

**Transfer of business from  
Steamship Mutual Underwriting  
Association Limited to Steamship  
Mutual Underwriting Association  
(Europe) Limited**

Scheme Report of the Independent  
Expert under Part VII Section 109 of  
the Financial Services and Markets Act  
2000

23 June 2020

## Use of this report

This report has been prepared for, and is addressed to, the High Court of England and Wales for the purpose of the terms agreed in the letter between Ernst & Young LLP and Steamship Mutual Underwriting Association Limited ('SMUAL'), dated 8 July 2019. This report has been prepared to describe the transfer of insurance business from SMUAL to Steamship Mutual Underwriting Association (Europe) Limited ('SMUAE'), which will be effected under Section 109 of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012 (together the 'FSMA').

A copy of this report will be made available to competent regulatory authorities, the High Court of England and Wales, policyholders, and any other person entitled to receive a copy under the FSMA.

I assume no responsibility whatsoever in respect of, or arising out of or in connection with the contents of this report to parties other than those mentioned above. If other parties choose to rely in any way on the content of this report then they do so entirely at their own risk. This report has been prepared solely for the purposes of the FSMA requirements for insurance business transfer schemes and should not be relied upon for any other purposes by any party.

Draft versions of this report and any other interim working papers must not be relied on by any person for any purpose.

Judgements about the conclusions drawn in this report should be made only after considering the report in its entirety as parts read in isolation may be misleading.

The responsibilities of Ernst & Young LLP shall also be limited as stated above.

Signatory



Ruth Nelmes  
Fellow of the Institute and Faculty of Actuaries  
Partner  
Ernst & Young LLP

## Abbreviations and important defined terms

Full Name	Abbr.	Description
Steamship	the Club	A collective term covering SMUAE and the regulatory group of SMUAL, SMUAB and SMUAT as defined below. The Bermuda Monetary Authority ('BMA') in Bermuda and the Insurance Companies Control Service ('ICCS') in Cyprus are in the process of entering into a Memorandum of Understanding which will include SMUAE within the regulatory group.
Club Member	Member	Various policyholders of SMUAL or SMUAE who hold a mutual policy, and take a share in the surpluses, or contribute to the deficit of the Club.
Steamship Mutual Underwriting Association Limited	SMUAL	A company limited by guarantee incorporated in the United Kingdom. The principal activity is the insurance and reinsurance of Protection and Indemnity ('P&I') and Freight, Demurrage and Defence ('FDD') risks. SMUAL is authorised by the PRA and regulated by the FCA and the PRA in the UK. SMUAL has branches in Singapore, Hong Kong and Japan which are subject to local regulation.
Steamship Mutual Underwriting Association (Europe) Limited	SMUAE	A company limited by guarantee incorporated in Cyprus. The principal activity is the insurance and reinsurance of P&I and FDD risks. SMUAE is authorised and regulated by the ICCS in Cyprus.
Steamship Mutual Underwriting Association (Bermuda) Limited	SMUAB	A reinsurer incorporated in Bermuda and regulated by the BMA in Bermuda. SMUAB reinsures 90% of SMUAL's net underlying liabilities for the policy years beginning 20 February 2015 and subsequently. SMUAB reinsures 90% of SMUAE's net underlying liabilities for the policy years beginning 20 February 2020 and subsequently. All Members of SMUAL and Members of SMUAE are automatically Members of SMUAB and beneficiaries of The Steamship Mutual Trust.
Steamship Mutual Underwriting Association (Bermuda) Trust Limited	SMUAT	A reinsurer incorporated in Bermuda and regulated by the BMA. SMUAT reinsures 100% of SMUAB's liabilities and, for the policy years beginning 20 February 2014 and prior, 100% of SMUAL's net underlying liabilities. It is the designated insurer for group supervision purposes.
The Steamship Mutual Trust	The Trust	The Trust names a number of charitable institutions and the mutual Members of SMUAB as beneficiaries. SMUAT acts as an independent trustee for the benefit of the beneficiaries, which include the Members of SMUAE and SMUAL.
Steamship P&I Management LLP	SPIM	Day to day operations of Steamship are managed by independent external managers. SPIM is the parent of the management companies. It is a partnership with 11 partners who are jointly the owners. SPIM works exclusively for Steamship on the basis of management service contracts. SPIM is an appointed representative of SIMSL, itself authorised and regulated by the

		FCA in the UK. SPIM receives a fee from SMUAL and SMUAE for its services.
Steamship Insurance Management Services Limited	SIMSL	A subsidiary of SPIM and authorised and regulated by the FCA in the UK. Its staff carries out the day-to-day operations of SMUAL and will assist in the day-to-day operations of SMUAE. SIMSL has a branch in Greece which deals with claims handling which supports SMUAE.
Steamship Insurance Agency (Europe) Limited	SIAE	SIAE is a subsidiary of SIMSL. It employs staff in Cyprus who support SPIM in providing management services to SMUAE.
The Managers		Together, SPIM, SIMSL and SIAE will be referred to as the "Managers".
Hydra Insurance Company Limited	Hydra	Hydra is a reinsurance captive set up by the International Group in Bermuda under the Segregated Account Companies Act 2000. It is a segregated cell company established to provide reinsurance for its members (i.e., a company with a number of cells, each of which acts as an account to reinsure a particular member of the International Group).

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# 1. Introduction

## Purpose of this report

- 1.1 Steamship Mutual Underwriting Association Limited ('SMUAL') is proposing to transfer the European insurance and reinsurance business of SMUAL from SMUAL to Steamship Mutual Underwriting Association (Europe) Limited ('SMUAE') by means of an insurance business transfer scheme (the 'Transfer'). After the Transfer is effected, the relevant policyholders of SMUAL will become policyholders of SMUAE.
- 1.2 SMUAL is part of a regulatory group of companies with SMUAB and SMUAT. SMUAT is the designated insurer for regulatory purposes. The BMA and the ICCS are in the process of entering into a Memorandum of Understanding which will include SMUAE within the regulatory group. These companies trade under the name Steamship Mutual ('the Club').
- 1.3 The Club is a mutual marine insurance business providing cover for marine P&I risks and FDD cover on behalf of its Members (who are in the main, individual ship owners).
- 1.4 The Transfer will be effected under Section 109 of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012 (together the 'FSMA'). The High Court of England and Wales (the 'Court') must approve such insurance business transfer schemes at a sanctions hearing. The FSMA requires that a scheme report must accompany any application to the Court to approve an insurance business transfer scheme. This scheme report (the 'Report') should be produced by a suitably qualified independent person (the 'Independent Expert', 'IE') who has been nominated or approved for this purpose by the Prudential Regulatory Authority ('PRA'). The Report should address the likely effects of the insurance business transfer on policyholders.
- 1.5 This Report has been prepared for, and is addressed to, the Court. The purpose of this Report is to describe the Transfer, and to inform the Court and the affected policyholders of the likely effect of the Transfer. This Report is not suitable for any other purpose. A copy of this Report will be made available to competent regulatory authorities, the Court, policyholders, and any other person entitled to receive a copy under the FSMA. This Report has been prepared solely for the purposes of the FSMA requirements for insurance business transfer schemes and should not be relied upon for any other purposes by any party. Judgements about the conclusions drawn in this Report should be made only after considering the Report in its entirety as parts read in isolation may be misleading.
- 1.6 The Transfer is intended to be effected on 20 December 2020 (the 'Transfer Date'). This is after the date for the sanctions hearing of the Transfer, which is currently scheduled for 2 December 2020.
- 1.7 Insurance and reinsurance companies in the UK are authorised to carry out contracts of insurance and reinsurance by the PRA. Insurance and reinsurance companies in the UK are regulated by a combination of the PRA and the Financial Conduct Authority ('FCA'). The PRA and FCA replaced the Financial Services Authority ('FSA') as the regulator of the UK insurance industry on 1 April 2013. In this Report, the term PRA/FCA shall mean the combination of the PRA and the FCA carrying out their roles as the regulator of the UK insurance industry and/or the FSA carrying out its role as the regulator of the UK insurance industry prior to 1 April 2013.
- 1.8 My Report considers the effect of the Transfer upon:
  - ▶ All policyholders of the companies involved in the Transfer.
  - ▶ Any other group of policyholders which I believe could be affected, or potentially affected, by the Transfer.

- ▶ Any other interested party which could be affected by the Transfer (for example, reinsurers of the firms involved in the Transfer).

1.9 I will consider various groups of policies. In particular, the following three groups:

- ▶ The policies of SMUAL, which will become policies of SMUAE after the Transfer (the 'Transferring Policies' and the holders of which are the 'Transferring Policyholders').
- ▶ The policies of SMUAL, which will remain as policies of SMUAL after the Transfer (the 'Non-Transferring Policies').
- ▶ The policies of SMUAE (the 'Transferee Policies') at the time of the Transfer.

1.10 My Report contains a description of the Transfer, the methodology I have used to analyse the Transfer, the opinions I have formed and reasons why I have formed those opinions.

1.11 The use of 'I' and 'my' in this Report generally refers to the work done by myself and the team operating under my direct supervision during the course of this review. However, when it is used in reference to an opinion, it is mine and mine alone.

## **Independent Expert appointment**

1.12 SMUAL has nominated Ruth Nelmes of Ernst & Young LLP ('EY') to act as the Independent Expert for the Transfer. This nomination has been approved by the PRA in consultation with the FCA. I am a Fellow of the Institute and Faculty of Actuaries and a partner in the Actuarial Services practice of Ernst & Young LLP. I have more than 20 years' experience in general insurance. I have skills in all areas of general insurance actuarial work (including reserving, capital, Solvency II compliance, pricing, and transactions) and have previously worked on a number of other insurance business transfer schemes. Full details of my experience can be found in Appendix C. Ernst & Young LLP is a part of the global network of EY firms.

1.13 I confirm that I am aware of the requirements of Part 35 of the Civil Procedure Rules and the Protocol for Instruction of Experts to give Evidence in Civil Claims. As required by 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. I confirm that I have made clear which facts and matters referred to in this Report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed represent my true and complete professional opinions on the matters to which they refer.

1.14 I can confirm that I have no direct or indirect connections with SMUAL, SMUAE or the Club that I believe would affect my ability to act as the Independent Expert for the Transfer. In particular, I have never worked on any project involving SMUAL, SMUAE or the Club. I have no shareholding, investment or any other financial connection with any of the parties to the Transfer.

1.15 EY have performed some previous work for the parties involved in the Transfer, and related entities, although that work was all prior to 20 February 2015. My assessment of the Transfer is not in any way affected by this previous work and so I do not believe that this affects my independence for this engagement. The PRA/FCA were aware of the services that EY have performed for the parties involved in the Transfer when approving my appointment as Independent Expert. This previous engagement was detailed in the application to the PRA for me to act as Independent Expert in respect of the Transfer.

1.16 SMUAL will be bearing the costs of producing this Report.

## Professional guidance

- 1.17 This Report complies with the applicable rules on expert evidence and with the guidance for Scheme Reports set out by the PRA in the PRA's Statement of Policy and by the FCA in SUP 18 of the FCA Handbook. This Report also complies with the FCA's Finalised Guidance FG18/4.
- 1.18 This Report complies with Technical Actuarial Standards TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance as issued by the Financial Reporting Council ('FRC'), which is responsible for setting UK actuarial standards.
- 1.19 The review performed on this work complies with Actuarial Profession Standard X2: Review of Actuarial Work issued by the Institute and Faculty of Actuaries.
- 1.20 The work complies with Actuarial Profession Standard X3: The Actuary as an Expert in Legal Proceedings issued by the Institute and Faculty of Actuaries.
- 1.21 I believe that this compliance has been achieved with no major deviations from the guidelines.

## Scope of my work

- 1.22 The scope of my work is detailed in the extract from my terms of reference provided in Appendix B. There are no areas where the actual work performed differs from this agreed scope.
- 1.23 I have not considered any alternative arrangements that could be implemented in place of the Transfer because I have been able to conclude that the Transfer is appropriate. I am also not aware of any alternative arrangements to the Transfer proposed by any party, so I have not considered it necessary to discuss alternative proposals within this Report.

## Use of data and reports

- 1.24 My analysis is based upon my review of the data and documentation produced by SMUAL, SMUAE and their advisors, and on discussions with representatives from those firms. This Report has been reviewed by the management of the Club, SMUAL and SMUAE to ensure all factual information as presented is correct.
- 1.25 I have relied on the completeness of the data provided to me. I have not audited, nor have I independently verified the data and information supplied to me. This is because the data relies heavily on financial and internal management accounts which can only be verified by SMUAL and SMUAE themselves, or by their auditors. However, I have reviewed it for reasonableness and for internal consistency. I have also received a specific statement of data accuracy from the management of SMUAL and SMUAE.
- 1.26 I have also placed reliance upon the data insofar as when assessing claims, I have not explicitly considered the potential for future causes of new claims that are not seen in the historical data. I consider this approach to be reasonable and in line with accepted actuarial practice.
- 1.27 A summary of the data provided to me can be found in Appendix D.
- 1.28 All monetary amounts shown in this Report are shown in millions of United States Dollar ('USD' or \$). The underlying numbers contained in this Report are calculated to many decimal places and so totals and summaries are subject to rounding differences.

## Peer review process

- 1.29 In accordance with the internal control processes of EY, the work documented in this Report has been peer reviewed by a suitably qualified person (an Actuary within my own firm who has acted as the Independent Expert in other insurance business transfer schemes). The peer review process has included review of the methodology used and discussion of the key elements of the analysis. The peer reviewer for this review is Alex Lee, a Fellow of the Institute and Faculty of Actuaries.

## Layout of this Report

- 1.30 My Report is structured as follows:

- ▶ Section 1: Introduction
- ▶ Section 2: Executive Summary: This section provides detail on the companies and portfolios of business involved in the Transfer. It explains the details of the operation of the Transfer. It also sets out my overall conclusion on the Transfer and the key reasons for reaching this conclusion.
- ▶ Section 3: Summary of the approach I have taken for reaching my conclusion.
- ▶ Section 4: Assessment of assets and liabilities: This section describes the work that I have carried out to assess the technical provisions of SMUAL and SMUAE and the balance sheets of SMUAL and SMUAE.
- ▶ Section 5: Assessment of capital requirements: This section describes the work that I have carried out to assess the capital modelling of SMUAL and SMUAE.
- ▶ Section 6: Assessment of other aspects of the Transfer: This section summarises my assessment of other factors that might affect policyholders.
- ▶ Section 7: Reliances and limitations.
- ▶ Appendix A - Glossary of technical terms.
- ▶ Appendix B - Extract from my terms of engagement letter.
- ▶ Appendix C - CV of Ruth Nemes as Independent Expert.
- ▶ Appendix D - List of data and materials reviewed
- ▶ Appendix E - Checklist against the guidance on scheme reports as set out in the PRA's 'Statement of Policy, the PRA's approach to insurance business transfers - April 2015' ('PRA's Statement of Policy') and Chapter 18 of the Supervision Manual of the FCA Handbook ('SUP18 of the FCA Handbook').

## 2. Executive Summary

### Overview

- 2.1 Until 19 February 2020 SMUAL wrote insurance policies in the European Economic Area ('EEA') which it continues to administer. The Transfer of business is part of a reorganisation of the Club, made in response to the challenges arising from Brexit, to ensure that relevant policyholders will continue to have policies and claims serviced in the EEA post Brexit.
- 2.2 The Club is a mutual association that is owned by its Members. The security provided to policyholders is derived from the intra-group reinsurance and the mutual relationships between SMUAL, SMUAE, SMUAB and SMUAT. There is an established way of moving funds around the Club if needed and this does not change after the Transfer. There is also an established method for raising additional capital if required through premium by a levy on members, and again this does not change after the Transfer.
- 2.3 SMUAE provides the same type of insurance cover as SMUAL and therefore the associated claims being transferred from SMUAL to SMUAE are of the same nature. The technical provisions are set on an appropriate and consistent basis for both SMUAL and SMUAE pre and post Transfer.
- 2.4 Below I provide a description of the Transfer, the background to the entities involved and my conclusions on how the Transfer affects policyholders and other parties involved in the Transfer.
- 2.5 As a result of my work, I conclude that there is no reason that the Transfer should not go ahead.

### Background to the Transfer

- 2.6 The UK voted to leave the European Union ('EU') on 23 June 2016 and then notified the European Commission of its intention to withdraw from the EU ('Brexit'). The UK left the EU on 31 January 2020, with the current transitional arrangements ending on 31 December 2020. The EU and the UK are negotiating arrangements for the UK's relationship with the EU post 31 December 2020. The nature of these arrangements is currently unknown, and I believe are not guaranteed.
- 2.7 SMUAL currently uses various legislation set out in European law to be able to write and administer insurance policies in the EEA. After Brexit, there is a risk that SMUAL will lose the right to carry out these activities. The Transfer is part of a reorganisation of the Club, made in response to these challenges arising from Brexit. The reorganisation is designed to enable the Club to continue providing services to their policyholders in the EEA.
- 2.8 Prior to 20 February 2020, SMUAL, a UK company, wrote insurance business across the EEA using the passporting mechanism of the EU set out in the Treaty on the Functioning of the EU, and implemented in the UK through the Passporting Regulations. This was enabled using a Freedom of Services basis, i.e., writing EEA insurance business directly from SMUAL.
- 2.9 Following the decision of the UK to leave the EU, the Club decided to use an alternative model to ensure business continuity, given that there is a risk that the existing model would not be viable after Brexit, mainly due to the loss of passporting.
- 2.10 Cyprus was chosen as the location for SMUAE since it is one of the largest European markets for the Club by premium. The Club is well thought of in Cyprus with local members being viewed positively in the country. Having a common law jurisdiction with which the Club and the Managers were familiar was an important consideration for both the operation

of SMUAE and its governance giving a good fit with the other companies in the regulatory group and the management company group.

2.11 Therefore, the Club has carried out, or is carrying out, the following steps:

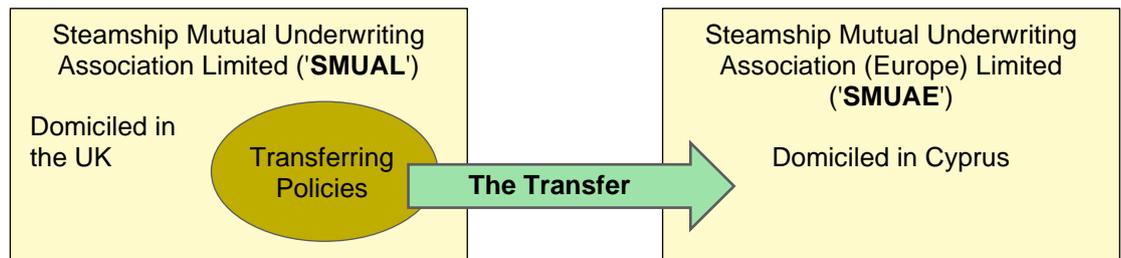
- ▶ Set up a new insurance company, SMUAE, domiciled in Cyprus, which is a Solvency II compliant authorised insurer able to continue to operate under the passporting mechanism of the EU post-Brexit. SMUAE has the same governance structure as SMUAL.
- ▶ Any new policies incepting on or after 20 February 2020 for European policyholders (including from Monaco and Switzerland) have or will be provided by SMUAE.
- ▶ The Club will transfer the remaining affected European business (i.e. the run-off of European policies) from SMUAL to SMUAE using an insurance business transfer scheme (i.e. the Transfer). The Club is also transferring business written in Monaco and Switzerland for operational and governance benefits.

2.12 In summary, the effect of these changes is that all EEA (excluding UK) exposures of the Club (plus exposures in Monaco and Switzerland) will be insured by SMUAE, after the Transfer.

### Transfer description

2.13 The diagram below shows a summary of the Transfer. The policies which will transfer (the ‘Transferring Policies’) are those where the purchasing policyholder has its country of management prior to the Transfer Date within the EEA (excluding UK), Switzerland or Monaco. Even where a policyholder is managed in an EEA country (or Switzerland and Monaco), there may be parts of the insured risk which are located outside of those countries; for the avoidance of doubt, policies held by those policyholders are included in the definition of Transferring Policies.

Diagram 2a: Summary of the Transfer



2.14 The Transferring Policies will move from SMUAL to SMUAE as part of the Transfer. After the Transfer, SMUAE will be legally responsible for administering and paying the valid claims of the Transferring Policies.

