Milliman Report

Report of the Independent Expert on the proposed transfer of the UK branch insurance business of Sompo Japan Nipponkoa Insurance Inc. to Transfercom Limited

Prepared for:
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CONTENTS

1. INTRODUCTION

Purpose of Report

1.1. It is proposed that the UK branch business of Sompo Japan Nipponkoa Insurance Inc. ("SJNKI") be transferred to Transfercom Limited ("Transfercom") by an insurance business transfer scheme (the "Scheme") as defined in Section 105 of the Financial Services and Markets Act 2000 ("FSMA").

1.2. Section 109 of FSMA requires that an application to the High Court of Justice in England and Wales (the "Court") for an order sanctioning an insurance business transfer scheme must be accompanied by a report on the terms of the transfer (the "Report") by an independent person (the "Independent Expert") having the skills necessary to make the report and who is nominated or approved by the Prudential Regulation Authority ("PRA"), having consulted with the Financial Conduct Authority ("FCA"). The Report is required in order that the Court may properly assess the impact of the proposed transfer, including the effect on the policyholders of the insurance companies in question.

1.3. SJNKI and Transfercom have nominated me to act as Independent Expert to provide the Report in respect of the Scheme, and the PRA has approved my appointment (see paragraph 1.11 below).

1.4. This Report describes the proposed transfer and discusses its possible effects on the policyholders of SJNKI and Transfercom, including effects on security and levels of service.

1.5. A list of terms defined in this report is shown in Appendix 1. Otherwise I use the same defined terms as are in the Scheme.

The Proposed Scheme

1.6. SJNKI is a company incorporated in Japan and is a subsidiary of Sompo Japan Nipponkoa Holdings, Inc. (further details about SJNKI and its corporate group are given in Section 3). SJNKI and its subsidiaries form the non-life insurance business of the group of companies ultimately owned by Sompo Japan Nipponkoa Holdings, Inc. ("SJNK" and the "SJNK Group"). SJNKI relocated a series of inwards reinsurance contracts originally written by Nipponkoa Insurance Company Limited ("NKJ") from Japan to the UK branch of SJNKI (the "UK Branch") on 6 March 2015. Following the aforesaid relocation, SJNKI plans to transfer the entire business of the UK Branch (referred to henceforth as the "Transferring Business") to Transfercom, a UK subsidiary of National Indemnity Company ("NICO"). More details on the Transferring Business (including the aforesaid former NKJ business relocated to SJNKI) are given in Section 3 below. Likewise, further details on Transfercom and NICO (both firms in the Berkshire Hathaway Group) are given in Section 4 below.

1.7. In order to facilitate the proposed Scheme, a Framework Agreement was entered into between SJNKI, Transfercom and NICO on 28th April 2014, which provides for:

- SJNKI (NKJ as was) and Resolute Management Limited, a Berkshire Hathaway Group company, ("Resolute") to enter in to a run-off management agreement (which commenced with effect from 6 March 2015), whereby Resolute manages the business of the UK Branch on behalf of SJNKI through to the Effective Date of the Scheme;
- NICO and Transfercom to enter in to a reinsurance agreement (the "NICO Agreement") whereby NICO will reinsure the whole of the Transferring Business with effect from the Effective Date; and
- The transfer of the Transferring Business (i.e. the entire business of the UK Branch) to Transfercom on the Effective Date, in accordance with the Scheme.

1.8. Under the Scheme, the entire (re)insurance business of the UK Branch, including all of its insurance liabilities, are to be transferred into Transfercom. In addition, SJNKI will transfer investments in relation to the business to Transfercom. No outwards reinsurance or any other assets will be transferred under the Scheme. Assuming that the Scheme proceeds as planned and that, after the Effective Date, there remain no assets or liabilities within the UK Branch, it is anticipated that the UK Branch will apply to be de-authorised, following SJNKI's internal approval to do so.

1.9. As outlined in paragraph 1.7 above, the claims (and other) administration of the Transferring Business is currently undertaken by Resolute under an outsourcing agreement. Following the transfer Resolute will continue to administer the business on behalf of Transfercom.

1.10. The business involved, the arrangements for the transfers and the effect of the transfers are discussed in more detail in Sections 3 to 11 of this Report.

The Independent Expert

1.11. I, Gary Wells, have been appointed by SJNKI and Transfercom as the Independent Expert to consider the Scheme under Section 109 of FSMA. My appointment has been approved by the PRA in a letter dated 22 April 2015 from the PRA to SJNKI.

1.12. I am a Principal of Milliman LLP ("Milliman") and I am based in its UK General Insurance practice in London. I am a Fellow of the Institute and Faculty of Actuaries which was established in 2010 by the merger of the Institute of Actuaries and the Faculty of Actuaries. I became a Fellow of the Institute of Actuaries in 1986. My experience of general insurance includes the (reserved) roles of Signing Actuary to Lloyd's syndicates and Irish non-life insurance companies, as well as acting as the Independent Expert in a number of insurance business transfer schemes. A list of previous schemes for which I have acted as independent expert under the terms of FSMA, and as an independent actuary under the Insurance Companies Act 1982, the legislation replaced by FSMA, can be found in Appendix 2.

1.13. I confirm that I do not have any personal, financial, or any other interest in SJNKI or Transfercom. During 2012 (and early 2013) I acted as independent expert in the transfer of certain Italian branch business from Sompo Japan Insurance Company of Europe Limited (an SJNK Group company) to Berkshire Hathaway International Insurance Limited (a Berkshire Hathaway Group company). I also acted as the independent expert in the transfer of the business of Nipponkoa Insurance Company (Europe) Limited to Sompo Japan Nipponkoa Insurance Company of Europe Limited (both SJNK Group companies) during 2014/2015. I have further been appointed to carry out the role of Independent Expert/Actuary in relation to two transfers of small portfolios of business from third parties into Tenecom Limited, another company within the Berkshire Hathaway Group. Other than these assignments, I have not acted on behalf of or in relation to SJNKI, Transfercom, or any other companies in their respective groups, in any professional capacity.

