

## Supplementary Report on the proposed insurance business transfer from Steamship Mutual Underwriting Association Limited to Steamship Mutual Underwriting Association (Europe) Limited

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## Abbreviations and important defined terms

Full Name	Abbr.	Description
Steamship	the Club	A collective term covering the regulatory group of SMUAL, SMUAE, SMUAB and SMUAT as defined below.
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	<p>A company limited by guarantee incorporated in the United Kingdom. The principal activity is the insurance and reinsurance of Protection and Indemnity ('P&amp;I') and Freight, Demurrage and Defence ('FDD') risks.</p> <p>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.</p>
Steamship Mutual Underwriting Association (Europe) Limited	SMUAE	<p>A company limited by guarantee incorporated in Cyprus. The principal activity is the insurance and reinsurance of P&amp;I and FDD risks.</p> <p>SMUAE is authorised and regulated by the ICCS in Cyprus.</p>
Steamship Mutual Underwriting Association (Bermuda) Limited	SMUAB	<p>A reinsurer incorporated in Bermuda and regulated by the BMA in Bermuda.</p> <p>SMUAB reinsures 90% of SMUAL's net underlying liabilities for the policy years beginning 20 February 2015 and subsequently.</p> <p>SMUAB reinsures 90% of SMUAE's net underlying liabilities for the policy years beginning 20 February 2020 and subsequently.</p> <p>All Members of SMUAL and Members of SMUAE are automatically Members of SMUAB and beneficiaries of The Steamship Mutual Trust.</p>
Steamship Mutual Underwriting Association (Bermuda) Trust Limited	SMUAT	<p>A reinsurer incorporated in Bermuda and regulated by the BMA.</p> <p>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.</p>
The Steamship Mutual Trust	The Trust	<p>The Trust names a number of charitable institutions and the mutual Members of SMUAB as beneficiaries.</p> <p>SMUAT acts as an independent trustee for the benefit of the beneficiaries, which include the Members of SMUAE and SMUAL.</p>
Steamship P&I Management LLP	SPIM	<p>Day to day operations of Steamship are managed by independent external managers.</p> <p>SPIM is the parent of the management companies. It is a partnership with 11 partners who are jointly the owners.</p> <p>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.</p>

Steamship Insurance Management Services Limited	SIMSL	<p>A subsidiary of SPIM and authorised and regulated by the FCA in the UK.</p> <p>Its staff carries out the day-to-day operations of SMUAL and will assist in the day-to-day operations of SMUAE.</p> <p>SIMSL has a branch in Greece which deals with claims handling which supports SMUAE.</p>
Steamship Insurance Agency (Europe) Limited	SIAE	<p>SIAE is a subsidiary of SIMSL.</p> <p>It employs staff in Cyprus who support SPIM in providing management services to SMUAE.</p>
The Managers		Together, SPIM, SIMSL and SIAE will be referred to as the “Managers”.
Hydra Insurance Company Limited	Hydra	<p>Hydra is a reinsurance captive set up by the International Group in Bermuda under the Segregated Account Companies Act 2000.</p> <p>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).</p>
Prudential Regulation Authority	PRA	A financial services regulatory body in the United Kingdom.
Financial Conduct Authority	FCA	A financial regulatory body in the United Kingdom which operates independently of the UK Government.
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.