2.15 On the Transfer Date, various assets, including the reinsurance asset in respect of Transferring Policies, will transfer to SMUAE. The majority of the assets of SMUAL (and the assets transferring to SMUAE) are reinsurance assets and institutional deposits (i.e., cash). I describe the effect of the Transfer on the balance sheets of SMUAL and SMUAE from paragraph 4.42.

### Background to entities involved in the Transfer

2.16 The diagram below shows the current structure of the Club, with the relevant insurance entities shown, and the Transfer marked as a green arrow. The red dotted lines represent the material intra-group reinsurance (see below for details on each company).

2.17 SMUAE and SMUAL are the only companies in the Club which provide direct insurance cover with SMUAB and SMUAT acting as reinsurers.

Diagram 2b: Pre-Transfer - Relevant insurance entities

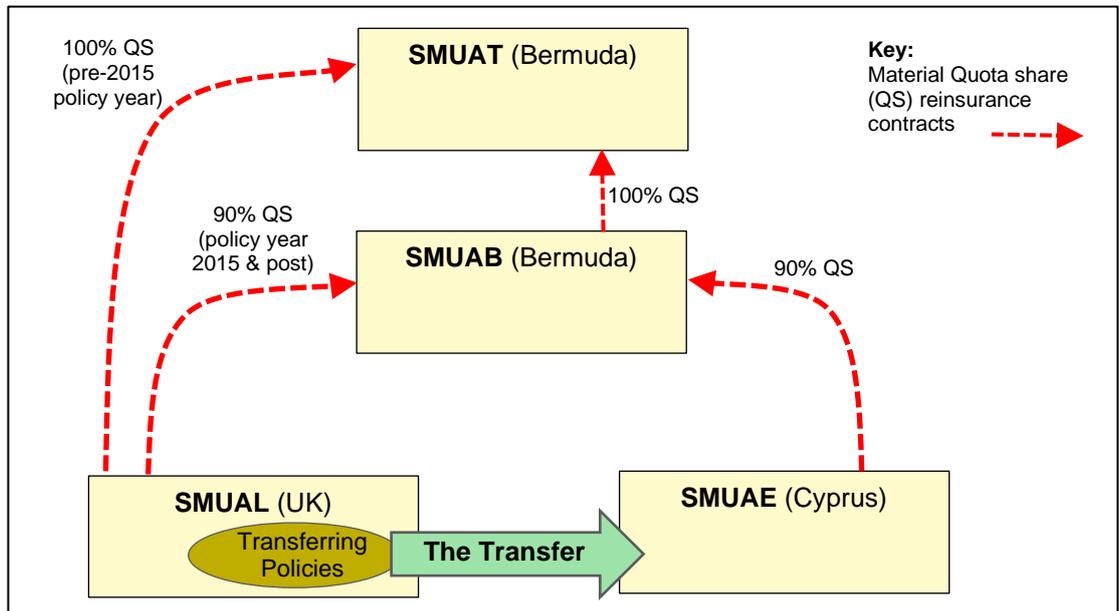
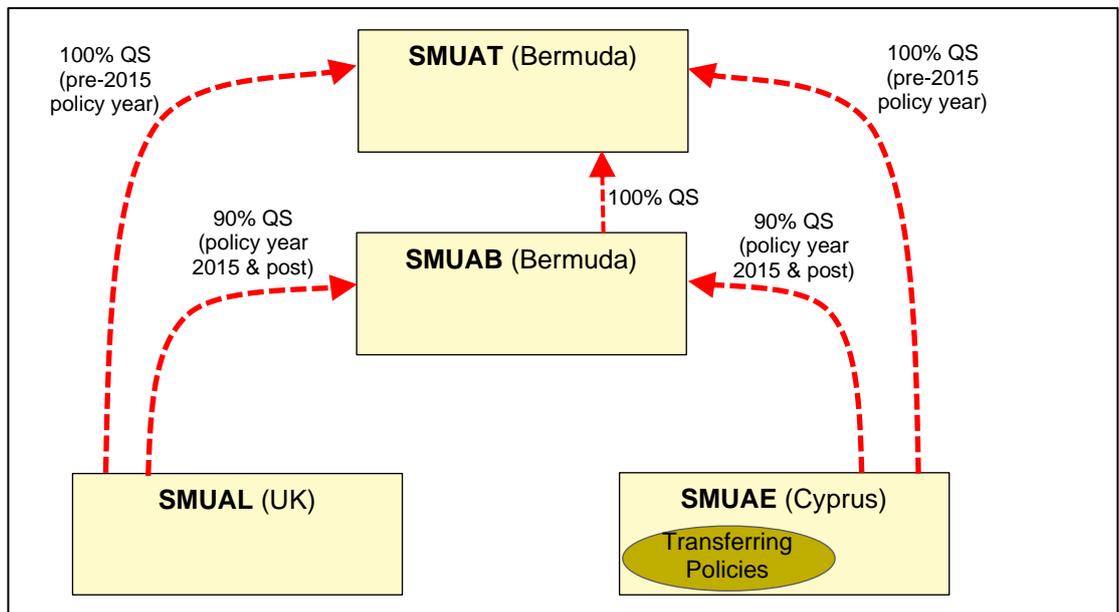


Diagram 2c: Post-Transfer - Relevant insurance entities



**Steamship Mutual ('the Club')**

2.18 The Club is a mutual marine insurance business providing cover for marine P&I (Protection and Indemnity) and FDD (Freight, Demurrage and Defence) risks to its members and other policyholders. The Club issues insurance policies through SMUAL and SMUAE. The terms of insurance cover offered by SMUAL and SMUAE are identical.

*Mutual members of the Club*

2.19 As a group of mutual companies, the Club does not have shareholders. The companies are owned by, and exist for the benefit of, their members. These are (with the exception of

certain individual directors) various policyholders of SMUAL or SMUAE (the 'Club Members'). They are generally ship owners and other entities that have ships insured with either SMUAL or SMUAE. All of the companies of the Club are ultimately owned by the Club Members.

- 2.20 The Club will vary the premium charged to Club Members from time to time; this is the mechanism through which Club Members take a share in the surpluses or contribute to the deficit of the Club.
- 2.21 Club Members might also be required to make an additional premium payment (an 'Additional Premium Call') if the Club needs additional funds. If there is a need for additional capital, the Board of each of SMUAE and/or SMUAL will consider whether an Additional Premium Call is required and, if so, the level at which such call will be made.

#### *Fixed Premium Business*

- 2.22 Both SMUAE and SMUAL also issue policies to policyholders who are not Club Members; this business is provided on commercial terms to those policyholders. Their premium is not varied in the same way as for Club Members (i.e., they do not share in the surpluses, or contribute to the deficit of the Club), and they are not required to pay Additional Premium Calls when those are required.

#### **Steamship Mutual Underwriting Association Limited ('SMUAL')**

- 2.23 SMUAL is an insurance company limited by guarantee incorporated in the UK in October 1909 as Steamship Mutual Underwriting Association Limited. SMUAL is authorised by the PRA and regulated by the FCA and the PRA in the UK. Its principal activity is insurance and reinsurance of P&I and FDD risks. SMUAL has branch offices in Singapore, Hong Kong and Japan which are subject to local regulation.
- 2.24 SMUAL has various external reinsurance in place and two material intra-group reinsurance contracts; namely, a 100% quota share for policy years 2014 and prior (with SMUAT), and a 90% quota share of policy years 2015 and post (with SMUAB). The intra-group reinsurance applies to the net amount after other external reinsurance.

#### **Steamship Mutual Underwriting Association (Europe) Limited ('SMUAE')**

- 2.25 SMUAE is an insurance company limited by guarantee incorporated in Cyprus on 4 September 2019 as Steamship Mutual Underwriting Association (Europe) Limited. SMUAE is authorised and regulated by the Insurance Companies Control Service in Cyprus. Its principal activity is insurance and reinsurance of P&I and FDD risks.
- 2.26 SMUAE has various external reinsurance in place and a material intra-group reinsurance; namely, a 90% quota share with SMUAB. The intra-group reinsurance applies to the net amount after other external reinsurance.

#### **Steamship Mutual Underwriting Association (Bermuda) Limited ('SMUAB')**

- 2.27 SMUAB is a reinsurer incorporated in Bermuda and regulated by the BMA in Bermuda. The only policies issued by SMUAB are those reinsurance contracts with SMUAL and SMUAE (as described above).
- 2.28 SMUAB is 100% reinsured by SMUAT (the reinsurance premium is based on the premium payable to SMUAB by SMUAL and SMUAE, less certain expenses).

#### **Steamship Mutual Underwriting Association (Bermuda) Trust Limited ('SMUAT')**

- 2.29 SMUAT is a reinsurer incorporated in Bermuda and regulated by the BMA in Bermuda. SMUAT is the designated insurer for group regulatory supervision purposes of the Club.

- 2.30 SMUAT reinsures 100% of the liabilities of SMUAB and, for policy years 2014 and prior, 100% of the liabilities of SMUAL.

#### **Intra-group reinsurance**

- 2.31 As described above, there are various important intra-group reinsurance contracts ('Group Quota Shares') in place. The overall effect of these contracts is that a very high proportion of the net liabilities (after other external reinsurance) are ultimately reinsured to SMUAT (this is 100% for policy years 2014 and prior, and 90% for policy years 2015 and post).
- 2.32 The Group Quota Shares are secured with collateral agreements, entered into by: (i) SMUAT, SMUAB and SMUAE; and, (ii) SMUAT, SMUAB and SMUAL.
- 2.33 These collateralisation arrangements each provide for SMUAT to hold a minimum amount in a collateral account which the ultimate reinsured (SMUAL or SMUAE) can take control of in the event that SMUAT (or where relevant SMUAB) fails to meet its reinsurance obligations. The amount of collateralisation is broadly equal to the value of the reinsurance asset and is adjusted from time to time as claims are paid and premiums collected.

#### **The International Group**

- 2.34 The International Group is a group of 13 P&I clubs that collectively provide 90% of P&I cover to the global shipping industry. The members of the International Group have an agreement to share losses in a "pooling" arrangement for claims against owners of ships. If a claim incurred by a particular club is above the club retention for a given year, then the agreement would mean that the excess over this retention would be shared amongst the members of the International Group (including the club against which the original claim was made). The International Group also purchases reinsurance from the external reinsurance market to provide protection to its 13 members.
- 2.35 The Club is a member of the International Group and participates in the International Group pool. SMUAB is jointly and severally liable for the pooling obligations of SMUAE and SMUAL. Neither SMUAE nor SMUAB are liable for the pooling obligations of the other or SMUAB.
- 2.36 Hydra Insurance Company Limited ('Hydra') is a reinsurance captive created by the members of the International Group in Bermuda. It is a segregated cell company established to provide reinsurance for its members (i.e., a company with a number of cells, each of which acts as an account to reinsure a particular member of the International Group).
- 2.37 The Club's cell provides reinsurance to the Club, and the funds within that cell cannot be accessed by any of the other members of the International Group, nor can the Club access funds within any other cell.
- 2.38 The Club's cell in Hydra is held by SMUAB and will continue to be held by SMUAB after the Transfer.

#### **Chain of security**

- 2.39 The 'chain of security' is the order in which the assets of the Club can be used to make a claim payment to a policyholder. From the point of view of the policyholders of SMUAL and SMUAE, the pre-Transfer chain of security is as follows:
- ▶ Unencumbered assets (mostly cash and bonds) held by SMUAL and SMUAE can be used to pay the claims of the respective policyholders (i.e., assets held by SMUAL can be used to pay policyholders of SMUAL etc.).

- ▶ SMUAL and SMUAE have various external reinsurance arrangements (see paragraphs 2.31-2.38), including those available under the International Group pooling and (via SMUAB) Hydra arrangements (see paragraphs 2.34 to 2.38).
- ▶ The Group Quota Shares in place with SMUAB and SMUAT cover 90% of the liabilities after other reinsurance (and 100% for liabilities prior to 2015). As described in paragraph 2.32 the Group Quota Shares are collateralised, so that there is a ring-fenced pool of assets for the benefit of each of SMUAL and SMUAE.
- ▶ The Group Quota Shares include provisions so that the reinsurance premium payable by SMUAL and SMUAE will be reduced by such amount as is necessary to maintain the capital held by SMUAL and SMUAE at 100% of the regulatory capital requirement. Therefore, in a stressed situation, there is an automatic and immediate mechanism to allow the capital of SMUAL and SMUAE to be maintained at the regulatory requirement.
- ▶ In addition, the Group Quota Shares premium may be renegotiated with SMUAB/SMUAT. There is a recent precedent for this when SMUAL renegotiated its reinsurance arrangement with SMUAB to increase the capital held by SMUAL. There is no obligation on SMUAB/SMUAT to agree to such change, but I believe that it is reasonable to assume that SMUAB/SMUAT would consider this in the future.
- ▶ There are additional unencumbered assets of SMUAB and SMUAT. There is no obligation on SMUAB and SMUAT to agree to provide additional capital to SMUAL and SMUAE; however, given that SMUAB and SMUAT are effectively owned by the Club Members, I believe that it is reasonable to assume that SMUAB and SMUAT would consider providing additional capital to SMUAL and SMUAE.
- ▶ The Boards of SMUAL and SMUAE can, if necessary, each levy an Additional Premium Call on their members. Those members would then be required to pay an additional premium amount.

2.40 I believe that the chain of security is essentially unchanged after the Transfer (except that the Transferring Policies will be insured by SMUAE rather than SMUAL). The Group Quota Shares and the mechanism for making Additional Premium Call will operate in the same way as before the Transfer.

## Conclusion

2.41 I have considered the Transfer and its likely effects on the policyholders of SMUAL and SMUAE and any other parties affected by the Transfer. I confirm that I understand my duty to the Court.

**I conclude that the security provided to policyholders will not be materially adversely affected after the Transfer, that no group of policyholders would be adversely affected to a material extent by the Transfer, that the level of customer service provided to policyholders would be unaffected by the Transfer.**

**I also conclude that there are also no other parties (e.g. reinsurers) who will be materially adversely affected by the Transfer.**

**As a result, I conclude that there is no reason that the Transfer should not go ahead.**

## Materiality

- 2.42 As Independent Expert, I have considered the effect of the Transfer on the policyholders involved, and in particular, I have considered whether any group of policyholders is adversely affected to a material extent by the Transfer. I will explain below what I mean by a “material extent”.
- 2.43 Firstly, it is important to note that an insurance business transfer can have different effects on different groups of policyholders. There may be some effects of a transfer that are positive to a particular policyholder, and some effects that are negative (i.e., adverse). If some of the effects of a transfer are adverse, this does not necessarily mean that the transfer is unfair, because the adverse effect might be insignificant, or it might be outweighed by other positive effects.
- 2.44 Secondly, my conclusions are partly based on various statistical estimates of future events, and those estimates will always be subject to some uncertainty (because they are estimates of future, unknown events). I have used my professional judgement to weigh up the conclusions from those statistical estimates, bearing in mind the uncertainties involved.
- 2.45 For the purpose of this Report, I consider that a matter is material if it could, either individually or collectively, influence the decision to be taken by the user of the Report. Assessing this materiality requires reasonable judgement on the context of the work and the way in which it is reported. I have considered the overall effect of the Transfer on each group of policyholders, after considering the aggregate effect of all of the various issues. There might be some matters described in this Report which are not material, but which I believe would be of interest to policyholders.

## Reasons for reaching my conclusion

- 2.46 I set out below the key reasons for reaching my conclusions. This is not an exhaustive list of the issues I have addressed, but rather a summary of the parts that I believe are most relevant to policyholders.
- 2.47 There are five main topics I will discuss below:
- ▶ Mutual relationships between SMUAL, SMUAE, SMUAB and SMUAT.
  - ▶ The sufficiency of the technical provisions.
  - ▶ The level of capitalisation of SMUAL, SMUAE, SMUAB and SMUAT, and the associated financial strength of those firms.
  - ▶ The considerations of changes to the servicing of policies.
  - ▶ The impact of Brexit.

### **Mutual relationships between SMUAL, SMUAE, SMUAB and SMUAT**

- 2.48 My primary reason is that it is the Club as a whole which is providing security to its policyholders: although individual policyholders hold their policy with either of SMUAL or SMUAE, a large part of that security provided to policyholders is derived from the intra-group reinsurance and the mutual relationships between SMUAL, SMUAE, SMUAB and SMUAT. In particular:
- ▶ The ‘chain of security’ (as described in paragraph 2.39) is unchanged after the Transfer (except that the Transferring Policies are insured with SMUAE rather than SMUAL).
  - ▶ The same reinsurance will be in place after the Transfer, and the contracts will operate in the same way. In particular, the Group Quota Shares will operate in the same way; a

very large proportion of the liability of SMUAL and SMUAE is reinsured by SMUAT and SMUAB and so those contracts are a key part of the overall security provided to policyholders.

- ▶ The mechanism for making an Additional Premium Call (if this is required) from Club Members will not change after the Transfer. If either of SMUAL or SMUAE require additional funds to meet claim payments, then this can be achieved from an Additional Premium Call. The call is made across all Club Members (i.e., each of SMUAE and SMUAL can make a call from their members independently).
- ▶ The method for moving funds around the regulatory group has traditionally been the reinsurance agreements. Changes to the reinsurance agreements require the agreement of both parties but, as happened prior to Solvency II, SMUAB and/or SMUAT could agree with SMUAL and/or SMUAE to alter the percentage of reinsurance premium or reinsurance claims specified in the reinsurance agreements thus creating additional capital in one of the companies. This may also happen automatically as a result of the existing provisions in the reinsurance agreements to replenish SMUAL's or SMUAE's capital to the required regulatory minimum. Although, there are no shareholdings which would allow dividends/share purchases to move capital between companies. On 11 October 2019, SMUAE was capitalised by means of a \$30m capital injection from SMUAB and it would be possible for there to be further voluntary capital injections, if required. Currently, there are no additional planned capital injections of this nature expected in the future and the Transfer is not dependent on any such injection of capital. The total amount of capital in the Club is unchanged after the Transfer.

#### **Sufficiency of technical provisions**

- 2.49 The technical provision is the money set aside by an insurance company to pay future claim amounts. It is an important part of the security offered to policyholders; it is important that an insurance company has sufficient money available to pay these future claims. I have reviewed the technical provisions of SMUAL and SMUAE, pre and post transfer (see paragraphs from 4.1 for details).
- 2.50 My review has included an assessment of the approach, methodology and governance that are used to determine the technical provision levels. I have also assessed key assumptions used in determining the technical provisions and also carried out a benchmark review for the most material and uncertain aspects of the technical provisions.
- 2.51 I have concluded that the technical provisions are set on an appropriate and consistent basis for both SMUAL and SMUAE, both before and after the Transfer. The technical provisions of SMUAB and SMUAT are set in a consistent way with SMUAL and SMUAE.

#### **Level of capitalisation and financial strength**

- 2.52 The regulatory capital requirement is one measure of the overall financial strength of an insurance firm. I have reviewed the regulatory capital position of SMUAL, SMUAE, SMUAB and SMUAT, pre and post the Transfer (see paragraphs from 4.1 for details).
- 2.53 Post Transfer, all entities would meet regulatory capital requirements by a margin. The regulatory capital is calibrated at a 1 in 200 level of sufficiency. This suggests that the overall level of security provided to the policyholders of the Club is good.
- 2.54 SMUAL, SMUAE, SMUAB and SMUAT are rated together and have an 'A' rating with a stable outlook by Standard & Poor's ('S&P'), and I am not of aware of anything to suggest that this would not be maintained after the Transfer. This suggests a good level of financial strength. A significant proportion of the assets held by SMUAL and SMUAE will be in the form of collateralised reinsurance assets with SMUAB and SMUAT. Note, the use of reinsurance

reduces insurance risk which more than offsets the small increase in counterparty default risk for SMUAL and SMUAE.

- 2.55 I believe that the assets transferring from SMUAL to SMUAE (mostly reinsurance assets and cash) are appropriate for SMUAE, and do not materially affect the mix of assets held by SMUAE after the Transfer.

#### Customer service

- 2.56 I have considered the impact of the Transfer on customer service levels for policyholders of SMUAL and SMUAE. This includes understanding SMUAE's future plans for recruitment levels and whether suitable experienced individuals are available. The Transferring Policies are currently serviced in the UK and Cyprus by various service companies (collectively, the 'Managers') and post-Transfer will continue to be serviced in the same way. I believe that the Transfer will not cause any change in the method or standard of service provided to policyholders.

