unapproved Internal Model SCR implies that the Standard Formula calculation may result in a prudent measure of the capital that AIIDAC's actually requires.

8.92 As discussed in paragraph 8.74, AIIDAC may potentially consider applying for Internal Model approval. In my view, it may be beneficial from AIIDAC's management's perspective for AIIDAC to use an Internal Model to calculate its SCR as an Internal Model may provide more detailed information to AIIDAC's management in respect of AIIDAC's risk profile and the breakdown of its capital requirements.

8.93 In the event that AIIDAC applies for Internal Model approval, I understand from AIIDAC that it will seek to extend AIL's Partial Internal Model to also model AIIDAC's business. As a result, the capital requirements calculated in respect of the Transferring Portfolio in the future will be consistent with those calculated by AIL for the Transferring Portfolio prior to the Scheme. In my opinion, this would reduce any changes affecting the transferring policyholders in relation to the calculation of capital requirements. Based on the calculations described above, it may also significantly reduce AIIDAC's SCR and significantly increase its coverage ratio. Were that the case, it would imply that AIIDAC's regulatory capital requirements calculated using the Standard Formula were prudent and, given this, I do not believe that the transferring policyholders are materially adversely affected by the fact that AIIDAC currently calculates its regulatory capital requirements using the Standard Formula rather than an Internal Model.

### Stress testing

- 8.94 In order to test the robustness of AIIDAC's Standard Formula SCR and Eligible Own Funds to support my conclusions, I have undertaken a number of high level stress tests as set out in the paragraphs below. It should be noted that all references to AIIDAC's SCR within this subsection of the report refer to AIIDAC's Standard Formula SCR.
- 8.95 As shown in Table 17 above, AIIDAC would have £89.6m of Eligible Own Funds to meet its SCR of £59.4m as at 31 December 2017 assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect. As a result, there would be an excess of £30.2m in AIIDAC's Eligible Own Funds on top of its SCR.
- 8.96 I have assessed the resilience of AIIDAC's capital position against a number of scenarios. I have selected the scenarios below based on my review of AIIDAC's proposed business structure and risk profile. The scenarios that I have considered represent, in my opinion, the risks that could most significantly impact AIIDAC's financial and capital strength. The scenarios I have considered in my stress tests are as follows:
- Deterioration of AIIDAC's net best estimate technical provisions
  - Deviation of AIIDAC's underwriting performance from its business plan
  - Default of reinsurance recoverable from AIIDAC's reinsurance providers
  - Financial losses from significant catastrophe events
  - Deterioration in the value of AIIDAC's investment portfolio
- 8.97 AIIDAC's net technical provisions (excluding the Solvency II risk margin) as at 31 December 2017 are £56.5m. In order to reduce its SCR coverage ratio to 100% or below, AIIDAC would need to experience a deterioration in the region of 53.5% of its net best estimate technical provisions which equates to £30.2m. The probability of AIIDAC experiencing a reserve deterioration in excess of £30.2m over the 12 month period following 31 December 2017 has been calculated by using AIL's Partial Internal Model to be less than 0.01%. Given the remoteness of this scenario, I am comfortable that AIL has sufficient Own Funds to cover it against the risk of a reserve deterioration in all but extremely remote circumstances.
- 8.98 In its 2017 ORSA Report, AIIDAC projects that AIIDAC's combined loss ratio will be 92.4% in the first year of its operation following the Scheme. AIIDAC also projects that gross written premium of £556.7m in the first year following the Scheme. In order to reduce AIIDAC's SCR coverage ratio to 100% or below, its combined loss ratio would need to deteriorate to a level around 136.2%. It has been calculated using AIL's Partial Internal Model that the probability of AIIDAC experiencing a combined ratio in excess of 136.2% over the 12 month period following 31 December 2017 is less than 0.06%. Given the remoteness of this scenario, I am comfortable that AIIDAC has sufficient Own Funds to protect it against the risk of deterioration in its underwriting performance in all but remote circumstances.
- 8.99 Assuming that the Scheme and the AIIDAC-AIL Quota Share arrangement are in effect, AIIDAC's reinsurance asset as at 31 December 2017 is £780.8m. In order to reduce the SCR coverage ratio to 100% or below, AIIDAC would need to experience a default in the region of 3.9% of its total reinsurance asset. The AIIDAC-AIL Quota Share arrangement accounts for 93.9% of AIIDAC's reinsurance asset. Under the terms of the AIIDAC-AIL Quota Share arrangement, the reinsurance recoveries due to AIIDAC will be secured by a floating charge of approximately the same value as AIL's investment portfolio. This floating charge significantly reduces AIIDAC's exposure to credit risk

from this reinsurance arrangement. Also, from my analysis of the strength of AIL's capital position as discussed in paragraphs 8.16 to 8.36, I consider the likelihood of AIL's default to be remote. In addition, the remaining 6.1% of AIIDAC's reinsurance asset is diversified across a range of large reinsurers with credit ratings of A and above and with no one reinsurer taking a material proportion of the remaining reinsurance asset.

8.100 In order to reduce AIIDAC's SCR coverage ratio to 100% or below, AIIDAC would need to experience reinsurance defaults in excess of £30.2m. The probability of AIIDAC experiencing reinsurance defaults in excess of this over the 12 month period following 31 December 2017 has been calculated using AIL's Partial Internal Model to be less than 0.01%. I am comfortable that this is a sufficiently remote scenario.

8.101 Therefore, I believe that AIIDAC has sufficient Own Funds to protect it against reinsurance credit defaults in all but extremely remote circumstances.

8.102 I have considered AIIDAC's exposure to catastrophe events. AIIDAC's largest catastrophe exposure arises from its exposure to Ireland windstorm. In AIIDAC's 2017 ORSA, it assessed the loss arising as a result of five separate significant weather events over a single winter resulting in severe flooding and weather damage. The estimated gross loss in relation to this scenario is £59.9m and allowing for the AIIDAC-AIL quota share arrangement, I estimate that the corresponding net loss is £9.0m. Following this scenario loss, I estimate that AIIDAC would still have an SCR coverage ratio of 135.8%.

8.103 Based on this analysis, I am comfortable that AIIDAC has sufficient Own Funds to protect it against severe and remote catastrophe events.

8.104 Assuming that the Scheme and the AIIDAC-AIL quota share arrangement are in effect, the investments held by AIIDAC as at 31 December 2017 would amount to £245m. In order to reduce the SCR coverage ratio to 100% or below, AIIDAC would need to experience a reduction in the value of its investments in the region of 12.1% which equates to £30.2m.

8.105 I understand from AIL that £360m of its investment portfolio as at 31 December 2017 is in Euro denominated assets. 99% of these assets are bonds, money market instruments and cash, with the remaining 1% made up of property and discretionary derivatives. From comparing AIIDAC's Solvency II balance sheets prior to and following the Scheme as at 31 December 2017, in paragraphs 8.111 and 8.116, AIIDAC's investments are expected to increase by £245m following the Scheme. I have been informed by AIL that part of the Euro denominated investment portfolio will be transferred to AIIDAC under the Scheme. Of these investments, 59.3% are held in debt instruments with a credit rating of BBB or higher with the vast majority of the remainder in money market instruments and cash.

8.106 The probability of AIIDAC experiencing investment losses in excess of £30.2m over the 12 month period following 31 December 2017 has been calculated using AIL's Partial Internal Model to be less than 0.01%.

8.107 Given AIL's relatively cautious investment strategy and the remoteness of the probability calculated by AIL's Partial Internal Model for investment losses to exceed AIIDAC's capital coverage, I believe that AIIDAC has sufficient Own Funds to cover it against the risk of investment losses in all but extremely remote circumstances.

8.108 The stress testing that I have undertaken, the results of which I have summarised in the paragraphs above, supports my conclusion that AIIDAC has sufficient Own Funds in comparison to its regulatory capital requirements.

8.109 In the above, I have assessed the robustness of AIIDAC's own funds against its SCR as calculated under the Solvency II Standard Formula. As discussed in paragraphs 8.86 to 8.93 and 8.129 to 8.135, it appears as if this is a prudent measure of AIIDAC's capital requirements in comparison to AIIDAC's unapproved Internal Model SCR and ORSA capital requirement. It follows therefore that my analysis above also supports my conclusion that AIIDAC has sufficient Own Funds in comparison to its Internal Model SCR and ORSA capital requirement.

### **IFRS balance sheet, Solvency II balance sheet and Own Funds**

#### **IFRS and Solvency II Balance Sheet**

8.110 I have been informed by AIL that AIIDAC will not transact any insurance business prior to the Effective Time of the Scheme.

8.111 The table below shows the simplified Solvency II balance sheet for AIIDAC as at 31 December 2017 assuming that the Scheme is not in effect at that date.

**Table 20: Solvency II balance sheet for AIIDAC as at 31 December 2017 prior to the Scheme being in effect (£m)**

|  | IFRS basis | Solvency II basis |
|--|------------|-------------------|
| <b>Assets:</b>                               |            |                   |
| Cash   | 4          | 4                 |
| Investments                                  | 0          | 0                 |
| Reinsurance assets                           | 0          | 0                 |
| Other assets                                 | 0          | 0                 |
| <b>Total assets</b>                          | <b>4</b>   | <b>4</b>          |
| <b>Liabilities:</b>                          |            |                   |
| Technical provisions (excluding risk margin) | 0          | 0                 |
| Risk Margin                                  | 0          | 0                 |
| Other liabilities                            | 0          | 0                 |
| <b>Total liabilities</b>                     | <b>0</b>   | <b>0</b>          |
| <b>Excess of assets over liabilities</b>     | <b>4</b>   | <b>4</b>          |

8.112 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.

8.113 As mentioned in paragraph 8.73. AIIDAC's capital requirement prior to the Scheme is €3.7m. At the time of AIIDAC's authorisation from the CBI, AIIDAC held €5.0m in the form of issued share capital to meet this requirement.

8.114 AIL has also calculated IFRS and Solvency II Balance Sheets for AIIDAC as at 31 December 2017 assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect.

8.115 I have considered the approach used by AIL to calculate the IFRS and Solvency II Balance Sheets for AIIDAC as at 31 December 2017 assuming that the Scheme was in effect.

8.116 As mentioned in section 7, I am comfortable with AIL's calculation of IFRS reserves and Solvency II Technical provisions, and consider the approach and results to be reasonable.

8.117 The table below shows the simplified IFRS and Solvency II balance sheets for AIIDAC as at 31 December 2017 assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect at that date.

**Table 21: IFRS and Solvency II balance sheet for AIIDAC as at 31 December 2017 assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect (£m)**

|  | IFRS basis   | Solvency II basis |
|--|--------------|-------------------|
| <b>Assets:</b>                                   |              |                   |
| Cash   | 6            | 6                 |
| Investments                                      | 239          | 239               |
| Loan and mortgage assets                         | 0            | 0                 |
| Reinsurers' share of technical provisions        | 893          | 781               |
| Investments in group entities and participations | 12           | 12                |
| Other assets                                     | 124          | 12                |
| <b>Total assets</b>                              | <b>1,273</b> | <b>1,049</b>      |
| <b>Liabilities:</b>                              |              |                   |
| Technical provisions (excluding Risk Margin)     | 1,041        | 837               |
| Risk Margin                                      | 0            | 11                |
| Deposits from reinsurers                         | 0            | 0                 |
| Other liabilities                                | 154          | 112               |
| <b>Total liabilities</b>                         | <b>1,195</b> | <b>959</b>        |
| <b>Excess of assets over liabilities</b>         | <b>78</b>    | <b>90</b>         |

8.118 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.

8.119 AIL has also calculated the Own Funds for AIIDAC as at 31 December 2017 assuming that the Scheme and AIIDAC-AIL Quota Share were in effect at that date.

8.120 AIL has informed me that it expects a significant majority of the Solvency II Own Funds transferring to AIIDAC to be Tier 1 Own Funds. AIL also expects AIIDAC's Tier 1 Own Funds to be comprised of ordinary share capital and the reconciliation reserve and to be classed as unrestricted Tier 1 capital.

8.121 The table below shows the Own Funds for AIIDAC as at 31 December 2017 assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect at that date.

**Table 22: Eligible Own Funds for AIIDAC as at 31 December 2017 (£m)**

| Item                            |           |
|---------------------------------|-----------|
| <b>Tier 1</b>                   | <b>76</b> |
| <b>Tier 2</b>                   | <b>0</b>  |
| <b>Tier 3</b>                   | <b>13</b> |
| <b>Total Eligible Own Funds</b> | <b>90</b> |

8.122 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.

8.123 I consider AIIDAC's allocation of Own Funds to the tiers to be reasonable. I also observe that 85% of the Eligible Own Funds are Tier 1 which is the highest tier of Own Funds.

### **AIIDAC's Own View of Capital Requirements**

#### **ORSA**

8.124 I have been provided with a copy of the report outlining AIIDAC's ORSA, dated June 2017. This represents a forward looking assessment of AIIDAC's risk profile and capital requirements. It is stated in this ORSA report that the Board was being asked to review, challenge and approve this report for formal submission to the CBI as part of AIIDAC's application for authorisation.

8.125 AIIDAC has carried out an assessment of the risks that it believes it will be exposed to assuming that the Scheme and the AIIDAC-AIL Quota Share are in effect and has conducted various scenario tests within its ORSA to test the robustness of its capital base in comparison to its SCR calculated using the Solvency II Standard Formula. AIIDAC believes that the stress and scenario testing it has conducted covers a wide range of risks that AIIDAC is exposed to. The scenarios considered in AIIDAC's stress and scenario testing are summarised as follows:

- The company performs poorly against the business plan with lower sales than expected
- A fall in the profitability of motor insurance business driven by increased competition
- A sudden increase in injury claims reserves driven by an increase in the cost of bodily injury claims
- Five severe weather events impacting Ireland over a single winter
- A shock in the investment market affecting both sovereign and corporate bonds
- A severe operational risk loss for example as a result of a regulatory fine or internal control failure

8.126 AIIDAC's scenario tests show that AIIDAC would have sufficient capital to meet its Capital Coverage Target in all of the scenarios above other than the scenarios where sales are lower than expected or there is a sudden increase in its injury claims reserves. Of these scenarios, only the latter causes the SCR coverage ratio to fall below 100%. This scenario corresponds to a sudden 30% increase in the cost of injury claims. In this scenario AIIDAC's coverage ratio is projected to fall to 97% but AIIDAC still has

sufficient capital to meet its MCR and the value of its assets still exceeds that of its liabilities.

8.127 AIIDAC's ORSA also considers a number of management actions that will be deployed where an event threatens the solvency of the company. I have reviewed these management actions and I am satisfied that they will help AIIDAC to improve its capital position over time should the necessity arise.

8.128 I consider the range of stresses and scenarios that AIIDAC has considered and the results it has obtained to be reasonable.

#### **ORSA capital requirements for AIIDAC**

8.129 As discussed in paragraphs 8.86 to 8.93, AIIDAC has also calculated its capital requirements using AIL's Partial Internal Model. On this basis, AIIDAC's unapproved Internal Model SCR as at 31 December 2017 is £37.9 million.

8.130 As discussed in paragraphs 8.51 to 8.53, AIL takes the sum of its SCR calculated based on its Partial Internal Model, its Solvency II Risk Margin (excluding its Canadian subsidiary) and the Solvency II Risk Margin in respect of its Canadian subsidiary to represent its own view of its capital requirement. I have calculated an equivalent measure of the capital requirements for AIIDAC. I refer to this in the remainder of this report as "AIIDAC's ORSA Capital Requirement". In other words, I have calculated AIIDAC's ORSA Capital Requirement as the sum of AIIDAC's unapproved Internal Model SCR and its Solvency II Risk Margin.

8.131 I believe that AIIDAC's ORSA Capital Requirement is an appropriate measure of AIIDAC's capital requirements and is equivalent and comparable to AIL's ORSA Capital Requirement.

8.132 The table below shows the capital coverage ratio for AIIDAC as at 31 December 2017 against its ORSA Capital Requirement, assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect.

**Table 23: Capital coverage ratios for AIIDAC as at 31 December 2017 (£m) assuming that the Scheme and the AIIDAC-AIL Quota Share were in effect against its ORSA capital requirement**

| Item                     |      |
|--------------------------|------|
| ORSA capital requirement | 49   |
| Eligible Own Funds       | 90   |
| Coverage ratio           | 185% |

8.133 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.

8.134 As can be seen from the above table, AIIDAC has substantial Own Funds in excess of its ORSA capital requirement.

8.135 In addition, AIIDAC's ORSA capital requirement is lower than its SCR capital requirement of £59.4m which is calculated using the Solvency II Standard Formula,

which indicates that the Solvency II Standard Formula is a prudent measure of the capital requirements for AIIDAC.

8.136 Given this, the conclusions from my stress and scenario testing in respect of AIIDAC's Standard Formula SCR in paragraphs 8.94 to 8.104 and AIIDAC's stress and scenario testing in paragraphs 8.125 to 8.128, I am satisfied that AIIDAC's ORSA capital requirement is a robust measure of AIIDAC's capital requirements.

## 9 Policyholder security

- 9.1 In this section, I describe the effect of the Scheme on each group of policyholders with regards to security, set out my conclusions and explain how I have reached them.
- 9.2 Note that all post-Scheme figures shown in paragraphs 9.4 through 9.43 below assume that the AIIDAC-AIL Quota Share is in effect.
- 9.3 As mentioned in paragraph 5.42, I have reviewed AIL's and AIIDAC's Petition to the Court of Session in Scotland which includes the AIIDAC-AIL Quota Share as a part of the Scheme. As a result, the Scheme will not be able to proceed without the AIIDAC-AIL Quota Share arrangement being in place prior to the Effective Time of the Scheme.

### **Impact of the Scheme on the balance sheets of the affected companies**

- 9.4 The table below shows simplified Solvency II balance sheets both before and after the Scheme. These figures are consistent with the balance sheets shown earlier in this report in section 8.
- 9.5 The amounts shown for the positions after the Scheme are hypothetical, based on the Scheme becoming effective on 31 December 2017. The actual Effective Time is scheduled to be 00:01 GMT on Friday 1 February 2019.

9.6 The actual balance sheets before and after the Scheme will be different to those shown below due to the actual experience of the companies between 31 December 2017 and the Effective Time. However, I believe the table below gives a reasonable indication as to how the companies involved will be affected by the Scheme.

**Table 24: Solvency II balance sheets of AIL and AIIDAC as at 31 December 2017, both prior to and post the Scheme (£m)**

|  | Prior to Scheme |          | Post Scheme   |              |
|--|-----------------|----------|---------------|--------------|
|  | AIL             | AIIDAC   | AIL           | AIIDAC       |
| <b>Assets:</b>                                   |                 |          |               |              |
| Cash   | 109             | 4        | 107           | 6            |
| Investments                                      | 5,219           | 0        | 5,007         | 239          |
| Loan and mortgage assets                         | 1,922           | 0        | 1,922         | 0            |
| Reinsurers' share of technical provisions        | 4,480           | 0        | 4,370         | 781          |
| Investments in group entities and participations | 1,093           | 0        | 1,175         | 12           |
| Other assets                                     | 714             | 0        | 677           | 12           |
| <b>Total assets</b>                              | <b>13,537</b>   | <b>4</b> | <b>13,258</b> | <b>1,049</b> |
| <b>Liabilities:</b>                              |                 |          |               |              |
| Technical provisions (excluding Risk Margin)     | 6,291           | 0        | 6,187         | 837          |
| Risk Margin                                      | 242             | 0        | 241           | 11           |
| Deposits from reinsurers                         | 3,237           | 0        | 3,194         | 0            |
| Other liabilities                                | 1,508           | 0        | 1,402         | 112          |
| <b>Total liabilities</b>                         | <b>11,278</b>   | <b>0</b> | <b>11,025</b> | <b>959</b>   |
| <b>Excess of assets over liabilities</b>         | <b>2,259</b>    | <b>4</b> | <b>2,234</b>  | <b>90</b>    |
| Subordinated liabilities                         | 283             | 0        | 283           | 0            |
| <b>Solvency II Own Funds</b>                     | <b>2,542</b>    | <b>4</b> | <b>2,517</b>  | <b>90</b>    |

9.7 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.