## Introduction

2. Section 109 of the Financial Services and Markets Act 2000 as amended by the Financial Services Act 2012 ('FSMA') requires that a scheme report must accompany an application to the High Court of England and Wales ('the Court') to approve an insurance business transfer scheme.
3. My report (the 'Scheme Report') on the proposed insurance business transfer (the 'Transfer') from Steamship Mutual Underwriting Association Limited ('SMUAL') to Steamship Mutual Underwriting Association (Europe) Limited ('SMUAE') entitled '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' dated June 2020 was submitted in evidence to the Court.
4. The purpose of this document (the 'Supplementary Report') is to briefly document for the Court any developments since the date of the Scheme Report and outline the additional information I have considered to be able to do this. In particular, I have considered whether any of the developments since the Scheme Report have been sufficiently different from my expectations for my conclusions as presented in the Scheme Report to change.
5. The Supplementary Report must be read in conjunction with the Scheme Report in order to be taken in its proper context. It represents an addition to the Scheme Report and does not contain the full background to the Transfer as contained within that document. Therefore, considering the Supplementary Report in isolation may be misleading. All terms used in the Supplementary Report are as defined in the Scheme Report. In combination with the Scheme Report, it complies with the actuarial guidance and standards set out in paragraphs 1.17 to 1.21 of the Scheme Report. In line with the Scheme Report (paragraph 1.29), the work documented in this Supplementary 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) and so complies with Actuarial Standard of Practice X2.
6. I note the reliance and limitations described in Section 1 and Section 7 of the Scheme Report, as these apply equally to the Supplementary Report. In particular, the parties that may have access to this Supplementary Report and those who may place reliance on this Supplementary Report, and the extent to which they may do so, are identical to those described in the Scheme Report.
7. Note that figures within this Supplementary Report have been rounded.
8. I also note that this the Supplementary Report has been reviewed by representatives of SMUAL and SMUAE for factual accuracy.

## Overview of the Transfer

9. 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.
10. 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.
11. 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.
12. 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.
13. 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.
14. Therefore, the Club has carried out, or is carrying out, the following steps:
  - ▶ Has 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 been provided by SMUAE.
  - ▶ The Club transferred \$5m of capital from SMUAB to SMUAE under a deed of capitalisation in early November 2020.
  - ▶ 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.
15. 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.

## Summary conclusion

16. The expected impact of the Transfer on policyholders of SMUAL and SMUAE was shown in paragraph 2.59 of the Scheme Report.
17. Following the developments since 20 February 2020, my opinion is unchanged as the updated financial positions of SMUAL and SMUAE do not affect my conclusion on the Transfer. The rationale for my conclusion is explained in the following sections of the Supplementary Report.

In line with the conclusion provided in the Scheme Report, I conclude that the security provided to policyholders will not be materially adversely affected after the Transfer, that no group of policyholders will be adversely affected to a material extent by the Transfer, that the level of customer service provided to policyholders will 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.

## Updated information considered

18. I have based my findings in this Supplementary Report on the following information supplied by the Club, together with the information used in preparing the Scheme Report:
  - ▶ Unaudited GAAP / IFRS and Solvency II balance sheets for SMUAL and SMUAE as at 20 August 2020
  - ▶ Claims files for SMUAL and SMUAE as at 20 August 2020
  - ▶ The Club reserve files and exhibits as at 20 May 2020 and 20 August 2020 including the impacts of the Covid-19 pandemic
  - ▶ Updated schedules showing the impact of the Transfer on the GAAP and IFRS claims reserves and balance sheets of SMUAL and SMUAE as at as at 20 August 2020
  - ▶ Updated schedules showing the impact of the Transfer on the Solvency II technical provisions and balance sheets of SMUAL and SMUAE as at as at 20 August 2020
  - ▶ Updated Standard Formula calculation files for SMUAL and SMUAE, pre and post the Transfer, as at 20 August 2020
  - ▶ Updated Standard Formula calculation files for the Club as at 20 August 2020
  - ▶ Confirmation of VAT clearance from the Cypriot tax authority
  - ▶ Documentation from SMUAE's auditor on the accounting and tax treatment of the transfer of a group of assets under IFRS

- ▶ Board papers summarising the risk and impact assessment undertaken for the Covid-19 pandemic
  - ▶ Board papers summarising the rationale and approval of the capital injection from SMUAB to SMUAE
  - ▶ The draft witness statement of Graham Jones
  - ▶ The Notification Issue List report
19. My assessment of the information received has been supplemented by discussions with staff from both SMUAL and SMUAE.
20. The table below shows a summary of the information reviewed as part of the Scheme Report and that used as part of the Supplementary Report.