1.14. I note that Milliman is part of Milliman, Inc., a global consulting firm and, as such, Milliman Inc. practices have worked with parts of the Berkshire Hathaway and SJNK Groups on assignments globally. Milliman Inc.'s worldwide annual revenue in respect of the SJNK Group and Berkshire Hathaway Group has not, however, exceeded 0.1% of the firm's total fee income over each of the last 5 years in respect of each group.

1.15. I do not believe that my involvement in the insurance business transfers mentioned in paragraph 1.13 above, or the involvement of other Milliman Inc. consultants with the SJNK and Berkshire Hathaway Groups affects my ability to act independently in my assessment of the Scheme.

1.16. The Scheme is subject to sanction by the Court under Section 111 of FSMA.

1.17. SJNKI will be responsible for payment of all fees in respect of my work as Independent Expert.

The Scope of my Report

1.18. My terms of reference have been reviewed by the PRA and are set out in Appendix 3.

1.19. I have considered the terms of this Scheme only and have not considered whether any other scheme may provide a more efficient or effective outcome.

1.20. The Report describes the proposed Scheme and the likely effects on policyholders of SJNKI and of Transfercom, including effects on security and levels of service. These factors are contrasted to the position which will apply after the completion of the proposed transfer. This Report should be read in conjunction with the full terms of the proposed Scheme.

1.21. My work has required an assessment of the liabilities of SJNKI and Transfercom, for the purposes of describing the effect of the transfer. My review of the liabilities was based on actuarial reserve assessments conducted by internal and/or external actuaries of SJNKI or Transfercom (as the case may be). I have reviewed the methodology and assumptions used in their work and assessed the key areas of uncertainty in relation to these liabilities. I have not attempted to review in detail the calculations performed by the internal and/or external actuaries (as the case may be) or to produce independent estimates of the liabilities.

1.22. In addition to the liabilities, I have assessed the appropriateness, in nature and amount, of the assets to be transferred under the Scheme, and the capital position of SJNKI and Transfercom pre and post the proposed transfer. Again, I have not attempted to review in detail the calculations performed for/by SJNKI or Transfercom, or to produce independently my own capital estimates.

1.23. As far as I am aware, there are no matters which I have not taken into account in undertaking my assessment of the Scheme and in preparing this Report, but which nonetheless should be drawn to the attention of policyholders in their consideration of the Scheme.

1.24. In reporting on the Scheme as the Independent Expert, I recognise that I owe a duty to the Court to assist the Court on matters within my expertise. This duty overrides any obligation to the companies involved in the Scheme. I confirm that I have complied with this duty.

1.25. I am aware of the requirements regarding experts set out in Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Protocol for Instruction of Experts to give Evidence in Civil Claims.

1.26. 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.

1.27. The use of 'I' and 'my' in this Report generally refers to work done by myself and the team operating under my direct supervision during the course of this review (including relevant colleagues based in the Tokyo office of Milliman who have provided me with information about the Japanese insurance market and the regulation thereof where such information was beyond my own knowledge and have provided me with English translations of relevant information provided by SJNKI where such information was provided in Japanese). Notwithstanding the above, when I use 'I' and 'my' in reference to an opinion, it is mine and mine alone.

1.28. Shortly before the date of the Court hearing at which an order sanctioning the Scheme will be sought, I will prepare a supplementary report covering any relevant matters which might have arisen since the date of this Report. It is intended that the supplementary report will be published on a SJNKI website at least one week before the date of that Court hearing.

The Structure of my Report

1.29. The remainder of the Report is set out as follows

- In Section 2, I provide some background to the regulatory environment in which the companies involved in the Scheme operate.
- In Sections 3 and 4, I provide some background to SJNKI and to Transfercom, i.e. the companies involved in the Scheme.
- Section 5 summarises the key provisions of the Scheme.
- Section 6 describes the matters I need to consider as Independent Expert.
- In Section 7, I consider the likely effects of the Scheme on the group of transferring policyholders.
- In Section 8, I consider the impact of the Scheme on the current policyholders of Transfercom.
- In Section 9, I consider the impact of the Scheme on the policyholders remaining in SJNKI.
- In Section 10, I cover more general issues relating to the Scheme.
- My conclusions are summarised in Section 11.

Reliances and Limitations

1.30. In carrying out my review and producing this Report I have relied upon the accuracy and completeness of the data and information provided to me, in both written and oral form, by SJNKI and Transfercom, and can confirm, in accordance with PS7/15 and SUP 18 (see paragraph 1.47 below), that all the information that I have requested has been provided. Reliance has been placed upon, but not limited to, the information detailed in Appendix 4. My opinions depend on the substantial accuracy of this data, information and the underlying calculations.

1.31. I have not sought independent verification of data and information provided to me by SJNKI and Transfercom, nor does my work constitute an audit of the financial and other information provided to me. I have reviewed the information for reasonableness and consistency and with the benefit of my experience this has not raised any concerns. I note that the information has been provided to me by members of the senior management of SJNKI and Transfercom (as appropriate), or by responsible senior professionals from the advisors to SJNKI and Transfercom (as appropriate), and I'm not aware of any inaccuracies or limitations in the data and information so provided to me that would materially impact the results of my analysis in relation to the Scheme.

1.32. I have met in person or conducted conference calls with representatives of SJNKI and Transfercom (as appropriate) to discuss the information provided to me and specific matters arising out of the considerations and analysis conducted. This includes the legal advisers to SJNKI and Transfercom in relation to the Scheme, where appropriate. Where significant pieces of information have been provided orally I have requested and received written confirmation.