#### The impact of Brexit

- 2.57 Brexit has introduced or exacerbated a number of risks for insurers operating in the UK, particularly for those that trade across EEA borders. There is also the potential that after the transition period expires, UK insurers lose the ability that currently exists to service risks in the EEA without being authorised by local regulators. The Transferring Policies are from numerous EEA countries and there is risk of different EEA countries taking different stances on how policyholders could have their claims paid or policies serviced. Not proceeding with the Transfer gives the potential, depending on the outcome of ongoing negotiations between the EU and the UK, of policyholders not legally being able to have their claims paid or policies serviced.
- 2.58 There are Brexit risks as discussed in paragraphs 6.2 to 6.14 which cannot be avoided in any practical way; however, I believe that the most material risks, relating to how services can be provided to EEA policies, can be mitigated by transferring those policies to SMUAE (i.e., by effecting the Transfer).

#### Effect on specific policy groups

- 2.59 The table below shows a summary of the reasons for reaching my conclusion, for each of the three groups of policies.

Type of policy	Summary of the reasons for my conclusion
<p><b>Non-Transferring Policies</b></p> <p>These SMUAL policies will remain with SMUAL after the Transfer</p>	<p>There will be minimal change to the balance sheet and financial strength of SMUAL after the Transfer because the Transferring Policies are only approximately 20% of the overall SMUAL net technical provisions.</p> <p>Based on my review, I conclude that the technical provisions of SMUAL are set on a reasonable basis, and that SMUAL would meet its regulatory capital requirement after the Transfer.</p> <p>The policyholders will belong to the same legal entity, with exactly the same governance structure, regulatory framework, policy terms and conditions, and their policies will be serviced in the same manner as prior to Transfer.</p>
<p><b>Transferring Policies</b></p>	<p>Based on my review, I conclude that both SMUAL and SMUAE are both strongly capitalised companies (when compared to the regulatory minimum capital requirements), and that they provide a broadly equivalent level of security.</p>

<p>These SMUAL policies will move from SMUAL to SMUAE as part of the Transfer</p>	<p>There will be minimal change to the balance sheet and financial strength of SMUAL after the Transfer. Whilst the impact on the SMUAE balance sheet will be more notable, there will be minimal change to the financial strength after the Transfer.</p> <p>Based on my review, I conclude that the technical provisions of SMUAE are set on a reasonable basis, and that SMUAE would meet its regulatory capital requirement after the Transfer.</p> <p>The policy terms and conditions will be the same, and the policies will be serviced in the same manner as prior to Transfer. The policyholders will be insured by a different legal entity; but the governance structure and regulatory framework is not materially different.</p> <p>Without the Transfer, I believe that there are some key risks related to Brexit; in particular, that SMUAL could be prevented by law from paying claims and servicing policies. This would be detrimental to policyholders.</p> <p>A significant number of the Transferring Policyholders have already renewed their 2020 policy with SMUAE (and there were no complaints from policyholders after this change). The Transfer is simply bringing their policies from prior years to the same insurance entity.</p>
<p><b>Transferee Policies</b></p> <p>These SMUAE policies will remain with SMUAE after the Transfer</p>	<p>Based on my review, I conclude that SMUAE will be strongly capitalised (when compared to the regulatory minimum capital requirements) and provide high level of security. There will be a small reduction of the balance sheet and financial strength of SMUAE after the Transfer with the capital ratio still above the expectation of the ICCS and significantly in excess of the Standard Formula SCR.</p> <p>Based on my review, I conclude that the technical provisions of SMUAE are set on a reasonable basis, and that SMUAE would meet its regulatory capital requirement after the Transfer.</p> <p>The policyholders will belong to the same legal entity, with exactly the same governance structure, regulatory framework, policy terms and conditions, and their policies will be serviced in the same manner as prior to Transfer.</p>

**Considerations for reinsurers of the Club**

2.60 I have considered any possible effect on the reinsurers of the Club (including the principle reinsurers SMUAB and SMUAT, as well as the International Group pooling and Hydra arrangements), where the underlying business is transferred to SMUAE. The amount payable by those reinsurers to SMUAL and SMUAE in respect of that reinsurance will not change as a result of the Transfer. There are no additional liabilities being created as part of the Transfer. I understand from the Club there are no set-off rights. Therefore, other than the change of legal entity for transferring reinsurance arrangements, I conclude that these reinsurers are not materially affected.

**Proprietary rights of Members**

2.61 I have considered the effect of the Transfer on the proprietary rights of the Club Members of SMUAL and SMUAE. Paragraph 2.48 summarises the impact of the Transfer and highlights that there is no impact on the rights of the Club Members after the Transfer. The right to make Additional Premium Calls remains for both SMUAE and SMUAL.

- 2.62 Therefore, there is no compensation to Club Members as part of the Transfer for any diminution of proprietary rights.

**Effect on other parties**

- 2.63 The arrangements between the Club and the International Group of P&I Clubs would be the same after the Transfer, and so I do not believe that those other P&I clubs are adversely affected by the Transfer. I did not identify any other third parties that I believe would be materially adversely affected by the Transfer.

**Supplementary Report**

- 2.64 My conclusions are based on the information available to me at the time of writing this Report. I will produce a Supplementary Report prior to the Transfer Date, and this will comment on the most recent information available. I expect that this will include details of movements in claims paid and claims incurred since 20 February 2020. There may be other data that I will request for the purposes of the Supplementary Report, depending on the circumstances and any changes to the financial positions of the companies involved; in particular, I will consider views on any objections received and comments on compliance with directions related to the communications plan.

**Independent Expert declaration**

- 2.65 In reaching the conclusions set out below, I have applied the following principles. 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 policyholders of SMUAL and SMUAE);
  - ▶ Indicate how the Transfer might lead to any changes in the material risks to the benefits of different classes of beneficiaries;
  - ▶ Consider how any other parties may be impacted by the Transfer (such as other entities, members of the Club, reinsurers and members of the International Group);
  - ▶ Indicate (in broad terms) the impact on the actuarial information of adopting alternative plausible assumptions;
  - ▶ Assess the impact on all classes of beneficiaries;
  - ▶ Indicate the proposed rationale for the Transfer to proceed;
  - ▶ Include (in summary) the most material information on which my opinion is based; and,
  - ▶ Describe the rationale for my opinion.
- 2.66 I confirm that I have made clear which facts and matters referred to in this Report are within my own knowledge and which are not. Those that are within my own knowledge I confirm to be true. The opinions I have expressed and conclusions I have drawn represent my true and complete professional opinions on the matters to which they refer.
- 2.67 As required by 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.

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

### 3. Summary of my approach

3.1 The section below sets out my approach for assessing the Transfer.

#### **Gain a thorough understanding of the Transfer and identifying the groups of policyholders that would be affected.**

3.2 This was achieved through discussions with SMUAL, SMUAE, their managers and their advisors to understand the Transfer, together with reviewing the documents agreed between the parties for the implementation of the Transfer. The documents I reviewed included:

- ▶ The SMUAL PRA (regulatory) returns, to understand SMUAL's balance sheet on a UK GAAP basis.
- ▶ The Club's Risk Appetite statement, Capital Management policy, Underwriting policy, Actuarial policy and Investment policy outlining the various functional policies for Steamship.
- ▶ A structure diagram of the Club, to understand the relationships between the entities involved in the Transfer.
- ▶ Extract from the Scheme of Operations financial projections for SMUAE to understand SMUAE's financial position.
- ▶ The Clubs' annual report and financial statements, to understand their financial position on a GAAP basis.
- ▶ The Group Solvency Self-Assessment ('GSSA') report and signed financial condition report for Steamship, to understand the Club's capital position and balance sheet on Solvency II basis as well as rules prescribed by the BMA.
- ▶ An external actuarial report for review of the technical provisions for SMUAL as at February 2019, to understand the technical provisions adequacy for SMUAL.
- ▶ An external actuarial memo for review of the technical provisions for SMUAL as at February 2020, to understand the technical provisions adequacy for SMUAL.
- ▶ Reserving model for SMUAL (this includes SMUAE) as at February 2020, to understand how the technical provisions have been estimated.
- ▶ SMUAL and SMUAE excel models which calculate the Standard Formula for each company as at 20 February 2020.
- ▶ A document detailing the Basis of Preparation of the Solvency II balance sheet for SMUAL and SMUAE.
- ▶ A reinsurance structure diagram for the Club to understand the reinsurance programmes in place.
- ▶ Schedules showing the investment portfolios of the Club as at 20 February 2020 to understand how the assets are invested.

#### **Review of the claims reserves of SMUAL and SMUAE**

3.3 The claims reserves of an insurance company are an estimate of the amount of money that the company will need to pay out to its policyholders as claim payments in the future. It is

an unknown amount of money (because future claim amounts are unknown and uncertain) but it can be estimated by the company by using various statistical methods.

- 3.4 An important question when considering the security provided to policyholders of a company is whether the estimation of the technical provisions has been carried out in an appropriate way. This is because there is a risk that the company has underestimated the amount of money that it will need to pay future claim amounts to policyholders, and therefore a risk that it will not be able to pay those claim amounts.
- 3.5 Therefore, I have considered the adequacy of significant parts of the technical provisions of SMUAL and SMUAE. This is described in from paragraph 4.4.

### **Review of the assets and capital requirements of SMUAL and SMUAE**

- 3.6 A second important aspect of the modelling work I have reviewed relates to the uncertainty over the size of the future claim amounts. The amount of capital in an insurance company is the difference between the value of the assets of the company (e.g., investments, cash and amounts due from debtors), and the value of the liabilities of the company (e.g., future claim payments and amounts due to creditors). It is one measure of the financial strength of the company.
- 3.7 Insurance regulators require that an insurance company has at least a certain minimum amount of capital (i.e., so that it has a level of buffer to help make future claim payments). The capital requirement is needed because the ultimate amount of the future claim payments is uncertain; the insurance company and the regulator wish to be confident that the company is able to meet all future claim payments, even in an unlikely adverse scenario. However, this does not mean that a company will be able to meet all claim payments in all circumstances; only that there is a higher probability of being able to do so.
- 3.8 As part of my work I have checked that the probability of both SMUAL and SMUAE's future claim payments being met is not materially affected by the Transfer, and that their ability to meet the regulatory capital requirements is not materially affected by the Transfer. This is described in section 5. I describe the changes in asset mix in paragraph 4.49.

### **Consider the level of security offered to each group of policyholders, assuming existing arrangements, and assuming the Transfer is effected**

- 3.9 I have considered each group of policyholders, both before and after the Transfer, and the relative strength of capital available compared to their capital requirements. This is described in the executive summary, from paragraph 2.39.

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

- 3.10 I have considered how the level of customer service provided to each group of policyholders could change following the Transfer. This is described from paragraph 6.35.

### **Consider any other factors that might affect policyholders (for example, ongoing expense levels, pension arrangements etc.)**

- 3.11 I have considered other factors (such as the impact of Brexit, the Financial Services Compensation Scheme, the Financial Ombudsman Service, policyholder communication strategy, tax implications, policyholders outside EEA jurisdiction, the split between direct and reinsurance policyholders, ongoing expense levels, the relevant entities liquidity position, set-off rights, investment management implications and pension arrangements, through discussions with the management teams of the Club (see section 6).

## **Materiality**

- 3.12 Throughout my work I have applied the concept of materiality, as set out from paragraph 2.42.

## 4. Assessment of assets and liabilities

- 4.1 The technical provision amount is the money set aside by an insurance company to pay future claim amounts. It is an important part of the security offered to policyholders; it is important that an insurance company has sufficient money available to pay these future claims. A firm will carry out some form of actuarial analysis to estimate the amount of the technical provisions required. I have carried out a review of this analysis. I have reviewed the technical provisions of SMUAL and SMUAE, and the technical provisions associated with the Transferring Policies (which will form part of the technical provisions of SMUAE after the Transfer).
- 4.2 I will use the term technical provisions to refer to the total provision set aside for all of the future claim payments. This is on a GAAP basis for SMUAL and on an IFRS 4 basis for SMUAE, with no material difference in the calculation of the technical provisions. Some of the intermediate calculations in the actuarial work will not be on a GAAP basis for SMUAL or an IFRS 4 basis for SMUAE, and in those circumstances I will use, for convenience, the term 'claims reserve'. In the tables below, I will show a reconciliation of the claims reserve to the total technical provision shown in the GAAP or IFRS financial statements.
- 4.3 I will use the term 'best estimate' when referring to an estimate of the claims reserve, where that estimate has no intended margin for prudence or optimism, and where it is a reasonable estimate of the claims reserve given the data and information available. There are inherent risks in insurance business, and there are uncertainties when estimating a claims reserve amount. The methods used by actuaries to estimate a claims reserve often involve subjective judgements. Given that there is a range of assumptions that can be reasonably justified, there is also a range of best estimates that can be considered to be reasonable.

### Summary of GAAP technical provisions for SMUAL and the Transferring Policies

- 4.4 The following table shows a breakdown of the technical provisions of SMUAL, gross of reinsurance, net of external reinsurance, and net of all reinsurance as at 20 February 2020 on a GAAP basis. These reconcile to the technical provisions in the financial statements.

Table 4a: GAAP technical provisions for SMUAL - 20 February 2020 (\$m's)

	Gross [A]	External Reinsurance [B]	Club Reinsurance [C]	Net [D] = [A] + [B] + [C]
[1] Outstanding	471	(198)	(250)	23
[2] IBNR	350	(113)	(219)	18
[3] Unearned Premium	4	0	0	4
<b>Technical Provisions ([4] = [1] + [2] + [3])</b>	<b>825</b>	<b>(311)</b>	<b>(469)</b>	<b>45</b>

- 4.5 SMUAL undertake their reserving analysis by claims categories representative of risk. The material claim categories are: Cargo, Collision, US and Non-US Crew & Passengers, Pollution, Fixed or Floating Objects ('FFO'), Wreck removal, Defence, European Inland and Short Sea Facility ('EISSF'), Chartered and Health Hazard. Additionally, there are small run off classes.
- 4.6 The claim categories are modelled gross and net of SMUAL's retentions (e.g. Owned Pool retention of \$10m in 2019/2020), with separate modelling for all pooled claims above SMUAL's retention (including those under Hydra).
- 4.7 The table below provides a breakdown of the technical provisions for SMUAL as at 20 February 2020 with the corresponding amounts transferring to SMUAE as part of the Transfer.

Table 4b: GAAP technical provisions for SMUAL Pre &amp; Post Transfer - 20 February 2020 (\$m)

	SMUAL			Transfer % of Total
	Pre Transfer	Effect of Transfer	Post Transfer	
<b>Earned Claims Reserves</b>	<b>821</b>	<b>(116)</b>	<b>705</b>	<b>14%</b>
Unearned Premium	4	0	4	
<b>Gross Technical Provision</b>	<b>825</b>	<b>(116)</b>	<b>709</b>	
External Reinsurance Claims Reserves	311	(11)	300	
Club Reinsurance Claims Reserves	469	(97)	372	
Unearned Reinsurance Premium	0	0	0	
<b>RI Technical Provision</b>	<b>780</b>	<b>(108)</b>	<b>672</b>	
<b>Net Technical Provision</b>	<b>45</b>	<b>(9)</b>	<b>36</b>	<b>20%</b>

- 4.8 The first column of the table shows a breakdown of the technical provisions for SMUAL as at 20 February 2020 which reconciles with table 4a. The second column shows the corresponding amounts transferring to SMUAE as part of the Transfer. The third column shows the technical provisions remaining in SMUAL after the Transfer.
- 4.9 In total, on a net of reinsurance basis, \$9m will transfer to SMUAE. This represents 20% of the total net technical provisions.
- 4.10 As part of the Transfer, assets from SMUAL matching these liabilities will also transfer along with a further cash asset equivalent to an appropriate risk margin of \$1.8m. This is discussed further in paragraph 4.50.
- 4.11 In reviewing the technical provisions, I have considered the types of business which are moving as part of the Transfer and therefore the change in mix of technical provisions pre and post Transfer.
- 4.12 There is a proportion of all types of business transferring to SMUAE with the exception of US exposed business, all of which will remain in SMUAL. Given the overall quantum of the reserves transferring is a relatively small percentage, I do not believe the mix of liabilities will change materially. I also note that the majority of the reserves are reinsured out of SMUAL.
- 4.13 Therefore, I do not believe the change in mix of technical provisions will materially impact the Transferring or Non- transferring Policyholders because I do not believe either party will be materially disadvantaged.

### Claims reserving approach used by the Club

- 4.14 The claims reserving work is carried out by a team of actuarial staff of the Club, based in the UK. They are responsible for various actuarial activities, including claims reserving and capital modelling for various parts of the business. The claims reserving work is carried out on a quarterly basis. There is a common methodology and integrated IT data systems for the Club, so that the claims reserving process for SMUAL and SMUAE will be carried out in exactly the same way. Where there is overlap between the business written, that claim category would typically be projected as an aggregate amount, and the amounts are then apportioned between the legal entities.
- 4.15 The analysis is carried out on a gross of reinsurance basis by claim category. The methods used are standard actuarial methodologies including the Chain Ladder Method, the Bornhuetter-Ferguson Method and the Expected Loss Ratio Method (these methods are described at the foot of the Glossary in Appendix A). The assumptions used in the models are based on analysis of the historical data and on actuarial judgement as appropriate.

- 4.16 Actuarial judgement is also applied to select estimates where these methods are not appropriate (for example, where there is a change in the underwriting, claim patterns or legal environment). The actuaries review the results of the various methods, including but not limited to paid: ultimate ratio analysis and frequency / severity analysis, and select the most appropriate estimate based on judgement.
- 4.17 For large claims (including incidents relating to the Covid-19 pandemic), the actuarial team rely on claim specific information to assess any IBNR needed over the case reserves established. As at 20 February 2020, the Club have one large incident relating to the Covid-19 pandemic. They also separately use industry data to derive industry wide benchmarks, as a cross check against their own analysis.
- 4.18 The net of reinsurance claims reserve is calculated by standard actuarial techniques on claims triangles net of the club's pool retention. For known/specific large losses, reinsurance recoveries are calculated by claim. For some specific unusual events, the actuarial team has built models to calculate the reinsurance recoveries explicitly.

#### **External advisors**

- 4.19 SMUAL also commission an external actuarial review, performed by their actuarial advisors each year. The booked claims reserve of SMUAL at 20 February 2020 is \$44.1m higher than the external advisor's best estimate on a net of reinsurance basis (but before the intra-group reinsurance). This difference is effectively a margin for prudence in the booked claims reserve. In my experience, this is a similar level of caution in the booked claims reserve in comparison to the insurance market.

#### **Changes to the reserving process after the Transfer**

- 4.20 There will be no change to the reserving process itself after the Transfer. The same team of actuaries will be performing the analysis, and there will be no changes to the existing claims reserving process.

#### **My review of the claims reserve**

- 4.21 For my review of the claims reserve, I have considered the appropriateness of the data and methodology used by SMUAL and their advisors. I have reviewed the most recent report on claims reserve produced by SMUAL's advisors, dated May 2020.
- 4.22 I have not independently audited the data provided to me. I have, however, carried out reconciliation checks to the reported audited accounts and have carried out various diagnostics on the data. This has led me to believe that the data is appropriate for the purposes of my exercise.

#### **Actuarial team of the Club**

- 4.23 I believe that the actuarial team has a sufficient level of experience and expertise to carry out the necessary activities. The level of actuarial resource is what I would expect for firms of a similar size and complexity. The standard and depth of work that I have reviewed is at a level that I would expect for firms such as SMUAL and SMUAE. My interactions with the actuarial team suggest to me that they have the required level of competence.

#### **Overall methodology and process**

- 4.24 The overall methodology is based on standard actuarial methods which I believe are appropriate for these types of liabilities. The type, and range of methods used, is as I would expect for SMUAL and SMUAE.
- 4.25 The business is reviewed in approximately 15 claim categories (with some analysis split further between large and attritional claims. I have reviewed the categorisation for reserving purposes and am satisfied that this is an appropriate basis. In particular, it

provides a sufficient level of granularity by type of claim, and has sufficiently homogeneous categories, with sufficient volume of data in each category.

#### **Case reserves**

- 4.26 I have considered the process used by the claims team of the Club to set the level of case reserves for individual claim events. It is important that this process is on a consistent basis from year to year because this data is used in the actuarial methods to make projections for the future claim development.
- 4.27 From my discussions with management, I believe there have been no material changes to the way that case reserves have been set. Additionally, from my review of the claim development patterns, and from diagnostics of paid and incurred claim data I did not identify any concerns.