Table 1: Comparison of information reviewed when producing the Scheme Report and the Supplementary Report

Data item / modelling area	Used for Scheme Report	Used for Supplementary Report
Balance sheets for SMUAL, SMUAE and the Club	In the Scheme Report I set out the audited financial statements based on data as at 20 February 2020.	In the Supplementary Report I used financial statements as at 20 August 2020.  The SMUAE Solvency II asset valuation was audited by Deloitte.  No other financial statements have been audited as at 20 August 2020.  I have undertaken additional procedures to verify material items of each statement. The process followed is detailed in sections 41 to 56 of this Report.
Claims reserving studies and Solvency II technical provision calculations used as part of my review	I used internal and external reserving studies as at 20 February 2020.	I have used the same sources for the Supplementary Report except dated as at 20 August 2020.  These have been updated to reflect the impact of the Covid-19 pandemic on the claims reserves and the Solvency II technical provisions.
Capital modelling work and SCR calculation	I have reviewed the SMUAL and SMUAE Standard Formula calculation spreadsheets as at 20 February 2020.  I have reviewed the Club Financial Condition Reports report as at 20 February 2020.	I have reviewed the SMUAL and SMUAE Standard Formula calculations and the capital requirements as at 20 August 2020.  Additionally, I have reviewed the Club's capital position as at 20 August 2020.

## Developments since the issue of the Scheme Report

21. The information presented in the Scheme Report was based on analysis as at 20 February 2020. Subsequent to this analysis, the Club has carried out further claims reserving, and capital modelling work based on information up to 20 August 2020.
22. Further, in early November 2020, the Club transferred \$5m of capital from SMUAB to SMUAE under a deed of capitalisation. This capital contribution initially increases the capital adequacy ratio to 165% and ensures that, post-Transfer, the capital adequacy ratio of SMUAE will be above 150% as referred to in the transfer documents.
23. In this section I describe the main changes from the information presented in the Scheme Report to the updated information described above.

## Effect of the Transfer on the technical provisions of SMUAL and SMUAE

### Update on my review of the claims reserves

24. As part of the work I carried out when producing the Scheme Report, I received and reviewed documentation prepared by the Club that described the analysis they carried out. I also reviewed the most recent report on claims reserve produced by the Club's advisors, dated May 2020.
25. I discussed the appropriateness of the data and methodology used by the Club and their advisors, and also compared the reserves with my wider market benchmarks. Based on this, I concluded that the actuarial best estimate of the claims reserve was set on a reasonable basis.
26. For this Supplementary Report, I have reviewed the claims development for both SMUAL and SMUAE combined, and separately for the Transferring Policies. This covered the period between 20 February 2020 and 20 August 2020.
27. I believe that the change in claims reserves for both SMUAL and SMUAE and the Transferring Policies are in line with my expectations. This is because:
  - ▶ There have been no material changes to the methodology or key assumptions used by the Club in setting their GAAP / IFRS reserves. The approach to estimating the transferring reserve has also not changed and remains broadly consistent with the aggregate reserve review in terms of reserving assumptions.
  - ▶ For the 2019 and prior policy years,
    - the overall claims experience over the 6 months from the Club's members has been broadly in line with expectations based on the assumptions for claim development used by the Club as part of the 20 February 2020 review, including the losses from the Covid-19 pandemic which have continued to be in line with expectations.
    - Experience from the International Group pooling arrangement ('Pool') claims has been worse than expected due to one new large loss and a deterioration on a previously reserved loss. This has led to strengthening of the booked reserves over the 6 months. The Club have considered their reserving assumptions for these movements and are comfortable their approach remains reasonable. I note that the increase in reserves is ceded through to SMUAB (and then to the SMUAB Hydra cell and SMUAT).