1.33. The Report has been prepared for the purposes of the Scheme in accordance with Section 109 of FSMA. A copy of this Report will be sent to the PRA and FCA and will accompany the Scheme application to the Court.

1.34. This Report must be considered in its entirety, since individual sections, if considered in isolation, may be misconstrued.

1.35. Neither the Report, nor any extract from it, may be published without my specific written consent having been given, save that copies of the Report may be made available for inspection by policyholders and copies may be provided to any person requesting the same in accordance with legal requirements. I also consent to the Report being made available on the website to be operated by SJNKI in connection with the Scheme.

1.36. No summary of the Report may be made without my express consent. I will provide a summary of the Report for inclusion in a document that will be made available to policyholders of SJNKI and the policyholders of Transfercom under the Scheme (the "Report Summary").

1.37. The Report has been prepared within the context of the assessment of the terms of the Scheme and must not be relied upon for any other purpose. No liability will be accepted by Milliman, or me, for any application of the Report to a purpose for which it was not intended or for the results of any misunderstanding by any user of any aspect of the Report. In particular, no liability will be accepted by Milliman or me under the terms of the Contracts (Rights of Third Parties) Act 1999.

1.38. Actuarial estimates are subject to uncertainty from various sources, including changes in claim reporting patterns, claim settlement patterns, judicial decisions, legislation, economic and investment conditions. It should therefore be expected that the actual emergence of claims, premiums, expenses and investment income will vary from any estimate. Such variations in experience could have a significant effect on the results and conclusions of this Report. No warranty is given by Milliman or me that the assumptions, results and conclusions on which this Report is based will be reflected in actual future experience.

1.39. This review does not comprise an audit of the financial resources and liabilities of SJNKI or Transfercom.

1.40. This Report should not be construed as investment advice.

1.41. Nothing in the Report should be regarded as providing a legal opinion on the effectiveness of the Scheme.

1.42. The external costs of the Scheme will be met by SJNKI.

1.43. In considering the background to SJNKI and Transfercom, the companies involved in the Scheme, and in considering the likely impact of the Scheme, I have made extensive use of financial information as at 31 December 2014 for Transfercom and as at 31 March 2015 for SJNKI (and the UK Branch) as these are the most recent dates at which the respective audited financial information is available. I have also taken into account updated financial information which has been made available to me, although I note that this updated information has not been audited. At the date of the Report, I am not aware of any material changes in circumstances since 31 December 2014 (or 31 March 2015 for SJNKI) other than those referred to in the Report. The Report also takes no account of any information that I have not received, or of any inaccuracies in the information provided to me.

1.44. The use of Milliman's name, trademarks or service marks, or reference to Milliman directly or indirectly in any media release, public announcement or public disclosure, including in any promotional or marketing materials, websites or business presentations, is not authorised without Milliman's prior written consent for each such use or release, which consent shall be given in Milliman's sole discretion.

1.45. The Report should not be used or relied upon for any purpose other than as the expression of my opinion on the impact of the Scheme in accordance with Section 109 of FSMA. I hereby expressly disclaim any liability to any party who relies or purports to rely on the Report for any other purpose whatsoever.

Professional and Regulatory Guidance

1.46. I am required to comply with relevant professional standards and guidance issued by the Financial Reporting Council and the Institute and Faculty of Actuaries, including *Transformations Technical Actuarial Standard* (as published in December 2010), *Insurance Technical Actuarial Standard* (as published in October 2010), *Technical Actuarial Standard D: data* (as published in November 2009), *Technical Actuarial Standard M: modelling* (as published in April 2010) and *Technical Actuarial Standard R: reporting actuarial information* (as published in November 2009). I have complied with such standards, subject to the principles of proportionality and materiality.

1.47. The Report has been prepared under the terms of the guidance set out in the PRA Policy Statement (PS7/15) and SUP 18 of the FCA Handbook ("SUP 18") to cover scheme reports on the transfer of insurance business.

2. REGULATORY BACKGROUND

Introduction

2.1. In this section I describe the UK and Japanese general insurance markets and the regulatory regimes in each country.

Overview of the UK Insurance Market

BACKGROUND

2.2. UK insurers, as well as other financial services organisations, are regulated by both the PRA and the FCA using a system of dual regulation. Between them, the PRA and the FCA have approximately 3,500 employees and an annual budget of over £600 million. The PRA and the FCA are statutory bodies set up under the Financial Services Act 2012 ("FinSA").

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

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

2.4. The FCA is a separate institution and is responsible for:

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

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

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

2.7. The FCA is concerned with achieving fair outcomes for consumers and seeks to ensure that firms adhere to its conduct principles. Its operational objectives are:

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

2.8. For the purposes of the Report where I refer to the "Regulator" this should be taken to refer to the PRA and/or the FCA (or their predecessor body, the Financial Services Authority, the “FSA”) as appropriate.

TAXATION

2.9. In the UK, general insurance companies are taxed on profits achieved at the main rate of corporation tax (which, from 1 April 2015, is 20%).

FINANCIAL SERVICES COMPENSATION SCHEME

2.10. As well as through the PRA and FCA regulations, consumer protection is also provided by the Financial Services Compensation Scheme ("FSCS"). This is a statutory "fund of last resort" which compensates customers in the event of the insolvency (or other defined default) of a financial services firm authorised by the PRA or FCA. Insurance protection exists for private policyholders and small businesses (those with an annual turnover of less than £1,000,000) in the situation when an insurer is unable to meet fully its liabilities. The FSCS is funded by levies on firms authorised by the Regulator, so there is no charge on individual consumers for using the services of the FSCS.