#### **Review of material assumptions**

- 4.28 I have identified and reviewed what I believe to be the key assumptions in the claims reserving analysis. The key areas are the assumptions used for the future claim development and the assumption for the loss ratio on the later underwriting years.
- 4.29 I have reviewed the future claim development pattern for a sample of claim categories, predominantly those claim categories with the largest claims reserves and with the most uncertainty (these are the US and Non-US Crew & Passengers claims categories). This included transferring business and non-transferring business. I have checked that these assumptions are consistent with the historical claim development data of SMUAL. I have also checked these against benchmark claim development patterns from my own wider experience of these type of liabilities. I have therefore concluded that these assumptions are set on an appropriate basis.
- 4.30 I have reviewed the assumed initial expected claims ratios for the latest underwriting year for the most material claim categories, making up 75% of the total claims reserve of SMUAL. I have cross checked these assumptions are consistent with the historical ratios of SMUAL. I therefore concluded that these assumptions are set on an appropriate basis.
- 4.31 During the financial year, there emerged one specific large claim. The Club have provided me with details on this claim, the circumstances, legal basis and coverage concerns. A specific reserve is being held for this claim. I mention this claim specifically in the Report as this loss would be transferred to SMUAE as part of the Transfer. I have reviewed the Club's assumptions in respect of this matter and believe them to be reasonable. However, the outcome of the claim is extremely uncertain at a gross of reinsurance level, while given the Club's retention there is less uncertainty on a net of reinsurance basis.
- 4.32 The results of my analysis did not imply any requirement for an IBNR for policy years prior to 2007, except for of a small volume of Health Hazard losses. Given the generally short tailed nature of the marine insurance written by SMUAL, this is in line with my expectations and the market benchmarks that I have used as a comparison.

#### **The impact of the Covid-19 pandemic on claims reserves**

- 4.33 The financial year end coincided with the rapid escalation of the Covid-19 pandemic, which at the 20 February 2020 had has a limited impact on the booked reserves of SMUAL and SMUAE. The largest known claim to date would remain in SMUAL after the Transfer.
- 4.34 The pandemic is also having an impact on expected claims, particularly in passenger vessels, but these events are post 20 February 2020.
- 4.35 I discuss the impact of the Covid-19 pandemic on future business plan assumptions in paragraph 4.75 where I discuss Solvency II technical provisions.

- 4.36 Given the above, I believe that the methodology and assumptions used are reasonable, and that the actuarial best estimate of the claims reserve is set on a reasonable basis. This applies to SMUAL as a whole, and to the component in respect of the Transferring Policies. My main reasons for reaching this conclusion are:
- ▶ SMUAL commission a full actuarial analysis of the claims reserves, which uses methods and assumptions that I believe are consistent with standard actuarial practice and are suitable for reviewing these types of liabilities.
  - ▶ I have reviewed the key assumptions for future claims development in that analysis and have compared them against market benchmarks. I believe that those key assumptions are consistent with the market benchmarks. The market benchmarks I have used as a comparison are derived from a range of my other insurance clients, and I believe that those comparisons are valid because SMUAL writes similar business to those other peer group companies.
  - ▶ The booked statutory technical provisions of SMUAL is higher than the actuarial best estimate, so that there is a margin for prudence included within the booked technical provisions amount.
  - ▶ The assumed exposure ratio (i.e., the ratio of claims to an exposure ratio such as tonnage) for SMUAL for 2019, is in line with the recent historical performance of the company, and I believe that the planned assumptions for future premium volumes and profitability are therefore realistic.

#### **SMUAE IFRS technical provisions**

- 4.37 SMUAE was incorporated on 4 September 2019 and began writing business from 20 February 2020.
- 4.38 The IFRS technical provision amounts transferring to SMUAE as part of the Transfer will include a mix of all types of business but, as noted in paragraph 4.12, will not include any US business.
- 4.39 On a net of reinsurance basis, (based on estimated figures as at 20 February 2020), \$9m of technical provisions will transfer from SMUAL to SMUAE, plus a further cash asset equivalent of \$1.8m of risk margin. The table below summarises the breakdown of the technical provisions being transferred to SMUAE.

Table 4c - Table showing the breakdown of the IFRS technical provisions being transferred to SMUAE (\$ms)

	SMUAE			
	Gross	External Reinsurance	Club Reinsurance	Net
Outstanding Claims	86	-10	-70	6
IBNR Claims	23	0	-20	2
Claims Handling Expenses	8	0	-7	1
<b>Technical Provisions</b>	<b>116</b>	<b>-11</b>	<b>-97</b>	<b>9</b>

### Key uncertainties in GAAP technical provisions for SMUAL and IFRS technical provisions for SMUAE

- 4.40 I believe that the key uncertainties in the GAAP technical provisions of SMUAL and the IFRS technical provisions of SMUAE are as follows:
- ▶ There is uncertainty for the most recent year because the claims are at an early stage of development. SMUAL and SMUAE mitigate this risk by managing their exposure to losses (both incidence and accumulation) through reinsurance arrangements.
  - ▶ There is exposure to bodily injury claims which can be long tailed in nature (i.e., claims take a long time to be reported and settled). The settlement cost can be affected by legislative changes, which increases the uncertainty.
  - ▶ There is exposure to large single claims on older policy years. SMUAL and SMUAE mitigate this risk by managing their exposure to losses (both incidence and accumulation) through reinsurance arrangements. SMUAL also holds a margin within the technical provisions to provide additional security.
  - ▶ Both businesses have exposure to losses from the Covid-19 pandemic. I believe the impact on the 2019 underwriting year to be limited. I believe that the majority of the losses will impact the 2020 underwriting year. To date, claims have impacted the Cruise ship business to which SMUAL has more exposure.
  - ▶ The technical provisions do not include an explicit allowance for future new latent claim types arising and does not include any explicit allowance for claim events not observed within the historical data. Whilst I believe that this is very unlikely, should either of these issues arise, the settlement cost of the claims could be higher than the current booked claims reserve.
- 4.41 I have considered the above identified uncertainties. I believe that they are uncertainties that would be typical for insurance firms such as SMUAL and SMUAE.
- 4.42 For any insurance company, the future financial position will depend on the outcome of future unknown events. There is no particular uncertainty identified which should preclude the Transfer from being effected.
- 4.43 I believe that the methods used to quantify the claims reserve are appropriate and these uncertainties do not affect the conclusion I reached on the level of the technical provisions.

## Effect of the Transfer on the GAAP balance sheets of SMUAL, IFRS balance sheets of SMUAE and the Club

- 4.44 The table below shows simplified balance sheets for SMUAL and SMUAE before and after the Transfer. The balance sheet for SMUAL is shown on a UK GAAP basis (the standard basis for the preparation of accounts of UK insurance companies) and the balance sheet for SMUAE is shown on an IFRS basis.
- 4.45 The financial amounts are based on a scenario where the Transfer was notionally effected on 20 February 2020. I believe that this is most appropriate basis to view the Transfer, because it is based on the most recent set of audited financial statements. I will produce a Supplementary Report prior to the Transfer Date, and this will comment on the most recent information available.
- 4.46 The starting point for the data shown in the table below is the audited financial statements of SMUAL and the regulatory application for SMUAE. The actual position of the portfolios will be different to that represented below due to the actual experience between 20 February 2020 and the Transfer Date. However, I believe that this gives the best currently available picture of the Transfer.

Table 4d and 4e: Impact of the Transfer on the balance sheets of SMUAL and SMUAE (\$m's)

	Pre - Transfer				
	SMUAL			SMUAE	Combined
	Remaining	Transferring	Total	Remaining	
[A]	[B]	[C]=[A]+[B]	[D]	[E]=[C]+[D]	
Cash and Other Financial Investments [1]	70	11	81	32	113
Unearned Premium - Reinsurance [2]	-	-	-	-	-
Claims Reserve - Reinsurance [3]	672	108	780	-	780
Receiveables and Other Assets [4]	92	-	92	0	92
<b>Total Assets [5] = [1]+[2]+[3]+[4]</b>	<b>834</b>	<b>118</b>	<b>953</b>	<b>32</b>	<b>985</b>
Unearned Premium - Gross [6]	4	-	4	-	4
Claims Reserve - Gross [7]	705	116	821	-	821
Payables and Other Liabilities [8]	22	-	22	2	25
<b>Total Liabilities [9] = [6]+[7]+[8]</b>	<b>731</b>	<b>116</b>	<b>847</b>	<b>2</b>	<b>850</b>
<b>Net Assets [10] = [5] - [9]</b>	<b>104</b>	<b>2</b>	<b>105</b>	<b>30</b>	<b>135</b>

	Post Transfer				
	SMUAL	SMUAE			Combined
	Remaining	Receiving	Transferring	Total	
[F]	[G]	[H]	[I]=[G]+[H]	[J]=[F]+[I]	
Cash and Other Financial Investments [1]	70	32	11	43	113
Unearned Premium - Reinsurance [2]	-	-	-	-	-
Claims Reserve - Reinsurance [3]	672	-	108	108	780
Receiveables and Other Assets [4]	92	0	-	0	92
<b>Total Assets [5] = [1]+[2]+[3]+[4]</b>	<b>834</b>	<b>32</b>	<b>118</b>	<b>151</b>	<b>985</b>
Unearned Premium - Gross [6]	4	-	-	-	4
Claims Reserve - Gross [7]	705	-	116	116	821
Payables and Other Liabilities [8]	22	2	-	2	25
<b>Total Liabilities [9] = [6]+[7]+[8]</b>	<b>731</b>	<b>2</b>	<b>116</b>	<b>119</b>	<b>850</b>
<b>Net Assets [10] = [5] - [9]</b>	<b>104</b>	<b>30</b>	<b>2</b>	<b>32</b>	<b>135</b>

- 4.47 The Net Assets pre- and post-Transfer remain at \$135m.

### SMUAL GAAP balance sheet

- 4.48 The investments held by SMUAL are cash deposits and short-term bonds (30% cash, 32% as deposits with credit institutions rated A or above, 17% with AAA rated money market instruments, and 21% with AA rated bonds and loans).
- 4.49 I understand that this is in line with the Club policy for the distribution of the asset mix, and that there are no plans to change the mix of assets held by SMUAL. The Club policy is to hold assets in a mixture of currencies which match the currencies of the underlying claim liabilities (this avoids the exchange rate risk which might arise if there were a mismatch between assets and liabilities). SMUAL periodically adjusts the balance of assets held in different currencies as and when the mix of liabilities changes.
- 4.50 The assets transferring from SMUAL consist of the reinsurance asset in respect of the transferring business and investments. There is also a small number of other debtors, which is mainly in respect of amounts of premium owed by policyholders. The investment transferring is in the form of cash. The amount of assets transferring is relatively small relative to the overall asset size and would not materially change the mix of assets held by SMUAL.
- 4.51 I am satisfied that the mix of assets held by SMUAL is appropriate for a firm of this type, and that the Transfer will not materially affect the level of market and liquidity risk.
- 4.52 The balance sheet of SMUAL as at 20 February 2020 shows gross technical provisions of \$825m and a reinsurance asset of \$780m (and so technical provisions net of reinsurance of \$45m). These amounts reconcile to the technical provisions shown in table 4a in paragraph 4.4.
- 4.53 The liabilities transferring from SMUAL consist mainly of the technical provisions (discussed in section 4 above) in respect of the transferring business. Approximately 20% of the total net technical provision amount would transfer. There is also a small number of other creditors, which is mainly in respect of amounts owing to brokers and reinsurers.
- 4.54 SMUAL had available capital of \$126m. There will be a small increase in the level of available capital after the Transfer, based on these estimates as discussed in section 5.

### SMUAE IFRS balance sheet

- 4.55 SMUAE was incorporated on 4 September 2019 with \$30m of Tier 1 capital provided through a deed of capitalisation from SMUAB on 11 October 2019. Therefore, the notional balance sheet of SMUAE as at 20 February 2020 only shows this entry.
- 4.56 As described above, the assets (other than the reinsurance asset and debtors) will be cash. The longer-term investment strategy of SMUAE will be to hold a portfolio of assets similar to SMUAL. Therefore, there would be no change to the investment strategy of the insurer of the Transferring Policies, and this does not affect my conclusion on the Transfer.
- 4.57 The SMUAE policy on the currency of assets held is the same as the policy for SMUAL; i.e., to hold assets in a mixture of currencies which match the currencies of the underlying claim liabilities. The claim liabilities for SMUAE will be predominantly in Euros and USD. SMUAE periodically adjusts the balance of assets held in different currencies as and when the mix of liabilities changes.
- 4.58 After the Transfer, the balance sheet of SMUAE shows gross technical provisions of \$116m and a reinsurance asset of \$108m (and so technical provisions net of reinsurance of \$9m). The available capital of SMUAE is \$32m.

## Combined position

- 4.59 The table below shows the GAAP balance sheet for SMUAL and the IFRS balance sheet for SMUAE together with the combined position, after the Transfer.
- 4.60 The starting point for the data shown in the table below is the audited financial statements of SMUAL, SMUAB, SMUAT and the Club and the regulatory application for SMUAE. The actual position of the portfolios will be different to that represented below due to the actual experience between 20 February 2020 and the Transfer Date. However, I believe that this gives the best currently available picture of the Transfer.

Table 4f: Combined balance sheet for the Club, post the Transfer (\$m's)

	Post Transfer					
	SMUAL	SMUAE	SMUAB	SMUAT	Consolid Adj	Club Total
	[A]	[B]	[C]	[D]	[E]	<sup>[f]</sup> = Sum of [A] to [E]
Cash and Other Financial Investments [1]	70	43	142	871	-	1,126
Unearned Premium - Reinsurance [2]	-	-	-	-	-	-
Claims Reserve - Reinsurance [3]	672	108	373	-	925	228
Receiveables and Other Assets [4]	92	0	36	5	106	28
<b>Total Assets [5] = [1]+[2]+[3]+[4]</b>	<b>834</b>	<b>151</b>	<b>551</b>	<b>876</b>	<b>1,030</b>	<b>1,382</b>
Unearned Premium - Gross [6]	4	-	-	-	-	4
Claims Reserve - Gross [7]	705	116	456	469	925	821
Payables and Other Liabilities [8]	22	2	30	93	106	41
<b>Total Liabilities [9] = [6]+[7]+[8]</b>	<b>731</b>	<b>119</b>	<b>486</b>	<b>562</b>	<b>1,030</b>	<b>866</b>
<b>Net Assets [10] = [5] - [9]</b>	<b>104</b>	<b>32</b>	<b>66</b>	<b>314</b>	<b>-</b>	<b>515</b>

- 4.61 Columns [A] and [B] show the Net Assets post-Transfer for SMUAL and SMUAE remaining at \$135m.
- 4.62 Column [C] and [D] provide the balance sheet positions of SMUAB and SMUAT post-Transfer, with column [E] summarising the group consolidation adjustment. The Net Assets of the Club are \$515m post Transfer.
- 4.63 The Club's investment policy aims to maintain financial security and stability. One portfolio of assets is used to match the underlying claim liabilities both in terms of currency and duration with highly rated government and corporate bonds and cash, providing collateral for the reinsurance obligations of SMUAT to SMUAL, SMUAE and SMUAB.
- 4.64 The surplus assets in excess of those required to match the underlying claim liabilities is invested to target a reasonable risk-adjusted return net of fees. These investments can be more wide ranging such as equities, property and hedge funds.

## Conclusion on balance sheet comparison

- 4.65 I believe that SMUAL and SMUAE will both have a strong balance sheet and balance sheet protection after the Transfer. I reached this conclusion because:
- ▶ Investments held by both SMUAL and SMUAE will remain in liquid cash deposits and short-term bonds.
  - ▶ The majority of the reinsurance asset of both SMUAL and SMUAE is collateralised by SMUAT and SMUAB and these contracts are a key part of the overall security provided to policyholders. Cash deposits and short-term bonds are used as collateral for these reinsurance obligations.

## Solvency II technical provisions

- 4.66 The European Commission has developed regulatory requirements for insurance and reinsurance undertakings within the EU known as 'Solvency II'. This was implemented on 1 January 2016 and the UK is still following this regulatory regime.
- 4.67 The Solvency II balance sheet differs from the GAAP and IFRS balance sheet as the valuation rules for several balance sheet items under Solvency II differ from those under GAAP and IFRS. For example, Solvency II technical provisions must be on a discounted best estimate basis, whereas under GAAP they could be undiscounted and may include a margin for prudence. Moreover, under Solvency II, companies must allow for contracts that they are legally bound to, even when such contracts have not incepted.
- 4.68 In addition, under Solvency II, companies must hold a Risk Margin, which represents the additional amount above the best estimate of the liabilities that another insurance or reinsurance undertaking would need to be paid to take on the obligations of that insurance company.
- 4.69 I have used the information from the annual returns prepared as at 20 February 2020, prepared under the common rules set out in Solvency II, and which have been audited and submitted to the UK and Cypriot regulators.
- 4.70 The table below shows the gross and net technical provisions on both a GAAP/IFRS and Solvency II basis for SMUAL and SMUAE, before and after the Transfer.

Table 4g: Comparison of GAAP/IFRS technical provision to Solvency II technical provisions for SMUAL and SMUAE (\$m's)

Gross	Pre - Transfer			Post - Transfer		
	SMUAL	SMUAE	Combined	SMUAL	SMUAE	Combined
	[A]	[B]	[C] = [A] + [B]	[A]	[B]	[C] = [A] + [B]
Published technical provisions	825	0	825	709	116	825
Solvency II technical provisions	779	21	799	664	133	798

Net	Pre - Transfer			Post - Transfer		
	SMUAL	SMUAE	Combined	SMUAL	SMUAE	Combined
	[A]	[B]	[C] = [A] + [B]	[A]	[B]	[C] = [A] + [B]
Published technical provisions	45	0	45	36	9	45
Solvency II technical provisions	63	6	68	53	13	66

- 4.71 I have reviewed the analysis carried out by the Club to convert the technical provisions from a GAAP (or IFRS) basis to a Solvency II basis for both SMUAL and SMUAE. I have additionally reviewed the calculations for the Risk Margin. The Club has adopted a methodology in line with Solvency II regulations and assumes that the Standard Formula SCR runs off in line with the underlying reserves. This methodology is also used by peers of the Club and the PRA has not objected to the Club using this methodology.
- 4.72 I am satisfied that the calculations, methodology and assumptions used for the Solvency II technical provisions, best estimate and Risk Margin are in line with Solvency II regulations and are reasonable given the business written by the Club. I believe the Solvency II technical provisions, best estimate and Risk Margin are reasonable and are set on a reasonable basis.
- 4.73 Post transfer, the net technical provisions for SMUAL increase from \$36m on a GAAP basis to \$53m on a Solvency II basis. The most material changes are due to the allowance of claims relating to contracts that SMUAL are legally bound to, but have yet to incept (increase of \$4m), the removal of a margin for prudence (reduction of \$5m), the discounting of the best estimate reserves (reduction of \$1m) and the inclusion of a Risk Margin (increase of \$13m).
- 4.74 Post transfer, the net technical provisions for SMUAE increase from \$9m on an IFRS 4 basis to £13m on a Solvency II basis. The most material changes are due to the allowance of

claims relating to contracts that SMUAL are legally bound to, but have yet to incept (increase of \$2m) and the inclusion of a Risk Margin (increase of \$2m).

#### **The impact of the Covid-19 pandemic on business plans**

- 4.75 The Club expects a greater impact from the Covid-19 pandemic to emerge in respect of 2020 underwriting year and for it to impact both premium income and claims experience.
- 4.76 The premiums have been assumed to reduce due to the likely impact on world economy resulting in less demand for shipping and transport with the main impact currently being on Cruise and Ferry trade where almost all are currently without passengers. Other sectors of shipping are currently less impacted, but if 'lockdown' continues this will affect international trade. The impact on claims is less certain with potential reductions in damage losses, but potentially more losses from liability exposures.
- 4.77 The Club have also considered second order impacts such as the impact on admin costs and the impact on Pool contributions.
- 4.78 I have identified and reviewed what I believe to be the key assumptions relating to the Covid-19 pandemic as they relate to the Solvency II technical provisions. The key areas are the assumptions used for future premium income and the assumption for the loss ratio on the 2020 underwriting year.
- 4.79 I have reviewed the assumptions used for future premium income where allowance has been made for vessels being laid up (effectively not being used) and for cruise ship operators which have suspended operations. I have concluded that these assumptions are set on an appropriate basis.
- 4.80 I have reviewed the assumed initial expected claims ratio on the 2020 underwriting year for the most material claim categories. The Club have considered each of the claim categories and assessed how claims relating to the Covid-19 pandemic could emerge, for example: claims from passengers from cruise ships, crew claims or claims due to cargo delays or quarantine. For each of these there has then been an assessment of potential exposure and potential loss. I have concluded that these assumptions are set on an appropriate basis, noting the uncertainty that remains as to how the pandemic will impact the remainder of 2020.