9.8 As discussed in section 7 of this report, the valuation basis for calculating the Solvency II technical provisions will not change as a result of the Scheme. I understand from AIL and AIIDAC that AIIDAC will apply the same valuation basis to value balance sheet assets and liabilities as that applied by AIL prior to the Scheme. As a result, there will be no impact on the transferring or remaining policyholders arising from changes in the valuation bases underlying the balance sheets.

9.9 In the table above, the sum of the total assets and the sum of the total liabilities across AIL and AIIDAC increase following the Scheme. This is due to the AIL-AIIDAC Quota Share arrangement which is an intragroup reinsurance arrangement. To arrive at a consolidated balance sheet for AIL and AIIDAC following the transfer, the intragroup reinsurance transfer arising as a result of this arrangement must first be eliminated. In particular, AIL's gross technical provisions attributable to the AIL-AIIDAC Quota Share

arrangement should be eliminated on AIIDAC's balance sheet to avoid a double count with the "Reinsurers' share of technical provisions" line item.

- 9.10 Similarly, in the table above, the sum of the excess of assets over liabilities across AIL and AIIDAC increases following the Scheme. This is due to the fact that AIL's investment in AIIDAC is recognised as an asset on AIL's balance sheet. To calculate a consolidated balance sheet for AIL and AIIDAC following the transfer, this intragroup investment asset must first be removed.
- 9.11 The movements in the balance sheets above are consistent with AIL and AIIDAC's estimates of the transferring Solvency II Technical Provisions and Own Funds.
- 9.12 I am comfortable that the movements in the balance sheets above reflect appropriate estimates of the assets and liabilities that will transfer as a result of the Scheme.

### Impact of the Scheme on the solvency positions of the affected companies

- 9.13 The capital requirements of AIL and AIIDAC and their approaches to capital modelling are discussed in Section 8 of this report. As discussed in Section 8, AIL calculates its regulatory capital requirements using a Partial Internal Model whereas AIIDAC will initially calculate its regulatory capital requirements using the Standard Formula.
- 9.14 The positions of AIL and AIIDAC before and after the Scheme in relation to regulatory and ORSA capital requirements are summarised in the table below.

**Table 25: Regulatory and ORSA capital requirements for AIL and AIIDAC**

|   | Prior to Scheme |             | Post Scheme  |             |
|---|-----------------|-------------|--------------|-------------|
|   | AIL             | AIIDAC      | AIL          | AIIDAC      |
| MCR                                     | 386             | 3           | 376          | 17          |
| SCR                                     | 1,283           | 3           | 1,291        | 59          |
| ORSA capital requirement                | 1,659           | 3           | 1,667        | 49          |
| Eligible Own Funds to meet the MCR      | 2,271           | 4           | 2,311        | 76          |
| Eligible Own Funds to meet SCR and ORSA | 2,542           | 4           | 2,517        | 90          |
| <b>Excess of Own Funds over the SCR</b> | <b>1,259</b>    | <b>1</b>    | <b>1,225</b> | <b>30</b>   |
| <b>MCR Coverage ratio</b>               | <b>588%</b>     | <b>135%</b> | <b>614%</b>  | <b>455%</b> |
| <b>SCR Coverage ratio</b>               | <b>198%</b>     | <b>135%</b> | <b>195%</b>  | <b>151%</b> |
| <b>ORSA Coverage ratio</b>              | <b>153%</b>     | <b>135%</b> | <b>151%</b>  | <b>185%</b> |

- 9.15 Note that I understand from AIL that the figures provided in the table above are calculated to the nearest million. Therefore, I have not been able to provide these figures to the same level of precision as shown elsewhere in this report.
- 9.16 As discussed in paragraphs 8.15, 8.36, 8.48 and 8.57 AIL has substantial Own Funds in comparison to its regulatory and ORSA capital requirements prior to the Scheme.

- 9.17 As discussed in paragraph 8.69, the Scheme does not materially change AIL's capital position. AIL's surplus of Own Funds in relation to its SCR will reduce following the Scheme from £1,258.9m to £1,225.4m; however the Own Funds following the transfer are still substantial. As shown in table 24 above, AIL's coverage ratios against the SCR and ORSA reduce following the Scheme; however the reductions are not substantial and will not materially affect the solvency position of AIL.
- 9.18 It follows that, in my opinion, the Scheme will not materially change the likelihood of AIL being able to meet policyholder obligations.
- 9.19 As discussed in paragraph 8.84, AIIDAC will have substantial Own Funds in comparison to its regulatory capital requirements following to the Scheme.
- 9.20 I also conclude in paragraph 8.136 that AIIDAC's ORSA capital requirement is a robust measure of AIIDAC's capital requirements. Following the Scheme, AIIDAC's ORSA capital ratio is materially higher than that of AIL's prior to the Scheme.
- 9.21 As discussed in paragraphs 8.94 to 8.109, I have also undertaken a number of high level stress and scenario tests to test the robustness of AIIDAC's capital position following the Scheme and have concluded that AIIDAC has sufficient Own Funds in comparison to its SCR calculated under the Solvency II Standard Formula. In addition, it can be seen from the table above that AIIDAC's capital requirement calculated under the Solvency II Standard Formula SCR is higher than its ORSA capital requirement. As a result, repeating the tests on the adequacy of AIIDAC's Own Funds against its ORSA capital requirements would show stronger results.
- 9.22 For the reasons discussed in paragraph 8.88, even though AIIDAC does not currently use an Internal Model to calculate its SCR, I believe that it is still appropriate to consider its unapproved Internal Model SCR. As discussed in paragraph 8.91, AIIDAC's coverage ratio against its unapproved Internal Model SCR is significantly higher than that against the Standard Formula SCR which implies that the Standard Formula calculation may be a prudent measure of the capital that AIIDAC requires. Further, AIIDAC's coverage ratio against its unapproved Internal Model SCR is significantly higher than AIL's coverage ratio against its SCR prior to the Scheme.
- 9.23 It follows from paragraphs 9.19 to 9.22 that, in my opinion, AIIDAC will have substantial coverage over its regulatory and ORSA capital requirements following the Scheme.

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

- 9.24 As set out in paragraph 8.84, should the Scheme become effective, AIIDAC will have substantial Own Funds in comparison to its regulatory capital requirements (which are calculated using the Standard Formula).
- 9.25 Nevertheless, the transferring policyholders would be moving to a smaller entity with a significantly lower surplus of Own Funds in relation to its SCR. However as discussed in paragraphs 9.19 and 9.20, following the Scheme, the transferring policyholders will have:
- a significantly higher coverage ratio in relation to the ORSA capital requirements
  - a significantly higher coverage ratio against regulatory capital requirements calculated using an unapproved Internal Model

- 9.26 I have also been provided with a draft letter that AIL's Board of Directors intends to issue to AIIDAC that indicates AIL's intention to provide financial support to AIIDAC, subject to certain conditions, in the event that AIIDAC's coverage ratio against its SCR falls below a specified threshold, measured in accordance with the Aviva Group's guidance in respect of Solvency Risk Appetite, and AIIDAC is not able to restore this coverage ratio through management actions and other means within a period of six months. In this scenario, AIL intends to provide sufficient financial support to AIIDAC to restore its coverage ratio against the SCR to a specified level measured in accordance with the Aviva Group's guidance in respect of Solvency Risk Appetite that is broadly equivalent to AIIDAC's minimum coverage ratio as described in paragraph 8.70.
- 9.27 I understand from AIL that this letter is not legally binding and would not be expected to have any impact on AIIDAC's balance sheet or SCR (unless, of course, AIL actually provides financial support). However, there could be significant adverse reputational consequences for the Aviva Group should AIIDAC get into financial difficulties and AIL not honour the commitment in the letter. It follows that, in my view, there would be a substantial incentive for AIL to honour the commitment and a very high likelihood that it would do so.
- 9.28 Given this, as well as the relative magnitude of AIL's excess capital compared to AIIDAC's, I believe that the intention underlying the letter of support increases the security of AIIDAC's capital position and therefore the security of the transferring policyholders.
- 9.29 The recent ORSA produced for AIIDAC includes various stress and scenario tests conducted in order to test the robustness of AIIDAC's capital calculations. These indicate that AIIDAC will have sufficient capital following the Scheme in all but extreme circumstances. The stress testing that I have undertaken, the results of which I have summarised in paragraphs 8.94 to 8.109, supports my conclusion that AIIDAC will have substantial Own Funds following the Scheme in comparison to its regulatory and ORSA capital requirements.
- 9.30 As detailed in paragraph 5.40, AIIDAC intends to establish the AIIDAC-AIL Quota Share arrangement with AIL which will cede the majority of risk associated with the Transferring Portfolio back to AIL. AIL has substantially more capital than AIIDAC in monetary terms and has been issued with an A+ credit rating by Standard & Poor's, which provides supporting evidence of its financial security. Prior to the Scheme, 100% of the liabilities associated with the Transferring Portfolio are covered by AIL's funds. Following the Scheme and the application of the reinsurance, AIIDAC will retain 15% of the risk in respect of the Ireland GI branch business and MDI business. For the reasons given in paragraphs 9.24 and 9.26, I do not believe that AIIDAC's retention of 15% of the risk in respect of the Ireland GI branch and MDI business materially impacts the security available to these policyholders.
- 9.31 Further to this, I have been informed by AIL that in relation to the reinsurance agreement between AIL and AIIDAC, AIL (as chargor) will grant a floating charge to AIIDAC (as chargee) over certain fixed income assets to secure AIL's obligations under the reinsurance agreement. A clause within the floating charge will restrict AIIDAC's recovery under the floating charge to such amount as AIIDAC would have been entitled to recover had AIIDAC been an ordinary policyholder (rather than a secured creditor) of AIL. The purpose of this is to align the transferring policyholders, who are reinsured by AIL, with the policyholders that remain with AIL in relation to a distribution of AIL's assets in the event of the insolvency of AIL. I understand that this legal provision is designed to treat the transferring policyholders and the remaining policyholders

equitably. I refer to this legal provision in the remainder of this report as “the Provision” and I discuss it in more detail in paragraphs 10.21 to 10.27.

- 9.32 I am conscious that similar provisions have been used on a number of earlier Part VII transfers and that those schemes, including the provisions, have been approved by the Court. In addition, I have received legal advice from an appointed Queen’s Counsel (“QC”) who was instructed jointly by AIL’s solicitors, myself and another Independent Expert. The QC’s advice confirmed that the Provision achieves its aim of ensuring that, in effect, the transferring and remaining policyholders are aligned in relation to a distribution of AIL’s assets in the event of the insolvency of AIL as is the case prior to the Scheme. Based on this advice and the information provided to me, I am satisfied that the application of the Provision within the AIIDAC-AIL Quota Share security documents is appropriate and that it will not materially disadvantage either the remaining or transferring policyholders when compared to the pre-Scheme position.
- 9.33 The majority of the Transferring Portfolio will be ceded back to AIL on an 85% quota share basis and for these policies 15% of the risk will be retained by AIIDAC. I do not believe that these policies will be materially disadvantaged by the fact that 15% of the risk is retained by AIIDAC given that AIIDAC has substantial Own Funds in comparison to its regulatory and ORSA capital requirements, as discussed in paragraphs 8.82 to 8.104, 8.124 to 8.136 and 9.13 to 9.19.
- 9.34 It should be noted that the methodology used to calculate the regulatory capital requirements associated with the Transferring Portfolio is due to change following the Scheme. Currently the policies sit within AIL, which calculates its SCR using a Partial Internal Model. Post Scheme, AIIDAC proposes to calculate its SCR using a Standard Formula approach, at least initially. As discussed in paragraphs 8.81 to 8.85, I am comfortable that the Standard Formula calculation is adequately robust and appropriate to the proposed business mix of AIIDAC. Therefore, I am comfortable that this change in approach will not materially impact the security of the transferring policyholders.
- 9.35 To summarise the above:
- The stress and scenario testing undertaken by AIIDAC indicates that it will have sufficient capital following the Scheme in all but extreme circumstances.
  - Following the Scheme the transferring policyholders will benefit from a significantly higher coverage ratio in relation to the ORSA capital requirements.
  - The stress testing that I have undertaken supports my conclusion that AIIDAC will have substantial Own Funds following the Scheme in comparison to its regulatory and ORSA capital requirements.
  - The transferring policyholders will also benefit from a significantly higher coverage ratio against regulatory capital requirements calculated using an unapproved Internal Model.
  - AIL will issue a letter to AIIDAC setting out AIL’s intention to provide financial support to AIIDAC in the event that AIIDAC’s coverage ratio against its SCR falls below a specified threshold.
  - The AIIDAC-AIL Quota Share arrangement will be effected which will transfer the majority of the insurance risk associated with the Transferring Portfolio to AIL.
  - The AIIDAC-AIL Quota Share arrangement benefits from the Provision described above in the event of the insolvency of AIL.
- 9.36 Based on these considerations, I believe the likelihood of AIIDAC encountering significant financial difficulties to be remote. Consequently, I conclude that, despite the

fact that the transferring policyholders will be moving to a smaller entity with a significantly lower surplus of Own Funds in relation to its SCR, the Scheme will not have a material adverse impact on the security of those policyholders.

### **Impact of the Scheme on the security of the remaining policyholders**

- 9.37 The impact of the Scheme on the remaining policyholders is relatively minor in comparison to AIL's overall risk profile. As demonstrated in table 25, the Scheme causes relatively small reductions in AIL's regulatory and ORSA coverage ratios, which I would not expect to materially impact the security of the remaining policyholders.
- 9.38 The most recent ORSA document produced for AIL includes various stress and scenario tests conducted in order to test the robustness of AIL's capital calculations. These indicate that AIL has sufficient capital and will have sufficient capital post-Scheme in all but extreme circumstances. The stress testing that I have undertaken, the results of which I have summarised in paragraphs 8.29 to 8.35 of this report, support my conclusion that AIL has substantial Own Funds in comparison to its regulatory capital requirements.
- 9.39 Although a substantial portion of AIL's portfolio will transfer to AIIDAC on a gross basis, the AIIDAC-AIL Quota Share will cede the majority of the Transferring Portfolio back to AIL. Net of the AIIDAC-AIL Quota Share, the best estimate reserves retained by AIIDAC represent only 2.3% of AIL's total pre-Scheme reserves.
- 9.40 The Provision outlined in paragraphs 9.31 to 9.32 will ensure that transferring policyholders will, in effect, be aligned with the remaining policyholders of AIL upon the insolvency of AIL (as they are prior to the Scheme). For the reasons discussed in paragraph 9.32, I am comfortable with the Provision and, as a result, I am comfortable that this aspect of the AIIDAC-AIL Quota Share arrangement will not materially impact the security of the remaining policyholders.
- 9.41 I note that the AIIDAC-AIL Quota Share arrangement and the associated security arrangement will apply to all new business written by AIIDAC following the Scheme as well as to the Transferring Portfolio, regardless of whether this new business is in similar classes to the Transferring Portfolio or in new classes. I further note that this could dilute the assets available to the remaining policyholders in the event of the insolvency of AIL. Nevertheless, I am satisfied that this will not materially disadvantage the remaining policyholders compared to the position if the Scheme does not go ahead since, in those circumstances, the business that AIIDAC will write following the Scheme would be written by AIL instead so would still dilute the assets available to the remaining policyholders. In fact, in this situation, the assets would be diluted to a greater extent because 100% of the business would be written by AIL as opposed to reinsuring 85% of much of it.
- 9.42 Following the Scheme, AIL intends to continue using its PRA-approved Partial Internal Model to calculate its regulatory capital requirement. AIL's approach to calculating its regulatory capital requirements therefore is not expected to change following the Scheme. As a result, the security of the remaining policyholders is not expected to be affected as a result of a change in AIL's approach to calculating its regulatory capital requirements.
- 9.43 Based on the considerations discussed in paragraphs 9.4 to 9.18 and 9.37 to 9.42, I conclude that the likelihood of AIL encountering significant financial difficulties is remote

9.44 Given this, I further conclude that the Scheme will not have a detrimental impact on the security of the policyholders remaining in AIL.

## 10 Other financial considerations

10.1 In this section, I discuss the following items in turn:

- Investment strategy implications
- Implications of the Scheme on ongoing expense levels
- Implications under insolvency
- Impact on compensation
- Liquidity position
- Tax implications
- Pension arrangements
- Impact on existing reinsurers
- Impact on new business strategy
- Impact on existing guarantees.

### **Investment strategy implications**

- 10.2 I have analysed the impact of the Scheme on the investment strategy and its corresponding impact on either the transferring or remaining policyholders. I do not believe that policyholders will be materially impacted as a result of the change in investment strategy. This is primarily due to the fact that investment strategy is expected to remain materially unchanged following the Scheme.
- 10.3 In relation to policyholders that remain in AIL following the Scheme, AIL's investment strategy and investment management processes will remain unchanged. AIL's investment strategy is reviewed annually and is set in accordance with the relevant UK legal and regulatory requirements, as well as Aviva Group's internal policies and requirements in respect of Asset Liability Management. AIL's investment strategy is approved by its Board based on the risk adjusted returns on the asset classes, AIL's risk appetite and insurance liabilities. AIL's asset allocation is reviewed annually in line with the Aviva Group's requirements in respect of Asset Liability Management. I have reviewed the Aviva Group's requirements in respect of Asset Liability Management and am satisfied that they are appropriate to AIL's business and risk profile.
- 10.4 I understand from AIIDAC that its investment strategy will be set in accordance to the relevant Irish legal and regulatory requirements, as well as Aviva Group's internal policy and standard requirements. AIIDAC's investment strategy will be approved by its Board based on the risk adjusted returns on the asset classes, AIIDAC's risk appetite and insurance liabilities. AIIDAC's risk appetite on asset and liability matching is to minimise the risk to its Solvency II Own Funds from changes in various economic factors, which is in line with the approach currently taken by AIL with respect to the Transferring Portfolio.
- 10.5 AIIDAC has informed me that its investment strategy, and implementation thereof, is expected to be broadly similar to that currently applied by AIL to the Transferring Portfolio. AIIDAC's asset portfolio will initially consist predominantly of fixed interest investments in highly rated and highly liquid government and corporate bonds denominated in Euro.

- 10.6 I have been informed by AIIDAC that AIIDAC's investment strategy will be tailored to more closely reflect AIIDAC's financial risk requirements, e.g. it is expected that the duration of AIIDAC's investment portfolio will be shorter than AIL's as AIIDAC's liabilities are expected to be shorter than those of AIL. I have also been informed by AIL that it anticipates that AIIDAC's portfolio will consist of more liquid investments, e.g. fixed interest investments such as sovereign and investment grade corporate bonds. In my opinion, these changes will assist AIIDAC by ensuring that its investment portfolio is in closer alignment with its policyholder liabilities. In my opinion, these changes will not materially disadvantage the transferring policyholders.
- 10.7 AIIDAC's investment strategy will be managed by Aviva Investors Holdings Limited, which is an entity within the Aviva Group that currently manages the investments of AIL.
- 10.8 The investment portfolio of AIIDAC will be subject to the Aviva Group's standards and management framework as is the investment portfolio of AIL. It will be governed by several internal governance functions such as AIIDAC's Investment Committee.
- 10.9 As mentioned in paragraph 5.40, following the Scheme, AIIDAC will cede a significant proportion of its liabilities back to AIL under the AIIDAC-AIL Quota Share arrangement. Given this, the transferring policyholders will remain exposed to AIL's investment strategy, particularly in respect of the investments backing the liabilities that are ceded back to AIL. This will not in my opinion disadvantage the transferring policyholders as the transferring policyholders would have been exposed to AIL's investment strategy prior to the Scheme and AIL's investment strategy is not expected to change as a result of the Scheme.
- 10.10 As a result, I do not anticipate that changes in investment management will create any adverse impact on either the transferring or remaining policyholders as a consequence of the Scheme.