2.11. For general insurance business, the FSCS will pay 100% of any claim incurred before the wind-up under compulsory insurance (such as motor third party liability cover, UK employers' liability and professional indemnity insurance) and 90% of the claim incurred before the wind-up for non-compulsory insurance (such as home insurance, or the non-compulsory parts of motor insurance), without any maximum. However, no protection is available for Goods in Transit, Marine, Aviation and Credit Insurance. Furthermore, contracts of reinsurance are also not protected (so no policyholder protection arrangements exist for the relocated inwards reinsurance business – see paragraph 1.6 above).

2.12. There are no EU wide arrangements to pay compensation to customers of failed insurance entities. The Regulator, therefore, requires all insurers undertaking business in the UK (whether based in the UK, the subsidiary or branch of an overseas insurer or under pass-porting arrangements) to join the FSCS.

FINANCIAL OMBUDSMAN SERVICE

2.13. The Financial Ombudsman Service ("FOS") provides private individuals (and micro enterprises[1]) with a free, independent service for resolving disputes with financial companies. It is not necessary for the private individual (or micro enterprise) to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the FOS; it is necessary for the insurance policy concerned to be, or have been, administered from within the UK.

RISK-BASED CAPITAL FRAMEWORK

2.14. At the end of 2004 the FSA introduced a risk-based capital framework (known as the ICAS framework) under which companies are required to assess solvency under two regimes, referred to as Pillar I and Pillar II. This framework is now supervised by the PRA.

Pillar I

2.15. Under ICAS Pillar I, each insurer has both to meet statutory requirements based on EU Directives and to provide a more risk-based enhanced capital requirement ("ECR") calculation to the PRA. This includes setting up Technical Provisions in accordance with those Directives and having sufficient available capital to meet at least the Minimum Capital Requirement ("MCR"). Composites calculate separate ECRs and MCRs for their long-term and general insurance businesses; those relating to general insurance business can only be met by assets outside of the long-term funds, although capital resources arising outside the long-term funds may be allocated towards long-term business.

2.16. Details of the calculation of the MCR as it relates to general insurance are given in Appendix 5, but essentially it comprises the greater of a premium measure, a claims measure, a prior year MCR measure, and a minimum amount, currently set at €3.7 million. The ECR is the sum of an asset charge, a premium charge and a charge for technical provisions less the claims equalisation reserve ("CER"). Insurers are not required to make publicly available their ECR calculation and supporting documentation insofar as it relates to non-life insurance. For long-term insurance business, insurers are required to show the ECR on Form 2 of their returns to the PRA.

[1] Micro-enterprises (an EU term covering smaller businesses) can bring complaints to FOS as long as they have an annual turnover of less than €2m and fewer than ten employees.

2.17. The Technical Provisions required under the EU Directives as relating to general insurance business are:

- The unearned premium provision ("UPR") – the UPR is the amount set aside from premiums written before the valuation date to cover risks incurred after that date;
- The additional amount for unexpired risk ("URR") – the URR is the amount held in excess of the UPR, to allow for any expectation as at the valuation date that the UPR will prove to be insufficient to cover the cost of claims and expenses incurred during the period of unexpired risk; and
- The claims outstanding provision – the reserve set up in respect of the liability for all outstanding claims at the valuation date, whether reported or not.

2.18. The UPR is typically calculated on a daily basis (but alternative methods may be acceptable where the daily basis is not appropriate) and makes no allowance for the time value of money (i.e. discounting).

2.19. The claims outstanding provision typically comprises the case reserves plus the amount, if any, for claims incurred but not reported ("IBNR") at the valuation date. Case reserves are the amounts estimated on a case-by-case basis as being required to settle reported (open) claims. The IBNR reserve is the amount estimated as being required to provide for:

- claims still to be reported to the insurer as at the valuation date which related to claim events that have occurred before that date; and
- any perceived shortfall between the projected ultimate costs and the case estimates for claims already notified, although occasionally this provision is shown separately where it is often referred to as an "incurred but not enough reported" ("IBNER") reserve. The IBNR (and IBNER) reserves would typically be evaluated using statistical techniques based on grouped data.

2.20. Under UK regulatory practices, only in particular limited circumstances may the claims outstanding provision estimate include any allowance for the time value of money. Therefore, all other things being equal, a margin exists in the provision to cover (at least in part) unexpectedly adverse claims development.

Pillar II

2.21. The capital that must be held under ICAS Pillar II is an amount based upon the Individual Capital Assessment ("ICA"), which is the company's own assessment of its capital requirements. Pillar II is intended to provide a more realistic and complete view (than is provided by the MCR under Pillar I) of the risks to which the company is exposed, and to provide a framework within which the company should be managed. The separate management of the long-term and general insurance businesses within composites necessitates these entities to prepare separate ICAs for the two business types.

2.22. The PRA requires each insurer, when preparing its ICA, to identify the major risks it faces and, where capital is appropriate to mitigate those risks, to quantify how much (and what type) of capital is appropriate. The PRA expects each insurer to conduct stress tests and scenario analyses in respect of each risk. The capital requirements so determined are then aggregated, allowing for diversification between risks where appropriate. These stress tests and scenario analyses, together with the supporting analysis, must be documented and, along with the results, submitted to the PRA (on request) as the ICA. The insurer is not required to publish its Pillar II capital requirement.

2.23. For the ICA, an insurer will assess the amount of capital it needs to hold to remain able to meet its liabilities as they fall due to a level of certainty prescribed by the Regulator – the level of capital so determined is intended to ensure that an insurer is less than 0.5% likely to become insolvent, allowing for one year's trading (or the equivalent percentage over a longer new business period) and the subsequent run-off to extinction of the liabilities.