#### **Supplementary Report**

- 4.81 I will issue a Supplementary Report prior to the final Court hearing after reviewing the most recent information on the technical provisions, risk margin and balance sheets including commentary on any significant movements in these over the period.

## 5. Assessment of capital requirements

### Background on capital requirements for insurance companies

- 5.1 The level of security provided to the policyholders of an insurance company depends on the available assets of the company, and in particular, on the probability that this level of assets is sufficient to make all claim payments as they fall due.
- 5.2 The European Commission has developed regulatory requirements for insurance and reinsurance undertakings within the EU known as 'Solvency II'. This places requirements on the level of capital held by those undertakings (where capital is the available assets of the undertaking). This was implemented on 1 January 2016 and the UK is still following this regulatory regime.
- 5.3 When considering capital requirements in this section, figures are calculated on a Solvency II basis. The Solvency II balance sheet differs from the GAAP balance sheet as the valuation rules for several balance sheet items under Solvency II differ from those under GAAP. For example, the technical provisions must be on a discounted Best Estimate basis on the Solvency II balance sheet, whereas under GAAP they could be undiscounted and may include a margin for prudence. Moreover, under Solvency II, companies must allow for contracts that they are legally bound to, even when such contracts have not inceptioned.
- 5.4 In addition, under Solvency II, companies must hold a Risk Margin, which represents the additional amount above the best estimate of the liabilities that another insurance or reinsurance undertaking would need to be paid to take on the obligations of that insurance company.
- 5.5 The key metric to trigger regulatory intervention under Solvency II is the Solvency Capital Requirement ('SCR'), which should be determined as the economic capital to be held by insurance and reinsurance undertakings in order to ensure that the probability of not meeting their obligations in the coming year is less than 1 in 200. It is intended to represent a minimum target level of capital for the insurer, and capital falling below this level would trigger a response from the insurer's regulator.
- 5.6 A Minimum Capital Requirement ('MCR') is also calculated as a linear function of specified variables, with a floor of 25% of the SCR and a cap of 45% of the SCR. In addition, there is an absolute floor of the MCR which is currently €3.7m, which equates to £3.2m.
- 5.7 Insurers can choose one of three methods on which to base their SCR and MCR calculations; a Standard Formula approach, an Internal Model approach or a Partial Internal Model approach:
- ▶ The Standard Formula approach entails a prescribed basis for calculation and a prescribed set of parameters to use in working out the capital requirement. Within the Standard Formula framework, entities can employ undertaking specific parameters ('USPs') to improve the appropriateness of the parameterization for their specific business.
  - ▶ The Internal Model approach involves the (re)insurer using their own capital model to calculate their regulatory capital requirement. Both the approach to calculating available capital (via the Solvency II balance sheet) and the approach to calculating the capital required are different to the Standard Formula approach.
  - ▶ The Partial Internal Model approach is a mixture of the Standard Formula approach and the Internal Model approach. An Internal Model is used to calculate parts of the regulatory capital, and the Standard Formula to calculate the remainder.

- 5.8 The choice of which of these three approaches to use is made by the (re)insurer themselves; however, the form and structure of Internal Models and Partial Internal Models are subject to approval by the relevant regulator (generally the regulator in the home country of the (re)insurer). In cases where the regulator does not approve an Internal Model or Partial Internal Model, the Standard Formula will be applied by default.
- 5.9 SMUAL falls under the Solvency II capital regime in the UK and SMUAE falls under the Solvency II capital regime in Cyprus. Both companies use the Standard Formula approach to calculate the SCR.
- 5.10 In order to perform my assessment of the impact of the Transfer on policyholder security, I have selected the Standard Formula as the basis to use for the comparison. I have chosen this basis since:
- ▶ The calculation of the Standard Formula SCR takes into account the risks faced by the companies in a consistent manner and is helpful for providing a risk sensitive measure against which the capital strength of separate companies can be assessed.
  - ▶ It is more straightforward to ensure that the Standard Formula SCR calculation is being performed in line with my expectations than it is for any other capital and risk assessments.
  - ▶ The UK (PRA) and Cypriot (ICCS) regulators have accepted the use of the Standard Formula approach for both SMUAL and SMUAE.
- 5.11 The level of capital determined by the Standard Formula SCR is intended to ensure that a company is at least 99.5% likely (199 chances in 200) to remain solvent over a single year time horizon. As the Standard Formula is a model designed to be applied to all insurance companies across Europe, there are areas where it may not adequately address the specific risks to which a company is exposed.
- 5.12 In relation to SMUAL, pension risk is an area which is not captured by the Standard Formula and an additional capital charge is calculated and held for this. As shown in paragraph 5.18, SMUAL hold an additional amount of \$12.5m within the SCR. SMUAE is not impacted.
- 5.13 Apart from Pension risk, the risk profiles of SMUAL and SMUAE do not have any unusual adverse features that would need to be modelled using an Internal Model.
- 5.14 When considering my assessment of the capital position of SMUAL and SMUAE below, I have used the information from the annual returns as at 20 February 2020, prepared under common rules set out under Solvency II, and which have been audited and submitted to the UK (PRA) and Cypriot (ICCS) regulators.

## SMUAL regulatory capital requirements

- 5.15 The table below shows the Solvency II capital requirement by risk type for SMUAL as at 20 February 2020, prior to the Transfer and as at 20 February 2020, post Transfer.

Table 5a: Solvency II capital requirement for SMUAL pre and post-Transfer (\$m's)

	SMUAL		
	Pre-Transfer [A]	Post-Transfer [B]	Change [C] = [B] - [A]
[1] Insurance Risk	36	35	(1)
[2] Counterparty Default Risk	22	19	(3)
[3] Market Risk	6	6	(0)
[4] Operational Risk	16	15	(1)
[5] Diversification	(11)	(10)	1
[6] Pension Risk charge	12	13	0
<b>[7] Solvency Capital Requirement</b>	<b>82</b>	<b>77</b>	<b>(5)</b>
<b>[8] Solvency II Own Funds</b>	<b>134</b>	<b>131</b>	<b>(3)</b>
<b>[9] Capital Adequacy Ratio ([8] / [7])</b>	<b>164%</b>	<b>169%</b>	<b>5%</b>
<b>[10] MCR</b>	<b>20</b>	<b>19</b>	<b>(1)</b>

- 5.16 Under the Solvency II rules, a firm must compare the level of available assets (the capital, or "Own Funds"), against the SCR; if the Own Funds is greater than the SCR then the firm will meet its regulatory capital requirement.

### Pre-Transfer

- 5.17 The table shows that the SCR (line [7]) is \$82m. The Own Funds amount for SMUAL as at 20 February 2020 was \$134m. This gives a Capital Adequacy Ratio of 164%. The MCR (line [10]) was \$20m.

- 5.18 The components of the SCR are as follows:

- ▶ **Non-Life Underwriting Risk:** This risk relating to the upcoming year of insurance business and the uncertainties relating to the technical provisions (i.e., the uncertainty that the cost of settling these liabilities could be higher or lower than the booked technical provision amount). In other words, SMUAL will need to pay some insurance claims to their policyholders over the coming years, but the amount of those payments and the timing of those payments is uncertain. There is a risk that the amount to be paid is more than expected.
- ▶ **Counterparty Default Risk:** The risk of any defaults of counterparties including reinsurers. A major part of this for SMUAL is the risk from the extensive reinsurance coverage.
- ▶ **Market Risk:** The risk of loss from a change in market prices of assets, relative to the value of the liabilities. The major part of this for SMUAL is 'currency risk', because a significant proportion of funds is invested in non-US Dollar asset categories which do not match the liability profile.
- ▶ **Operational Risk:** This includes uncertainties relating to failures in operational procedures. For example, IT systems failure or fraud, including the additional risk arising from the operation of the defined benefit pension scheme by SIMSL.

- ▶ Diversification: The risks are spread over a number of areas, so the overall capital requirement is somewhat less than the sum of the individual parts.
- ▶ There is an additional amount of \$12.5m included in respect of a defined benefit pension scheme operated by the SIMSL.

#### Post-Transfer

- 5.19 After the Transfer, the Standard Formula SCR for SMUAL would reduce slightly, and there would also be a small reduction in Own Funds. This is as I would expect, because there is only a small, 20%, reduction in net technical provisions, and a corresponding small reduction in the value of the assets. The overall coverage ratio on the SCR basis increases by a very small amount from 164% to 169%. On this basis, the capital strength is practically the same.

### **My conclusion on SMUAL regulatory capital requirements**

- 5.20 I have reviewed the summary output and documentation from the Solvency II calculations for SMUAL and discussed the methodology used in this calculation with the management team of SMUAL.
- 5.21 Based on my review I believe that the calculations are materially correct and have been calculated in an appropriate way. I also believe that the Standard Formula is an appropriate basis for calculating the capital requirement for SMUAL under Solvency II. This is because:
- ▶ The SMUAL risk profile does not have any particularly unusual features that would need to be modelled using an Internal Model.
  - ▶ The Standard Formula approach is a common approach for insurance firms similar to SMUAL.
  - ▶ The PRA has accepted SMUAL's use of the Standard Formula approach and this method is currently used as the capital requirement basis for the company.
- 5.22 SMUAL currently holds Own Funds well above the regulatory requirements and meets the Club's risk appetite statement as referred to in paragraph 5.44.
- 5.23 Although the present balance sheet position of SMUAL is sufficiently strong enough to comfortably cover expected liabilities, there always remains an inherent risk of a deterioration in the relative value of assets to liabilities. If a large deterioration of this nature were to occur, then the Own Funds may fall below the SCR. It is important to note that even if an insurer does not have sufficient eligible Own Funds to meet the required capital level then this does not necessarily mean that it would not be able to settle all its claims in full. The balance sheet strength of the insurer may still be sufficient to pay its liabilities even if the regulatory capital amount is not met. In SMUAL's case the Group Quota Share includes provisions so that the reinsurance premium payable by SMUAL will be reduced by such amount as is necessary to maintain the capital held by SMUAL at 100% of the regulatory capital requirement. Therefore, in a stressed situation, there is an automatic and immediate mechanism to allow the capital of SMUAL to be maintained at the regulatory requirement.

### **SMUAE regulatory capital requirements**

- 5.24 SMUAE was incorporated on 4 September 2019 with \$30m of Tier 1 capital provided through a deed of capitalisation from SMUAB on 11 October 2019. This capital is not repayable.

- 5.25 SMUAE falls under the Solvency II capital regime in Cyprus and uses the Standard Formula approach to calculate the SCR.

Table 5b: Solvency II capital requirement for SMUAE pre and post-Transfer (\$m's)

	SMUAE		
	Pre-Transfer [A]	Post- Transfer [B]	Change [C] = [B] - [A]
[1] Insurance Risk	11	13	2
[2] Counterparty Default Risk	7	10	3
[3] Market Risk	0	0	0
[4] Operational Risk	1	4	3
[5] Diversification	(3)	(3)	(1)
[6] Adjustments	0	0	0
[7] Solvency Capital Requirement	17	25	8
[8] Solvency II Own Funds	33	40	7
[9] Capital Adequacy Ratio ([8] / [7])	197%	164%	-33%
[10] MCR	4	6	2

#### Pre-Transfer

- 5.26 The table shows that the SCR (line [7]) is **\$17m** with Own Funds for SMUAE of **\$33m**. This gives a Capital Adequacy Ratio of **197%**. The MCR (line [10]) was calculated as \$4m.

#### Post-Transfer

- 5.27 After the Transfer, the Standard Formula SCR for SMUAE would increase, and there would also be an increase in Own Funds. The overall coverage ratio on the SCR basis would reduce from 197% to 164%. This is as I would expect, whilst the gross reserves are large, most of this is reinsured out of SMUAE to the group. Only the relatively small level of net reserves which remain lead to an increase in insurance risk. The significant level of reinsurance recoveries also increases the credit risk, as shown in Table 5b above.
- 5.28 Pre-Transfer, SMUAE has a low Operational risk charge. Post Transfer, the Operational risk charge increases proportionately more than other risks due to the transfer of the reserves. The total increase of the SCR is greater than the increase in free funds, which only increases by the net reserves and the risk margin transferred.
- 5.29 The Capital Adequacy Ratio after the Transfer is practically the same as that of SMUAL, pre and post Transfer. I believe the resulting capital adequacy and overall coverage ratio on the SCR basis shows that SMUAE has a strong balance sheet since it is capitalised well above regulatory minimum capital requirements.

### **My conclusion on SMUAE regulatory capital requirements**

- 5.30 I have reviewed the summary output and documentation from the Solvency II calculations for SMUAE and discussed the methodology used in this calculation with the management team of SMUAE.
- 5.31 Based on my review I believe that the calculations are materially correct and have been calculated in an appropriate way. I also believe, as for SMUAL, that the Standard Formula is an appropriate basis for calculating the capital requirement under Solvency II for the same reasons noted above.

- 5.32 SMUAE currently holds Own Funds well above the regulatory requirements and meets the Club's risk appetite statement as referred to in paragraph 5.44.
- 5.33 Although the present balance sheet position of SMUAE is sufficiently strong enough to comfortably cover expected liabilities, there always remains an inherent risk of a deterioration in the relative value of assets to liabilities. If a large deterioration of this nature were to occur, then the Own Funds may fall below the SCR. It is important to note that even if an insurer does not have sufficient eligible Own Funds to meet the required capital level then this does not necessarily mean that it would not be able to settle all its claims in full. The balance sheet strength of the insurer may still be sufficient to pay its liabilities even if the regulatory capital amount is not met. In SMUAE's case (as for SMUAL), the Group Quota Share includes provisions so that the reinsurance premium payable by SMUAE will be reduced by such amount as is necessary to maintain the capital held by SMUAE at 100% of the regulatory capital requirement. Therefore, in a stressed situation, there is an automatic and immediate mechanism to allow the capital of SMUAE to be maintained at the regulatory requirement.

### **Own assessment of risk**

- 5.34 For SMUAL and SMUAE, the uncertainty over the eventual cost of the amount of claims will not be resolved until all claims are paid which will take longer than one-year and so there is more uncertainty around the ultimate payment of the reserves than is captured within the Standard Formula.
- 5.35 This additional uncertainty is one of the reasons why SMUAL and SMUAE hold a capital amount in excess of the SCR. As the SCR coverage ratio remains broadly unchanged following the Transfer, the allowance for these additional risks can be also be seen as broadly unchanged and so does not affect my conclusion on the Transfer.
- 5.36 The Club undertake a Group Solvency Self-Assessment ('GSSA') under Bermuda regulation. This document contains a description of the risk profile and risk management processes in place. In particular it captures risks that might occur that would not be captured by the regulatory framework. This document has sections for the individual entities with the Club and considers the appropriateness of the use of the Standard Formula.
- 5.37 The Club identifies three areas, other than Pension risk, within the initial qualitative assessment where there are differences to EIOPA's underlying assumptions for the Standard Formula on a regulatory Solvency II equivalent basis. These are not material as the mitigation of these risks lowers Steamship's risk exposure.
- 5.38 I have reviewed the GSSA produced by the Club and found there to be no further risks which I believe would have a material impact on the appropriateness of the Standard Formula being used to assess the capital requirement for the Club, or SMUAL and SMUAE. Based upon the above and my discussions with the management, I am satisfied that the Standard Formula SCR is a suitable basis to compare the impact on policyholders before and after the Transfer.

### **Rating agency assessment**

- 5.39 Another estimate of financial strength of an insurer can be obtained from ratings provided by credit rating agencies. S&P provide a credit rating for the Club as a whole, and for each of SMUAL and SMUAE individually.
- 5.40 The rating provided to the Club is 'A' with a stable outlook. The addition of 'stable outlook', reflects S&P's expectation that the Club's capital adequacy will remain in the 'A' category over the next two years.
- 5.41 S&P also comment on:

- ▶ their positive view of the Club’s risk management culture and risk controls for its underwriting and investment risks. They comment specifically on the consistency of the Club’s strategy in recent years with a focus on maintaining its mutual ethos and delivering value to its members.
- ▶ the liquidity of the Club and with the Club well positioned to meet any liquidity needs that may arise, largely due to the generally very strong credit quality of its bond portfolio.

5.42 SMUAL and SMUAE also have an ‘A’ with a stable outlook. This rating is given due primarily to the high capitalisation of the Club, but additionally due to the security provided to policyholders which is derived from the intra-group reinsurance and the mutual relationships between SMUAL, SMUAE, SMUAB and SMUAT. In particular, due to the chain of security, the intra group reinsurance, the ability to make additional premium calls and the ability to move funds around the regulatory group.

### Capital objective for the Club

5.43 The Club has an overall target level of capital that they would like to maintain. This target is set not only to meet the regulator’s required capital, but also to hold sufficient capital to maintain an available capital surplus in excess of that required to hold an S&P ‘A’ (Stable) rating.

5.44 The Club’s risk appetite statement also states that each regulated entity should hold Own Funds at least equal to a minimum of 120% of the regulatory required capital. Management action would commence before capital levels breached this minimum.

5.45 At 20 February 2020, the Club had a capital requirement of US\$251.1 million and total eligible capital resources of US\$549.6 million. The solvency ratio of 219% is evidence of the strength of the Club’s capital position which as noted by S&P above, is equivalent to excess capital as measured using S&P’s risk-based capital model for insurers, at the ‘AAA’ level.

5.46 Under Solvency II, the Club is considered to be a regulatory group comprising SMUAL, SMUAB and SMUAT. The supervisor for the Club is the BMA and so the Club calculates its group solvency capital requirement using the BMA’s standard formula.

Table 5c: Solvency capital for the Club (\$ms)

US\$ms	The Club	SMUAT	SMUAB	SMUAL	SMUAE
Capital resources	550	301	62	33	134
Solvency Capital Requirement (SCR)	251	124	32	82	17
Capital Adequacy Ratio	219%	242%	195%	164%	197%

### Overall conclusion on capital strength

5.47 I believe that SMUAL and SMUAE will both have a strong balance sheet after the Transfer, and that the probability of either firm becoming insolvent or otherwise unable to pay policyholders’ claims is remote. I reached this conclusion because:

- ▶ Both SMUAL and SMUAE meet the regulatory capital requirements by a margin, both before and after the Transfer. The regulatory capital is calibrated at a 1 in 200 level of sufficiency over a one-year period. The fact that SMUAL and SMUAE meet that

requirement by a large margin suggests that there is a very high probability that the policyholders would have claim payments made as they fall due.

- ▶ As a new company, SMUAE had an unusually high level of capitalisation, simply because the company has only just begun trading, and does not yet have many policyholders. Post Transfer, the capitalisation is in line with SMUAL.
- ▶ The credit ratings provided by the rating agencies also suggest that SMUAL and SMUAE are strongly capitalised (when compared to the regulatory minimum capital requirements) due to the security provided by the Club, from the intra-group reinsurance and the mutual relationships between SMUAL, SMUAE, SMUAB and SMUAT.

## 6. Assessment of other aspects of the Transfer

6.1 In this section I will set out other potential issues relevant to each group of policyholders.

### Impact of Brexit

6.2 The UK left the EU on 31 January 2020, with the current transitional arrangements ending on 31 December 2020. The EU and the UK are negotiating arrangements for the UK's relationship with the EU post 31 December 2020. The nature of these arrangements is currently unknown, and it will take some time for the full implications to become clear.

6.3 Brexit has introduced or exacerbated a number of risks for insurers operating in the UK, particularly for those that trade across EEA borders. There is also the potential that after the transition period expires, UK insurers lose the ability that currently exists to service risks in the EU without being authorised by local regulators.

6.4 Some potential areas of concern are market volatility with a particular emphasis on exchange rate volatility, a higher risk of negative interest rates in the future and the impact of a changing regulatory environment.