### **Implications of the Scheme on ongoing expense levels**

- 10.11 Other than the initial costs of the Scheme to AIL, I understand that there are no additional expenses anticipated in relation to the Remaining Portfolio of AIL as a result of the Scheme. In my view, the initial cost of the Scheme are immaterial in the context of the Remaining Portfolio and, therefore, will not impact the security of the remaining policyholders' contractual rights.
- 10.12 I understand from AIIDAC's application to the CBI that there will be relatively minimal initial costs for AIIDAC as AIL's Ireland GI branch has significant existing infrastructure, systems, headcount and professional resources in place. The Ireland GI branch's resources and headcount will be used to establish AIIDAC's operations.
- 10.13 AIIDAC has estimated the expenses that will be incurred in addition to the Ireland GI branch current expenses following the Scheme. The ongoing expense levels for AIIDAC are expected to increase for the following items:
- transfer pricing charges and VAT arising in relation to services provided by other entities within the Aviva Group to AIIDAC in the future (c. €3.24 million per annum)
  - salary funding for additional senior staff required in AIIDAC, including the Head of the Actuarial Function and Chief Underwriting Officer of Personal Lines and Chief Underwriting Officer of Commercial Lines(€0.55 million per annum)

- an additional Competition and Consumer Protection Commission (CCPC) Levy (€0.07 million per annum)
- other levies due to the CBI.

10.14 As mentioned in paragraph 6.41, the implementation of the Bill could lead to increased levies being owed to the CBI in relation to the Irish risks within the Transferring Portfolio.

10.15 The Ireland GI branch business currently pays levies to regulators both in the UK and Ireland. Following the Scheme, no levy will be owed to regulators in the UK in relation to this book of business. This will reduce the current expenses of the Ireland GI branch by £0.21 million per annum which will partially offset the increase in ongoing expenses discussed above and a potential increase to AIIDAC's levy to the CBI.

10.16 The increase in the ongoing expenses is not insignificant in comparison to the net transferring insurance liabilities after allowing for the AIIDAC-AIL Quota Share arrangement. AIIDAC has however considered these additional expenses in its 2017 ORSA and its business plan and the business plan projection allowing for these additional expenses is profitable.

10.17 Given this, the offset arising from the loss of the levy to the UK central bank and the level of security within AIL and AIIDAC, as described in sections 8 and 9, I do not anticipate that the increases in expense levels will create an adverse impact on the security of the policyholders within the Remaining Portfolio and Transferring Portfolio as a result of the Scheme.

### **Implications under insolvency**

10.18 As discussed in paragraph 6.20, under the UK insolvency regulations, insurance claims take precedence over other claims on the insurance undertaking, with the exception of certain preferential claims (e.g. claims by employees, rights in rem etc.). Direct policyholders rank equally and above inwards reinsurance policyholders and all other unsecured or non-preferential creditors in the event that an insurer is wound up.

10.19 As discussed in paragraph 6.38, under the Irish insolvency regulations, claims made on the assets underlying the technical provisions which relate to insurance losses take precedence over non-insurance claims.

10.20 Following the Scheme, policyholders within the Transferring Portfolio will move from the UK insolvency regulations to the Irish insolvency regulations. I do not believe this will have a material adverse impact on the level of security provided to the transferring policyholders, as both regulations provide a similar level of security in the event of insolvency.

10.21 Also following the Scheme, AIIDAC's liabilities under the transferring policies will, in part, be reinsured to AIL under the AIIDAC-AIL Quota Share arrangement. This has the potential to create an inequity in an insolvency situation due to the way in which creditors are ranked. The ranking of creditors in an insolvency situation, in order of descending priority, can be summarised into categories as follows:

- ( 1 ) fixed charge holders;
- ( 2 ) expenses (including remuneration of the liquidator)
- ( 3 ) preferential creditors
- ( 4 ) prescribed part creditors

- ( 5 ) floating charge holders
- ( 6 ) insurance debts
- ( 7 ) other unsecured creditors.

10.22 Prior to the Scheme, both transferring policyholders and remaining policyholders will fall into category 6 and have priority over other unsecured creditors. However, following the Scheme, the transferring policyholders who are reinsured by AIL will no longer be direct policyholders of AIL and AIIDAC will fall into category 7 and rank behind the remaining policyholders (who remain in category 6).

10.23 This would disadvantage the transferring policyholders in the event of the insolvency of AIL. However, the AIIDAC-AIL Quota Share arrangement employs bespoke legal drafting to overcome this issue.

10.24 Under the AIIDAC-AIL Quota Share arrangement, AIL (as chargor) will grant a floating charge to AIIDAC (as chargee) over certain fixed income assets to secure AIL's obligations under the reinsurance agreement. Ordinarily, this would put AIIDAC into category 5 and give it priority over the remaining policyholders (who are in category 6) in the event of the insolvency of AIL. This would disadvantage the remaining policyholders.

10.25 However, a clause within the floating charge will restrict AIIDAC's recovery in the event of insolvency to such amount as AIIDAC would have been entitled to recover had AIIDAC been an ordinary policyholder (rather than a secured creditor) of AIL. The purpose of this is to align the transferring policyholders, who are reinsured by AIL, with the policyholders that remain with AIL in relation to a distribution of AIL's assets in the event of the insolvency of AIL. I understand that this legal provision is designed to treat the transferring policyholders and the remaining policyholders equitably. I refer to this legal provision elsewhere in this report as "the Provision".

10.26 The floating charge will crystallise and be enforced when an administrator, liquidator or person in a similar capacity takes any steps to distribute a dividend to the creditors of AIL, or gives notice of his intention to do so.

10.27 I am conscious that similar provisions have been used on a number of earlier Part VII transfers and that those schemes, including such similar provisions, have been approved by the Court. In addition, I have received legal advice from a QC who was instructed jointly by AIL's solicitors, myself and another Independent Expert. The QC's advice confirmed that the Provision achieves its aim of ensuring that that, in effect, transferring and remaining policyholders are aligned in relation to a distribution of AIL's assets in the event of the insolvency of AIL as is the case prior to the Scheme. Based on this and the information provided to me, I am satisfied that the application of the Provision within the AIIDAC-AIL Quota Share is appropriate and that it will not materially disadvantage the transferring or remaining policyholders.

10.28 There will be no change in the insolvency regulations for policyholders remaining within AIL as a result of the Scheme.

10.29 I note that the AIIDAC-AIL Quota Share arrangement and associated security arrangements will apply to business written by AIIDAC following the Scheme as well as to the Transferring Portfolio, and that this could dilute the assets available to the remaining policyholders in the event of the insolvency of AIL. Nevertheless, I am satisfied that this will not materially disadvantage the remaining policyholders compared

to the position if the Scheme does not go ahead since, in those circumstances, the business that AIIDAC will write following the Scheme would be written by AIL instead so would still dilute the assets available to the remaining policyholders. In fact, in this situation, the assets would be diluted to a greater extent because 100% of the business would be written by AIL as opposed to reinsuring 85% of much of it.

10.30 Therefore, I do not anticipate that there will be any changes in the event of insolvency as a consequence of the Scheme that will create any material adverse impact on either the transferring policyholders or those remaining within AIL.

### **Impact on compensation**

10.31 As discussed in paragraph 6.21, consumer protection is provided by the FSCS in the UK prior to the Scheme.

10.32 Most private policyholders, small businesses and charities are eligible for protection from the FSCS, in the event that an insurer is unable to meet its liabilities.

10.33 The FSCS will pay 100% of any claim incurred for compulsory insurance (e.g. motor third party liability insurance) and 90% of the claim incurred for non-compulsory insurance without any limit on the amount payable. The FSCS does not protect certain classes of insurance business such as Goods in Transit, Marine, Aviation and Credit Insurance; nor does it protect contracts of reinsurance.

10.34 As well as providing cover for risks situated in the UK written by UK authorised insurance companies, the FSCS also provides cover for risks situated in EEA countries which are written by an insurer authorised in the UK through an establishment in the UK. In addition, it provides cover for EEA risks written by branches of UK-authorised and domiciled insurers in other EEA states.

10.35 Following the Scheme, the AIIDAC UK Branch will be authorised in the UK and will pay levies to the FSCS. As a result, the business within the Transferring Portfolio that is allocated to the AIIDAC UK Branch and that received consumer protection from the FSCS prior to the Scheme will, under the FSCS rules currently in force, continue to receive consumer protection from the FSCS following the Scheme.

10.36 The consumer protection for Irish risks within the Transferring Portfolio that are not allocated to the AIIDAC UK Branch will move to the Insurance Compensation Fund ("ICF") from the FSCS. The ICF is a fund of last resort in Ireland. As discussed in paragraph 6.39, the ICF provides cover for policyholders in relation to risks situated in Ireland where an Irish authorised non-life insurer or a non-life insurer authorised in another European Member State goes into liquidation. In addition, the protection of the ICF does not cover all policyholders' liabilities, with exclusions including health, dental and life policies.

10.37 Therefore, it is my understanding that the compensation protection that is available to some of the transferring policyholders may reduce as a result of the Scheme. The reasons for this are as follows:

- For the transferring personal lines policyholders based in Ireland, the FSCS would cover 100% of any claim incurred on a compulsory insurance product and 90% of any claim incurred on a non-compulsory product. However, the ICF will only cover the lesser of 65% of the sum due to the policyholder and €825,000, and any payments are subject to the approval of the High Court of Ireland. However, as discussed in

paragraph 6.41, these caps will not apply in relation to third party motor claims on implementation of the Bill. Rather, the ICF will pay personal injury claims in full and places a limit of €1,220,000 on property claims.

- For the transferring commercial lines policyholders based in Ireland, the FSCS would cover some small business claims and certain risks for larger businesses, e.g. employers' liability claims. However, the ICF does not cover corporate policyholders unless the claim is in respect of a liability of the corporate policyholder to an individual.
- For the transferring risks situated in EEA countries other than Ireland and written on a Freedom of Services basis, the FSCS currently provides protection to the same extent as described above, since these policies are written by a UK insurer. However, following the Scheme, the ICF will not cover these policies as the ICF does not cover risks written in other EEA states. The groups of policyholders who will be impacted by this limitation are those with European MDI policies.
- AIIDAC will cede a significant proportion of the transferring liabilities back to AIL under the AIIDAC-AIL Quota Share arrangement. However as the FSCS does not provide any protection for reinsurance contracts, the AIIDAC-AIL Quota Share arrangement will not give the transferring policyholders any right to FSCS protection.

10.38 It follows that, in the event of AIIDAC experiencing significant financial difficulties, some of the transferring policyholders may be disadvantaged following the Scheme with respect to access to compensation. However, I would not expect this to affect my conclusions for the following reasons:

- As discussed in sections 8 and 9 of this report, it is my opinion that AIIDAC will be sufficiently capitalised following the Scheme. It is therefore unlikely that AIIDAC will experience financial difficulties that result in the transferring policyholders requiring FSCS or ICF compensation. Given the remoteness of this scenario, I believe the actual detriment to policyholders from losing access to the FSCS to be minimal.
- If the UK leaves the EU with no deal in place on passporting and the Scheme does not come into effect, the risk of AIL losing the right to continue to provide insurance cover to the transferring policyholders will have a more material adverse impact on those policyholders than the changes in access to compensation as a result of the Scheme.
- If, before AIL and AIIDAC are legally committed to the Scheme and before the commencement of policyholder notifications, it becomes clear that the UK is not going to leave the EU or a deal on passporting is agreed between the UK and EU, I have been informed by AIL that it will review the appropriateness of the Scheme in the context of this development and may seek to amend aspects of the Scheme to meet these environmental changes as required.
- In the situation where Brexit is abandoned or a deal on passporting is agreed after the commencement of policyholder notifications, some of the transferring policyholders may end up in a detrimental position as a result of the Scheme. However, as discussed in the first bullet point above, AIIDAC will be sufficiently capitalised following the Scheme and it is therefore unlikely that AIIDAC will experience financial difficulties. Given this, the likelihood that the policyholders will require access to a compensation scheme is remote. It follows that the likelihood that the loss of access to such a scheme will be detrimental to them is also remote.

10.39 For the policyholders remaining within AIL, there will be no change with respect to the compensation available.

10.40 I therefore conclude that the Scheme will not create any material adverse impact to the remaining policyholders' access to compensation.

10.41 I further conclude that, given the remoteness of the scenario where compensation is required by the transferring policyholders, I believe the actual detriment to transferring policyholders from losing access to the FSCS to be less material than the potential impact to these policyholders should the Scheme not go ahead.

### **Liquidity position**

10.42 Aviva Group's approach to liquidity risk management is set out in its Liquidity Risk Policy and Liquidity Risk Business Standard. The Liquidity Risk Policy and Liquidity Risk Business Standard apply to both AIL and AIIDAC.

10.43 Following the Scheme, I understand from AIL that there will be no change to its approach to managing liquidity risk. Remaining policyholders will therefore retain a similar level of security against liquidity risk following the Scheme as they did prior to the Scheme.

10.44 I also understand from AIL that, following the Scheme, the Aviva Group will require AIIDAC to attest to compliance with its Liquidity Risk Policy and Liquidity Risk Business Standard. Therefore, the approach to managing the liquidity risk associated with the Transferring Portfolio will be unchanged following the Scheme.

10.45 In addition, I have been informed by AIL that the AIIDAC-AIL Quota Share arrangement will contain provisions for regular cash settlements between AIL and AIIDAC, which are designed to ensure that AIIDAC's liquidity risk remains within appetite. In addition, as AIIDAC's reinsurer, AIL has informed me that it will provide its forecasted and actual capital and liquidity positions to AIIDAC on a monthly basis to assist AIIDAC in managing its liquidity risk.

10.46 Following the AIIDAC-AIL Quota Share, AIL's post Scheme liabilities will be similar to its liabilities before the Scheme although reduced in line with AIIDAC's retention. As a result, AIL will retain a slightly lower proportion of the Transferring Portfolio's liquidity risk. Given this, it is my opinion that AIL's liquidity risk following the Scheme will not be materially affected by the AIIDAC-AIL Quota Share arrangement.

10.47 As a result, I do not anticipate that the Scheme will create any adverse impact in respect of liquidity to the policyholders transferring to AIIDAC or to the policyholders remaining with AIL.

### **Tax implications**

10.48 AIL and AIIDAC have informed me that they do not believe there are likely to be any material tax implications as a result of the Scheme. AIL and AIIDAC have received advice from their internal tax subject matter experts on this, and they have provided me with copies of this advice.

10.49 I have taken advice from the tax experts at Grant Thornton who specialise in the insurance sector. They have reviewed the information provided to me and do not believe there to be any material tax implications that affect the Scheme.

### **Pension arrangements**

10.50 I have been informed by AIL and AIIDAC that there will be no material change to staff pension schemes as a result of the Scheme.

10.51 As mentioned in paragraph 5.37, the employees that service AIL's Ireland GI branch are employed by AGSIL and are assigned to AIL to perform roles and activities in respect of the Ireland GI branch. Following the Scheme, AIL and AIIDAC do not anticipate any material change to AGSIL. The AGSIL employees that currently service AIL's Ireland GI branch will be assigned to AIIDAC to perform the same roles. Therefore, there will be no change to the staff pension schemes as a result of the Scheme and as a result, I would not expect there to be a material impact on the combined expenditure of AIL and AIIDAC on staff pension schemes as a result of the Scheme. Each will merely bear its share of the costs.

10.52 Therefore, my opinion is that I do not expect either group of policyholders to be materially adversely affected in relation to pension arrangements as a result of the Scheme.

### **Impact on existing reinsurers**

10.53 Following the Scheme, AIL and AIIDAC will continue to participate in the Aviva Group's reinsurance programme and will retain the same reinsurers that currently provide reinsurance cover to AIL.

10.54 AIL's external reinsurance programmes, i.e. reinsurance provided by reinsurers that are not part of the Aviva Group, comprises of four main programmes covering:

- Property claims arising from catastrophe events
- Annual aggregate catastrophes property claims
- Individual large property claims
- Individual large motor and liability claims

10.55 AIL and AIIDAC have also informed me that no changes are envisaged to the gross businesses reinsured under the external reinsurance programme following the Scheme. In particular, AIL and AIIDAC intend to continue to participate in AIL's existing external reinsurance programme on broadly the same terms. It follows that the risk exposures of the external reinsurers involved in the external reinsurance programmes are not expected to change as a result of the Scheme. As a result, I am comfortable that the Scheme will not materially impact any of AIL's external reinsurers on its current reinsurance programme.

10.56 I have reviewed AIL's and AIIDAC's Petition to the Court of Session in Scotland which includes the AIIDAC-AIL Quota Share as a part of the Scheme. As a result, the Scheme will not be able to proceed without the AIIDAC-AIL Quota Share arrangement being in place prior to the Effective Time of the Scheme.

10.57 The terms of the AIIDAC-AIL Quota Share arrangement state that the reinsurance will take effect immediately following the Scheme and will apply to both existing and future business. However, the AIIDAC-AIL Quota Share arrangement will redistribute risk between AIL and AIIDAC and will not therefore affect the risk carried by these entities in aggregate. As a result, the AIIDAC-AIL Quota Share arrangement will not impact reinsurance contracts that cede risk out of AIL and AIIDAC.

10.58 Under the AII reinsurance mixer (described in paragraph 7.10), AIL currently reinsures 50% of its insurance business to AII on a Quota Share basis. Following the Scheme, a small proportion of the risk associated with the Transferring Portfolio will be retained by AIIDAC. Since AIIDAC will not be directly covered by the AII reinsurance mixer, AII

will have a reduced reinsurance premium and correspondingly reduced exposure to the risks within the Transferring Portfolio.

10.59 AIIDAC will not commence underwriting prior to the Scheme and therefore will not have any existing or historical reinsurance protections.

10.60 As a result, my opinion is that the Scheme will have no material adverse impact on AIL's or AIIDAC's current or historic reinsurers.

### **Impact of new business strategy**

10.61 In relation to policyholders that remain in AIL following the Scheme, I understand from AIL that its new business strategy will not change as a result of the Scheme.

10.62 In addition, I understand from AIIDAC that, following the Scheme, AIIDAC's new business strategy, and implementation thereof, will be consistent with AIL's new business strategy in respect of the Transferring Portfolio prior to the Scheme. More specifically, I understand from AIIDAC that its new business strategy will be to continue writing business in the classes that AIL currently writes. I further understand from AIIDAC that there is no intention for it to write business in new classes. In addition, I understand from AIIDAC that there are no plans to change the underwriting strategy, policyholder mix or the risk profile of the business in comparison to the Transferring Portfolio.

10.63 As a result, I do not believe that the Scheme will impact the security of the transferring or remaining policyholders' contractual rights as a result of changes in new business strategy. Also, I do not believe that the Scheme will impact the level of service provided to the transferring or remaining policyholders as a result of changes in new business strategy.

### **Impact on existing guarantees**

10.64 In response to Solvency II regulations, the Aviva Group removed its intra group guarantees in respect of policyholder liabilities in 2011. I understand from AIL that it does not currently hold any guarantees that impact on the policyholders of the Remaining Portfolio or the Transferring Portfolio. As a result, there are no existing guarantees that will be impacted by the Scheme.