2.24. As stated above, ICAS Pillar II financial information is not published and remains private between the PRA and the company. I have therefore reviewed this information and have commented on it in general terms, but I have not included any ICAS Pillar II figures in the Report.

2.25. The PRA will review the ICA periodically and may prescribe an additional amount of capital that must be held by the insurer in addition to the ICA. The total amount of Pillar II capital prescribed by the PRA is called Individual Capital Guidance ("ICG"). The ICG is usually set as a percentage of the ECR, gross of CER. The ICG is not published and details of this remain private between the insurer and the PRA.

2.26. The PRA has indicated that ICG will be given taking into consideration capital resources consistent with at least a 99.5% confidence level, i.e. a likelihood of less than 0.5% to become insolvent) that the insurer will be able to meet its liabilities over a one-year timeframe allowing or, if appropriate to the insurer's business, an equivalent lower confidence level over a longer timeframe.

FCA CONDUCT PRINCIPLES

2.27. As noted above, the FCA is responsible for conduct regulation of all financial firms, including insurers. Rules and guidance that authorised firms must comply with are set out in the FCA Handbook. The Handbook includes 11 Principles for Businesses, which are high-level standards that all firms must meet.

2.28. Within its "*Journey to the FCA"* document, the FCA notes that it expects firms to continue to demonstrate that they are achieving the six consumer outcomes set out in an earlier document, published in July 2006 under the auspices of the FSA and entitled "*Treating customers fairly – towards fair outcomes for consumers*" ("TCF"). The aim of this document was to develop Principle 6 of the FSA's Principles for Businesses (PRIN 2.1.1) which stated that each insurer "*must pay due regard to the interests of its customers and treat them fairly*". Principle 7 outlines that each insurer "*must pay due regard to the information needs of its clients, and communicate information to them in a way which is clear, fair and not misleading*" while Principle 8 states that each insurer "*must manage conflicts of interest fairly, both between itself and its customers and between a customer and another client*".

2.29. The TCF document lists six outcomes that collectively outline insurers' regulatory obligations for the fair treatment of customers. These are as follows:

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

THE INSURERS (REORGANISATION AND WINDING UP) REGULATIONS 2004

2.30. Under English law, the winding-up of an insurance undertaking is governed by the Insurers (Reorganisation and Winding Up) Regulations 2004. Under these regulations direct insurance creditors have precedence over any claim on the insurance undertaking with the exception of certain preferential claims (e.g. claims by employees, rights in rem etc.) with respect to the whole of the insurance undertaking's assets. Therefore, direct insurance creditors rank ahead of inwards reinsurance creditors and all other unsecured/non-preferential creditors in the event that an insurer is wound up.

SOLVENCY II

2.31. The regulatory solvency reporting requirements for EU insurers and reinsurers will undergo a major change with effect from 1 January 2016, as they will need to meet the requirements of a new solvency regime developed by the European Commission. While the formal date for full implementation of these new rules is 1 January 2016, there will be transitional arrangements during which insurers and reinsurers need not meet all of the minimum solvency requirements (subject to approval by the local supervisor).

2.32. This new regime is referred to as Solvency II and aims to introduce solvency requirements that reflect better than the existing solvency regimes the risks that insurers and reinsurers actually face and to introduce consistency across the European Union. UK companies will be required to adhere to a set of new, risk based capital requirements and, in contrast to the position under the current UK Pillar II requirements, some of the results will be shared with the public.

2.33. EU member states were required to transpose the Solvency II Directive into national legislation by 31 March 2015. In the UK this transposition was indeed completed during March 2015:

- the PRA incorporated the provisions of the Solvency II regime into the PRA Rulebook; and
- HM Treasury published the Solvency 2 Regulations 2015 which, together with FSMA, implement the Solvency II Directive into UK legislation and establish a regulatory system for operating the Solvency II regime.

2.34. Solvency II will be a principles-based regime and will be based on three pillars:

- Under Pillar I, quantitative requirements define a market consistent framework for valuing the company's assets and liabilities, and determining the Solvency Capital Requirement ("SCR");
- Under Pillar II, insurers must meet minimum standards for their corporate governance, and also for their risk and capital management. There is a requirement for permanent internal audit and actuarial functions. Insurers must regularly complete an Own Risk and Solvency Assessment ("ORSA");
- Under Pillar III, there are explicit requirements governing disclosures to supervisors and policyholders.

2.35. The SCR under Solvency II is the amount of capital required to ensure continued solvency over a 1 year time frame with a probability of 99.5%. There are two main approaches to calculating the SCR:

- Using an internal model approved by the local supervisor. An internal model calculation of the SCR is based upon an assessment of the risks specific to an insurer, and is calibrated so as to correspond to a confidence level of 99.5% over a one-year trading period that net assets remain positive (i.e. the insurer remains solvent); or
- Using the standard formula specified in detail in the Solvency II legislation. The standard formula is designed to be applicable to all insurers and is not therefore tailored to the circumstances of an individual insurer. In plain terms, the basic SCR consists of 5 risk modules (non-life, life, health, market and counterparty) that are in turn further sub-divided into 18 sub-modules (e.g. premium and reserve risk, catastrophe risk and currency risk). The results for each sub-module are aggregated using a correlation matrix to arrive at a capital charge for each of the 5 main modules, which in turn are aggregated using a further correlation matrix to determine the basic SCR. A further module is used to calculate operational risk which is added to the basic SCR to produce the (standard formula) SCR.

2.36. The Minimum Capital Requirement under Solvency II ("MCR_2"), which will be lower than the SCR, defines the point of intensive regulatory intervention. The MCR_2 calculation is more formulaic and less risk sensitive than the SCR calculation.

2.37. Further details on Solvency II (specifically in relation to the UK Branch of SJNKI and Transfercom) are given in paragraphs 10.20 to 10.32 inclusive below.