- I conclude that these assumptions are set on an appropriate basis.
- ▶ For the 2020 policy year,
  - I have reviewed the selected claims ratio on the 2020 underwriting year for the most material claim categories excluding losses from the Covid-19 pandemic.
  - For reserves in respect of the Covid-19 pandemic, to date, claims have mainly arisen from the Cruise ship business. I have identified and reviewed what I believe to be the key assumptions relating to the Covid-19 pandemic reserves, namely the reserves set for known cruise ship losses and provisions set for the other classes without known losses.
  - Experience for Pool claims has been worse than expected in the year to date due to the severity of losses being higher than expected. Given the trend in both 2019 & prior and 2020 in respect of the Pool claims, I have discussed with the Club their reserving assumptions which are based on the development of past losses. I remain comfortable with their assumptions, but this is an area of uncertainty.
  - SMUAE's 2020 reserve have been estimated as part of the aggregate reserving process for SMUAL and SMUAE as discussed above. The reserves have been allocated between entities based on premium income. This includes SMUAE's share of the 2020 reserves in respect of the Covid-19 pandemic.
  - The Club's income in 2020 has been broadly in line with expectations based on the assumptions used by the Club when setting the financial year forecast at its June 2020 Board meeting, including the impacts of the Covid-19 pandemic.
  - For all of the above, I have concluded that these assumptions are set on an appropriate basis, noting the uncertainty that remains as to how the Covid-19 pandemic will impact the remainder of 2020.
- ▶ The margin for prudence in the booked claims reserve on the 2019 & prior years (policy years incepting prior to 20 February 2020) for SMUAL has reduced since February 2020. This is due to the reduced uncertainty with regard to the losses arising from the Covid-19 pandemic on the 2019 policy year, as these claims have now been incurred in line with expectations from my review as at February 2020. Uncertainty remains on the 2020 policy year (incepting on 20 February 2020) when considering future impacts on claims including from any "second wave" and the impact of any economic downturn during 2021. I believe the margin adopted by SMUAL as at 20 August 2020 remains reasonable in light of the uncertainties which remain in the reserves. In my experience, this is a similar level of caution in the booked claims reserve in comparison to the insurance market.
- ▶ I have also considered the security of the external reinsurers. The Club has provided an analysis of its reinsurers who have had their rating reduced by S&P since February 2020 following the Covid-19 pandemic. It shows that these reinsurers all remain above an A-rating, which, whilst reduced, still means the overall level of security remains very good.

28. I conclude that the actuarial best and booked estimate of the claims reserve for SMUAL and SMUAE, as well as the reserves estimated for the Transferring Policies as at 20 August 2020 are also set on a reasonable basis.

#### SMUAL GAAP technical provisions (pre-Transfer)

29. The Club have provided me with an update to tables 4a and 4b in paragraphs 4.4 and 4.7 of the Scheme Report.
30. Overall, pre-Transfer, there has been an increase in the net technical provisions for SMUAL (a \$98m gross increase less an additional \$52m in reinsurance recoveries).
31. This is as I would expect, given the introduction of the new policy year and associated unearned premiums, the context of performance from Pool claims, the emergence of losses in relation to the Covid-19 pandemic, offset by the reduction in margin on the 2019 & prior years as discussed above.

#### SMUAE IFRS technical provisions (pre-Transfer)

32. The Club have provided me with an update to table 4c in paragraph 4.39 of the Scheme Report, as well as the details of the SMUAE IFRS technical provisions as at 20 August 2020.
33. At February 2020, SMUAE had no earned reserves since it only commenced writing business from 20 February 2020.
34. At 20 August 2020, SMUAE has its own technical provisions in respect of the 2020 premium/business it now writes.

#### Technical provisions for the Transferring Policies

35. The technical provisions in relation to the Transferring Policies have reduced broadly in line with claim payment expectations and since new business has been written directly into SMUAE from the current policy year.
36. As part of the Transfer, assets from SMUAL matching the estimated liabilities will transfer to SMUAE along with a further cash asset equivalent to an estimated risk margin of \$2.0m.

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

37. In paragraph 4.40 of the Scheme Report, I provided details on the main uncertainties in the GAAP technical provisions of SMUAL and the IFRS technical provisions of SMUAE.
38. Based on this review, I have not identified any additional uncertainties. I have considered the uncertainties and believe they are typical for insurance firms such as SMUAL and SMUAE. 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.

#### Conclusion

39. I believe that my conclusions as set out in the Scheme Report (paragraph 4.36) with respect to the claims reserves are still valid because:
- ▶ There have been no material changes to the reserving basis adopted by the Club.

- ▶ The movement in the claims incurred since 20 February 2020 has been explained and reflected in the assumptions used by the Club.
- ▶ The reserves established for the Covid-19 pandemic are reasonable given the uncertainty that remains as to how the Covid-19 pandemic will impact the remainder of policy year 2020.