## 11 Other non-financial considerations

11.1 In this section, I discuss the following items in turn:

- EEA business remaining with AIL following the Scheme
- Changes in regulatory jurisdiction
- Claims handling
- Policy servicing
- Complaints
- 'Brexit'
- Management and governance frameworks
- Should the Scheme not become effective
- Should the application for the AIIDAC UK Branch to convert to a third country branch following Brexit not be successful
- Policyholder notifications
- Reinsurer notifications

### **EEA business remaining with AIL following the Scheme**

11.2 As mentioned in paragraphs 2.3 to 2.8, certain policies written on a FOS basis will remain with AIL following the Scheme. The policies with EEA risks that are not included in the Scheme fall under one of the following categories:

- Inwards reinsurance business other than French construction inwards reinsurance risks
- Policies from portfolios of insurance business in respect of EEA risks that are in run-off and where AIL's reserving experts have concluded that no further claims are expected
- Policies written by AIL on a FOS basis which will either have expired shortly before Brexit or where the continued periods of cover are for a very short time following Brexit, and, in either case, where all resulting claims are expected to have been notified within a relatively short period following Brexit
- EEA risks from certain global policies where it is not possible to separate out the EEA elements from the UK or wider global elements.

11.3 Generally speaking, AIL has not included inwards reinsurance in the scope of the Scheme, as AIL expects to be able to continue providing reinsurance to EEA insurers following Brexit. Based on my knowledge and experience, I agree with this assessment and therefore I agree that there is no need to include these policies in the Scheme as the reinsurance policyholders will not be disadvantaged by not being part of the Scheme.

11.4 In respect of the portfolios with EEA risks where AIL's reserving experts have concluded that no further claims are expected, there remains a remote but non-zero probability that claims may arise under these policies after the date of Brexit. However, I understand from AIL that these policies have been excluded from the scope of the Scheme as the cost and complexity of transferring them would be disproportionate to the likelihood of claims being reported under these policies following Brexit.

- 11.5 In respect of portfolios which will either have expired shortly before Brexit or where the remaining period of unexpired cover following Brexit will be very short and where, in either case, all resulting claims are expected to have been notified within a relatively short period following Brexit, AIL has informed me that it will cease to write or renew policies from 1 June 2018 and that it expects that there will be 10 or fewer unexpired policies with EEA risks remaining by the Effective Time of the Scheme. There will remain a non-zero probability that claims may arise from the both the expired and unexpired policies in these portfolios after the date of Brexit. However I understand from AIL that these policies have been excluded from the scope of the Scheme as the cost and complexity of transferring these policies would be disproportionate to the magnitude of claims likely to arise under them.
- 11.6 On 19 March 2018, the EU and UK published a draft agreement on the withdrawal of the UK from the EU. Under the terms of this agreement, it is proposed that there will be a Brexit implementation period from 29 March 2019 to 31 December 2020. During this implementation period, it is expected that passporting rights for insurers will continue to apply as they do prior to Brexit. Assuming that the implementation period does come into effect, and that passporting rights continue to apply during this period, this will further reduce the likelihood there being open or unreported claims remaining on the policies discussed in paragraphs 11.4 and 11.5 following the date when AIL loses its passporting rights.
- 11.7 In respect of the EEA covers on global policies where it is not possible to split out the EEA elements, I understand from AIL that the total outstanding claims reserves relating to claims in the EEA are less than \$200,000 which is not material in comparison to the scope of this Scheme. Due to low materiality of these liabilities and the complexity involved in splitting these liabilities between the EEA and non EEA components, AIL has decided to exclude this pool from the Scheme.
- 11.8 I have been informed by AIL that it intends to continue to honour its legal obligations on all of the policies described in paragraphs 11.2 to 11.7 following the Scheme in all circumstances.
- 11.9 Also, in the event that AIL loses its passporting rights following the UK's departure from the EU, it is my opinion based on my experience and discussions with market participants, that it is unlikely that courts and financial regulators in the UK and/or the EEA would prevent AIL from paying valid claims as a result of this.
- 11.10 For the reasons outlined in paragraphs 11.3, 11.8 and 11.9, above, I am comfortable that excluding the policies described in paragraphs 11.2 to 11.7 above from the Scheme will not result in a material detriment to these policyholders.
- 11.11 Despite my comment in paragraph 11.9, there remains a possibility that AIL could be subject to a regulatory censure as a result of paying claims to policyholders in the EEA, where it is no longer authorised to service insurance business. Such censure may include fines, and should fines be issued, this would reduce the capital available to the remaining policyholders. However, as discussed in paragraphs 9.13 to 9.19, AIL will have a substantial surplus of own funds in comparison to its SCR following the Scheme. As a result, in my opinion, the likelihood of the regulatory fine or fines being of such a magnitude as to have a material adverse impact on the security of the remaining policyholders is remote.

11.12 Given this, I am comfortable that excluding the policies described in paragraphs 11.2 to 11.7 above from the Scheme will not result in a material detriment to the remaining policyholders.

### **Impact of changes in regulatory jurisdiction**

11.13 For the Transferring Portfolio, the prudential regulation will move to the CBI from the PRA. The impact of this change in terms of policyholder security will be immaterial as both regulators are required to operate in line with Solvency II, the common prudential regulatory framework across the EU. At the Effective Time of the Scheme, Solvency II regulations are still expected to apply to UK insurers as UK will still be within the EU. The UK will have the ability to change its local regulations following Brexit, however I believe that it is highly unlikely that UK regulations will be changed to be materially weaker than Solvency II.

11.14 From a conduct perspective, the Transferring Portfolio is regulated by a combination of the FCA (in the capacity of the home state regulator), the CBI and various other EEA regulators corresponding to the EEA states in which the risks are located and the EEA states in which the policies have been sold. Following the Scheme, the FCA will be replaced by the CBI as the home state regulator in respect of the Transferring Portfolio. As the CBI has mature and established conduct regulatory frameworks, I do not expect the change in the home state regulator to have a material detrimental impact on the transferring policyholders.

11.15 Following the Scheme, both the FCA and the CBI will continue to be involved in the conduct regulation of the business within the Transferring Portfolio that is allocated to the AIIDAC UK Branch. However, the precise roles undertaken by the two regulators will change. Since both the FCA and the CBI have mature and established conduct regulatory frameworks, I do not expect the change in roles of the two regulators to have a material detrimental impact on this group of policyholders.

11.16 Also following the Scheme, the FCA will no longer be involved in the conduct regulation of the business within the Transferring Portfolio that is not allocated to the AIIDAC UK Branch, with its role being taken over by the CBI. Since the CBI has mature and established conduct regulatory frameworks, I do not expect this change to have a material detrimental impact on the affected group of policyholders.

11.17 For the policies written in EEA countries other than Ireland, there will be no change in the supervision provided by the regulator in that country following the Scheme.

11.18 For the Remaining Portfolio, regulation is currently provided by the PRA and FCA and will remain so following the Scheme.

11.19 Therefore, my opinion is that I do not expect either group of policyholders to be materially adversely affected in relation to regulatory jurisdiction as a result of the Scheme.

### **Claims handling**

11.20 Prior to the Scheme, AIL is responsible for the claims handling activities in respect of the Transferring Portfolio. Following the Scheme, AIIDAC will be responsible for the claims handling of the Transferring Portfolio.

11.21 However, I understand from AIL and AIIDAC that there are not expected to be any changes in the claims handling procedures for the transferring policyholders as a result of

the Scheme. In particular, I have been informed by AIL and AIIDAC that the claims settlement philosophy will not change following the Scheme. In addition, I have been informed by AIL and AIIDAC that, when a claim is reported, there will be no changes to the customer journey (including processes, contact numbers and so on) for any element of the Transferring Portfolio.

11.22 The claims handling for the Remaining Portfolio will not change following the Scheme.

11.23 Therefore, I do not anticipate that any changes to the claims handling provided following the Scheme will have a material adverse impact on either group of policyholders.

### **Policy servicing**

11.24 Prior to the Scheme, AIL is responsible for the policy servicing activities. Following the Scheme, the responsibility for policy servicing the Transferring Portfolio will transfer to AIIDAC. There will be no changes in the policy servicing of the remaining policyholders.

11.25 Policy servicing activities on the Transferring Portfolio are currently carried out as follows:

- In relation to policyholders that have been written by AIL through what is currently the Irish Branch, all policy administration is currently undertaken in the Republic of Ireland.
- In relation to MDI business, MDI is operated through Binding Authorities in the UK and several other EEA countries and the binding authority holders undertake the policy administration services for these policies
- In relation to Other FOS business, policy administration is undertaken by AIL

11.26 Following the Scheme, the policy servicing for the Transferring Portfolio will be the responsibility of AIIDAC. For those elements of the Transferring Portfolio that are allocated to AIIDAC's UK Branch, AIIDAC will use staff supervised and managed by itself in both the UK and Ireland, as operationally optimal. These staff will be sourced, as are all staff in UK and Ireland from employment companies in each country, but managed and supervised through the management structure cascaded from the AIIDAC board.

11.27 No changes are expected in respect of who undertakes policy servicing as a result of the Scheme, for either the elements of the Transferring Portfolio that are not allocated to the AIIDAC UK Branch, or to the Remaining Portfolio.

11.28 I have been informed by AIL and AIIDAC that there will not be any material changes to the policy servicing processes following the Scheme. I have also been informed that both AIL's and AIIDAC's policy servicing practices will continue to be subject to the Aviva Group's policies, in particular the Aviva Group's requirements to ensure that customers are treated fairly and that the customer experience is adequately considered.

11.29 Therefore, I do not anticipate that any changes to the policy servicing provided following the Scheme will have a material adverse impact on either group of policyholders.

## Complaints

11.30 At present eligible claimants from AIL's Ireland GI Branch can refer any complaint not dealt with satisfactorily by AIL to the FSPO in Ireland, where these policyholders meet the FSPO's eligibility criteria as described in paragraph 11.36. All policyholders within the Transferring Portfolio other than those from the Ireland GI Branch can refer their complaints to FOSUK in the UK where these policyholders meet the FOSUK's eligibility criteria as described in paragraph 11.31.

11.31 FOSUK is a free service for consumers that provides an out-of-court adjudication service for consumer complaints. FOSUK is able to make decisions that are binding on the insurer in relation to the complaints it considers; these decisions can include redress and remediation.

11.32 Similarly to FOSUK, FSPO is a free service for consumers that provides an out-of-court adjudication service for consumer complaints. FSPO is able to make decisions that are binding on the insurer in relation to the complaints it considers, these decisions can include redress and remediation.

11.33 Eligible claimants for the FOSUK in the UK are defined to be:

- Consumers, which for these purposes means natural persons acting for purposes outside their trade, business or profession;
- Micro-enterprises, which means any enterprise (being a person, irrespective of legal form, engaged in an economic activity) which employs fewer than 10 persons and has a turnover or annual balance sheet that does not exceed €2 million;
- Charities which have an annual income of less than £1 million; and
- Trustees of a trust which has a net asset value of less than £1 million.

11.34 Personal lines policyholders and some commercial lines policyholders (those falling into the micro-enterprises category) of the Transferring Portfolio are eligible to refer complaints to the FOSUK in the UK.

11.35 To be eligible claimants for the FSPO in Ireland, the policyholder must be a policyholder with an Irish authorised insurer or an EEA authorised insurer who is permitted to carry on business in Ireland on a passported basis.

11.36 Eligible claimants, subject to limitations on turnover, for the FSPO in Ireland are defined to be:

- Private individuals;
- Limited companies;
- Sole traders;
- Trusts;
- Clubs;
- Charities; and
- Partnerships.

11.37 In addition to FOSUK and FSPO, policyholders may also be able to refer complaints to their nearest ombudsman instead, as long as it is a member of FIN-NET. In this instance, the nearest ombudsman is the one that covers insurance business in the country where the policyholder is a resident.

- 11.38 FIN-NET was set up by the European Commission in 2001 to promote cooperation among national ombudsmen in financial services and provide consumers with easy access to alternative dispute resolution procedures in cross-border disputes regarding the provision of financial services. FIN-NET is a network of national organisations responsible for settling consumers' complaints in the area of financial services out of court. The network covers all EEA countries.
- 11.39 Should the Scheme become effective, business within the Transferring Portfolio that is allocated to the AIIDAC UK Branch will continue to be able to refer complaints to FOSUK. However, transferring policies that are not allocated to the AIIDAC UK Branch will lose the ability to refer complaints to the FOSUK in the UK, except in the case that the complaint relates to the acts or omissions of AIL prior to the Scheme. Instead, all policyholders in Ireland will be able to refer complaints to the FSPO subject to policyholders meeting the FSPO's eligibility requirements summarised in paragraphs 11.35 and 11.36 above.
- 11.40 I understand from AIL that AIL has reviewed the policies in Ireland and has not identified any policyholders that meet FOSUK's eligibility criteria but do not meet FSPO's eligibility criteria. As a result, I do not believe the loss of access to FOSUK will have a material adverse impact on these policyholders as these policyholders will have access to the FSPO which also offers a free service and is an equivalent ombudsman in terms of scope and authority to issue binding decisions.
- 11.41 For the transferring policies that are not in Ireland or the UK, these policyholders will be able to refer their complaints to their nearest ombudsman who will be able to assess the complaint. I do not believe the loss of access to FOSUK will have a material adverse impact on these policyholders as these policyholders will have access to the ombudsman services of their home country where the relevant home countries are Belgium, France, Germany, Netherlands, Portugal, Spain and Sweden. All of these countries are members of FIN-NET and have an ombudsman that offers a free service and is an equivalent to FOSUK in terms of scope and authority to issue binding decisions.
- 11.42 The Scheme will not change remaining policyholders' access to complaints handling services. The remaining policyholders that meet FOSUK's eligibility criteria will retain access to FOSUK following the Scheme.
- 11.43 I therefore conclude that the Scheme will not create any material adverse impact to the transferring or remaining policyholders' access to adequate complaints handling procedures.

### **'Brexit'**

- 11.44 As discussed in paragraph 6.29, the UK voted to leave the EU on 23 June 2016. On 29 March 2017, the UK officially notified the European Commission of its intention to withdraw from the EU. It will take some time for the full implications of this decision to become clear. Nevertheless, it has introduced or exacerbated a number of risks for insurers in the UK that have policyholders based in other EEA countries. Some areas of potential concern are the loss of business passporting rights, exchange rate volatility and a changing regulatory environment.
- 11.45 Despite these risks to the insurance market as a whole, I do not believe that changes in the insurance market or the UK regulatory environment resulting from the outcome of the EU referendum will affect my conclusions contained in this report.

11.46 My reasons for this are:

- The transferring policyholders are transferring to an entity registered, authorised and regulated in Ireland, which will remain in the EU after Brexit. AIIDAC will be able to provide insurance cover for the transferring policyholders in Ireland and other EEA countries, even if the UK leaves the EU with no deal in place on passporting rights. Uncertainty regarding whether or not their policy provider has business passporting rights will, therefore, be removed for the transferring policyholders as a result of the Scheme.
- Claim payments are mainly settled in Euros for the Transferring Portfolio. Therefore, exchange rate volatility will be reduced for the Transferring Portfolio as a result of the Scheme, as AIIDAC will report in Euros, whilst AIL will continue to report in GBP.
- AIIDAC will continue to be subject to Solvency II, as discussed in paragraph 11.13.
- A sub-group of Transferring policyholders will be disadvantaged in respect of consumer protection as a result of the Scheme as discussed in paragraphs 10.31 to 10.41. However, in comparison, the impact on the affected policyholders from not transferring is in my opinion more detrimental due to the uncertainty regarding whether AIL will be permitted to continue to service the policies following UK's departure from the EU.
- Uncertainty will increase for the transferring policyholders in respect of eligibility to refer complaints to the FOSUK as discussed in paragraphs 11.30 to 11.40. However, for Transferring Policies that meet the FSPO's eligibility criteria, there will not be a material adverse impact on these policyholders.
- There will be no change with respect to the remaining policyholders of AIL. The impact of the UK's decision to leave the EU will be the same regardless of whether the Scheme proceeds or not.

11.47 I will comment on any further Brexit developments in my Supplementary Report.

## **Governance and management framework**

### **Aviva plc's Governance framework**

11.48 AIL and AIIDAC are fully owned subsidiaries Aviva plc. Given that Aviva plc is the ultimate owner of both of these entities, Aviva plc's Board of Directors have the authority to provide oversight over both AIL and AIIDAC's activities.

11.49 Aviva plc's Board of Directors and Board Committees will not change as a result of the Scheme. Given the continuity of the ultimate parent company's Board of Directors and Board Committees, the oversight provided by Aviva plc's Governance Framework to the Transferring Portfolio and Remaining Portfolio will remain consistent following the Scheme.

### **AIL's Governance and management framework**

11.50 AIL's Board of Directors is comprised of three Executive Directors, five independent Non-Executive Directors and one other Non-Executive Director. All three Executive Directors, along with the Non-Executive Director, sit on the boards of a number of other entities within the Aviva Group. The five independent Non-Executive Directors sit on AIL's Board exclusively.

11.51 AIL's governance committee structure comprises of the following Board sub-committees:

- Risk Committee
- Audit Committee
- Nomination Committee
- Operational Risk Committee
- Conduct Committee
- General Insurance Assets Liability Committee
- General Insurance Reserving Committee
- General Insurance Investment & Pricing Committee.

11.52 AIL's senior management team includes a number of Senior Management Function holders who have received regulatory pre-approval for these appointments from the PRA and FCA. AIL has informed me that its senior management team, Board of Directors and Board Committees will not change as a result of the Scheme.

11.53 I have reviewed the management and governance framework of AIL and, in my opinion, it is proportionate to the size and complexity of AIL's business. I have not identified any material adverse impacts to the remaining policyholders as a result of the Scheme in relation to the management and governance framework.

#### **AIIDAC's Governance and management framework**

11.54 The Aviva Group has acquired a life insurance company in Ireland, Friends First Life Assurance Company DAC ("LifeCo").

11.55 The Board of Directors of AIIDAC and LifeCo will be appointed separately. The current Chief Executive Officer for the Aviva Group's operations in Ireland will oversee the operations of the two entities and will be an executive director on AIIDAC's Board of Directors. The Chief Executive Officer will also be supported by one other executive Board member, three independent Non-Executive Directors and three other Non-Executive Directors.

11.56 AIIDAC has informed me that the proposed new governance structure will be underpinned by the following core guiding principles:

- There is sufficient independence and challenge at the Board level
- There is no one person with unfettered powers of decision
- AIIDAC and LifeCo operate independently from each other with effective governance and decision making
- The proposed governance structure complies with the Aviva Group's Corporate Governance Code and Solvency II requirements
- The individuals in the Executive and Senior Management roles have sufficient capacity, skills and experience to perform their roles
- Any conflicts of interest (actual and perceived) between the AIIDAC, LifeCo and the Aviva Group are managed effectively
- There is sufficient oversight from the Aviva Group.

11.57 AIIDAC's proposed governance committee structure comprises of the following Board committees and management committees:

- Risk Committee
- Audit Committee
- Nomination Committee

- Remuneration Committee
- Operational Risk Committee
- General Insurance Assets Liability Committee
- General Insurance Reserving Committee
- General Insurance Reinsurance Committee
- General Insurance Committee
- Strategic Change Committee
- Investment Committee
- Conduct Committee
- Customer Forum.

I note that the first nine committees listed above are AIIDAC committees but that the last four are joint committees between AIIDAC and LifeCo.

11.58 I have reviewed the proposed terms of reference for AIIDAC's key governance committees and the role descriptions for the key executive roles within AIIDAC's governance structure and I am satisfied that these are appropriate for the size and complexity of AIIDAC's business following the Scheme.

11.59 I understand from AIIDAC that AIIDAC and LifeCo will have separate management teams, each lead by a General Manager. The Chief Executive Officer of Aviva's operations in Ireland will also be appointed as AIIDAC's General Manager.

11.60 The General Managers and their immediate direct reports will be Pre-Approved Control Function ("PCF") role holders requiring CBI pre approval before appointment. The General Managers will have direct and unfettered access to the Board of their respective entities and will be on the Board.