Overview of the Japanese Insurance Market

BACKGROUND

2.38. Japan is the third largest economy in the world and has the world's second largest insurance market with total life and non-life direct insurance premium income for the financial year end 31 March 2014 estimated at more than US$500bn[2]. Approximately 80% of this amount related to life insurance business and 20% to non-life insurance. As of March 2015 there were a total of 52 companies operating in the non-life market in Japan (including 22 branches of foreign companies)[3] and 42 life insurance companies (including 3 branches of foreign companies)[4].

THE CURRENT REGULATORY REGIME IN JAPAN

2.39. Insurance companies in Japan are licensed and regulated by the Financial Services Agency (the "JFSA") under the Insurance Business Act ("IBA"). Other financial institutions are also supervised by the JFSA.

2.40. The objective of the IBA is to protect policyholders' interests by ensuring the sound management of insurers and the fairness of insurance solicitation. For example, under the IBA:

- Article 1 – the purpose of the Act is to protect policyholders by ensuring sound and appropriate management of person carrying on insurance business and fairness of insurance solicitation, and thereby contributing to the stability of the life of the citizens and to the sound development of the national economy;
- Article 5 (1) (iii) (b) – no specific persons will be subject to unfair discriminatory treatment under the contents of the insurance contract; and
- Article 5 (1) (iv) (b) – no specific persons will be subject to unfair discriminatory treatment with regard to insurance premiums.

2.41. The IBA has a hierarchical structure, of which the IBA occupies the top tier. It is supplemented by the Order for Enforcement of the IBA, which is further supplemented by the Ordinance for Enforcement of the IBA. The IBA is approved by the National Diet, while the Order and the Ordinance are established by the cabinet and the minister, respectively. In addition, the minister order can be issued where the delegation of IBA/Order/Ordinance exists.

2.42. Major reform to IBA was enforced in April 1996, when the solvency regime was officially implemented.

ROLE OF THE JFSA

2.43. The JFSA has three major policy objectives: (1) establishment of a stable financial system; (2) protection of users and improvement in user convenience; and (3) establishment of fair and transparent financial markets. In the context of insurance business, these objectives are achieved by various policy makings, the off-site monitoring including the solvency margin ratio and the on-site monitoring including the periodical inspection. Within the JFSA, the Supervisory Bureau and the Inspection Bureau are directly involved in the supervision of insurance companies. The Supervisory Bureau is in charge of licensing and off-site monitoring, while the Inspection Bureau is in charge of on-site monitoring. Since 2012, the two bureaus have been collaborating with each other for efficient supervision.

RESERVING

2.44. Technical reserves of Japanese insurance companies consist of the policy reserve and the loss reserve.

[2] http://www.iii.org/publications/insurance-handbook/economic-and-financial-data/world-insurance-marketplace

[3] www.fsa.go.jp/en/regulated/licensed/ins_nonlife.pdf

[4] www.fsa.go.jp/en/regulated/licensed/ins_life.pdf

2.45. There are two types of the policy reserves – the ordinary policy reserves and the catastrophe reserves:

- The ordinary policy reserves are analogous to an unearned premium provision. However, the ordinary policy reserves are subject to a minimum of the 1st year balance (which allows for seasonality in the loss occurrence);
- The catastrophe reserves are similar in nature to an equalization reserve. A certain percentage (3% to 5% depending on the line of business) of premium is reserved every year. When the (paid-to-written) loss ratio exceeds a threshold (e.g. 50% for fire insurance), the excess amount is released from the catastrophe reserves.

2.46. Loss reserves are comprised of case reserves and IBNR. Usually, the indemnity and ALAE are not separate in calculating the loss reserves. ULAE reserve is not established. The IBNR is calculated using actuarial methods for long-tail and material lines of business or on a formula basis for short-tail or immaterial lines.

2.47. Technical reserves are calculated net of reinsurance. Loss reserves are also calculated net of salvage and subrogation.

REGULATORY SOLVENCY MARGIN

2.48. The solvency margin ratio ("SMR") is calculated as SMR = "Solvency Margin" ÷ "Risk × ½", where "Solvency Margin" and "Risk" are defined below in paragraphs 2.50 and 2.51 respectively.

2.49. In practice, the SMR is subject to a minimum standard of twice the calculated "Risk". If the SMR goes below 200%, regulatory action will be triggered.

2.50. The "Solvency Margin" is the adjusted capital and surplus (part of which is converted to pre-tax basis). The Catastrophe reserve is treated as part of the Solvency Margin, rather than a liability.

2.51. "Risk" is calculated on a VaR[5] on a one-year time horizon basis. From 2012, a 95% VaR measure is generally used. "Risk" for Fire insurance is calculated as the maximum of a 99.5% (i.e. a 200 year return period) VaR for earthquake and a 98.57% (i.e. a 70 year return period) VaR for wind (or typhoon). Further details are given in Appendix 5.

2.52. Most Japanese non-life companies have relatively high SMRs. As of March 2014, the SMRs of SJII (defined in paragraph 3 below) and NKJ were 713% and 653% respectively.

POLICYHOLDER PROTECTION

2.53. There are two protection corporations: Life Insurance Policyholder Protection Corporation of Japan and the Non-Life Insurance Policyholder Protection Corporation of Japan. The corporations are funded by industry levies. They will protect up to 90% of the policy reserves and may:

- Provide financial assistance for the transfer or payment of insurance contracts of a bankrupt insurer;
- Assume rights to insurance claims of a bankrupt insurer;
- Purchase rights to insurance claims of a bankrupt insurer.