40. I have also received and reviewed an update from the Club on the key claims activity from 20 August 2020 to the time of finalising the Supplementary Report. There is nothing in the information I have reviewed that leads me to change my conclusions.

### Effect of the Transfer on the balance sheets of SMUAL and SMUAE

41. The Club have provided me with the GAAP balance sheet of SMUAL and IFRS balance sheet of SMUAE as at 20 August 2020.
42. I have compared the GAAP and IFRS balance sheets we received at 20 August 2020 to those I received as at 20 February 2020 and have discussed with the Club the reasons behind the more material movements in the other elements of the balance sheet besides the technical provisions discussed above.
43. The level of cash held has increased since 20 February 2020. This mainly reflects the current 2020 year premium, which has been received and not paid out as claims to date.
44. There are some increases to 'Receivables and Other Assets' which are largely driven by seasonal effects in respect of premiums due to the Club from members. The Club receives its premium from members in stages.
45. Further, the Club have provided me with the IFRS balance sheet of SMUAE following the \$5.0m capital contribution from SMUAB in early November 2020.

### SMUAL GAAP balance sheet (pre-Transfer)

46. The amount of available capital of SMUAL has not materially changed between 20 February 2020 to 20 August 2020. Therefore, I believe that the overall strength of the SMUAL GAAP balance sheet is not materially different to the position set out in the Scheme Report (paragraph 4.46).
47. I do not believe that any of the changes to the balance sheet of SMUAL between 20 February 2020 to 20 August 2020 described above would affect my conclusion on the Transfer, as set out in the Scheme Report (paragraphs 2.41 to 2.68).

### SMUAE IFRS balance sheet (pre-Transfer)

48. The amount of available capital of SMUAE has not materially changed between 20 February 2020 and the date of this report (including the capital contribution from SMUAB to SMUAE in early November 2020). Therefore, I believe that the overall strength of the SMUAE IFRS balance sheet is not materially different to the position set out in the Scheme Report (paragraph 4.46).
49. I do not believe that any of the changes to the balance sheet of SMUAE between 20 February 2020 to the date of this report as described above would affect my conclusion on the Transfer, as set out in the Scheme Report (paragraphs 2.41 to 2.68).

#### Expected impact of the Transfer on SMUAL and SMUAE

50. The Club have also provided the expected impact of the Transfer on SMUAL and SMUAE. This is an update to tables 4d and 4e in paragraph 4.46 of the Scheme Report.
51. In total, on a net of reinsurance basis, \$7.8m of claims liabilities will transfer to SMUAE. As part of the Transfer, assets from SMUAL matching these liabilities will also transfer along with a further cash asset equivalent to an estimated risk margin of \$2.0m.
52. The risk margin has marginally increased from my analysis at February 2020, where it was \$1.8m. This is to ensure that the SMUAE capital ratio remains above 150% as required by the transfer documents, and secondly, so it is broadly equitable to SMUAL's capital ratio.

#### The combined Club balance sheet position

53. The Club have provided me with an updated balance sheet position of the Club as at August 2020, after the capital contribution from SMUAB to SMUAE (in early November 2020) and after the Transfer. This is an update of table 4f in paragraph 4.60 of the Scheme Report.
54. The Club's liquidity has increased due to maturing bonds which have not been reinvested to date.
55. The net assets of the Club have reduced since 20 February 2020. This is expected due to the impact of the underwriting losses within the Club and associated legal entities.
56. I believe that the updated financial position of the Club has not materially changed since 20 February 2020 and does not affect the security for policyholders of SMUAL and SMUAE.

#### Conclusion

57. I believe that my conclusions as set out in the Scheme Report (paragraph 4.65) with respect to balance sheet strength of SMUAL, SMUAE and the Club are still valid.

#### Effect of the Transfer on the Solvency II technical provisions for SMUAL and SMUAE

##### Update on my review of the Solvency II technical provisions

58. As part of the work I carried out when producing the Scheme Report, I received and reviewed the analysis prepared by the Club to convert the technical provisions from a GAAP (or IFRS) basis to a Solvency II basis for both SMUAL and SMUAE, as well as the calculations for the Risk Margin. Based on this, I concluded that Solvency II technical provisions, best estimate and Risk Margin were reasonable and were set on a reasonable basis.
59. For this Supplementary Report, I have reviewed Solvency II technical provisions to assess any changes in the calculations, methodology and assumptions used for the best estimate and Risk Margin since 20 February 2020.
  - ▶ There have been no material changes to the calculations and methodology used for the Solvency II technical provisions, best estimate and Risk Margin. The methodology remains in line with Solvency II regulations.