11.61 AIIDAC's proposed senior management team comprises of the following roles:

- General Manager
- Head of Risk
- Head of Underwriting (Individual)
- Head of Underwriting (Corporate)
- Head of Claims
- Head of Investment
- Head of Finance
- Head of Actuarial Function
- Head of Pricing
- Head of Compliance
- Head of IT
- Head of Broker Relations.

11.62 I have reviewed the experience of AIIDAC's proposed senior management team members above and I am satisfied that the proposed individuals have the necessary experience for their proposed roles.

11.63 In summary, I have reviewed the management and governance framework of AIIDAC and, in my opinion, it is proportionate to the size and complexity of AIIDAC's business. Consequently, I have not identified any material adverse impacts to the transferring

policyholders as a result of the Scheme in relation to the management and governance framework.

### **Should the Scheme not become effective**

- 11.64 I have considered the likely effects on the transferring policyholders of AIIDAC and the remaining policyholders of AIL should the Scheme not become effective.
- 11.65 If the Scheme were not to become effective, there would be significant uncertainty regarding the effect of Brexit on the Transferring Portfolio. It is currently unclear whether AIL will retain its passporting rights when the UK leaves the EU. This would mean that AIL could be in a position where it is no longer authorised to underwrite Freedom of Establishment or Freedom of Services business in other EEA countries, including Ireland. I have been informed by AIL that, in the event that the Scheme is not able to become effective before UK's departure from the EU, the contingency plan is for AIL to continue to service the Transferring Portfolio within AIL until the policyholders renew, and write new business and renewed policies into AIIDAC. However, given the uncertainty around passporting rights following Brexit, it is not known at present whether AIL would have the necessary permissions to service these policies following UK's departure from the EU.
- 11.66 As a result, my opinion is that the policyholders associated with the Transferring Portfolio are likely to be worse off should the Scheme not proceed, as a result of the uncertainty of AIL retaining passporting rights following Brexit.
- 11.67 If the Scheme were not to become effective, there would be no impact on the remaining policyholders of AIL compared to the current position.

### **Should the application for the AIIDAC UK Branch to convert to a third country branch following Brexit not be successful**

- 11.68 Following Brexit, AIIDAC will be required to apply for the AIIDAC UK Branch to convert to a third country branch in the UK.
- 11.69 In the scenario that this application is not successful, the Transferring Policyholders that are allocated to the AIIDAC UK Branch will have to be reallocated to the Irish entity. Such policyholders will be impacted in respect of regulatory jurisdiction, consumer compensation and complaints handling.
- 11.70 In this situation, the transferring policyholders that were allocated to the AIIDAC UK Branch (and would, as a result, have been subject to a combination of the FCA's conduct rules, and the CBI's conduct rules) will instead be subject solely to the CBI conduct rules. However, as the CBI has mature and established conduct regulatory frameworks, I do not expect this change to have a material detrimental impact on these policyholders.
- 11.71 Also, in the event that the application for a third country branch is not approved, the transferring policyholders that were allocated to the AIIDAC UK Branch (and would, as a result, have had access to the FSCS) would no longer have access to the FSCS and may, therefore, be disadvantaged as a result.
- 11.72 I note that, in this situation, these policyholders will be in the same position following the Scheme as the policyholders that will not be allocated to the AIIDAC UK Branch. In paragraphs 10.36 to 10.41, I discuss my analysis of the loss of FSCS protection for the policyholders not allocated to the AIIDAC UK Branch and conclude that, given the

remoteness of the scenario where compensation is required by these policyholders, I believe the actual detriment to the policyholders from losing access to the FSCS to be less material than the potential impact to these policyholders should the Scheme not go ahead. The same arguments and conclusion hold for any policyholders who may lose access to FSCS compensation as a result of AIIDAC's third country branch not being authorised.

11.73 Also, in the event that AIIDAC's third country branch is not approved, the transferring policyholders that were allocated to the AIIDAC UK Branch (and would, as a result, have been able to refer complaints to the FOSUK) would no longer be able to refer complaints to the FOSUK (except in the case that the complaint relates to the acts or omissions of AIL prior to the Scheme) and may, therefore, be disadvantaged as a result.

11.74 I note that, in this situation, these policyholders will be in the same position following the Scheme as the policyholders that will not be allocated to the AIIDAC UK Branch. In paragraphs 11.39 to 11.43, I discuss my analysis of the loss of access to the FOSUK complaints scheme for the policyholders not allocated to the AIIDAC UK Branch and conclude that this will not create any material adverse impact to these policyholders. The same arguments and conclusion hold for any policyholders who may lose access to the FOSUK complaints scheme as a result of AIIDAC's third country branch application not being approved.

11.75 It follows from the above that I am comfortable that, should the AIIDAC's third country branch application not be successful, any adverse impact to the policyholders that were allocated to the AIIDAC UK Branch will be less material than the potential adverse impact to these policyholders should the Scheme not go ahead.

### **Policyholder notifications**

11.76 The regulations surrounding Part VII transfers require that, unless the Court orders otherwise, all policyholders in all affected companies should be written to in order to inform them of the Scheme. The affected companies may apply for waivers considering, among other things, the likely benefits of contacting the policyholders compared with the practicality and costs of doing so.

11.77 Below I discuss the proposed communication strategy of AIL and AIIDAC including the waivers they have informed me that they plan to request at the first Court hearing.

11.78 Prior to requesting the various waivers discussed below at the first Court hearing, AIL has informed me that it will be seeking confirmation from the PRA and FCA that they have no objections to these waivers.

### **Transferring policyholders**

#### **Ireland GI branch business**

11.79 With respect to policyholders of the Ireland GI branch business, I understand from AIL that it intends to notify all policyholders where the policy is still in effect on 15 August 2018 ("the Cut-off Date") and any further policyholders with an open claim on this date. This includes both direct policyholders and policyholders intermediated by either a broker or another sales intermediary such as a retailer. I refer to the latter intermediaries as "sales partners".

11.80 For those policyholders intermediated by AIL's sales partners, AIL has agreed with partners that AIL will mail the policyholders on their behalf.

11.81 The Transferring Portfolio includes policies where the beneficiary of the policy is a party other than the policyholder. The beneficiaries for these policies are typically banks. In these cases, AIL intends to notify the beneficiary of the Scheme, as well as the direct policyholder.

11.82 I believe that the above approach to notifying policyholders of the Ireland GI Branch to be reasonable.

#### **MDI business**

11.83 This business is administered by a number of binding authorities and, as such, AIL does not hold individual policyholder records for these policies. I understand from AIL that it intends to provide communication content to the binding authorities so that they can notify policyholders directly. The communications will be provided in respect of all policyholders with policies in effect on the Cut-off Date and any further policyholders with an open claim as at this date.

11.84 I believe this approach to be reasonable.

#### **Other FOS business**

11.85 The majority of this business is intermediated by a broker or an AIL sales partner. I understand from AIL that, for such policies, it intends to provide communication content so that the relevant intermediary can notify policyholders directly.

11.86 I understand that for this business the intention is for AIL to notify all policyholders with policies in effect on the Cut-off Date and any further policyholders with an open claim as at this date.

11.87 In my view, this approach is reasonable.

#### **Transferring policies that have expired and are without an open claim**

11.88 I understand from AIL that it is seeking a waiver from the requirement to notify transferring policyholders where the transferring policy expired prior to the Cut-off Date and where there is no open claim in respect of the policy. The Scheme's Effective Time is five-and-a-half months after the Cut-off Date, therefore these policies would have been expired for a period of five-and-a-half months or more by the Effective Time of the Scheme.

11.89 In respect of MDI business, I understand from AIL that the likelihood of claims arising on expired policies is remote and that claims from these policies are generally reported prior to the expiry of the policy or shortly thereafter. AIL believes that given the short reporting delay in respect of MDI claims, it is unlikely that a material number of new claims from MDI policies that expired prior to the Cut-off Date will be reported following the Scheme. I agree with this conclusion. AIL also believes that, given the number of policies within this cohort, the cost of notifying these policyholders would be disproportionate to the expected number of new claims reported following the cut-off date. I agree with this conclusion.

11.90 In respect of business other than MDI business, I understand from AIL that a substantial majority of the claims arising from expired policies within the transferring portfolio are expected to be reported to AIL before five-and-a-half months after the expiry date. The number of new claims reported on these policies after the Effective Time of the Scheme is therefore expected to be low. In particular, the number of new

reported claims is expected to be very low in proportion to the total number of policies that expired prior to the Cut-off Date.

- 11.91 In order to demonstrate this AIL has estimated the number of new claims that will arise in each class of policies that expired one, two and three years prior to the Cut-off Date, and the costs of notifying the policyholders of those policies. AIL's analysis concludes that the cost of notifying these policyholders is disproportionate to the number of new claims that are expected to be reported on these policies. For example, the largest cohort considered in AIL's analysis is in respect of personal motor insurance policies written through AIL's Ireland GI Branch. AIL estimates that there will be 303,624 policies that expired in the three year period prior to the Cut-off Date. AIL also estimates that only 151 claims are expected to be reported on these policies following the Scheme. AIL estimates that the cost of notifying all of the policyholders in this cohort would be £613,548. AIL has concluded that this is a disproportionate cost for notifying 151 potential claimants.
- 11.92 More generally, AIL estimates that there will be 492 expired UK FOS and 528,006 expired Ireland GI Branch policies from the three year period prior to the Cut-off Date. AIL estimates that there will be 38 and 585 new reported claims respectively from these policies following the Scheme. AIL's estimates that the costs for notifying these policyholder cohorts will be £24,084 and £1,093,812 respectively. AIL has concluded that this is a disproportionate cost in comparison to the number of expected claimants.
- 11.93 In order to gain comfort with AIL's analysis and the conclusions drawn thereof, I have held discussions with the relevant personnel at AIL to understand the methodology and key assumptions underlying this analysis. I have also reviewed the results of AIL's analysis in detail for each individual class of transferring policyholders.
- 11.94 Based on these discussions and my review of the results of AIL's analysis, I agree that the estimated cost for notifying these policyholder cohorts is very high in comparison to the expected number of new claims that will be reported following the Scheme.
- 11.95 AIL has informed me that its claims servicing procedures will be unchanged from both an operational perspective and from the perspective of potential claimants following the Scheme. In particular, I understand from AIL that, when a claim is reported, there will be no changes to the customer journey (including processes, contact numbers and so on) for any element of the Transferring Portfolio.
- 11.96 As the policies concerned are being transferred between entities within the Aviva Group and the claims handling process will be identical from the claimant's perspective, it is my opinion that the risk of transferring policyholders whose policies expired before the Cut-off Date and who do not have an open claim at the Cut-off Date being disadvantaged by not being notified about the Scheme is remote.
- 11.97 Given the low number of claims expected to emerge from expired policies within the transferring portfolio, the high costs of notifying these cohorts and the fact that the claims handling process will be identical from the claimant's perspective following the Scheme, I believe that it is reasonable and proportionate for AIL to seek the waiver discussed in paragraph 11.88.

**Transferring policies that incept after the notification cut-off date**

- 11.98 AIL has informed me that the policyholder notifications will continue to take place up to eight weeks prior to the Effective Time of the Scheme. Between the Cut-off Date and

this date, new policyholders and claimants not captured by the original list of policyholders and claimants as at 15 August 2018 will also be notified of the Scheme.

11.99 AIL has informed me that subsequent to the notifications above, all further new policyholders will be directed to <https://transfer.aviva.com>, a webpage developed in connection with the Scheme, for further information.

11.100 I believe that AIL's proposed policyholder communication strategy as described in paragraphs 11.98 and 11.99 above is proportionate and reasonable.

## **Waivers**

### **Waivers from the requirement to notify all Transferring Policyholders**

11.101 AIL has informed me that it will apply for four waivers in respect of the Transferring Portfolio. These are summarised in the following paragraphs.

11.102 Firstly, as discussed in paragraphs 11.88 to 11.97, AIL has informed me that it is seeking a waiver from the requirement to notify transferring policyholders where the transferring policy expired prior to the Cut-off Date and where there is no open claim in respect of the policy.

11.103 For the reasons set out in paragraph 11.97, I believe that it is reasonable and proportionate for AIL to seek this waiver.

11.104 In addition, AIL will apply for a waiver in respect of Transferring Policyholders that are intermediated by a sales partner and where, despite it being agreed that the sales partner will notify its policyholders, it fails to do so before the Cut-Off Date. I understand that, in the scenario AIL is made aware of the sales partner's failure to notify any policyholders, and is able to obtain the contact details of the affected policyholders, AIL will notify the policyholders directly. It follows that the waiver will only be used in situations where either Aviva is unaware of a sales partner's failure to notify policyholders, or Aviva is aware of the failure but is unable to obtain the policyholders' contact details.

11.105 My opinion is that it is proportionate and reasonable for AIL to seek this waiver.

11.106 AIL will also apply for a waiver in respect of Transferring Policyholders who are resident in a country which is subject to international sanctions. I have been informed by AIL that this waiver is sought as a precaution as AIL did not write any business in these countries so would expect few, if any, policyholders to be resident in any such country.

11.107 I understand that, as a result of the imposed sanctions, AIL is unable to write to such policyholders, should there be any. Given this, and the fact that I do not expect there to be many policyholders, my opinion is that it is proportionate and reasonable for AIL to seek this waiver.

11.108 In addition, AIL will apply for a waiver in respect of policyholders that have indicated, for reasons that pertain to their personal safety, that they do not wish to be mailed at the address held for them by AIL. Such requests for exclusion from communications would have been advised to AIL through a personal visit, a call or through written correspondence with AIL.

11.109 Given that such policyholders have explicitly asked not to be contacted for reasons that pertain to their personal safety, my opinion is that it is proportionate and reasonable for AIL to seek this waiver.

#### **Waiver from the requirement to notify the Remaining Policyholders**

11.110 AIL is seeking a waiver from the requirement to notify its approximately 15 million policyholders and potential claimants which are not transferring to AIIDAC for the following reasons:

- The Transferring Portfolio is not material in the context of AIL's overall portfolio
- As part of AIL's communication strategy, AIL will be placing two adverts in the UK national press with information about the Scheme.

11.111 My opinion is that it is proportionate and reasonable for AIL to seek this waiver given the materiality of the Scheme in comparison to AIL's existing business.

11.112 I note that, as mentioned in paragraph 5.15, there will be small numbers of policies written on a FOS basis that will not be included in the Transferring Portfolio. These policyholders may come across AIL's advertisements on the Scheme and assume as a result that they will be included in the Scheme. Although these policyholders will be included in the waiver described in paragraph 11.110, to avoid misunderstanding, AIL has informed me that it intends to advise them that the Scheme is taking place, but that their policy will not be included, along with the reason for not including it. In my opinion, it is appropriate to notify these policyholders about the Scheme in this manner.

#### **Waivers in respect of advertisements in the EEA**

11.113 Further to the above, in order to raise the awareness of policyholders with expired policies, as well as unknown potential claimants, AIL is proposing to place advertisements in the following publications:

- the London, Edinburgh and Belfast Gazettes, the Scotsman, and the Iris Oifigiúil (the official gazette of the Government of Ireland)
- the European edition of the Financial Times
- two national newspapers in the Republic of Ireland and UK; and
- Irish trade publications
- two national newspapers in each EEA state where AIL has more than 100 transferring policyholders

11.114 For EEA states in which AIL has fewer than 100 transferring policyholders, AIL is seeking a waiver from the requirement to publish press notifications in two national newspapers on the basis that it would be disproportionate. For these states, I understand that AIL will analyse its business to assess the likelihood of potential future claimants. I understand that AIL intends to place a notification in one publication where there is a reasonable likelihood of potential future claimants.

11.115 I believe that it is reasonable and proportionate for AIL to advertise the Scheme in only one national newspaper in each EEA state where AIL has less than 100 transferring policyholders given the small number of policyholders in these states.

11.116 I also believe that it is reasonable and proportionate for AIL to not advertise the Scheme in EEA states where AIL has fewer than 100 transferring policyholders and where there

is no reasonable likelihood of future claimants, given the small number of policyholders in these states and the low likelihood of the emergence of future claims.

### **Documentation**

11.117 I have reviewed the drafts of the proposed communications materials and in my opinion:

- The material is straightforward, provides sufficient information for the policyholders to understand and details any required actions, where relevant
- It explains to the policyholders their right to object and the ways in which they can exercise this right
- The access to the available documentation and relevant information is clear.

11.118 In addition to the communications discussed above, all of the material related to the Scheme will be published on <https://transfer.aviva.com>, a webpage developed in connection with the Scheme.

### **Opinion**

11.119 Given the size and implications of the Scheme, I believe that the proposed approach to policyholder and claimant notifications is proportionate and reasonable.

### **Reinsurer notifications**

11.120 AIL's reinsurers can be grouped into two distinct categories:

- External reinsurers - the reinsurance programme of the Aviva Group with external reinsurers, as outlined in paragraph 5.33
- Internal reinsurers - the Quota Share reinsurance agreement in place between AIL and AII, as outlined in paragraph 7.11

11.121 I understand from AIL that it intends to contact all of its external and internal reinsurers where the reinsurance contract is impacted by the Scheme prior to Cut-off Date.

11.122 I further understand from AIL that it will seek to amend the external reinsurance contracts where the underlying gross exposures are included in the scope of the Scheme so that, following the Scheme, the reinsurance will cover AIIDAC in addition to covering AIL where necessary.

11.123 I further understand from AIL that, whilst the Scheme will affect the transfer of the reinsurance contracts, it is its intention, prior to the Scheme, to amend all relevant external reinsurance contracts renewing on or after 1 January 2018 and endorse expired reinsurance contracts, if required, as this will help to demonstrate that its reinsurers are in agreement with the Scheme and help to identify any potential issues prior to the Scheme.

11.124 Given the size and implications of the Scheme, I believe that the proposed approach to reinsurer notifications is proportionate and reasonable.

## 12 Reliances and limitations

### **Events following the modelling date**

- 12.1 The conclusions in this report are based on analyses that have been undertaken on data as at different points in time. I have been informed by AIL and AIIDAC that there have been no material changes between the modelling dates and the date of this report. However, future events could occur between the date of this report and the Effective Time that could change my conclusions. I will provide a Supplementary Report prior to the sanction of the Scheme to update the Court on whether there have been any material changes since the issue of this report.

### **Reliance on other parties**

- 12.2 In developing the conclusions in this report, I have relied on the data and accompanying explanations provided to me by and on behalf of AIL and AIIDAC. I have not specifically reviewed the data for accuracy and completeness, but I have reviewed it for reasonableness.
- 12.3 I have carried out investigations, as detailed in this report, to gain comfort on the appropriateness of the methodology, assumptions and conclusions for the most significant liabilities and capital requirements.
- 12.4 For AIL's best estimate claims reserves, technical provisions and capital requirements, I have relied on the calculations and documentation provided to me by AIL and discussions with AIL's key subject matter experts. I believe this is reasonable given the experience and professional qualifications of the authors of reserving and capital documents provided to me by AIL and based on my review of the validation and testing that AIL has completed. The reviews that I have carried out give no indication of any significant deficiency and I believe that appropriate methodologies have been adopted throughout.
- 12.5 For AIIDAC's best estimate claims reserves and technical provisions, I have relied on the calculations and documentation provided to me by AIIDAC. I believe this is reasonable given the experience and professional qualifications of the authors of reserving documents provided to me by AIIDAC and the testing that I have done. I have also discussed the inputs underlying AIIDAC's regulatory capital calculations with AIIDAC's key subject matter experts. The reviews that I have carried out give no indication of any significant deficiency and I believe that appropriate methodologies have been adopted throughout.
- 12.6 I have also relied on correspondence and discussions that I have had with the management teams of AIL and AIIDAC. Where appropriate, I have challenged AIL's or AIIDAC's calculations or position on certain issues in order to gain sufficient insight and comfort before forming my conclusions. Where appropriate, I have also challenged the factual accuracy of matters that appeared inconsistent, confusing or incomplete. Where necessary, I have also sought documentation from AIL and AIIDAC to evidence the assertions made to me in correspondence and discussions, to supplement documentation already received or to obtain additional detailed information.