2.54. In the event of the winding-up of an insurance undertaking under Japanese law, all policyholders (direct and reinsurance) rank with general creditors (behind creditors with the right of a pledge/mortgage, claims by employees and tax) with respect to the whole of the insurance undertaking's assets. There is, however, a safety net for personal (or private) policyholders in the case where the residual assets do not support the prescribed coverage (in most cases, 80% of the original insured amount) – the difference is provided by the Policyholders Protection Corporation as outlined in paragraph 2.53 above. (I note that contracts of reinsurance are not protected under the scheme provided by the Non-Life Insurance Policyholder Protection Corporation of Japan.)

[5] Value at Risk ("VaR") is a widely used risk measure of the risk of loss on a specific portfolio of financial assets/risks. For example, if a portfolio of insurance risks has a one-year 99½% VaR, then there is a 0.005 probability that the portfolio will give rise to losses in value greater than the capital supporting those insurance risks. Informally, a loss in excess of the capital supporting the portfolio of insurance risks is expected no more frequently than 1 year out of 200 years (because of 0.5% probability).

GENERAL INSURANCE ADR CENTER

2.55. The General Insurance Association of Japan ("GIAJ"), also known as the "General Insurance ADR Center", provides mediation services to personal (or private) policyholders and medium enterprises. The services are <u>not</u> intended to deal with complaints from reinsurance policyholders. The operating rules of the General Insurance ADR Center stipulate that the services might not be provided to an expert with sufficient knowledge in insurance and a large corporation or equivalent which has essentially the same bargaining capability as an insurance company. This exclusion is based on the judgement of the dispute resolution mediator.

TAXATION

2.56. In Japan, general insurance companies are taxed on profits achieved at roughly 30%. In addition, business tax is imposed at between 0.7% and 0.8% (0.9% and 1.0% after March 2016) on 25% (hull), 45% (transit), 10% (CALI), 20% (Dwelling EQ), and 40% (other) of written premiums.

3. BACKGROUND ON SJNKI

SJNKI and its Corporate Group

3.1. SJNKI is a Japanese non-life insurance company formed on 1 September 2014 by the merger of Sompo Japan Insurance Inc.[6] ("SJII") and NKJ, both of which are Japanese companies. Following the merger of SJII and NKJ, SJNKI is Japan's largest non-life insurance company by premiums written.

3.2. SJII was a non-life insurance company incorporated in Japan. It conducted retail and wholesale non-life insurance and reinsurance business in Japan. As at 31 March 2014 it had paid-up capital of ¥70bn and total assets of ¥4,838.7bn.

3.3. SJII was created in 2002 as the result of the merger between two Japanese companies: Yasuda Fire & Marine Insurance Co Ltd ("Yasuda") and Nissan Fire & Marine Insurance Company Ltd ("Nissan"). The operations of Yasuda and Nissan became the operations of SJII under Japanese law.

3.4. NKJ was a non-life insurance company incorporated in Japan. It conducted retail and wholesale non-life insurance and reinsurance business in Japan. As at 31 March 2014 it had paid-up capital of ¥91.2bn and total assets of ¥2,260.2bn.

3.5. NKJ was established in April 2001 through a merger of The Nippon Fire & Marine Insurance Co., Ltd. ("Nippon") and The Koa Fire & Marine Insurance Co., Ltd. ("Koa"). The operations of Nippon and Koa became the operations of NKJ under Japanese law.

3.6. SJII and NKJ legally merged on 1 September 2014 with SJII as the surviving entity, to form SJNKI. The operations of SJII and NKJ became the operations of SJNKI under Japanese law.

3.7. SJNK is the parent company of SJNKI. Until 1 September 2014, the company was named NKSJ Holdings, Inc. It is the ultimate parent company in an insurance group with subsidiaries and/or affiliates in 32 countries worldwide, including Sompo Japan Nipponkoa Insurance Company of Europe Limited, an insurer incorporated in the UK and regulated by the PRA and the FCA.

3.8. SJNK, a holding company that operates in the insurance and financial services industries both in Japan and worldwide. Its core business is Japanese domestic non-life insurance, written through SJNKI. SJNK also operates overseas non-life insurance subsidiaries, a Japanese life insurance subsidiary, as well as subsidiaries focused on other areas of the Japanese financial services industry (e.g. asset management, risk consulting, healthcare and defined-benefit pensions).

3.9. SJNKI's principal activity relates to the underwriting of domestic Japanese general insurance risks. The main classes of business written by SJNKI are as follows (percentages in brackets are the proportions of total net (of reinsurance) premiums written during the six months ended 30 September 2014 for SJII and NKJ combined, which total ¥1,097.5 billion):

- Fire and Allied Lines (14%);
- Voluntary Automobile (47%);
- Compulsory Automobile Liability (14%);
- Personal Accident (9%);
- Marine (2%); and
- Other (14%).

[6] SJII was formed in 2002 by the merger of Yasuda Fire and Marine Insurance Company Limited ("Yasuda") and Nissan Fire and Marine Insurance Company Limited ("Nissan").

3.10. As at 30 September 2014, the net (of reinsurance) outstanding claim reserves within SJNKI (i.e. SJII and NKJ combined) were ¥916.0 billion, comprising:

- Fire and Allied Lines (14%);
- Voluntary Automobile (45%);
- Compulsory Automobile Liability (9%);
- Personal Accident (8%);
- Marine (3%); and
- Other (21%).

3.11. In addition, as at 30 September 2014, SJNKI (i.e. SJII and NKJ combined) held net (of reinsurance) ordinary underwriting reserves (analogous to a net provision for unearned premiums) of ¥1,897.3 billion, and a balance of ¥553.9 billion in respect of a catastrophic loss reserve (analogous to an equalisation provision).