6.5 There is currently a significant amount of interaction between SMUAL's Managers and clients located in the EEA, with different services moving across the border between the UK and the EEA. I set out below the main areas that I have identified; this is not an exhaustive list, but does cover, I believe, the most important areas of activity:

- ▶ SMUAL, through the Managers providing services to policyholders, where those policyholders are located in the EEA or have a part, or all of their risk located in the EEA. These activities include, for example, paying claims, receiving and paying premium, dealing with customer queries and complaints, policy amendments and lapses, and liaising with insurance brokers. This also includes advertising and selling new policies.
- ▶ The Manager's personnel and other resources in the UK providing services to both SMUAL and SMUAE in non-member facing roles (for example providing actuarial, finance and legal expertise). Staff of the Managers working and moving between the UK and the EU (including to meet policyholders and brokers).

6.6 Most of those activities are regulated to some extent; the question is, to what extent those activities will still be permitted after Brexit. It is not currently clear what the outcome of the Brexit negotiations will be. However, it appears likely that passporting will not continue in its current form and so SMUAL or the Managers acting on its behalf are unlikely to be able to conduct regulated activities in the EEA post-Brexit. There may be a deal reached between the EU and the UK in respect of existing contracts (known as 'contract continuity'). However, the EU and the European Insurance and Occupational Pensions Authority's public positions to date have been that existing EEA businesses should plan on the basis that existing business cannot be serviced from the UK post-Brexit.

6.7 There is also the risk of different EEA countries taking different stances on how policyholders could have their claims paid or policies serviced. Not proceeding with the Transfer gives the potential, depending on the outcome of ongoing negotiations between the EU and the UK, of policyholders not legally being able to have their claims paid or policies serviced.

6.8 In the absence of a wider deal, it may be unlawful for SMUAL or the Managers on its behalf to provide services to Transferring Policyholders. The ability of SMUAL or the Managers on its behalf to provide services (including payment of claims or policy amendments etc.) in respect of the Transferring Policies is of vital importance to such policyholders. SMUAL or

the Managers on its behalf being unable to provide these services to policyholders would clearly be detrimental to those policyholders.

- 6.9 By effecting the Transfer, I believe that SMUAL and the Club will achieve some certainty in this area because these activities will be performed by a legal entity domiciled in the EU (i.e., SMUAE or its Managers acting on its behalf). SMUAE or its Managers acting on its behalf would be legally able to provide those services to policyholders regardless of the outcome of the future relationship between the EU and the UK.
- 6.10 Many of the risks associated with Brexit are either unavoidable for insurance firms or could only be avoided with an unreasonable amount of time and resources, given the current state of knowledge of the arrangements post Brexit.
- 6.11 SMUAL have considered contingency/mitigation measures were the Transfer not able to complete and no further changes to laws or regulations were to occur as summarised below
- ▶ Rely on the legislative/regulatory actions taken in relevant states where possible. In 2019 certain states implemented legislation/regulations to address a “no deal” Brexit. Many allow business to be serviced until the end of the Transition period, some have different end dates, some did not put an end date on the ability to service business and many more did not introduce any legislation. At present, we do not know what will happen after 31 December 2020; there may be extensions, restrictions or just uncertainty.
  - ▶ SMUAL would also consider the impact of “non-admitted” risks regulations in certain EU jurisdictions and whether they mean that further action could be avoided. Some elements of cover may not, in some jurisdictions, require the passporting permissions and to a certain extent it may be possible to continue to service that business.
  - ▶ Novation of policies from SMUAL to SMUAE. This would be done on a case-by-case basis where required to ensure that SMUAL acts within the limits set by relevant states.
  - ▶ Use of a Brexit clause within SMUAL's policy wording in order to permit SMUAL to transfer business to SMUAE without needing to follow a Part VII process. This is only relevant for recent policy years.
- 6.12 Furthermore, there is risk to SMUAL regardless of whether the Transfer is effected. Dependent on the nature of the deal, there are other activities that might not be permitted, and it is possible that this could cause disruption to the Club and have some negative effect on policyholders. For example, there might be additional restrictions on sharing policyholder data between offices in the UK and offices in the EU. However, the problem will arise regardless of whether the Transfer is effected; indeed, the problem of data sharing will be much worse in a scenario without the Transfer. For these reasons I believe that no policyholder will be made materially worse off due to the effect of these other Brexit related risks.
- 6.13 I have considered the overall approach taken by SMUAL in respect of Brexit. The primary course of action has been to effect the Transfer, which as I described above, will ensure continuity of service for those risks located in the EEA. I do not believe that it is reasonable at this stage to expect that SMUAL has effected other detailed plans to remedy other Brexit risks. I expect that SMUAL would be able to address some of those risks should they arise. I believe that this is consistent with the approach taken by other peer group companies of SMUAL with operations across the EEA, and this does not affect my conclusion on the Transfer.
- 6.14 Given all the above arguments, I believe that the most pragmatic solution to the Brexit related issues is to effect the Transfer. There are some Brexit risks which cannot be avoided in any practical way. However, I believe that the most material risks, relating to how

services can be provided to EEA policies, can be mitigated by transferring those policies to SMUAE.

- 6.15 I will comment on further Brexit developments in my Supplementary Report nearer the date of the Transfer.

## The Financial Services Compensation Scheme

### Background to the FSCS

- 6.16 Consumer protection is provided by the Financial Services Compensation Scheme ('FSCS') in the UK. This is a statutory 'fund of last resort' which compensates customers in the event of the insolvency of a financial services firm. Insurance protection exists for private policyholders and small businesses (with annual turnover of less than £1 million) in the situation where an insurer is unable to meet its liabilities.
- 6.17 The FSCS will pay 100% of any claim incurred for compulsory insurance (e.g., motor third party liability insurance or professional indemnity insurance) and 90% of the claim incurred for non-compulsory insurance (e.g., home insurance), without any limit on the amount payable. The FSCS is funded by levies on firms authorised by the PRA.
- 6.18 No protection is available for contracts of reinsurance or the following classes of insurance business:
- ▶ Aircraft: Contracts of insurance upon aircraft or upon the machinery, tackle, furniture or equipment of aircraft.
  - ▶ Ships: Contracts of insurance upon vessels used on the sea or on inland water, or upon the machinery, tackle, furniture or equipment of such vessels.
  - ▶ Goods in transit: Contracts of insurance against loss of or damage to merchandise, baggage and all other goods in transit, irrespective of the form of transport.
  - ▶ Aircraft liability: Contracts of insurance against damage arising out of or in connection with the use of aircraft, including third-party risks and carrier's liability.
  - ▶ Liability of ships: Contracts of insurance against damage arising out of or in connection with the use of vessels on the sea or on inland water, including third party risks and carrier's liability.
  - ▶ Credit: Contracts of insurance against risks of loss to the persons insured arising from the insolvency of debtors of theirs or from the failure (otherwise than through insolvency) of debtors of theirs to pay their debts when due.
- 6.19 The FSCS covers risks located in the UK and EEA for insurance companies authorised in the UK.

### The effect of a transfer on FSCS protection

- 6.20 The PRA has issued a policy statement (*Policy Statement PS5/19: The Bank of England's amendments to financial services legislation under the European Union (Withdrawal) Act 2018*) setting out the approach for its rules following Brexit, including those relating to the FSCS.
- 6.21 This paper explains that equivalent FSCS protection will be provided to transferring policyholders who transfer from a UK insurer to a "successor firm" (i.e., an insurance firm covering the policyholders following a transfer) if certain conditions are met. The same FSCS protection for eligible policyholders will be provided if the successor firm is a "relevant person". A "relevant person" may be loosely summarised in this context as an insurer with

UK authorisation. Even if the successor firm is not a relevant person, the paper proposes that the transferring policyholders would retain some FSCS rights: specifically, claims arising from insured events which occur prior to the date of the transfer would be covered by the FSCS, but not claims arising from insured events occurring after the date of the transfer. In summary, the following cases would be covered by the FSCS after a transfer:

- (i) If a policy is eligible for FSCS protection before the transfer, and the policy transfers to a successor firm which is a relevant person, then a claim on the policy would be eligible for FSCS protection after the transfer.
- (ii) If a policy is eligible for FSCS protection before the transfer, and the policy transfers to a successor firm which is not a relevant person, then a claim on the policy is eligible for FSCS protection after the transfer only if the insured event which gave rise to the claim occurred before the date of the transfer.

#### **Transferring Policies affected**

- 6.22 SMUAL pays the basic levy of under £10k per annum.
- 6.23 I have considered the business written by SMUAL and do not believe there are policies protected by the FSCS. Therefore, no Transferring Policies are affected. This is due to the terms of the FSCS protection regulations described in paragraph 6.18, as all policies would be categorised as one of the classes of insurance business excluded from the scheme.
- 6.24 Given that SMUAE will not be classified as a relevant person, the Transferring Policies will fall under category (ii), as set out above in paragraph 6.18. If a policy is eligible for FSCS protection before the Transfer, then a claim on the policy is eligible for FSCS protection after the Transfer only if the insured event which gave rise to the claim occurred before the Transfer Date.

#### **Other compensation schemes available**

- 6.25 My understanding is that in Cyprus, there is no compensation scheme available to cover non-life insurance policies which are likely to offer equivalent protection to the UK FSCS.

#### **Conclusion for Transferring Policyholders**

- 6.26 I am satisfied that the Transferring Policyholders are not disadvantaged in relation to the FSCS arrangements for the following reasons:
  - ▶ The Transferring Policies would be categorised as one of the classes of insurance business excluded from the scheme.
  - ▶ The right to compensation arises only when an insurance company becomes insolvent. I describe in paragraph 5.47 the reasons why I consider that this is a remote possibility. Therefore, I believe that the scenario of needing to claim compensation under the FSCS or any other statutory compensation scheme is also remote.
  - ▶ The Transfer is taking place in response to Brexit. There are other Brexit risks which have a greater impact than the loss of FSCS rights. However, without the Transfer those same policyholders would still be SMUAL policyholders and would have the corresponding Brexit risks as set out from paragraph 6.2. Of course, it is not possible to say with any certainty which of the many Brexit risks will materialise and which will turn out to be benign. But this does show that Brexit gives rise to advantages and disadvantages to both the Transfer and the status quo position; i.e., there are Brexit risks to various policyholders regardless of whether the Transfer is effected.

## Financial Ombudsman Service

- 6.27 The Financial Ombudsman Service provides private individuals and micro-enterprises with a free, independent service for resolving disputes with financial companies. Micro-enterprises are defined to be businesses with less than €2m annual turnover and fewer than ten employees. It is not necessary for the private individual or micro enterprise to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the Financial Ombudsman Service. However, it is necessary for the insurance policy concerned to be, or have been, administered from within the UK and/or issued from the UK.
- 6.28 Following the Transfer, Transferring Policyholders who are currently eligible to refer a dispute with SMUAL to the UK Financial Ombudsman Service will retain such rights. Based on SMUAL's analysis of the Transferring Policies, very few policyholders will be impacted due to the following reasons:
- ▶ Most of the Transferring Policyholders are large commercial enterprises with €2m or more annual turnover and/or with more than ten employees, and hence do not qualify for the UK Financial Ombudsman Service.
  - ▶ The mutual nature of the Club and the relative bargaining power of its insureds mean that it is more likely to arrive at a negotiated settlement in the event of a complaint. Over the past seven years, there has not been any dispute with SMUAL which was referred to the UK Financial Ombudsman Service.
- 6.29 I have discussed with SMUAL the available ombudsman scheme in Cyprus. I understand that the ombudsman scheme in Cyprus is restricted to small enterprises with an annual turnover of no more than €250k. Other policyholders will be able to make complaints about SMUAE in respect of its activities in Cyprus to the Cypriot regulator.
- 6.30 I do not believe that any policyholders will be materially disadvantaged by the Transfer in relation to the Financial Ombudsman Service due to the following reasons:
- ▶ I understand from the Head of Compliance of SMUAL that the number of historical cases referred to the UK Financial Ombudsman Service is insignificant. Since, 2013, no referrals have been made to the UK Financial Ombudsman Service by SMUAL policyholders. Therefore, I believe that the loss of such a right is unlikely to have a material impact on the Transferring Policyholders.
  - ▶ As set out above, there is an alternative ombudsman service which may be available to some Transferring Policyholders in Cyprus.

## The impact of the Covid-19 pandemic

### Operational aspects

- 6.31 I have discussed with the Club the impact of the Covid-19 pandemic on the operations of the Club. The Club believe there will be no operational impact on the Transfer as a result of the Covid-19 pandemic as
- ▶ Records are computerised, and staff are able to access those records remotely.
  - ▶ The transfer will not cause a change of staff who will handle claims and arrange payments (whether they are based in the UK, Cyprus or Greece).
  - ▶ The Club is currently undertaking further IT work to ensure that regulatory and statutory reporting for SMUAL and SMUAE uses the correct information e.g. internal coding of business is correct, but again, this can be done remotely.

- ▶ Where travel is restricted, this would be the case whether the business remains in SMUAL or is transferred.

6.32 I am satisfied that the Covid-19 pandemic will not have an impact on the ability of the firm to perform their operations and so does not affect my conclusion on the Transfer.

### **Financial aspects**

6.33 In section 4.44 and section 4.66, I have considered the impact on SMUAL and SMUAE's business in terms of the GAAP, IFRS and Solvency II technical provisions.

6.34 I have concluded that the key assumptions used to assess and capture the impact of the Covid-19 pandemic are set on an appropriate basis, both within the GAAP, IFRS and Solvency II technical provisions.

### **Customer service**

6.35 I have considered how the level of customer service, specifically claims handling and policy servicing, experienced by each group of policyholders could change after the Transfer.

6.36 Services such as systems, staff and physical assets are currently provided to SMUAL and SMUAE by an external management company, Steamship P&I Management LLP ('SPIM'). SPIM is the parent of the management companies who assist in providing the services. It is a partnership with 11 partners who are jointly the owners. SPIM works exclusively for the Club on the basis of management service contracts. SPIM receives a fee from SMUAL and SMUAE for its services.

6.37 The Managers provide the same standard of service to policyholders SMUAL and SMUAE.

6.38 We understand the Club intends to replicate the claims management approach currently operating within SMUAL with SMUAE. This is to ensure there is no deterioration or adverse changes for any policyholder, and to ensure consistency of approach for policyholders of both companies. This equivalence includes staffing levels and all claims handling processes.

6.39 The EISSF business will continue to be administered by Post & Co. and the Transfer will not cause any change in the service they provide.

6.40 I do not anticipate any adverse impact to any group of policyholders following the Transfer as a result of claims handling and policy servicing. This is because:

- ▶ The same personnel will be providing the same types and levels as before the Transfer, from the same office locations.
- ▶ This is an intra-Club transfer scheme, and there are no new policies or claims (in the sense that what appears in one firm is taken away from the other), so no additional resources should be required to provide an equivalent level of customer care.
- ▶ The consequences on customer care in the case of a hard Brexit without the Transfer are much more serious. By effecting the Transfer, I believe that those risks are mitigated.

### **Policyholder communication strategy**

6.41 SMUAL and SMUAE propose to undertake procedures to notify policyholders and other interested parties of the Transfer. I understand that the following actions will be undertaken:

- (i) Notification of various policyholders, insurance brokers and reinsurers (see paragraphs from 6.36).

- (ii) Advertise in the press (see paragraphs from 6.47).
- (iii) Make relevant information, including this Report, available on their website
- (iv) Provision of a Part VII telephone line to deal with enquiries once the notifications are issued post Directions hearing and up to the Sanctions hearing

Parties notified as part of the Communication Strategy

6.42 The regulations under the FSMA require that a communication is sent to every policyholder of the parties of an insurance business transfer scheme as well as transferring reinsurers or their brokers, unless the Court waives this requirement. SMUAL and SMUAE intend to request that the Court grants certain waivers in relation to these notification requirements.

6.43 In considering these requests I have considered the relevance of the Transfer to the policyholder, the extent to which they might be disadvantaged by not receiving further notification, the extent to which they might be inconvenienced by the notification, and the practicalities and costs of making the notification.

6.44 The waivers that SMUAL and SMUAE intend to request are:

- (i) **Policyholders and Reinsurers of SMUAL (or the brokers who placed such reinsurance) before 20 February 2010 where there is no notified outstanding claim:** Based on analysis of claim notification, SMUAL would expect the transferring business to see 6 new claims from policyholders before 2010. To put this in context, approximately 2-3,000 claims are notified to SMUAL each year in respect of the transferring business. I believe that this is reasonable to waive the requirement to notify these policyholders based on materiality. It would be impractical to notify all these policyholders, and they are very unlikely to have to make further insurance claims.
- (ii) **Policyholders who are affiliates or other assureds of a Member:** Typically, a Member will notify the Club of the names of affiliates or other assureds who should be listed on their policy but do not provide the Club with contact details for such affiliates or other assureds. In the course of the Club's dealings in respect of such policies, the Member named on the relevant certificate of entry will normally act as the representative for any affiliates or other assureds listed on its policies. For these policyholders, SMUAL and SMUAE will notify the Member and request that they provide a copy of the notification to their affiliates or other assureds named on the relevant certificate of entry. I do not believe that there is any practical way of identifying the contact details of all affiliates or other assureds who are listed these policies. Therefore, I believe that this is a reasonable approach.
- (iii) **Policyholders who are members of a group of companies which have a Representative:** It is common practice within the maritime industry for ships to be owned through 'one-ship' companies and, where there is more than one vessel in a fleet, each of the one-ship companies together form part of the same group of companies under common management. Similarly, in the context of charterer business, there may be a number of companies within a group which enter into charter arrangements. Often these groups will have a main representative or contact who the Club will normally deal with ('the Representative'). In these situations, SMUAL and SMUAE will notify the Representative requesting that they provide a copy of the notification to the group of companies that they represent. It would be impractical to notify all underlying companies and therefore I believe that this is a reasonable approach.

- (iv) **Policyholders of EISSF business:** The EISSF business is serviced by an intermediary Post & Co (P&I) B.V. The business is typically introduced to Post & Co by brokers local to the policyholder who provide Post & Co with information such as the insured company name and the relevant vessel details in order for the business to be rated. The Club and Post & Co do not hold the contact details for individual policyholders and the Club does not usually have direct contact with the policyholder with communications such as Club circulars being provided to policyholders through Post & Co and their brokers. I would not expect the Club to hold the contact details of these parties and I do not believe that there is any practical way of identifying them. SMUAL and SMUAE will notify the brokers of these policies via Post & Co, in the normal way in which the Club communicates with these policyholders. Therefore, I believe that this is a reasonable approach.
- (v) **Policyholders of yacht business where the Club does not have contact details of the policyholder:** The details of these parties are unknown by the Club and contact details are held by brokers. SMUAL and SMUAE will notify the brokers of these policies and request that they notify policyholders of the Scheme. This is the normal way in which the Club communicates with these policyholders. Therefore, I believe that this is a reasonable approach.
- (vi) **Policyholders where SMUAL or SMUAE does not have contact details of the policyholder:** Where it becomes apparent that SMUAL or SMUAE do not have the most up to date records for the policyholder, broker or representative, SMUAL or SMUAE will take appropriate and proportionate steps to contact them. They will monitor email bounce backs or returned letters and attempt to find new contact details. In addition, they will be advertising in the press as discussed in paragraph 6.47.

6.45 Where there are further parties involved with the Member and listed on the certificate of entry, the recipient will be asked to provide a copy of the notification to other parties.

6.46 I also note that the SMUAL and SMUAE contact details which policyholders should use will not change after the Transfer.

- ▶ SMUAL was incorporated in 1909 with the same name it now has. It will continue in operation after the Transfer as an insurance company using the same management companies with the same staff (subject to normal turnover). Similarly, SMUAE will continue operating as an insurance company using the same management companies with the same staff (subject to normal turnover).
- ▶ The Steamship website will continue to operate and contains contact details of both SMUAL and SMUAE.
- ▶ In the event of future changes e.g. name or registered address, details of SMUAL are available from Companies House in the UK and from one or both of the PRA and FCA as its regulators
- ▶ In the event of future changes e.g. name or registered address, details of SMUAE are available from one or both of the Registrar of Companies in Cyprus and from the ICCS as its regulators.

#### Advertisements in the press

6.47 The regulations under the FSMA require that the parties of an insurance business transfer scheme place notifications in:

- ▶ the London, Edinburgh and Belfast Gazettes;

- ▶ two national newspapers in the UK
- ▶ two national newspapers in each EEA state in which policyholders are situated and
- ▶ one business newspaper in each EEA state in which reinsurance contracts are situated.

6.48 SMUAL intends to place advertisements in a range of publications, as noted below, to provide wide coverage across the territories where policyholders of the Transferring Policies are located.