## **Other**

- 12.7 The underlying figures in this report are calculated to many decimal places. In the presentation of the figures in the various tables, there may be reconciliation differences due to the effect of rounding.
- 12.8 In my judgement, the results and conclusions contained in this report are reasonable given the information made available to me.
- 12.9 However, there is a limitation upon the accuracy of any estimate of claims reserves or capital requirements in that there is an inherent uncertainty in any estimate of future liabilities. This is due to the fact that the claims will be subject to the outcome of events yet to occur, such as judicial decisions, legislative actions, claim consciousness amongst potential claimants, claims management, claim settlement practices, changes in inflation, and economic decisions. As a result, it should be recognised that future claim emergence will likely deviate, perhaps materially, from any estimate of claims reserves. In addition, it should be recognised that the actual capital required will likely deviate, perhaps materially from any estimate of the capital requirements.

## 13 Conclusions

- 13.1 I have considered the Scheme and its likely effects on the transferring policyholders and the policyholders remaining in AIL.
- 13.2 In reaching the conclusions set out below, I have applied the following principles as set out in relevant professional guidance. I have sought to:
- Exercise my judgement in a reasoned and justifiable manner
  - Describe the impact on all classes of beneficiaries (for the purposes of this report, being the transferring policyholders and the policyholders remaining in AIL)
  - Indicate how the Scheme might lead to any changes in the material risks to the benefits of the different classes of beneficiaries
  - Assess the impact on all the classes of beneficiaries
  - Indicate the proposed rationale for the Scheme to proceed
  - Include (in summary) the most material information on which my opinion is based
  - Describe the rationale for my opinion.
- 13.3 I have concluded that there will be some loss of cover for a subgroup of the transferring policyholders with regards to compensation cover. To the extent that the Scheme does create an adverse impact on the transferring policyholders' access to compensation, I have concluded that this will be less detrimental to them than the impact should the Scheme not go ahead.
- 13.4 Other than this, I have concluded that there will be no material change to the service provided to the transferring policyholders and, subject to the intention in paragraph 9.20 being honoured if necessary, no material adverse impact on the security provided to them.
- 13.5 In addition, I have concluded that there will be no material change to the security or service provided to the policyholders remaining in AIL. Therefore, I do not expect that the policyholders remaining in AIL would be materially adversely affected by the Scheme.
- 13.6 In addition, I have concluded that reinsurers of AIL will not be adversely affected by the Scheme.
- 13.7 Prior to the Scheme, AIIDAC will have no reinsurers and as a result the Scheme does not impact any existing reinsurers of AIIDAC.
- 13.8 Given the above, I do not expect any group of policyholders or reinsurers to be materially adversely affected by the Scheme and therefore I see no reason why the Scheme should not proceed.
- 13.9 I confirm that I have made clear which facts and matters referred to in this report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions that I have expressed and conclusions that I have

drawn represent my true and complete professional opinions on the matters to which they refer.

13.10 As required by the rules of Scots law which are, in functional terms, the broad equivalent of Part 35 of the Civil Procedure Rules, I hereby confirm that I understand my duty to the Court, I have complied with that duty and I will continue to comply with that duty.

13.11 I do however consider it necessary that I review the most recent information, up to the date of the Scheme, when this becomes available later in the year, before confirming my conclusions and opinions.

A handwritten signature in black ink, appearing to read 'S. Sheaf', with a horizontal line underneath.

Simon Sheaf FIA, FSAI

Head of General Insurance Actuarial & Risk  
Grant Thornton UK LLP

23 August 2018

## A Information Received

### Information provided by AIL

- Audited report and accounts as at 31 December 2017
- Valuation report as at 31 December 2017
- Valuation report as at 30 June 2017
- Valuation report as at 31 March 2017
- Valuation report as at 31 December 2016
- Valuation report as at 30 September 2016
- Management accounts as at 30 June 2017
- Solvency and Financial Condition Report as at 31 December 2017
- SCR Report as at 31 December 2017
- Solvency II Pillar III Quarterly Quantitative Reporting Templates as at 31 March 2017
- Actuarial Function report as at 30 June 2017
- Capital and Liquidity report plan as at 1 November 2016
- Summary diagrams of Aviva Group's general insurance reinsurance programme
- Liquidity Standard 2018
- Asset Liability Management Standard 2018
- Asset allocation as at 31 December 2017
- Business plan for 2017 to 2019
- Risk opinion on the 2017 – 2019 plan
- Claims handling business standard
- Senior Insurance Management Functions and Controlled Functions as at 31 July 2017
- Structure charts as at 11 August 2017
- Details of business in EEA branches as at January 2018
- Scope of Scheme documentation
- FOS impact based on scope of Scheme
- FOS Market implementation plans
- Monthly Financial Management Information as at June 2017
- Governance proposals as at 20 September 2017
- Large loss listing as at 30 June 2017
- Reinsurance recoveries and collateral as at 31 December 2017
- Claims ratio for the transferring business as at 30 June 2017
- Year-end 2017 Supervisory ORSA report
- Management actions for 2018 to 2020
- Internal Model outputs for Independent Expert based on year-end 2017 published results
- Audit Committee update as at 17 March 2017
- Interim audit update as at 12 December 2016
- Audit findings for the year ended 31 December 2017
- Solvency II audit report for the year ended 31 December 2016
- Reserving assumptions for personal motor, commercial motor and commercial liability for 2017

- Reserve Committee Meeting packs and minutes
- Valuation process timeline
- Peer group assumptions for certain claim types 2017
- Year end 2017 Internal Model Independent Validation report
- Board Training on Solvency II on 24 March 2017
- Reserve Margin analysis as at 31 May 2017
- Solvency II Balance Sheet as at 31 December 2017 prior to and following the Scheme
- IFRS Balance Sheet as at 31 December 2017 prior to and following the Scheme
- Schedule of Solvency II Technical Provisions prior to and following the Scheme
- Schedule of Solvency II SCR prior to and following the Scheme
- Schedule of Solvency II Own Funds prior to and following the Scheme
- Group General Insurance Risk Policy 2017
- Latent claims reserve report as at 31 December 2017
- Risk Margin analysis as at 31 December 2017
- Notification strategy for the Scheme as at February 2018
- Extract from AIL's response to PRA General Insurance Stress Testing exercise 2017
- EEA businesses excluded from scope of Scheme
- General Observation documents detailing AIL's feedback and answers to specific queries raised
- Expired policyholder notification strategy for the Scheme as at April 2018
- Draft communication materials including letters for postal notifications and text to be included on the webpage <https://transfer.aviva.com>

#### **Information provided for AIIDAC**

- Application to the CBI as at June 2017, all appendices and amendments thereafter and correspondences with the CBI
- Standard Formula inputs as at 31 December 2016 assuming that the AIIDAC-AIL Quota Share arrangement is in place
- Standard Formula inputs as at 31 December 2016 assuming that the AIIDAC-AIL Quota Share arrangement is not in place
- Team structure for the Brexit programme as at October 2017
- Governance and management structure proposal as at January 2018
- Interim reserving report as at 30 June 2017
- Solvency II Balance Sheet as at 31 December 2017 prior to and following the Scheme
- IFRS Balance Sheet as at 31 December 2017 prior to and following the Scheme
- Schedule of Solvency II Technical Provisions prior to and following the Scheme
- Schedule of Solvency II SCR prior to and following the Scheme
- Schedule of Solvency II Own Funds prior to and following the Scheme
- Projected gross written premium as at 30 June 2017
- Note on tax implications of Scheme dated February 2018
- FSCS coverage impact assessment as at January 2018
- Standard Formula calculations for various risk modules within the year-end 2016 SCR calculation
- ORSA report as at June 2017, which was prepared as part of the application to the CBI
- Summary of results from calculation of SCR for AIIDAC using on AIL's Partial Internal Model
- Proposed board and management committees and membership
- List of proposed CBI Pre-Approval Controlled Function holders
- Summary of experience for proposed CBI Pre-Approval Controlled Function holders

- Details of the New Business Strategy as at July 2018

**Information provided by AIIDAC's legal advisers**

- Draft Scheme document as at March 2018
- Instructions to Gabriel Moss QC on “the Provision”
- Note of consultation with counsel (Gabriel Moss QC) on ‘the Provision’ held on 1 March 2018
- Draft Petition to the Court of Session in Scotland as at April 2018

**Other**

I have also relied on information arising from correspondence and discussions with AIL, AIIDAC and their legal advisers.

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

A number of the items received are of a commercially sensitive or confidential nature. All relevant information received has been used to inform the conclusions given in this report, whilst taking care to respect the confidentiality of the entities involved. It should be noted that there are no instances where I have omitted implications of this documentation from this report for the sake of respecting confidentiality. Therefore, in my opinion it is not necessary to produce a separate document exclusively for the Court providing further details of these data items although these items can be made available to the Court if required.

## B Definitions

|   |  |
|---|--|
| <b>AIM model</b>                              | The ‘Actuarial Insight Model’, AIL’s internally developed in-house reserving tool.   |
| <b>AIIDAC-AIL Quota Share arrangement</b>     | The proportional reinsurance that will be provided by AIL to AIIDAC following the Scheme.  |
| <b>AIIDAC’s Capital Coverage Target</b>       | The minimum capital coverage which AIIDAC aims to maintain. The calculation of this target is broadly equivalent to the calculation of AIL’s Capital Coverage Target, as described below.  |
| <b>AIL’s Capital Coverage Target</b>          | The minimum capital coverage which AIL aims to maintain, as set out in its ORSA. This is calculated as AIL’s Internal Model SCR plus a 1-in-5 year stress.   |
| <b>AIIDAC’s Standard Formula SCR</b>          | AIIDAC’s capital requirement, as calculated using the Standard Formula.  |
| <b>AIIDAC’s unapproved Internal Model SCR</b> | AIIDAC’s capital requirement, as calculated using AIL’s partial Internal Model.  |
| <b>AIIDAC’s ORSA Capital Requirement</b>      | AIIDAC’s capital requirement calculated on an equivalent basis to AIL’s own view of capital requirements. This is calculated as the sum of AIIDAC’s unapproved Internal Model SCR and its Solvency II Risk Margin.                                 |
| <b>AIIDAC UK Branch</b>                       | The insurance branch that AIIDAC will establish in the UK.   |
| <b>Asset</b>                                  | Generally, any item of property whether tangible or intangible, that has financial or monetary value.  |
| <b>Assignee</b>                               | The proceeds of a policy may be transferred by the holder of the policy to a lender (the assignee) as collateral for a loan.   |
| <b>Available capital</b>                      | Total assets less total liabilities.   |
| <b>Available Own Funds</b>                    | The portion of Own Funds that can be used to meet capital requirements after taking account of any restrictions.   |
| <b>Aviva Group</b>                            | Aviva plc is a public limited company incorporated under the laws of England and Wales, which is the ultimate holding company of a group of companies referred to in this report as “the Aviva Group”.   |
| <b>Binding Authority</b>                      | A Binding Authority is an agreement whereby an insurer delegates underwriting authority to another party known as the Coverholder. The Coverholder is usually an insurance broker or underwriting agent.   |
| <b>Booked reserve</b>                         | The claims reserve shown in the financial statements.  |
| <b>Capital requirements</b>                   | The level of funds that an insurance or reinsurance undertaking is required to hold. This requirement may be stipulated by the regulator or else imposed internally based on the undertaking’s own assessment of the risks to which it is exposed. |

|   |   |
|---|---|
| <b>Chain Ladder Method</b>                  | This reserving method can be applied to both paid and incurred claims data. The method is based upon the assumption that the relative change in a given accident year's paid or incurred claims from one evaluation point to the next is similar to the relative change in prior accident year's paid or incurred claims between the same evaluation points.  |
| <b>Claims reserve</b>                       | Funds held for the payment of future claims.  |
| <b>Counterparty default risk</b>            | The risk that the counterparty of a contract will not fulfil its contractual obligations.   |
| <b>Coverage ratio</b>                       | The quantum of assets an insurer has to meet its capital requirements, expressed as a percentage of its capital requirements.   |
| <b>Credit rating</b>                        | A measure of the financial security of a company provided by a third party agency.  |
| <b>Cut-off Date</b>                         | 15 August 2018. Policyholders from the policyholder groups included in AIL's policyholder communications on the Scheme with a policy that is in effect or with an open claim on this date will be included in AIL's policyholder communications.  |
| <b>Direct policyholders</b>                 | Policyholders of an insurance undertaking who are not themselves insurers or reinsurers.  |
| <b>Diversification</b>                      | A risk-management technique employed by a business entity, to widen the variety of investments it holds or business in which it participates, in order to reduce the overall risk to which it is exposed.   |
| <b>Effective Time</b>                       | The date and time at which the Scheme becomes legally binding.  |
| <b>Excess of Loss</b>                       | This is a type of reinsurance contract, whereby cover is provided by the reinsurer above a certain amount, up to a certain limit.   |
| <b>FIN-NET</b>                              | A network of EEA national organisations responsible for settling consumers' complaints in the area of financial services out of court. The network covers all EEA countries.  |
| <b>Freedom of Establishment business</b>    | It is possible for an insurance undertaking authorised in one EEA state ("the home state") to conduct business in another EEA state ("the host state") by establishing a branch operation in the host state and conducting business on a "Freedom of Establishment" basis.<br>An insurance undertaking intending to write Freedom of Establishment business must notify the regulator of its home state of its intention to exercise its Freedom of Establishment passporting rights. |
| <b>Freedom of Services ("FOS") business</b> | It is possible for an insurance undertaking authorised in one EEA state ("the home state") to conduct business in another EEA state ("the host state") by writing business directly from the home state to the host state on a "Freedom of Services" basis.<br>An insurance undertaking intending to write Freedom of Services business must notify the regulator of its home state of its intention to exercise its Freedom of Services passporting rights.                          |
| <b>Gross</b>                                | Excluding the effect of reinsurance arrangements. For example, 'gross insurance liabilities' refers to insurance liabilities before taking into account any offsetting reinsurance assets.  |

|  |   |
|--|---|
| <b>Incurred but not reported (“IBNR”)</b>        | The estimate of the claims made by the claims handling team of an insurer for claims relating to events that have transpired, but which have not yet been reported.   |
| <b>Incurred claims</b>                           | The sum of the paid and outstanding claims.   |
| <b>Independent Expert</b>                        | The suitably qualified person that produces an independent report on the Scheme, in accordance with FSMA.   |
| <b>Internal Model</b>                            | A bespoke model developed by an insurance or reinsurance undertaking to calculate its Solvency Capital Requirement under Solvency II and which is required to be approved by the relevant regulator. All insurers are required to calculate their Solvency Capital Requirement using either an approved Internal Model or the Standard Formula. |
| <b>Inwards reinsurance</b>                       | Reinsurance coverage provided by a reinsurance undertaking to other insurance or reinsurance undertakings.  |
| <b>Ireland GI branch</b>                         | The business currently written by the Irish branch of AIL on a Freedom of Establishment basis.  |
| <b>Large claims</b>                              | Individual claims with a relatively high value, which may be modelled at an individual level for reserving and capital modelling purposes.  |
| <b>Liability</b>                                 | A claim against the assets, or legal obligations of a person or organisation, arising out of past or current transactions or actions.   |
| <b>Loss ratio</b>                                | A loss ratio of an insurance or reinsurance undertaking is a ratio of claims to premiums.   |
| <b>Minimum Capital Requirement (“MCR”)</b>       | The lower level of regulatory capital requirements under the Solvency II regime.  |
| <b>Net</b>                                       | Including the effect of reinsurance arrangements. For example, 'net insurance liabilities' refers to insurance liabilities after deducting any offsetting reinsurance assets from the gross insurance liabilities.  |
| <b>Ogden discount rate</b>                       | The discount rate used to calculate lump sum settlements on personal injury claims.   |
| <b>ORSA capital requirement</b>                  | The ‘own view’ capital requirement of either AIL or AIIDAC, as set out in their respective ORSA documents.  |
| <b>Outstanding claims</b>                        | The estimate of the claims made by the claims handling team of an insurer for claims that have been reported but not yet been paid.   |
| <b>Own Funds</b>                                 | The excess of an insurer's admissible assets over its liabilities on a Solvency II basis.   |
| <b>Own Risk and Solvency Assessment (“ORSA”)</b> | The insurance or reinsurance undertaking’s own assessment of the risks to which it is exposed and its solvency, as required under Solvency II.  |
| <b>Reinsurance</b>                               | An arrangement with another insurer or reinsurer whereby risks are shared (or passed on).   |
| <b>Remaining Portfolio</b>                       | The policyholders remaining in AIL based on the scope of the Scheme. This portfolio consists of all existing AIL business except for the business being transferred, which is set out in detail in paragraphs 2.2 to 2.9.   |
| <b>Reserve strength</b>                          | A measure of the likelihood that the claims reserve will be sufficient to meet future claims.   |

|   |  |
|---|--|
| <b>Return period</b>                        | A statistical measurement denoting the average recurrence interval of a given event over an extended period of time.   |
| <b>Reverse Flow Business</b>                | General insurance risks written by AIL's Ireland GI branch and situated in the UK.   |
| <b>Risk Margin</b>                          | Under Solvency II, insurers must hold a risk margin in excess of their best estimate of liabilities. This risk margin is designed to represent the amount of capital a third party would require to take on the obligations of a given insurance company. It effectively means that if an insurer were, as a result of a shock, to use up all its free surplus and capital, then it would still have sufficient assets to safely wind-up and transfer its obligations to a third party.                                |
| <b>Run-off</b>                              | A class of insurance business or an insurance undertaking that no longer accepts new business but continues to provide coverage for claims arising on its policies still in force and that makes payments for claims that have occurred on policies that have expired.   |
| <b>Sales Partner</b>                        | A sales intermediaries other than a broker (e.g. a retailer) that also act as a sales channel for insurance products.  |
| <b>Solvency II</b>                          | A regulatory regime for insurers which came into force on 1 January 2016 aimed at harmonising regulation across all EU and EEA countries.  |
| <b>Solvency Capital Requirement ("SCR")</b> | The higher level of regulatory capital requirement under the Solvency II regime.   |
| <b>Standard Formula</b>                     | A standardised calculation for the Solvency Capital Requirement of an insurance or reinsurance undertaking, as prescribed under Solvency II. All insurers are required to calculate their Solvency Capital Requirement using either the Standard Formula or an approved Internal Model.  |
| <b>State of Risk</b>                        | If the policyholder is an individual, the EEA State in which that policyholder has habitual residence at the date the contract is entered into. If the policyholder is not an individual, the EEA State in which the establishment of the policyholder to which the policy relates is situated at the date the contract is entered into.   |
| <b>Stress and scenario testing</b>          | An analysis to test the robustness of a financial quantity by varying a number of underlying assumptions (either one at a time or in various combinations) and observing the resulting change in the quantity of interest.   |
| <b>Subsidiary</b>                           | An enterprise controlled by another (called the parent) through the ownership of more than 50 percent of its voting stock.   |
| <b>Technical provisions</b>                 | The insurance liabilities of an insurer, as determined for regulatory purposes. These are calculated as 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 claims arising on unexpired periods of exposure less any premium in respect of the business written that has not yet been received. |

|                               |  |
|-------------------------------|--|
| <b>The Provision</b>          | The Provision is a legal mechanism that is used in insurance portfolio transfers involving a significant intra-group reinsurance following the transfer. It is designed to ensure that transferring and remaining policyholders are aligned in relation to a distribution of the assets of the reinsurer (in this case AIL) in the event of the insolvency of the reinsurer. |
| <b>Transferring Portfolio</b> | The transferring AIL policyholders based on the scope of the Scheme. This portfolio forms a subset of the existing AIL business and is set out in detail in paragraphs 2.2 to 2.9.   |
| <b>Valuation date</b>         | The date on which AIL's reserving team completes its reserving exercise each quarter.  |