- ▶ The Club's reserving assumptions have been slightly adjusted to reflect the claims experience in 2020 including the impact of losses from the Covid-19 pandemic. This includes changes to the profitability of the unearned premium. Premiums have remained consistent as the impact of the Covid-19 pandemic was considered within the 20 February 2020 Solvency II technical provisions.
  - ▶ The prescribed USD yield curves used for discounting with the Solvency II technical provisions have reduced due to the impacts of the Covid-19 pandemic on the investment market. This has led to a reduction in discounting and therefore an increase in the Solvency II technical provisions.
  - ▶ The Club has incurred minimal additional expenses due to the Covid-19 pandemic. These are in relation to IT infra-structure and have been included within the Solvency II technical provisions.
60. I remain 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 that the Solvency II technical provisions, best estimate and Risk Margin as at 20 August 2020 are reasonable and are set on a reasonable basis.
61. The Club have provided me the gross and net technical provisions on a Solvency II basis for SMUAL and SMUAE, before and after the Transfer. This is an update to table 4g in paragraphs 4.70 of the Scheme Report.
62. Pre-Transfer, the Solvency II technical provisions for both SMUAL and SMUAE have increased since 20 February 2020. This relates to the movement in the GAAP (or IFRS) technical provisions which are discussed in paragraphs 24 to 38 above, as well as the seasonal impact of changes in the debtors/creditors balance and reflects premium which has been received and not earned due to the 2020 year being only partially earned at August 2020. The relative movements of other aspects of the Solvency II technical provisions are similar to my previous review within the Scheme Report.
63. These changes so do not affect my opinion of the Transfer.
64. Post-Transfer, the net technical provisions for SMUAL and SMUAE increase on a GAAP (or IFRS) basis to a Solvency II basis. The post-Transfer adjustments between the GAAP (or IFRS) reserves to the Solvency II basis remain broadly consistent with the pre-Transfer movements.
65. The relative movements are similar to my previous review within the Scheme Report, and so do not change my opinion of the Transfer.

## Effect of the transfer on the capital requirements for SMUAL and SMUAE

66. SMUAL and SMUAE set their capital requirements using Solvency II. An overview of this regulatory regime and its capital requirements is discussed in sections 5.1 to 5.14 of the Scheme Report.

### SMUAL regulatory capital requirements (pre-Transfer)

67. The Club have provided me with the change in the capital position for SMUAL pre-Transfer, on a Solvency II basis. This is an update to table 5a in paragraph 5.15 of the Scheme Report.

68. The Capital Adequacy Ratio as at 20 August 2020 is 159% compared to 164% as at 20 February 2020. This is driven by a combination of positive and negative movements caused by:

- ▶ Own Funds have reduced due to the adverse claims experience observed during 2020 as discussed in paragraph 27. This decreases the capital adequacy ratio.
- ▶ The reduction in premium income in 2020 which impacts both Insurance Risk and Operational Risk, therefore reducing the SCR, increasing the capital adequacy ratio.
- ▶ 'Currency risk' within Market Risk has reduced as a consequence of the funds being matched more closely to the liability profile of the business, there now being less Euro cash balances. This reduces the SCR, increasing the capital adequacy ratio.

69. The overall coverage ratio on the SCR basis has reduced slightly but remains at a level of security which means it is capitalised well above regulatory minimum capital requirements pre-Transfer.

### SMUAE regulatory capital requirements (pre-Transfer)

70. The Club have provided me with the change in the capital position for SMUAE pre-Transfer, on a Solvency II basis (both pre and post the \$5.0m capital contribution from SMUAB). These are an update to table 5b in paragraph 5.25 of the Scheme Report.