- ▶ Advertisements in the following three newspapers: 'The Financial Times (UK Edition)', 'The Financial Times (International Edition)' and 'The Guardian' as well as one further maritime industry publication, Tradewinds.
- ▶ Notices in the London, Edinburgh and Belfast Gazettes as required.

6.49 SMUAL cannot accurately identify the EEA state of risk for all policyholders of the Transferring Policies but believes it has issued policies to policyholders in the majority of EEA states. SMUAL will seek a waiver from the strict EEA publication requirements.

6.50 I believe that this approach is reasonable because:

- ▶ The combination of the above publications provides wide coverage to the policyholders of SMUAL and SMUAE.
- ▶ I understand the Financial Times (International Edition) is widely circulated across the EEA and Tradewinds is a maritime industry publication which is widely read throughout the maritime industry and SMUAL and SMUAE believe these publications are far more likely to come to the attention of policyholders (past and present), reinsurers and other interested parties than national daily newspapers within the relevant EEA states. I believe that this is a reasonable approach.

#### Conclusion on Communication Strategy

6.51 From my review of the proposed communication to policyholders, I believe no group of policyholders would be materially adversely effected, and I therefore consider the proposed strategy to be reasonable.

#### **Tax implications of the Transfer**

6.52 SMUAL and SMUAE have considered the tax implications of the Transfer and have contracted with a consultancy to support this assessment.

6.53 I have received and reviewed the conclusions from the consultancy review and discussed these with management. I have further consulted with tax specialists from my own firm on these matters.

6.54 The conclusions from the assessment are summarised below:

- ▶ Work is underway to document the basis and rationale for the market valuation of the Transfer to support the UK tax position. This is also required for Cyprus. There are no anticipated issues with being able to document an appropriate rationale for the risk margin.

#### UK corporation tax and value added tax ('VAT')

- ▶ SMUAL will be disposing of assets to SMUAE at market value and therefore no corporation tax will be due.

- ▶ The disposal of assets to SMUAE will be outside the scope of UK VAT.
- ▶ The payment from SMUAL to SMUAE in respect of claims handling provisions should not be subject to UK VAT or reverse charge from Cyprus.

#### Cypriot corporation tax and VAT

- ▶ Management of SMUAE have discussed the tax implications of the Transfer with the Cypriot authority.
- ▶ Mutual companies are not exempt from tax in Cyprus as they are in the UK. Corporation tax applies to the risk margin being transferred which could be up to \$313k (12.5% on \$2.5m). This is a long-term tax cost for SMUAE with the potential for this amount to be limited due to accounting under IFRS 3 which SMUAE is exploring.
- ▶ SMUAE believe there are no VAT payable and have requested a tax authority ruling from the Cypriot tax authority to ensure this is confirmed. Management hope to have a known position before any sanctions hearing.
- ▶ Tax in relation to the transfer of business as a going concern will not apply as the transfer is not exclusively within Cyprus, i.e. both parties are not within Cyprus.

6.55 I do not believe that there are any tax implications which will materially affect the policyholders or the financial position of SMUAL and SMUAE. This is because:

- ▶ The Transfer is viewed as an arm's length third party transaction. This establishes the market value of the Transfer which is being documented for both the UK and Cypriot tax authorities.
- ▶ The longer-term tax payable in Cyprus is immaterial in relation to the size of the rest of the balance sheet of SMUAE.

#### **Direct and reinsurance policyholders**

6.56 All Transferring Policyholders of SMUAL, except for one, are 'direct' policyholders in the sense that they are individuals or owners of vessels and marine interests, as opposed to other insurance companies (in the latter case, an insurance company would insure some marine interests and then reinsure the risk to SMUAL).

6.57 One policyholder of SMUAL is a Polish insurer, with one underlying Polish risk reinsured to SMUAL (i.e., the underlying risk is a Polish ship owner, insured by a Polish insurer, who in turn reinsures a part of that risk to SMUAL). The policy is held with SMUAL for policy years 2019 and prior, and with SMUAE for policy year 2020.

6.58 A changing mix of direct and reinsurance policyholders might have an impact on an insurance business transfer scheme because the ranking of creditors in the event of an insolvency is different for direct and reinsurance policyholders.

6.59 However, I believe that this is not an issue for the Transfer because:

- ▶ Only one policyholder falls into this category, so there will not be any significant change to the split between direct and reinsurance policyholders post-Transfer.
- ▶ The transferring policyholder in question is also a policyholder of SMUAE for the 2020 policy year. Their post-Transfer 'ranking' for that policy will not change.
- ▶ As discussed in paragraph 5.47, I consider it a remote possibility that SMUAE becomes insolvent.

- 6.60 For the above reasons, my conclusion on the Transfer is not affected by the split of direct and reinsurance policyholders.

### **Regulatory protection**

- 6.61 SMUAL is currently regulated by the PRA and the FCA in the UK, and SMUAE is regulated by the ICCS in Cyprus.
- 6.62 The prudential regulatory regime, Solvency II, is the same in the UK and in Cyprus. I note that Solvency II is written into UK Law and therefore, immediately following Brexit, the regulatory regimes in the UK and Cyprus will continue to be equivalent. While it is possible that amendments could be made to the UK prudential regulatory regime following Brexit, in my view the prudential regulatory protection provided by Solvency II within the UK will remain aligned with the prudential regulatory protection provided in Cyprus in the foreseeable future.
- 6.63 I therefore conclude that policyholders are not likely to be adversely affected as a result of the Transfer in relation to regulatory protection.

### **Policyholders in jurisdictions outside the EEA**

- 6.64 I note that business written in respect of Monaco and Switzerland will also be transferred from SMUAL to SMUAE for operational and governance benefits. This business is mainly written and serviced by individuals who will be the underwriters and claim handlers for SMUAE. From 20 February 2020, SMUAE began writing the Club's Monaco and Switzerland business. Therefore, to assist with the continuation of the relevant relationships, understanding of the accounts and general administration, SMUAL intends to transfer business written in Monaco and Switzerland to SMUAE.
- 6.65 I have had discussions with SMUAL and understand that all the Transferring Policies in respect of the Monaco and Switzerland business are governed by English Law as they were written as part of SMUAL's UK regulated business. Therefore, there should be no issues of enforceability of the Transfer because all Transferring Policies will have transferred under English law.
- 6.66 SMUAL does not have or require a licence in Switzerland or Monaco. Swiss business can be written in either the UK or Cyprus (since it can be written on a non-admitted basis) and the Monegasque business written by SMUAL did not require a licence in Monaco.

### **Governance**

- 6.67 I have been provided with and have reviewed the governance structure for each of SMUAL and SMUAE. The document describes the governance and risk management system underpinning the management of SMUAL and SMUAE.
- 6.68 The documents set out the principles of governance, roles and responsibilities, governance structure, controls in place and escalation procedures. SMUAL and SMUAE have essentially the same governance structure at both the Board level and the management level. For instance, SMUAE benefits from its own Head of Risk and Compliance and operates its own risk register with individualised ratings that will contribute to the overall picture of the collective register managed on behalf of all Steamship underwriters. In my opinion, the governance framework for SMUAL and SMUAE contain all the key elements that I would expect, and I consider this framework to be in line with the market practice.
- 6.69 The governance frameworks for SMUAL and SMUAE are as I would expect for firms of this size and complexity. From my review I have found the frameworks to be consistent in all material areas. Therefore, this does not affect my conclusion on the Transfer.

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

- 6.70 I understand that there will be no impact on total ongoing expenses required to service the Transferring Policyholders. Expenses incurred in SMUAL while these policyholders were policyholders of SMUAL, will be incurred in SMUAE after the Transfer.
- 6.71 The expenses relating to the run-off of transferring liabilities will be supported by the inclusion of the future claims handling provision within the Transfer. In addition, the reinsurance contract allows for SMUAE's expenses to be deducted before the calculation of reinsurance premium enabling SMUAE to retain funds for expenses.
- 6.72 SMUAL will bear the cost of the Transfer. No material change is anticipated in its ongoing expense levels.
- 6.73 I therefore conclude that policyholders are not likely to be adversely affected as a result of the Transfer in relation to ongoing expenses.

### **Liquidity position**

- 6.74 As a result of the Transfer I do not anticipate any change to the liquidity position of the companies involved in the Transfer. Both companies have suitable liquidity to manage the ongoing activities of the business, and benefit from the ability to receive payments on reinsurance contracts quickly.
- 6.75 I therefore conclude that policyholders are not likely to be adversely affected as a result of the Transfer in relation to liquidity issues.

### **Set-off rights**

- 6.76 'Set-off' is a right that allows parties to cancel or offset debts with each other by subtracting one from the other and paying only the balance.
- 6.77 Given all Transferring Policies will remain under English law, I do not believe that there are any material set-off rights that can be exercised by cedants or reinsurers. I have not identified any set-off issues as part of my work, and so this does not affect my conclusion on the Transfer.

### **Investment management implications of the Transfer**

- 6.78 I understand that there are no planned changes to the investment policy of SMUAL or SMUAE post the Transfer. The longer-term investment strategy of SMUAE will be to hold a portfolio of assets similar to SMUAL (i.e., predominantly cash deposits and short-term bonds). Therefore, there would be no change to the investment strategy of the insurer of the Transferring Policies, and this does not affect my conclusion on the Transfer.

### **Pension arrangements**

- 6.79 There is a defined benefit pension scheme for SIMSL which is now closed to new members since 2007 and there is an obligation by SMUAL to fund this pension scheme.
- 6.80 The pension scheme does not affect my conclusion on the Transfer because:
- ▶ The Transfer does not affect the pension scheme obligations of SIMSL, and so there is no change to the amount of pension risk in SMUAL. SMUAE has no exposure.
  - ▶ In stressed scenarios, the pensioners do not become a creditor of SMUAL or SMUAE, they would remain a creditor of SIMSL.

### Legal opinions

- 6.81 There are no areas of my work where I have needed to obtain an independent legal opinion. I have discussed the following issues with SMUAL and the legal advisors of SMUAL:
- ▶ The options available in EEA states as a replacement for the UK FSCS and Financial Ombudsman Scheme.
  - ▶ The effect of the Transfer on Transferring Policyholders located outside of the EEA.
- 6.82 I did not deem those issues to be sufficiently material to require an independent legal opinion. The legal advisors have a good professional reputation and I am relying on their own professional independence. For that reason, I am comfortable with the conclusions I have reached for the matters set out above.

### Key dependencies of the Transfer

- 6.83 The Scheme does not require the approval of the Members of SMUAL or SMUAE. However, in order to assist with Membership engagement and transparency, both SMUAL and SMUAE intend to put the Scheme to their Members by way of a non-binding vote at their Annual General Meetings, currently scheduled to be held in October.
- 6.84 The Club are monitoring the Brexit negotiations in order to identify any developments which would have an impact on the Transfer, but they cannot see any likely outcome which would mean that the Transfer would not proceed. The impact of Brexit on the Transfer has been further discussed in Section 6.2.
- 6.85 The Cypriot authority confirmation on VAT payable, as described in paragraph 6.54, is not a dependency for the Transfer. The Club has confirmed that they would proceed with the Transfer, even with an associated tax cost.
- 6.86 The Transfer is not dependent on an injection of capital from the Club.
- 6.87 I believe that the Covid-19 pandemic will not affect the ability of the Club to effect the Transfer. The impact of the Covid-19 pandemic has been further explained in Section 7.12.
- 6.88 Otherwise, I am not aware of any key dependencies of the Transfer outside of the regulatory approval process, Court process and timeline for the insurance business transfer scheme at the sanctions hearing.

## 7. Reliances and limitations

### Events following the modelling date

- 7.1 The conclusions in this Report are based on various analyses that have been carried out on data as at different points in time (typically 20 February 2020). I have been informed by management of the Club 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 date of the Transfer that could change my conclusions. I will provide a letter prior to the sanction of the Transfer to update the Court on whether there have been any material changes since the issue of this Report.
- 7.2 The balance sheets shown in this Report are based on data as at 20 February 2020 for both SMUAL and SMUAE. I would expect some changes to have taken place between then and the date of this Report.

### Reliance on other parties

- 7.3 In developing the conclusions in this Report, I have relied on the data and accompanying explanations supplied to me by and on behalf of the Club. I have received specific statements of data accuracy from the Club. I have not specifically reviewed the data for accuracy and completeness, but I have reviewed it for reasonableness.
- 7.4 I have carried out investigations, as detailed in this Report, to gain comfort on the appropriateness of the methodology and conclusions for the most significant liabilities. However, this has not amounted to a full re-estimation of every claims category, so by definition I have relied upon the reserving work performed on behalf of the Club for some components of the technical provisions. I believe that this is reasonable given the experience and professional qualification of the authors of the documents and the testing that I have carried out. The reviews that I have carried out on the technical provisions give no indication of any significant deficiency and I believe that appropriate methodologies have been adopted throughout.
- 7.5 I have also relied upon discussions that I have had with the management of the Club. Where appropriate, I have sought documentation from them to evidence the assertions made to me in these discussions.
- 7.6 Additionally, draft versions of this Report have been reviewed by the management of the Club and challenged appropriately where they believed this Report did not capture structural or contractual information in sufficient detail or clarity.

### Use of benchmarks

- 7.7 As well as analysing the trends of the historical claim development, I have also relied upon benchmarks from wider market experience. Whilst the Club's own development can be expected to vary from the benchmarks based on individual circumstances, I believe that the benchmarks are an appropriate check. However, benchmarks are revised periodically as new information and trends emerge, and it is likely that individual accounts will differ from the average. Therefore, it is possible that these benchmarks will not be predictive of the future claim reporting of the Club.
- 7.8 I have also used other benchmarks based on my wider market experience to assess the appropriateness of some of the assumptions used within the technical provision estimations and capital modelling performed for SMUAL, SMUAE and the Club as a whole.

## Other reliances

- 7.9 The underlying numbers contained in this Report are calculated to many decimal places and so totals and summaries are subject to rounding differences.
- 7.10 In my judgement, the results and conclusions contained in this Report are reasonable given the information made available to me. However, the actual cost of settling future claims and those still outstanding as at the valuation date is uncertain as, amongst other things, it depends on events yet to occur such as future court judgments. It could be different from the estimates shown in this Report, and possibly materially so. Such differences between the estimated and actual outcome could possibly have a material impact upon the balance sheet strength of the companies involved, and therefore upon the Transfer.
- 7.11 I do not believe that there are any matters that are relevant to the policyholders of SMUAL and SMUAE in consideration of the scheme which I have not taken into account.

## Covid-19 pandemic

- 7.12 The Covid-19 pandemic could have a significant adverse effect on the global economy and the insurance industry. These effects could, in some scenarios, reduce the financial strength of the Club and have an adverse effect on its day-to-day operation. For example:
- ▶ **Financial Investments.** There is now a risk of a global recession and wider financial problems which would reduce the value of assets and currencies and make those values more volatile. The Club does not hold significant equity type investments (which have seen the largest falls in value since the beginning of the pandemic); however, the value of fixed income investments could also fall and there is now a greater risk of currency fluctuations.
  - ▶ **Counterparty Risk.** There is likely to be a greater risk of default of payment from third parties, notably, from the reinsurers of the Club. The reinsurance of the Club and of the International Group is however, spread between a wide range of highly rated reinsurers which does offer some benefits of diversification (so that there is no large exposure to a single counterparty).
  - ▶ **Shipping and Transport.** The pandemic is likely to reduce the demand for shipping and transport, at least in the short term. This will change the requirements of the members of the Club, and might require a change to the business plan of the Club (for example, in terms of premium written in the medium term).
  - ▶ **Insurance Claims.** It is still too early to fully assess how the pandemic will affect the ultimate level of insurance claims. A lower global shipping volume could, in theory, lead to fewer accidents and claims; conversely, with a fall in demand, owners often take the opportunity to carry out repairs and maintenance work which can increase the level of insurance claims.
- 7.13 **Operations.** The pandemic has affected all industries and parts of society, changing people's normal day-to-day activities. At the time of writing this Report, the Club has informed me that any disruption to service and support to the Members has been effectively mitigated by successfully working remotely. At the time of writing this Report, the pandemic is ongoing, and its longer-term effects are unknown and uncertain. However, I do not believe that any of the pandemic issues I have identified would be made any worse by effecting the Transfer, and therefore this does not affect my conclusion on the Transfer. See sections 4.33, 4.75 and 6.32 for my conclusions on the Covid-19 pandemic impact on claims reserves, Solvency II technical provisions and operational matters respectively.
- 7.14 I will comment further on the effect of the pandemic on the SMUAL and SMUAE financial positions within my Supplementary Report prior to the Transfer Date.

## Appendix A Glossary

The following key terms have been used throughout this Report and are gathered here for ease of reference.

Term	Abbr.	Definition
Additional Premium Call		The mechanism used by the Club to raise additional capital from Club Members, if the Club's claims experience were worse than expected. Such additional calls can only be made before the relevant policy year is 'closed', which usually occurs after three years.
Attritional claims		Smaller claims which can typically be modelled in aggregate in reviews of technical provisions.
Bermuda Monetary Authority	BMA	The integrated regulator of financial services sector in Bermuda.
Best estimate		An estimate prepared with no margin for either prudence or optimism included.
Bornhuetter-Ferguson method		Makes a blend of the Chain Ladder Method and the Expected Loss Ratio Method. The weighting given to each is dependent on how 'developed' the claims are for a particular underwriting year.
Brexit		The withdrawal of the UK from the European Union.
Chain ladder method		An actuarial method for estimating future payments or numbers by using the historical pattern of past payments or numbers to estimate a 'development profile', which can be used to extrapolate future payments or numbers.
Change of security		The assets available to make a claim payment to a policyholder expressed in the order that they would be used to make that payment
Claims reserve		Provision designated to cover the claims that have occurred but have not yet been settled.
Counterparty Default Risk		The risk of any defaults of counterparties (i.e. any institution or individual that is a debtor to the undertaking).
European Economic Area	EEA	The European Economic Area was established via the EEA Agreement in 1992. It is an international agreement which enables the extension of the European Union's single market to non-EU member parties. The EEA links the EU member states and three European Free Trade Association (EFTA) states (Iceland, Liechtenstein, and Norway) into an internal market governed by the same basic rules.
European Inland and Short Sea Facility	EISSF	Please note for the purposes of the transfer when we refer to the transferring EEA policyholders this excludes UK based policyholders. The EISSF business written by the Club is serviced by an intermediary called Post & Co (P&I) B.V which is based in the Netherlands.

European Union	EU	The political and economic union of 27 member states that are located primarily in Europe.
Expected loss ratio method		An actuarial method for estimating future payments or numbers based on combining an exposure measure and an assumed rate per unit of exposure (the 'initial expected loss ratio') for the written business.
Financial Conduct Authority	FCA	A financial regulatory body in the United Kingdom which operates independently of the UK Government.
Financial Reporting Council	FRC	The Financial Reporting Council, the body responsible for setting actuarial standards in the UK.
Financial Services Authority	FSA	The Financial Services Authority ('FSA') was the regulator of the UK insurance industry until 1 April 2013, when it was replaced by a combination of the PRA and the Financial Conduct Authority ('FCA').
Financial Services Compensation Scheme	FSCS	Financial Services Compensation Scheme, the consumer protection scheme in the UK
Financial Services and Markets Act 2000	FSMA	The Financial Services and Markets Act 2000 is an Act of the Parliament of the United Kingdom that created the Financial Services Authority as a regulator for insurance, investment business and banking, and the Financial Ombudsman Service to resolve disputes as a free alternative to the courts.
Fixed or Floating Objects	FFO	Claims resulting from contact between a ship and fixed or floating objects, Fixed objects include collisions with harbours, piers and jetties, floating objects include buoys or floating storage vessels, but not ships.
Freight, Demurrage and Defence	FDD	This form of insurance provides policyholders/Members with cover for claims handling assistance and for legal costs in relation to a wide range of disputes which fall outside the scope of traditional P&I insurance. Often referred to as "Class II" insurance.
Group Solvency Self-Assessment	GSSA	A BMA required report assessing each company's capital requirements. The primary purpose of the Solvency Self-Assessment exercise is to allow insurers to incorporate any analysis of the firm's internal capital needs into their risk management frameworks. It also ensures that both capital needs and available capital resources are considered in the development of business strategies and decision-making over the near and long term.
International Financial Reporting Standards	IFRS	International Financial Reporting Standards are standards issued by the IFRS Foundation and the International Accounting Standards Board to provide a common global language for business affairs so that company accounts are understandable and comparable across international boundaries.
Incurred but not enough reported	IBNER	Refers to the amounts an insurer will have to pay over and above existing case reserves for claims that have already been reported, i.e., the estimated cost of any anticipated future development on known claims. This is often included within IBNR.