## C Abbreviations

|                       |  |
|-----------------------|--|
| <b>AGH</b>            | Aviva Group Holdings                                 |
| <b>AGSIL</b>          | Aviva Group Services Ireland Limited                 |
| <b>AII</b>            | Aviva International Insurance Limited                |
| <b>AIL</b>            | Aviva Insurance Limited                              |
| <b>AME</b>            | Actuarial Mean Estimate                              |
| <b>AIIDAC</b>         | Aviva Insurance Ireland Designated Activity Company  |
| <b>CBI</b>            | Central Bank of Ireland                              |
| <b>CHE</b>            | Claims Handling Expense                              |
| <b>Court</b>          | the Court of Session in Scotland                     |
| <b>EEA</b>            | European Economic Area                               |
| <b>ENID</b>           | Events Not In Data                                   |
| <b>EU</b>             | European Union                                       |
| <b>FCA</b>            | UK Financial Conduct Authority                       |
| <b>FIA</b>            | Fellow of the Institute and Faculty of Actuaries     |
| <b>FOS</b>            | Freedom of Services                                  |
| <b>FOSUK</b>          | UK Financial Ombudsman Service                       |
| <b>FRC</b>            | UK Financial Reporting Council                       |
| <b>FSA</b>            | UK Financial Services Authority                      |
| <b>FSCS</b>           | UK Financial Services Compensation Scheme            |
| <b>FSAI</b>           | Fellow of the Society of Actuaries in Ireland        |
| <b>FSMA</b>           | Financial Services and Markets Act 2000, as amended  |
| <b>FSPO</b>           | Financial Services and Pensions Ombudsman in Ireland |
| <b>GBP</b>            | British Pound  |
| <b>Grant Thornton</b> | Grant Thornton UK LLP                                |
| <b>GWP</b>            | Gross Written Premium                                |
| <b>IBNR</b>           | Incurred But Not Reported                            |
| <b>ICF</b>            | Insurance Compensation Fund                          |
| <b>IFoA</b>           | Institute and Faculty of Actuaries                   |
| <b>LifeCo</b>         | Aviva Ireland Life Insurance Company                 |

|                      |  |
|----------------------|--|
| <b>MCR</b>           | Solvency II Minimum Capital Requirement  |
| <b>MDI</b>           | Mobile Device Insurance  |
| <b>ORSA</b>          | Own Risk and Solvency Assessment   |
| <b>PRA</b>           | UK Prudential Regulation Authority   |
| <b>PPO</b>           | Periodic Payment Order   |
| <b>QC</b>            | Queen's Counsel  |
| <b>RPI</b>           | Retail Price Index   |
| <b>SCR</b>           | Solvency II Solvency Capital Requirement   |
| <b>SUP18</b>         | Chapter 18 of the Supervision Manual from the FCA Handbook   |
| <b>TAS</b>           | Technical Actuarial Standards  |
| <b>the Bill</b>      | The General Scheme of the Insurance (Amendment) Bill 2017  |
| <b>the Provision</b> | The Provision is a legal mechanism that is used in insurance portfolio transfers involving a significant intra-group reinsurance following the transfer. It is designed to ensure that transferring and remaining policyholders are aligned in relation to a distribution of the assets of the reinsurer (in this case AIL) in the event of the insolvency of the reinsurer. |
| <b>the Scheme</b>    | Insurance Business Transfer Scheme of a portfolio of policies from AIL to AIIDAC   |
| <b>UK</b>            | United Kingdom   |
| <b>UPR</b>           | Unearned Premium Reserve   |
| <b>USPs</b>          | Undertaking specific parameters  |

## D Checklist against the PRA's Statement of Policy and SUP18

The table below cross references the relevant sections of this report to the requirements for the Scheme Report, as set out in the Statement of Policy produced by the PRA in April 2015, namely "The Prudential Regulation Authority's approach to insurance business transfers".

It also cross references the relevant sections of this report to the guidance set out in Chapter 18 of the Supervision Manual ("SUP18") contained in the FCA Handbook of Rules and Guidance to cover scheme reports on the transfer of insurance business. These requirements are identical to those set out in the PRA's Statement of Policy. However, please note that the paragraph references in the table below are to the PRA statement of policy rather than to SUP18.

| Reference to the PRA's approach to business transfers  | Reference to relevant section within this report |
|--|--|
| <b><i>2.30 The Scheme report should comply with the applicable rules on expert evidence and contain the following information:</i></b>                                   |  |
| (1) who appointed the independent expert and who is bearing the costs of that appointment;   | Paragraph 1.2 and 1.8                            |
| (2) confirmation that the independent expert has been approved or nominated by the PRA;  | Paragraph 1.3                                    |
| (3) a statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role; | Paragraphs 1.11 to 1.14 and Appendix F           |
| (4) whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties  | Paragraphs 1.15 to 1.17                          |

|   |  |
|---|--|
| which might be thought to influence his independence and details of any such interest;  |  |
| (5) the scope of the report;  | Paragraphs 3.1 to 3.11   |
| (6) the purpose of the Scheme;  | Paragraphs 5.31 to 5.37  |
| (7) a summary of the terms of the Scheme in so far as they are relevant to the report;  | Paragraphs 5.10 to 5.24 and 5.31 to 5.46                         |
| (8) what documents, report and other material information the independent expert has considered in preparing the report and whether any information that they requested has not been provided;          | Appendix A   |
| (9) the extent to which the independent expert has relied on:   |  |
| (a) information provided by others; and   | Paragraphs 12.2 to 12.6  |
| (b) the judgement of others;  | Paragraphs 12.2 to 12.6  |
| (10) the people the independent expert has relied on and why, in their opinion, such reliance is reasonable;  | Paragraphs 12.4, 12.5 and 12.6                                   |
| (11) Their opinion of the likely effects of the Scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies), distinguishing between: |  |
| (a) transferring policyholders;   | Paragraph 2.30   |
| (b) policyholders of the transferor whose contracts will not be transferred; and  | Paragraph 2.31   |
| (c) policyholders of the transferee;  | The transferee has no existing policyholders prior to the Scheme |
| (12) Their opinion on the likely effect of the Scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the Scheme;                                      | Paragraphs 2.43, 3.9 and 10.53 to 10.60                          |
| (13) what matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in their opinion, be relevant to   | Paragraphs 3.8 and 3.12  |

|   |  |
|---|--|
| policyholders' considerations of the Scheme; and  |  |
| (14) for each opinion that the independent expert expresses in the report, an outline of their reasons.   | Throughout the report  |
| <b><i>2.32 The summary of the terms of the Scheme should include:</i></b>   |  |
| (1) a description of any reinsurance arrangements that it is proposed should pass to the transferee under the Scheme; and   | Paragraphs 5.38 to 5.43  |
| (2) a description of any guarantees or additional reinsurance that will cover the transferred business or the business of the transferor that will not be transferred.                          | Paragraphs 5.40, 9.31, 9.32 and 10.64  |
| <b><i>2.33 The independent expert's opinion of the likely effects of the Scheme on policyholders should:</i></b>  |  |
| (1) include a comparison of the likely effects if the Scheme is or is not implemented;  | Likely effects if the Scheme is implemented – Addressed throughout the report<br><br>Comparative assessment of likely effects should the Scheme not be implemented – Paragraphs 11.64 to 11.67 |
| (2) state whether they considered alternative arrangements and, if so, what;  | Paragraph 3.10   |
| (3) where different groups of policyholders are likely to be affected differently by the Scheme, including comments on those differences they consider to be material to the policyholders; and | Sections 7 to 11   |
| (4) include their 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;                             | Paragraphs 10.18 to 10.41  |
| (b) the likely effects of the Scheme on matters such as investment management, new business strategy, administration, claims handling,  | Investment management - Paragraphs 10.2 to 10.10<br>New business strategy: Paragraphs 10.61 to 10.63   |

|   |  |
|---|--|
| expense levels and valuation bases in relation to how they may affect:  | Administration (Policy servicing) - Paragraphs 11.24 to 11.29<br>Claims handling - Paragraphs 11.20 to 11.23<br>Expense levels - Paragraphs 10.11 to 10.17<br>Valuation bases:<br>Assets: Paragraph 9.8<br>Liabilities: Sections 7, 8 and 9, paragraph 9.8 |
| (i) the security of policyholders' contractual rights;  | Section 9  |
| (ii) levels of service provided to the policyholders; or  | Paragraphs 11.24 to 11.29  |
| (iii) for the long-term insurance business, the reasonable expectations of policyholders; and   | Not applicable to Scheme – the Scheme does not involve long term insurance business  |
| (c) the cost and tax effects of the Scheme, in relation to how they may affect the security of policyholders' contractual rights, or for long-term insurance business, their reasonable expectations.   | Cost implications of the Scheme: Paragraphs 10.11 to 10.17<br>Tax implications: Paragraphs 10.48 to 10.49  |
| <b><i>2.36 For a scheme involving long-term insurance business, the report should:</i></b>  |  |
| (1) describe the effect of the Scheme on the nature and value of any rights of policyholders to participate in profits:   | N/A  |
| (2) if any such rights will be diluted by the Scheme, describe 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; | N/A  |
| (3) describe the likely effect of the Scheme on the approach used to determine:   |  |
| (a) the amount of any non-guaranteed benefits such as bonuses and surrender values; and   | N/A  |
| (b) the levels of any discretionary charges;  | N/A  |
| (4) describe what safeguards are provide by the Scheme against a subsequent change  | N/A  |

|  |     |
|--|-----|
| of approach to these matters that could act to the detriment of existing policyholders of either firm;   |     |
| (5) include the independent expert's overall assessment of the likely effects of the Scheme on the reasonable expectations of long-term insurance business policyholders;  | N/A |
| (6) state whether the independent expert is satisfied that for each firm, the Scheme is equitable to all classes and generations of its policyholders; and   | N/A |
| (7) 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 holders) to ensure that the Scheme operates as presented. | N/A |

## E Checklist against the FCA's guidance

The table below cross references the relevant sections of this report to the guidance published by the FCA in May 2018 setting out the FCA's approach to the review of Part VII insurance business transfers (FG18/4: The FCA's approach to the review of Part VII insurance business transfers: <https://www.fca.org.uk/publication/finalised-guidance/fg18-04.pdf>).

| Reference to the FCA's approach to business transfers  | Reference to relevant section within this report  |
|--|---|
| <b>Overarching guidance</b>  |   |
| 6.2 The FCA expect the report to be easily readable and understandable by all its users and for the IE to pay attention to the following:  |   |
| 6.2.1 Technical terms and acronyms should be defined on first use.   | Demonstrated throughout this report   |
| 6.2.2 There should be an executive summary that explains, at least in outline, the proposed transfer and the IE's conclusions.   | Section 2   |
| 6.2.3 The business to be transferred should be described early in the report.  | Paragraphs 2.2 to 2.9   |
| 6.2.4 The detail given should be proportionate to the issues being discussed and the materiality of the Transfer when seen as a whole. While all material issues must be discussed, IEs should try to avoid presenting reports that are disproportionately long. | Demonstrated throughout this report   |
| 6.2.5 IEs should prepare their reports in a way that makes it possible for non-technically qualified readers to understand.  | Not explicitly demonstrable but considered in the writing of this report  |
| 6.3 IE reports should have detailed analysis, critical review and a conclusion. Plus, a sufficient consideration and comparison of:  |   |
| 6.3.1 Reasonable benefit expectations (including impact of charges)  | Section 7 - Our analysis of the impact of the Scheme on the claims reserving process.<br><br>Section 9 - Our analysis of the impact of the Scheme on policyholder security. |

|  |   |
|--|---|
| 6.3.2 Type and level of service (including claims handling)  | Section 11 - In particular, the subsections on claims handling, policy servicing and complaints (paragraphs 11.20 to 11.29) |
| 6.3.3 Management, administration and governance arrangements   | Section 11 – Governance and management framework  |
| 6.4 IE reports should have good balance between factual description and supporting analysis. IE reports often include a very detailed description of the transaction and background but much less analysis of the effect on each Policyholder group's reasonable expectations.   | Demonstrated throughout this report   |
| <b>The level of reliance on the Applicants assessments and assertions</b>  |   |
| 6.6 IEs will sometimes rely on Applicants' assessments to reach their own conclusions. In these cases, we expect the IE to demonstrate that they have questioned the adequacy of those assessments. We may also expect the IE to have asked the Applicants to undertake additional work or provide more evidence to support their assertions to ensure that the IE can be satisfied on a particular point. | Paragraphs 12.2 to 12.6   |
| 6.7 & 6.8 We expect the IE to explain any challenges they have made to the Applicants about such underlying information and the outcome of these in their report, rather than just stating the final position. We will question and challenge the IE where we feel that they have relied on Applicant's assertions without sufficient challenge or asking for supporting detail or evidence.               | Paragraph 12.6  |
| 6.9 The IE should challenge calculations carried out by the Applicants if there is cause for doubt on review of the Scheme and supporting documents. As a minimum, we will expect the IE to:   | Paragraph 12.6  |
| 6.9.1 Review the methodology used and any assumptions made to satisfy themselves that the information is likely to be accurate and to challenge it where appropriate   | Reviews of reserving and capital calculations in Section 7, Section 8 and Section 9   |
| 6.9.2 Challenge the factual accuracy of matters that, on the face of the documents or considering the IE's knowledge and experience, appear inconsistent, confusing or incomplete  | Paragraph 12.6  |
| 6.10 We would also expect the IE to challenge Applicants where the documents provided contain an insufficient level of detail or analysis.   | Paragraph 12.6  |
| <b>Sufficient comparative regulatory framework analysis</b>  |   |

|   |  |
|---|--|
| <p>6.11 The regulatory framework may be different for the Transferor and Transferee. In these cases, we will want to see that the IE has carried out sufficient analysis of the differences including, where appropriate, taking independent advice.</p>  | <p>Paragraphs 11.13 to 11.19</p>   |
| <p>6.12 In particular, with cross-border transfers we often see insufficiently detailed analysis of regulatory protections post-transfer. This can include:</p>   |  |
| <p>6.12.1 The extent to which existing regulatory requirements and protections continue. This includes whether there is continued access to the Financial Ombudsman Service and the Financial Services Compensation Scheme. Our expectation is that Applicants aim to preserve Financial Ombudsman Service, whether under the Compulsory or Voluntary jurisdictions, as far as it is possible to do to avoid any loss of protections. In the context of EU withdrawal we would expect this at least until the point of policy renewal. Some firms are able to continue to service contracts from UK branches to preserve continuity.</p>  | <p>Paragraphs 10.31 to 10.41 and 11.30 to 11.43</p>  |
| <p>6.12.2 The comparative regulatory requirements and conduct protections across any relevant jurisdictions, compared to the UK. This includes but is not limited to complaints or compensation bodies.</p>   | <p>Paragraphs 10.31 to 10.41, 11.13 to 11.19 and 11.30 to 11.43</p>  |
| <p>6.12.3 Analysis of the likely impacts. For example, the number of Policyholders affected, the size of possible claims and any potential actions or provisions to mitigate this.</p>  | <p>Analysis of the likely impacts of changes in regulatory frameworks are carried out within the specific sections of the report highlighted above.</p>      |
| <p>6.12.4 Post EU withdrawal, non-UK EEA customers may be subject to the local conduct of business rules regime, which may not include FOS or FSCS issues. In these cases, we are likely to accept firms taking proportionate approaches to compare regimes. For example a high level analysis may be appropriate, selecting key UK protections for consumers that are not harmonised in the EEA, and that could be relevant to servicing contracts. This could be accompanied by an explanation that a full gap analysis has not been carried out, but that policyholders can contact the Applicants if they are concerned. Some firms are able to continue to service contracts from UK</p> | <p>Comparison of the regimes and protections available pre and post Scheme are carried out within the specific sections of the report highlighted above.</p> |

|  |   |
|--|---|
| branches to preserve continuity of regime at least until renewal.  |   |
| 6.13 In these instances, we would expect to see a statement describing the two regimes. We would also expect to see a considered comparison, highlighting points of significant difference that could adversely impact Policyholders. It is for the IE to use their judgement to decide on the level of detail to be included but it needs to be sufficient for the Court to be in a position to be satisfied. | A number of subsections within Section 10 and Section 11 explain key points of difference between the two regimes. In particular: <ul style="list-style-type: none"> <li>• Paragraphs 10.18 to 10.30 - Implications under insolvency</li> <li>• Paragraphs 10.31 to 10.41 – Impact on compensation</li> <li>• Paragraphs 11.13 to 11.19 – Impact of changes in regulatory jurisdiction</li> <li>• Paragraphs 11.30 to 11.43 – Complaints</li> </ul> |
| 6.14 The IE’s analysis may be inconclusive or may highlight potential conduct risks due to differences in the regulatory framework. In such cases we expect to see sufficient explanation of how Policyholders may be affected and the Applicant’s proposals to mitigate these risks.  | N/A   |
| 6.15 Where certain features of the Scheme are mentioned to demonstrate the IE’s satisfaction with the Scheme we would expect to see evidence and reasoning behind the IE’s conclusion.   | Demonstrated throughout this report   |
| 6.16 Where the IE states that there will be no material adverse impact the report should make clear whether the IE is certain that there will most likely not be an adverse impact or whether it is their best judgement, but lacks certainty. In these instances, we expect IEs to consider the following:  | Demonstrated throughout this report   |
| 6.16.1 Where the IE takes the view that there is probably no material adverse impact, we expect the IE to challenge the Applicants about further work the Applicants could undertake to enable the IE to be satisfied to a greater degree.   | Paragraph 12.6  |
| 6.16.2 IEs should be able to challenge the Applicants to gain the necessary level of confidence that their report’s conclusions are robust. In addition, they will need to consider how any proposed changes/mitigations will impact all Policyholder groups.  | Paragraph 12.6  |
| 6.17 When finalising the report, we expect the IE to have checked that the documents they are  | I understand from AIL that 31 December 2017 is the most recent date at which the majority of quantitative   |

|  |   |
|--|---|
| relying, and forming judgements, on are the most up-to-date.   | information relating to the Scheme is available.<br><br>As demonstrated in Appendix A, documentation has been requested as at 31 December 2017, where possible, to ensure that documentation used is as up-to-date as possible.   |
| 6.18 Market conditions may have changed significantly since the IE's analysis was carried out and they formed their judgement. In these cases, we would expect the Applicants to discuss any changes with the IE and for the IE to update their report as necessary. If the Scheme document has been finalised, the IE should give more detail in their Supplementary Report or by issuing supplementary letters to the Court to confirm whether their judgement is unchanged. | I am not aware of any significant changes in market conditions since carrying out the analysis detailed in this report.<br><br>As stated in paragraph 2.23 I will issue a Supplementary Report based on the most up to date information available to me prior to the second Court hearing. Paragraph 3.11 highlights that the Supplementary Report will cover any relevant matters which have arisen since the date of this report. |
| <b>Sufficient regard to relevant considerations affecting Policyholders</b>  |   |
| 6.19 We would expect to see IE consideration of all relevant issues for each individual group of Policyholders in both firms, as well as how an issue may affect each group. Our expectations include:   |   |
| 6.19.1 Current and proposed future position of each Policyholder group   | Paragraphs 2.2 to 2.11 explain in detail which policyholder groups are transferring to AIIDAC and, by implication, which are remaining with AIL.  |
| 6.19.2 Potential effects of the transfer on each of the different Policyholder groups  | The potential effects of the Scheme on each policyholder group are explained in detail throughout this report, and are summarised in Section 13.  |
| 6.19.3 Potential material adverse impacts that may affect each group of Policyholders, how these impacts are inter-related and how they will be mitigated  | The potential material adverse impacts of the Scheme are explained in detail throughout this report, and are summarised in Section 13.  |
| 6.20 To support this, we expect the IE to consider whether the groups of affected Policyholders have been identified appropriately.  | Paragraphs 5.10 to 5.24 detail my consideration of how the groups of affected policyholders have been identified by AIL.  |