71. The Capital Adequacy Ratio of SMUAE as at 20 August and allowing for the \$5m capital contribution in early November is estimated to be 165%. This compares to 197% as at 20 February 2020. This change is driven by:

- ▶ The new premium income in 2020 which impacts both Insurance Risk and Operational Risk. There are also new reinsurance balances which further increase the Counterparty Default Risk. This increases the SCR/capital requirement, decreasing the capital ratio.
- ▶ Own Funds have reduced due to the poor claims experience observed during 2020 as discussed in paragraph 27. This decreases the capital adequacy ratio.

72. The overall coverage ratio on the SCR basis has reduced, and this impact is more material due to the gearing of the smaller balances involved and the fact SMUAE only started writing business in February 2020.

73. At 20 August 2020, the solvency coverage ratio was 141% as a result of the above movements. The \$5m capital contribution from SMUAB in early November 2020 increased this to 165%. I still consider this to be a strong solvency position pre-Transfer.

#### SMUAL and SMUAE regulatory capital requirements (post-Transfer)

74. As mentioned above in paragraph 52, the Club will be slightly increasing the estimated amount transferred from SMUAL to SMUAE as a risk margin from that stated in the Scheme Report as required by the scheme document.
75. After the Transfer:
- ▶ the Capital Adequacy Ratio for SMUAL would increase from 159% to 164%.
  - ▶ the Capital Adequacy Ratio for SMUAE would reduce from 165% to 150%. (The 165% is after the capital contribution from SMUAB as stated above).
76. I believe the Capital Adequacy Ratios of SMUAL and SMUAE after the Transfer are sufficiently similar. SMUAL and SMUAE will hold Own Funds well above the regulatory requirements and meet the Club's risk appetite statement as referred to in paragraph 5.44 on the Scheme Report.
77. As noted in the Scheme Report paragraph 2.2 and 2.39, the security provided to policyholders is derived from the intra-group reinsurance and the mutual relationships between entities within the Club. 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.

#### Capital objective for the Club

78. In paragraphs 5.43 to 5.47 of the Scheme Report, I discussed the Club's 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) credit rating. I understand that as at July 2020, S&P have affirmed the Club's credit rating as 'A' (Stable).
79. The Club have provided me with the Capital Adequacy Ratios for each entity within the Club and the Club in aggregate, as at 20 August 2020 and pre-Transfer after allowing for the capital contribution moving from SMUAB to SMUAE in early November 2020. These ratios remain equivalent to holding excess capital as measured using S&P's risk-based capital model for insurers, at the 'AAA' level.

#### Conclusion

80. Based on the updated capital positions pre-Transfer, my conclusions on capital strength are unchanged from the analysis I described in the Scheme Report (paragraph 5.47).

## Other aspects of the Transfer

### Impact of Brexit

81. In section 6.5 to 6.15 of the Scheme Report, I note that the most pragmatic solution to 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.
82. Whilst there remains uncertainty around the operating environment for insurers due to the impact of Brexit, I am not aware of any developments relating to Brexit which lead me to change my conclusions in the Scheme Report.

### The impact of the Covid-19 pandemic

83. I discussed the impact of the Covid-19 pandemic on both the operational and financial aspects of the Club in sections 6.31 to 6.34 of the Scheme Report.
84. In the interim period since issuing the Scheme Report, the Club have demonstrated that they are able to operate successfully under the operational restrictions in place (such as increased remote working).
85. Additionally, I discussed the impact of the Covid-19 pandemic on the expense levels (paragraphs 6.70 to 6.73), liquidity (paragraphs 6.74 to 6.75) and investments (paragraph 6.78) of the Club of the Scheme Report.
86. I understand the Club's expense levels were only marginally impacted due to the pandemic by additional costs for IT hardware. The Club have had no issues with liquidity during the pandemic and both SMUAL and SMUAE hold more cash at 20 August 2020, than they did at 20 February 2020. Investments held in SMUAT were impacted by market volatilities between February 2020 and August 2020, but these have little impact on the financial statements as at August 2020.
87. I remain satisfied that the Covid-19 pandemic will continue not to have an impact on the ability of the Club to perform their operations, such a customer service, and thus does not affect my conclusion on the Transfer.
88. I have also considered the impact on SMUAL and SMUAE's business in terms of the GAAP, IFRS and Solvency II technical provisions. This is discussed in detail under the relevant headings in sections 24 and 58 of this Supplementary Report.
89. I conclude that the key assumptions used to assess and capture the impact of the Covid-19 pandemic are set on an appropriate basis, for all GAAP, IFRS and Solvency II reporting bases, for both SMUAL and SMUAE.
90. My conclusion on the operational and financial impacts of the Covid-19 pandemic on the Transfer remains unchanged to that stated in the Scheme Report.