Incurred but not reported	IBNR	Refers to the amounts an insurer will have to pay for claims that are reported in the future but relate to events that have already occurred. Often used to refer to any amounts insurers must pay over and above existing case reserves and hence also includes IBNER (as defined below). Where it does not include IBNER, it is sometimes referred to as 'Pure IBNR'.
Independent Expert	IE	The suitably qualified person appointed by the Court to produce an independent report on the Transfer, in accordance with the FSMA.
Insurance Companies Control Service	ICCS	The Cyprus Insurance Companies Control Service, being part of the Ministry of Finance, is responsible for examining applications and issues licenses for the registration of insurance undertakings and insurance intermediaries, i.e. insurance agents, insurance brokers, insurance sub-agents, insurance advisors and tied-insurance advisors.
Insurance Risk		Risks relating to insurance policies sold, i.e., the risk that the cost of claims for which the insurer is responsible proves to be higher than expected.
Latent claims / Health Hazards		A latent claim is a claim that arises from a risk not anticipated by the underwriter and not priced for in the original policy. Typically, the claims of this type will exhibit significant reporting delays; in the future there may be new types of latent claims arising which could impact insurance policies issued today.
Liquidity Risk		The risk that the assets that can be used to settle short-term liabilities (i.e., cash or readily saleable investments) are not sufficient to meet those liabilities, which may in turn require selling longer-term assets at depressed prices.
Market Risk		Risks relating to investment performance and changes in the value of investments.
Minimum Capital Requirement	MCR	A formulaic calculation of the capital requirement as part of the existing European Solvency II regulations for insurers.
Operational Risk		Risks relating to failure of operational procedures.
Own Funds		Available capital to meet the capital requirements under Solvency II.
Passporting		Passporting allows a firm registered in the EEA to do business in any other EEA state without the need for further authorisation from each country. Passporting regulations are covered in Financial Services and Markets Act 2000 (EEA Passport Rights) Regulations 2001 (SI 2001/2011).
Pension plan		The defined benefit pension plan of SMUAL.
Policy year		Year in which policy was written.

Protection and Indemnity	P&I	P&I insurance is a special type of marine insurance. Whereas traditional marine insurance companies (with shareholders) will generally provide hull and machinery cover for shipowners (repairs, costs of machinery malfunctions and problems with on-board equipment) and cargo cover for the owner of the shipped cargo, P&I insurance typically covers a carrier's third-party risks for damage caused to cargo during carriage, damage to third parties and risks of environmental damage such as oil spills and pollution. These (large) risks are almost overwhelmingly insured through a P&I Club supported by the international arrangements through which shipowners around the world share in each other's fortunes.
Prudential Regulation Authority	PRA	A financial services regulatory body in the United Kingdom.
Reasonable		Rational, appropriate, ordinary or usual in the circumstances.
Risk margin		A risk margin is a margin in excess of the best estimate of a liability. It is a form of compensation for the receiving entity for the additional risk they are accepting.
Standard & Poor's	S&P	Standard & Poor's, the rating agency.
Solvency and Financial Condition Report	SFCR	A report that the EU regulators require insurers to produce annually under Solvency II regulations (defined below) that is made publicly available.
Solvency Capital Requirement	SCR	The amount of capital insurers are required to hold under Solvency II regulations. If an insurer's capital (i.e., the excess of its assets over its liabilities) falls below the SCR, it will trigger regulatory intervention, with the intention of remedying that position.
Solvency II		An updated set of regulatory requirements for insurers that operate in the EU. These requirements apply to insurers from 1 January 2016.
Solvency ratio		A measure to indicate the strength of a company's capital position. This is usually calculated as total own funds divided by regulatory SCR.
Standard Formula		A prescribed approach under Solvency II for the calculation of capital based on an insurer's financial information (e.g. premium, technical provisions, etc.).
TAS 100		The Technical Actuarial Standard issued by the FRC which should be applied to all aspects of technical actuarial work.
TAS 200		The Technical Actuarial Standard issued by the FRC relating to matters where there is a high degree of risk to the public interest.

Technical Actuarial Standard	TAS	Standards that seek to promote high quality actuarial practice and the integrity, competence and transparency of the actuarial profession. The FRC is responsible for the independent setting of the TAS's.
Technical provisions		Technical provisions represent the amount that an insurer requires to fulfil its insurance obligations and settle all expected commitments to policyholders and other beneficiaries arising over the lifetime of the insurer's portfolio of insurance contracts.
the Court		The High Court of England and Wales.
the Report		The scheme report of the independent expert on the Transfer, in accordance with the FSMA.
Transfer		The proposed insurance business transfer of certain insurance and reinsurance business of SMUAL to SMUAE.
Transfer Date		The date on which the Transfer becomes effective, currently expected to be 20 December 2020.
UK		United Kingdom of Great Britain and Northern Ireland.
UK GAAP		Generally Accepted Accounting Principles as defined in the UK.
Undertaking Specific Parameters	USPs	If the Standard Formula does not provide an appropriate representation of the undertaking's underlying risks, they may replace a subset of parameters (standard parameters) by parameters specific to them.
Underwriting Risk		The risks relating to the upcoming year of insurance business to be written, unexpired policies at the balance sheet date, and the uncertainties relating to the technical provisions at the balance sheet date.
Value added tax	VAT	VAT is a consumption tax placed on a product whenever value is added at each stage of the supply chain, from production to the point of sale. The amount of VAT that the user pays is on the cost of the product, less any of the costs of materials used in the product that have already been taxed.

## Appendix B Extract from EY Terms of Engagement

### Scope of services

This engagement will cover the appointment of Ruth Nemes as Independent Expert for the Part VII Transfer from Steamship Mutual Underwriting Association Limited (“SSM London”) to Steamship Mutual Underwriting Association (Europe) Limited (“SSM Cyprus”) (the “Transfer”). We note that the primary duty of the Independent Expert in an insurance business transfer in the UK is to the High Court of England and Wales (“the Court”).

We will:

- ▶ Analyse work you have carried out on the companies and portfolios of policies involved in the Transfer, including (but not limited to) the adequacy of the claims reserves and capital modelling analysis (under solvency rules) for each of the groups of policyholders who are affected by the Transfer.
- ▶ Supplement this with such additional calculations and investigations as the Independent Expert believes are necessary to enable her to form a view on the implications of the Transfer on the policyholders involved and communicate this to the Court.

We will prepare the following reports (together the “Reports”):

- ▶ A report (the ‘Report’) providing the Independent Expert's conclusions on the Transfer and explanation of those conclusions, to be presented in draft to the PRA and FCA (together the “UK financial regulators”) on a date agreed with the UK financial regulators and then updated as required following the feedback from both the UK financial regulators (PRA and FCA) and then delivered to the Court in sufficient time prior to the initial directions hearing.
- ▶ A supplementary report for each transfer (the ‘Supplementary Report’) to be presented to the Court at the final court hearing to consider the sanction of the Transfer. The Supplementary Report will discuss issues that have arisen between preparation of the Report and the final court hearing that the Independent Expert considers material to the Transfer, as well as any impact on her conclusions.
- ▶ A summary report for the transfer (the ‘Summary Report’). In accordance with the Financial Services and Markets Act 2000 and subordinate regulations, a summary of the Independent Expert's report will be provided to affected policyholders and any other person entitled to receive a copy to assist them with assessing the Transfer.
- ▶ Such further reports as may be required by the Court, the UK financial regulators or by you in connection with the Transfer, it being acknowledged that the preparation of such reports may incur additional costs which (if relevant) will be agreed in advance of the relevant work being undertaken.

We will ensure that the Reports comply with the requirements of the Financial Services and Markets Act 2000, PRA’s Statement of Policy - “The Prudential Regulation Authority’s approach to insurance business transfers”, applicable case law, relevant professional guidance and requests made by the UK financial regulators and Part 35 of the Civil Procedure Rules (each as amended, supplemented or replaced from time to time). This includes any obligations we may have thereunder to evaluate and verify any information which you have provided to us in connection with the provision of the Services or the preparation of the Reports.

In performing the Services, we will use the skill, care, expertise and competence that could reasonably be expected from a highly reputable international consultancy firm or company providing to major multinational corporations the same or similar Services to those provided under the Agreement (including the particular skill and expertise of the Independent Expert selected for appointment to the Transfer).

Where the Independent Expert determines that she will require legal support in relation to any issues relating to the Transfer we will endeavour to use information produced by your legal advisors wherever possible. Where we do need to obtain an independent legal opinion on any matter, we will agree with you the instructions for this legal advice and associated fees in advance.

As part of this engagement Ruth Nelmes will be responsible for providing the Report in her role as Independent Expert. In that role Ruth will be undertaking the work on behalf of EY and EY takes responsibility for the work undertaken by its partners and employees. Specifically, in the context of clause 4 within Appendix B of this statement of work Ruth will be personally responsible for the Reports but that EY also takes responsibility for this work as a result of Ruth being employed by EY.

## Appendix C Ruth Nelmes experience

### Background

- ▶ Partner within the UK Actuarial practice based in London
- ▶ Over 20 years' general insurance experience
- ▶ Qualified as a Fellow of the Institute and Faculty of Actuaries in 2007
- ▶ Graduated in 2000 with a BSc in Mathematics from Imperial College of Science Technology and Medicine London

### Skills

- ▶ P&I club, UK Retail and Gibraltar Motor experience
- ▶ Lloyd's and London Market experience
- ▶ Solvency II Implementation, Model Validation and Gap Analysis
- ▶ Solvency II Balance sheets, Standard Formula and disclosures
- ▶ Experience in M&A transaction assessment and integrations
- ▶ Post-Merger Integration

### Professional Experience

Ruth has been involved in helping companies develop their Brexit strategies and implementation plans including planning for Part VII transfers.

- ▶ She is supporting a UK insurer through their application to a new regulator at present which includes the assessment of business plans, reserve levels, capital requirements under both GAAP and Solvency II, as well as new reinsurance arrangements and the set of new governance structures.
- ▶ She is supporting a Swiss reinsurer with their Standard Formula calculations to assess the viability and transfer structure into the UK.
- ▶ She is the peer reviewer for several Part VII transfers undertaking in-depth review and challenge of the proposed transfer, reserve levels and capital impacts. This has included P&I club transfers.

She has been involved in several merger / acquisition situations and integration workstreams across the UK and internationally for personal and commercial line business.

Ruth is currently also assisting a large Global Insurance and Reinsurance company with post-merger integration activity within the actuarial and finance space.

Ruth has extensive experience of performing independent reserve review exercises for UK Retail companies - with Motor, Household and Liability (including NIHL) exposures. She also has extensive experience of performing independent reserve review exercises for Marine, Liability, Property and Casualty portfolios within the Lloyd's and London Market.

She is heavily involved in the audits of GAAP, Solvency II technical provisions and Standard Formula capital for:

- ▶ Several UK Insurers writing Motor and Household business
- ▶ Several large Gibraltar Motor portfolios
- ▶ Lloyd's syndicates and London Market entities

Ruth has extensive experience in Solvency II.

- ▶ She has supported a large Global Insurance group based in the UK, Paris and the US with their Solvency II implementation, providing technical assistance in the areas of Risk and Capital Management, Capital Modelling, Documentation and the IMAP process.
- ▶ She has also performed an external model validation for a large UK Retail company which included a detailed review of insurance risk including PPOs, a review of their Catastrophe modelling process and internal validation procedures.
- ▶ She has also performed a Standard Formula review for the same UK Retail company.

## Appendix D Summary of data provided

Data area	File(s)	Description
Financial Information - Reserving	R01_February 2019 Steamship IBNR Opinion.pdf	Internal Actuarial Report 2019
	05 04 IBNR Review	Internal Actuarial Report 2020
	R02_February 2020 IBNR Review.xlsx	Booked Actuarial model 2020
	R03_February 2020 IBNR Review - Best Estimate.xlsx	Best Estimate Actuarial Model 2020
	SMUAL Report 2018Q4 Signed.pdf	External Actuarial report 2019
	SMUAL Executive Summary of 2019Q4 Results for ARC meeting_270420.pdf	External Actuarial Memo 2020 Exec Summary
	Feb 19 Results -Owned Split by class.xlsx	Split of European Claims Reserves for Owned Business
	Claims extract (EU members) - Part VII- Feb20_Values.xlsx	Split of European Claims Reserves 2020
	CMA - Cigarettes.docx	Claim Information on emerging Issue
Financial Information - Accounts	F01_2018-Annual-Report-and-Accounts.pdf	2018 Annual Report and Accounts
	F02_2019-Annual-Report-and-Accounts.pdf	2019 Annual Report and Accounts
	F03_2018-Steamship Management Highlights.pdf	2018 Steamship Management Highlights
	F04_2019-Steamship Mutual Combined Financial Statement.pdf	2019 Steamship Mutual Combined Financial Statement
	F05_2017-GSSA.pdf	Group Solvency Self Assessment 2017
	F06_2018-GSSA.pdf	Group Solvency Self Assessment 2018
	200121 Full GSSA Final 2019 v6.pdf	Group Solvency Self Assessment 2019
	F07_2018-SSM Financial Condition Report.pdf	2018 SSM Financial Condition Report
	F08_2019-SSM Financial Condition Report.pdf	2019 SSM Financial Condition Report
	C05_SMUAE_Standard_Formula_Feb_20.xlsx	SMUAE Standard Formula calculation 2020
	C06Standard_Formula_Feb_20.xlsx	SMUAL Standard Formula calculation 2020
	C03_Solvency II Balance Sheet_Feb_20.xlsx	SMUAL Solvency II Balance Sheets 2020
	C04_Solvency II Balance Sheet_Feb 20.xlsx	SMUAL Solvency II Balance Sheets 2020 (Adjusted Covid-19)

Summary of data provided

Financial Information	EY_Report_Data_v2.xlsx	Summary tables detailing pre and post transfer impacts on claims reserves and capital
Reinsurance	RI01_SSM Layers.pdf	Club Reinsurance Details
	RI02_IG Layers.pdf	International Group Reinsurance Details
	RI03_2019_Credit_Risk_Reinsurers.pdf	
	RI04_SSM Probable Maximum Loss.pdf	
	RI05_SSM Club wide RI contracts basic info.xlsx	
Capital and Risk	Nov19_Capital_Dashboard.pdf	
	RatingsDirect_ResearchUpdateSteamshipMutualGroupRatingsAffirmedAtAOutlookStable_42332820_Mar-03-2020.pdf	
	RatingsDirect_ResearchUpdateSteamshipMutualUnderwritingAssociationEuropeLtdAssignedARatingOutlookStable_43481753_Mar-03-2020.PDF	
	RatingsDirect_SteamshipMutualGroup_43133671_Mar-03-2020.PDF	
	SMUA_November2019_Ancillary_Own_funds_Application.pdf	
Operational Information	G01_Reserving and Claims Management Policy.pdf	Reserving and Claims Management Policy
	G02_Actuarial Policy.pdf	Actuarial Policy
	G03_Underwriting Policy.pdf	Underwriting Policy
	G04_Investment Policy.pdf	Investment Policy
	G05_Capital Management Policy.pdf	Capital Management Policy
	G06_Risk Appetite Statement.pdf	Risk Appetite Statement
Transfer Information	Part VII background.docx	Background Document
	Steamship Mutual - Part VII Transfer - Timetable V2 2019-09-13.pdf	Timetable
	List of Part VII European Members_by_Policy_Year_v2.xlsx	List of European Policyholders
	190722 Notification Plan V2.docx	
Other Information	Anthony-Warren-SIMSL-2020.04.17-Annotations-21-04-2020.pdf	SMUAL assessment of Covid-19 impacts on business

Legal Documents	SMUA - Transfer of business (final at 16.03.2020).pdf	
	Steamship Group Assets by Credit rating and Duration.pdf	
	Steamship Mutual - Part VII Progress Review - V3 2020-03-03 Notification proposals extract.pdf	
	Steamship Mutual Trust - Trust Deed.pdf	Trust Deed
	Summary of contingency mitigation measures_Received 09032020.docx	Summary of Contingency Mitigation Measures
	Trust explanation.docx	Trust Explanation

## Appendix E Checklist - PRA Statement of Policy and SUP18 of the FCA Handbook

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

Guidance Reference	Guidance	Scheme Report reference
PRA 2.30 (1) FCA 18.2.33 (1)	Who appointed the independent expert and who is bearing the costs of that appointment	1.12, 1.16
PRA 2.30 (2) FCA 18.2.33 (2)	Confirmation that the independent expert has been approved or nominated by the PRA (or appropriate regulator);	1.12
PRA 2.30 (3) FCA 18.2.33 (3)	A statement of the independent expert's professional qualifications and (where appropriate) descriptions of the experience that makes them appropriate for the role;	1.12, Appendix C
PRA 2.30 (4) FCA 18.2.33 (4)	Whether the independent expert, or his employer, has, or has had, direct or indirect interest in any of the parties which might be thought to influence his independence, and details of any such interest;	1.14 and 1.15
PRA 2.30 (5) FCA 18.2.33 (5)	The scope of the report;	1.22 to 1.23, Appendix B
PRA 2.30 (6) FCA 18.2.33 (6)	The purpose of the scheme;	2.6 to 2.12
PRA 2.30 (7) FCA 18.2.33 (7)	A summary of the terms of the scheme in so far as they are relevant to the report;	2.13 to 2.15
PRA 2.30 (8) FCA 18.2.33 (8)	What documents, reports and other material information the independent expert has considered in preparing the report and whether any information that they requested has not been provided;	1.24 to 1.28, Appendix D
PRA 2.30 (9) FCA 18.2.33 (9)	The extent to which the independent expert has relied on: (a) information provided by others; and (b) the judgement of others;	1.25, 1.26, 6.81, 7.3 to 7.6
PRA 2.30 (10) FCA 18.2.33 (10)	The people the independent expert has relied on and why, in their opinion, such reliance is reasonable;	1.25, 1.26, 6.82, 7.4, 7.5
PRA 2.30 (11) FCA 18.2.33 (11)	Their opinion of the likely effects of the scheme on policyholders (this term is defined to include persons with certain rights and contingent rights under the policies) distinguishing between: (a) transferring policyholders; (b) policyholders of the transferor whose contracts will not be transferred; and (c) policyholders of the transferee;	2.48 to 2.59, 2.61 and 2.62
PRA 2.30 (12) FCA 18.2.33 (11 A)	Their opinion on the likely effects of the scheme on any reinsurer of a transferor, any of whose contracts of reinsurance are to be transferred by the scheme;	2.60, 2.63. 6.56 to 6.60
PRA 2.30 (13) FCA 18.2.33 (12)	What matters (if any) that the independent expert has not taken into account or evaluated in the report that might, in their	7.11

	opinion, be relevant to policyholders' consideration of the scheme	
PRA 2.30 (14) FCA 18.2.33 (13)	For each opinion that the independent expert expresses in the report, an outline of their reasons.	2.46 to 2.63,
PRA 2.33 (1) FCA 18.2.36 (1)	Include a comparison of the likely effects if it is or is not implemented;	2.58, 6.5 to 6.14
PRA 2.33 (2) FCA 18.2.36 (2)	State whether they considered alternative arrangements and, if so, what;	1.23
PRA 2.33 (3) FCA 18.2.36 (3)	Where different groups of policyholders are likely to be affected differently by the scheme, include comment on those differences they consider may be material to the policyholders; and	2.59
PRA 2.33 (4) FCA 18.2.36 (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; (b) the likely effects of the scheme on matters such as investment management, new business strategy, administration, claims handling, expense levels and valuation bases in relation to how they may affect: (i) the security of policyholders' contractual rights; (ii) levels of service provided to policyholders; or (iii) for long-term insurance business, the reasonable expectations of policyholders; and (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.	Section 6
PRA 2.35 (1) FCA 18.2.38 (1)	For any mutual company involved in the scheme: Describe the effect of the scheme on the proprietary rights of Members of the company, including the significance of any loss or dilution of the rights of those Members to secure or prevent further changes which could affect their entitlements as policyholders;	2.61
PRA 2.35 (2) FCA 18.2.38 (2)	State whether, and to what extent, Members will receive compensation under the scheme for any diminution of proprietary rights; and	2.62
PRA 2.35 (3) FCA 18.2.38 (3)	Comment on the appropriateness of any compensation, paying particular attention to any differences in treatment between Members with voting rights and those without	2.62