|  |   |
|--|---|
| 6.21 We would also expect the IE to review and give their opinion on administrative changes affecting Policyholders and claimants. Here we would expect the IE to include:   |   |
| 6.21.1 Consideration of the impact of an outsourcing agreement entered into by the parties before the Part VII process began, where the administration duty 'moved' from the Transferor to the Transferee in preparation for the transfer. Here, we would expect to see a comparison of the pre and post-outsourced administration arrangements so the IE can clearly review and compare any changes to Policyholder positions and service expectations. | N/A – There are no such outsourcing agreements in relation to the Scheme.   |
| 6.21.2 The IE should consider what might happen if the Transfer does not proceed and the possibility that the outsourcing agreement could be cancelled, returning the administrative arrangements to the original state.   | N/A – There are no such outsourcing agreements in relation to the Scheme.   |
| 6.22 IEs should also review and give their opinion on all relevant issues for all Policyholder groups where reinsurance was entered into in anticipation of a transfer:  | Section 5 Reinsurance - Paragraphs 5.38 to 5.43 cover the new reinsurance for the Scheme  |
| 6.22.1 Some firms pre-empt regulatory scrutiny by buying reinsurance against risks before they begin the transfer process. In these instances, the IE should consider if it is appropriate to compare the proposed Scheme with the position the Transferor would be in if they did not benefit from the reinsurance contract.  | N/A – There are no such reinsurance arrangements in relation to the Scheme.   |
| 6.22.2 If the transfer is not sanctioned and the reinsurance either terminates automatically or can be terminated by the Transferee, the IE should consider the Scheme as if the reinsurance was not in place.   | N/A – There are no such reinsurance arrangements in relation to the Scheme.   |
| 6.23 The IE may identify particular sub-groups of Policyholders whose benefits, without other compensating factors, are likely to be adversely affected.   | I have concluded in paragraph 13.3 that there will be some loss of compensation cover for a particular subgroup of the transferring policyholders.  |
| 6.24 & 6.25 When a loss is expected for a particular subgroup of Policyholders, we would expect to see IE consideration and analysis of alternatives even if the IE does not consider this loss to be material. In these circumstances we may request that the IE and/or Applicants consider other ways of mitigating the adverse impacts on   | With regards to the expected loss in compensation cover, paragraphs 10.31 to 10.41 set out my analysis of this issue, as well as giving details of contingency plans discussed with AIL, should certain situations materialise. |

|   |   |
|---|---|
| <p>the affected Policyholders, should they happen, including providing compensation.</p> <p>We would expect to see this analysis even if the IE is able to conclude that the Policyholder group as a whole is not likely to suffer material adverse impact, even if a minority may.</p>   | <p>Paragraphs 10.31 to 10.41 also considers the alternative option of terminating the Scheme in order to retain compensation cover, and explains why the Scheme offers a preferable outcome for affected policyholders.</p>   |
| <p>6.26 &amp; 6.27 When an IE is assessing the potential material adverse impacts on various groups of Policyholders, we may feel they have reached their conclusion based on the balance of probabilities and without adequately considering the possible impact on all affected Policyholder groups.</p> <p>As a specific example, we might consider the right of Policyholders to make a claim on the FSCS following a cross-border general insurance transfer: The IE may say they are satisfied that there is no material adverse impact on Policyholders because the Transferee's capital position (meeting relevant requirements), and the short term nature of the liabilities (for example, annually renewable). The IE may conclude from this that it is unlikely the Transferee will fail and Policyholders need recourse to the FSCS as a result. While we accept that this is a potentially relevant consideration, we would not be satisfied with this view without further evidence. For example, some evidence and analysis of why the size and complexity of a particular firm may make a default, before the time that policyholders have to claim on policies, extremely unlikely.</p> | <p>Paragraphs 10.31 to 10.41 explains how I have reached my conclusions on the impact of the Scheme on FSCS compensation.</p> <p>Although I have used the balance of probabilities to support my conclusions, I have not relied on it exclusively, nor have I used it to conclude that the impact on policyholders is immaterial. I have considered alternative scenarios and contingency plans offered by AIL.</p> <p>I have concluded that, on the whole, it is in the interest of affected policyholders for the Scheme to go ahead.</p> <p>In this case, the affected policyholders cannot retain this protection by switching to an alternative provider since Brexit may not allow them to switch to a provider in the UK and, if they switch to a provider in another country, they will still lose the FSCS protection.</p> |
| <b>Commercially sensitive or confidential information</b>   |   |
| <p>6.29 &amp; 6.30 Often the IE will need to consider commercially sensitive or confidential information as part of their decision making process. In these circumstances, we remind IEs of their duty as an independent expert to consider Policyholder interests, particularly as this information will not be publicly available.</p> <p>In these situations we expect to see the analysis and the information relied upon. It is also possible that the Court may wish to see that information without it being publicly disclosed. The IE may wish to consider sending a separate document with further details, solely for the Court's use and not for public disclosure.</p>   | <p>Appendix A</p>   |

| <b>The level of reliance on the work of other experts</b>   |   |
|---|---|
| <p>6.31 For large scale and complex insurance business transfers we accept that the IE may rely on the analytical work of other qualified professionals, often to prevent their own work becoming disproportionately time consuming. However, we would still expect the IE to have carried out their own review of this analysis to ensure they have confidence in, and can place informed reliance on, the opinions they draw from another professional's work.</p>  | <p>Appendix A and section on Reliance on other parties, paragraphs 12.2 to 12.6</p>   |
| <p>6.32 We expect the IE to have obtained a copy of relevant significant legal advice given to the Applicants, subject to appropriate arrangements to safeguard any legal professional privilege. This should be in writing or transcribed, and approved by the advisor. It should also be in a sufficiently final form for the IE to be able to review and rely on it. The IE should reflect this review, and the opinions drawn from the advice, within their report.</p>   | <p>See list of Information provided AIIDAC's legal advisers in Appendix A.</p> <p>I have also relied on information arising from correspondence and discussions with AIL and AIIDAC's legal advisers.</p> <p>My review of this information, and the opinions drawn from it, are given throughout this report. The most notable example is in Section 9 where I discuss the implications of "the Provision" on the Scheme (paragraphs 9.31 to 9.32).</p> |
| <p>6.33, 6.34 and 6.35 The IE may refer to factors that are outside their sphere of expertise and relies on advice received by the Applicants. In these cases, the IE should consider whether or not to obtain their own independent advice on the relevant issue.</p> <p>In many cases, whether the IE's decides to get independent legal advice will depend on the significance and materiality of the issue.</p> <p>The IE's key consideration is whether it is reasonable for them to rely on the advice and whether their independence is compromised by doing so. Whether or not the legal advisor has acknowledged that it owes a duty of care to the IE will be relevant to this consideration. We may challenge IEs who rely on the Applicants' legal advice and merely state that they have no reason to doubt the advice and/or that it is consistent with their understanding of the position or experience of similar business transfers. Our decision to challenge will depend on how complex the legal issue is.</p> | <p>Paragraph 9.32 explains that in the case of "the Provision", mentioned above, I felt that it was necessary to obtain independent legal advice, given the materiality of the issue to the security of the transferring policyholders in the event of the insolvency of AIL.</p>   |

|   |  |
|---|--|
| <p>6.36 In deciding whether to obtain independent legal advice, we would expect the IE to consider, amongst other things, the following:</p> <ul style="list-style-type: none"> <li>• The significance of the issue and the degree of potential adverse impacts to Policyholders if the position turns out to be different from what the legal advice considers likely.</li> <li>• How much the IE relies on the legal advice to reach their conclusions. Also, if they did not rely on the legal advice, would the report contain too little information to justify the view that there is no material adverse impact?</li> <li>• The difficulty, novelty or peculiarity of the issue to the Applicants' own circumstances.</li> <li>• Applicants' proposals to explain to Policyholders in communication documents the issues involved, any uncertainty, and any residual risks.</li> <li>• Whether the Applicants have obtained an adequate level of advice, depending on the issue's significance or uncertainty. Where relevant, whether the Applicants have engaged external advisors with the appropriate expertise and qualifications for the specific subject or jurisdiction.</li> <li>• Whether any advice already received is heavily caveated, qualified or there is a significant degree of uncertainty.</li> </ul> | <p>Not explicitly demonstrable but considered in the undertaking of the work</p>   |
| <p>6.37 Alternatively, the IE may need to explain why they consider that they do not need to get independent advice to be adequately satisfied on a point.</p>  | <p>Throughout this report I have explained how I have reached the conclusions I have drawn.</p> <p>In my opinion, as well as the legal advice discussed above, the other area which required independent advice was tax. The matters for which I have sought legal and tax advice are discussed in paragraphs 9.32 and 10.48 respectively.</p> |
| <p>6.38 The IE should consider the Applicant's contingency plans if the risks identified in the legal advice occur and whether this may create negative consequences for Policyholders.</p>   | <p>N/A</p>   |
| <p><b>Ambiguous language or a lack of clarity</b></p>   |  |

|   |  |
|---|--|
| <p>6.45 &amp; 6.46 At the start of the document, the IE should provide a description of where they propose to rely on information provided by the Applicants. We will look for any overly general reliance, as it indicates a lack of critical assessment or challenge.</p>   | <p>Paragraphs 3.14 to 3.18</p>   |
| <p>6.47 In summary, where the report does not seem to reach a clear conclusion, either generally or on a specific issue, the IE report should state clearly:</p>  |  |
| <p>6.47.1 That the IE has considered and is satisfied about the likely level of impact on a particular point. Where uncertainty remains, the IE report needs to include details of, and reasons for, this uncertainty as well as any further steps the IE has taken to get clarification, such as seeking further advice from a subject matter expert.</p>  | <p>Demonstrated throughout this report, including:</p> <p>Section 7 – uncertainty with regard to level or reserves</p> <p>Section 8 – uncertainty with regard to level of required capital</p>   |
| <p>6.47.2 How has the IE satisfied him or herself about the identified uncertainty and formed an opinion on any potential impact.</p>   | <p>Demonstrated throughout this report, including:</p> <p>Section 7 – uncertainty with regard to level or reserves</p> <p>Section 8 – uncertainty with regard to level of required capital</p>   |
| <p><b>Demonstrating challenge</b></p>   |  |
| <p>6.48 To ensure the IE report is complete and considered we expect to see challenge from all involved parties. This includes evidence that Applicants have made appropriate challenges, particularly where they believe the IE has not fully addressed issues. We expect confirmation that the near-final version of the IE’s report had the relevant challenge at the time it was submitted.</p> | <p>AIL, AIIDAC and their legal advisers have all had the opportunity to challenge all aspects of this report. In order to arrive at my conclusions I have often discussed issues with the management teams of AIL and AIIDAC. The detail of their responses, including any challenges raised by AIL, are captured in the ‘General Observation’ documents we have received, as referenced in Appendix A of this report.</p> |
| <p>6.49 To ensure effective two-way challenge we would expect the IE to engage with FCA or PRA approved persons of sufficient seniority at the Applicant firm. This could be senior actuaries, including possibly the Chief Actuary, the CFO, Senior Underwriters and so on.</p>  | <p>As discussed in paragraphs 12.2 to 12.6, I have engaged with key subject matter experts from AIL and AIIDAC, including senior actuaries, to gain comfort on the appropriateness of the methodology and conclusions for the</p>  |

|  |  |
|--|--|
|  | <p>most material quantitative aspects of the Scheme.</p> <p>With regards to wider issues, paragraphs 12.2 to 12.6 explain that I have relied on discussions with the senior management teams of AIL and AIIDAC, including AIIDAC's Chief Actuary, AIL's Head of Capital Modelling, AIL's General Counsel, AIL's Performance Director &amp; UK Brexit Programme Director, the Head of AIL's Brexit Passporting Programme and AIL's Head of Actuarial Reserving.</p> |
| <b>Technical actuarial guidance</b>  |  |
| 6.50 We expect IEs who are both qualified and unqualified members of the Institute & Faculty of Actuaries to pay proper regard to the Technical Actuarial Standards (TAS) published by the Financial Reporting Council, particularly those for compiling actuarial reports.  | Paragraph 1.28   |
| 6.51 IEs should be particularly aware that the revised versions of the TAS which came into force with effect from 1 July 2017 specifically apply to technical actuarial work to support Part VII Transfers.  | Paragraph 1.28   |
| 6.52 We draw specific attention to paragraph 5 of TAS 100 which states that actuarial communications should be 'clear, comprehensive and comprehensible so that users are able to make informed decisions understanding the matters relevant to the actuarial information'.  | Not explicitly demonstrable but considered in the writing of this report   |
| 6.53 Actuarially qualified IEs and peer reviewers should also bear in mind the Actuaries' Code and Actuarial Profession Standards documents APS X2: Review of Actuarial Work and APS L1: Duties and Responsibilities of Life Assurance Actuaries. IEs and peer reviewers should adhere to the required standards of their professional body, as applicable and current at the time when the work is performed. | Paragraph 1.30   |

## F My experience

My professional experience is set out below:

- I have worked in or consulted to the general insurance industry for more than 25 years.
- I currently lead Grant Thornton's provision of actuarial and risk services to the general insurance sector.
- I have fulfilled the role of Independent Expert for several Part VII Transfers and Section 13 Transfers of insurance liabilities, with my other transaction experience including acting as Scheme Actuary for several schemes of arrangements; independent expert assignments; and due diligence for mergers and acquisitions.
- I am currently fulfilling the role of Independent Expert on a Part VII transfer of general insurance liabilities from the UK entity of a large insurance group to a newly authorised Luxembourg subsidiary of the group.
- In addition, I am currently fulfilling the role of Independent Actuary for a transfer of non-life insurance liabilities from the Irish entity of an insurance group to the Irish entity of a run-off insurance specialist under Section 13 of the Assurance Companies Act 1909 in Ireland
- I recently fulfilled the role of Independent Actuary for a transfer of non-life insurance liabilities from Zurich Insurance plc to East West Insurance Company Limited under Section 13 of the Assurance Companies Act 1909 in Ireland, which was sanctioned in March 2018.
- Prior to this, I most recently fulfilled the role of Independent Expert on the Part VII. transfer of non-life insurance liabilities from Congregational & General Insurance plc to International Insurance Company of Hannover SE which was sanctioned in November 2017.
- Prior to that, I fulfilled the role of Independent Expert on the Part VII. transfer of non-life insurance liabilities from Colbourne Insurance Company Limited to NRG Victory Reinsurance Limited which was sanctioned in July 2017.
- Prior to that, I fulfilled the role of Independent Expert on the Part VII transfer of non-life insurance liabilities from Guardian Assurance Limited to R&Q Insurance (Malta) Limited which was sanctioned in September 2016.
- Prior to that, I fulfilled the role of Independent Expert on the Part VII transfer of non-life insurance liabilities from Harworth Insurance Company Limited to Royal & Sun Alliance Insurance plc.
- I have substantial reserving experience for an extensive variety of classes of business, including all of the major classes currently written by AIL, and for a very wide range of companies. I also have experience reserving for non-standard liabilities, including PPOs and

latent claims.

- My other experience in the general insurance sector includes: producing skilled persons reports under s166 of FSMA 2000; Solvency II including all three pillars; design and construction of capital models; provision of strategic advice; design and implementation of management information systems; rating of portfolios and individual risks; reviews of rating adequacy; development of pricing models; and review and design of reinsurance programmes.
- In 2010, I set up an actuarial team for Quinn Insurance Limited (Under Administration) ("Quinn"). Between 2010 and 2012, I acted as the de facto Chief Actuary and Chief Underwriting Officer for Quinn.
- Prior to joining Grant Thornton in 2006, I was the Chief Actuary for Travelers Insurance Company Limited in the UK and Ireland.
- Before that, I was a senior consultant in the general insurance division of Towers Perrin.
- I hold a Chief Actuary (Non-life with Lloyd's) Practising Certificate and a Lloyd's Syndicates Practising Certificate. I have previously also held an Irish Signing Actuary Practising Certificate and been recognised as a Responsible Actuary by the financial regulator in Liechtenstein.
- My professional experience includes terms on the Institute and Faculty of Actuaries' Council, Management Board, General Insurance Board, Education Board, General Insurance Reserving Oversight Committee, General Insurance Education and CPD Committee (including a term as chairman), and Education Committee.

## G Extract from Statement of Work

With reference to the Consultancy and Secondment Services Master Framework Services Agreement dated 10 August 2016 (the "Master Agreement") between Grant Thornton UK LLP (the "Supplier") and Aviva Central Services UK Limited ("Aviva") pursuant to which the Supplier have agreed to perform certain services for and on behalf of Aviva subject to the Master Agreement.

This Work Order is made between:

- (1) Aviva Insurance Limited a company incorporated in Scotland under No. 2116. Registered Office: Pitheavlis, Perth PH2 0NH, ("AIL"); and
- (2) the Supplier.

The defined terms in the Master Agreement will, unless expressly stated otherwise, have the same meaning in this Work Order.

In consideration of the mutual covenant and agreements contained in the Master Agreement and in this Work Order, it is agreed as follows:

### 1. Description of the Services

#### 1.1 Background

AIL is incorporated in Scotland and currently writes c£500m of non-life gross written premium ("GWP") (c1.6m policies) in Europe using passporting rights. Given that Article 50 was triggered by the British government on 29 March 2017 then, assuming a hard Brexit scenario, the UK will lose its single-market passporting rights after March 2019. AIL therefore has to formulate a plan to protect such business.

AIL transacts and underwrites general and health insurance business in the UK and Ireland. The major classes of such business are personal lines (motor, home, creditor and other), and health and commercial lines (property, liability, motor and other). Total GWP in 2015 was £4,765m.

AIL's planned approach for the future of such currently-passported business is to establish a new insurance company in Ireland ("Newco"), authorised by the Central Bank of Ireland to write such currently-passported business. AIL will then consolidate and transfer such existing business to Newco using Part VII, s109 of the Financial Services and Markets Act 2000.

#### 1.2 Scope of the Services

- 1.2.1 Aviva has appointed the Supplier to provide an Independent Expert to report on the proposed insurance business transfer scheme to transfer the currently-passported business from AIL to Newco (the "Scheme"). The Independent Expert's report will be prepared in accordance with and for the purposes set out in Part VII of the Financial Services and Markets Act 2000 ("FSMA") and for no other purpose. The Supplier has accepted such appointment.
- 1.2.2 The Independent Expert's analysis and formal report will follow the relevant FSMA requirements and associated supplemental guidance. His report will consider the Scheme as a whole and its effect on the policyholders of AIL and Newco. In particular, it will include, but not be limited to, an opinion on:
  - the impact of the Scheme on the different groups of policyholders affected by the scheme, namely:
    - the transferring policyholders
    - the policyholders who remain with AIL after the Scheme.
 For the avoidance of doubt, there will be no policyholders in Newco prior to the Scheme;
  - the adequacy of any safeguards in the Scheme intended to protect the interests of the affected policyholders;
  - the fairness of any mechanism implemented at the same time as the Scheme, but not included in the Scheme, intended to improve the security of any policyholders affected by the Scheme;
  - any other information required to be included by the FSMA and any guidance issued by the Prudential Regulation Authority ("PRA") or the Financial Conduct Authority ("FCA").



**[www.grant-thornton.co.uk](http://www.grant-thornton.co.uk)**

© 2018 Grant Thornton UK LLP. All rights reserved.

"Grant Thornton" means Grant Thornton UK LLP, a limited liability partnership.

Grant Thornton UK LLP is a member firm within Grant Thornton International Ltd ("Grant Thornton International"). Grant Thornton International and the member firms are not a worldwide partnership. Services are delivered by the member firms independently.