### Update on communication to policyholders and other parties

91. I have received and reviewed the second witness statement, which sets out the implementation of the communication plan. In my opinion, this in all material aspects complies with the communication plan I had reviewed at the time of writing the Scheme Report. In particular:

- ▶ The process of notification of the Transfer to the relevant policyholders and other interested parties (including reinsurers) has been carried out in line with the communication plan.
  - ▶ The communication pack issued to the relevant policyholders, insurance brokers and reinsurers comprised the appropriate documents (translated to the appropriate languages) as set out in the communication plan.
  - ▶ The Transfer has been publicised in the press in accordance with the communication plan, and in the form which had been approved by the PRA. Relevant information, including the Scheme Report, was made available on Steamship's website.
  - ▶ Provision of a Part VII telephone line in accordance with the communication plan.
92. I have been kept informed by the Club of responses to the communications exercise. At the time of writing, the Club has received the following responses:
- ▶ 2 letters were returned to sender – the reason for both of these was that the letters were not addressed to an individual. The club have been unable to identify an individual at the recipient company, but have confirmed that notifications were also sent to representatives of the recipients; and
  - ▶ 4 enquiries from brokers and policyholders, asking for further details with respect to the Transfer. These were of a general nature and none of these enquiries contained any objections to the Transfer. The Club have provided the additional information to the parties as requested.
93. At the time of writing this Supplementary Report I am not aware of any objection to the Transfer or anything to affect my conclusions as set out in the Scheme Report (sections 6.41 to 6.51).

#### Tax implications of the Transfer

94. SMUAL and SMUAE have considered the tax implications of the Transfer as discussed in detail in sections 6.52 to 6.55 of the Scheme Report.
95. Since circulation of the Scheme Report, SMUAE have received confirmation from the Cypriot Tax authority that the Transfer does not constitute a supply for VAT purposes.
96. Also, SMUAE have received confirmation from their auditor that they believe, under IFRS 3, the Transfer should be treated as a transfer of a group of assets and liabilities. Any risk margin therefore transferred as part of the Transfer will be taxable under this interpretation.
97. Given the risk margin being transferred is an estimated \$2.0m and due to the expected financial result of SMUAE, any tax liability due will be small.
98. Thus, in line with the conclusions in the Scheme Report, I do not believe that there are any tax implications which will materially affect the policyholders or the financial position of SMUAL or SMUAE.

#### Other issues

99. I have also conducted a review of the remaining issues discussed in Sections 6 & 7 of my Scheme Report. There have been no developments that would have any effect on those topics since the date of the Scheme Report and my conclusions on these issues remain unchanged. Therefore, other than the impact of the Covid-19 pandemic, I have not discussed those topics again in this Supplementary Report.
100. I have not identified any other issues in relation to the Transfer since the date of the Scheme Report.
101. I also note that this the Supplementary Report has been reviewed by representatives of SMUAL and SMUAE for factual accuracy.

#### Overall Conclusion

102. 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.
103. I have considered the Transfer and its likely effects on the policyholders and reinsurers that I believe could be affected, or potentially affected, by the Transfer. I have also considered each of the different groups of policyholders which I identified in the Scheme Report.
104. I have considered the possible effects on the Transfer of developments such as changes in the balance sheet, the capital position, policyholder relations and the political environment (such as any changes to the various country approaches to dealing with the Covid-19 pandemic following the emergence of the second wave of infections, as well as developing views on the economic impact of the Covid-19 pandemic) that have occurred since the date of the Scheme Report, and my conclusion is unchanged from that stated in the Scheme Report.

#### Signatory



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

17 November 2020