3.12. As at 30 September 2014, SJNKI (i.e. SJII and NKJ combined) had assets of ¥6,997.5 billion, liabilities of ¥5,613.2 billion, giving net assets of ¥1,384.3 billion. For regulatory solvency margin purposes, the net assets are adjusted (in particular the catastrophic loss reserve is treated as an asset rather than a liability) to determine Available Capital. As at 30 September 2014, Available Capital was ¥2,464.2 billion compared with a Required Capital amount of ¥352.2 billion (see Appendix 5), i.e. the SMR was 700%.

3.13. As at the date of this Report, the financial strength ratings of both Standard & Poor's and A M Best for SJNKI were A+.

Risks

3.14. SJNKI is exposed to a large number of risks in the course of its operations. The key risks may be classified under the headings of underwriting, catastrophe, investment (including interest rate) and business management risk. I outline these risks as follows:

- Underwriting risk relates to the inherent uncertainties in the occurrence, amount and timing of insurance liabilities, both in the existing business and in the on-going underwriting. This covers the risk of reserve deteriorations on the existing liabilities, inappropriate pricing methodologies leading to inadequate premiums; and the risk of increased expenses.
- Catastrophe risk relates to the risk of catastrophes (e.g. earthquakes).
- Investment risk relates to SJNKI's investment portfolios, and arises mainly from exposure to changes in interest rates, foreign exchange rates and changes in the market value of equities and other assets. A decrease in the value of the assets backing the insurance contracts could adversely affect the financial position of SJNKI to the extent that a movement (in particular, a fall) in asset values is not matched by a corresponding movement in liability values. Guaranteed interest rate risk relates to the inability of SJNKI to meet its cash outflows as they fall due as a result of a mismatch in the timing of cash inflows and outflows.
- Business management risk relates to the risk of being in business. These include the risks to which SJNKI is exposed to during its day-to-day operations, mainly arising from possible failures of control and external events; reputational risk, i.e. the current or prospective risk to earnings and capital arising from adverse perception of the image of SJNKI on the part of customers, shareholders, investors or regulators; and strategic risk, i.e. the current or prospective risk to earnings and capital arising from adverse business decisions, improper implementation of decisions or lack of responsiveness to industry changes.

3.15. There is a range of actions that SJNKI management can take and has taken to mitigate the risks facing the business. For example, SJNKI uses techniques which include asset liability management strategies, monitoring the financial strength of its reinsurers, and review by external consultants of SJNKI's reserve risk exposure.

Corporate Social Responsibility ("CSR")

3.16. As part of the company's CSR vision, SJNKI will positively engage with its stakeholders in forward looking dialogue, respect international standards and codes of conduct. Within this vision SJNKI will: (1) provide products and services that furnish protection from various risks in society and contribute to the security, health, and wellbeing of its customers; and (2) establish a governance structure that enables sustainable growth and proactively disclose corporate information including non-financial information in a fair and transparent manner.

UK Branch

3.17. SJNKI has an authorised UK branch, based in London (i.e. the UK Branch). The insurance business originally written by the UK branch (the "Historic UK Branch Business") comprises business historically written by the former Nissan (which was a predecessor company to SJII) in 1990 and prior years.

3.18. The Historic UK Branch Business comprises business written as follows:

- From 1972 until 1983 the UK branch wrote Lloyd's broker marine, hull, property, casualty and liability business; and
- Until 1990 the UK branch also wrote UK Japanese interest marine, property, liability and accident business.

3.19. SJNKI does not have any outwards reinsurance cover in respect of the Historic UK Branch Business.

3.20. Except for casualty and liability business, the classes of the Historic UK Branch Business were short tail. There is no record of there ever having been a claim under any policy at least for the last 13 years. The last claim settlement was made in 1996 in respect of a 1978 liability claim.

3.21. In 2003 and 2004, SJII (as predecessor to SJNKI) contacted Lloyd's brokers and direct policyholders for whom contact details could be established, to request their confirmation that there were no outstanding claims. This exercise did not result in any relevant claims being notified to SJII.

3.22. I am informed that SJNKI now considers the possibility of a claim ever being made in respect of the Historic UK Branch Business to be so remote that it can for all practical purposes be discounted.

3.23. As of 6 March 2015, SJNKI relocated a portfolio of international reinsurance business (the "Relocated Business") to the UK Branch. While the Relocated Business was originally underwritten by NKJ (formerly Nippon Fire and Marine Insurance Company Limited, Koa Fire and Marine Insurance Company Limited and Taiyo Fire and Marine Insurance Company Limited) in Japan, it now resides in SJNKI following the merger of SJII and NKJ as described above.

3.24. The characteristics of the Relocated Business are as follows:

- The business is in run-off, and is a mix of international reinsurance business comprised mainly of liability reinsurance (there are no direct insurance risks). In addition to the liability reinsurance there is also some Fire and Aviation reinsurance business, with very small amounts of reported outstanding claim reserves. The vast bulk of the business was written in underwriting years 1985 & prior (over 95% measured by reported outstanding claim reserves);
- A review carried out by SJNKI of the governing law of the reinsurance policies, while not exhaustive, determined that a large number of the cedants are located in the US (other countries include the UK, Canada and Germany);
- As at 31 March 2015, the Relocated Business had approximately 894 policies in respect of which a claim was outstanding and a total of approximately 1,185 policies in respect of which a claim could still be made. I note that the contract between SJNKI and a cedant ("Subject Contract") may be renewed annually over a number of years, with each year being a separate "policy". So typically there will be several policies belonging to the same Subject Contract. There are 185 Subject Contracts (as per the Framework Agreement) to which the aforesaid policies belong;
- The cedants include a wide variety of insureds, including US companies, UK companies and continental European companies;

- The contracts/policies are predominantly exposed to Asbestos, Pollution and Health Hazard ("APH") claims[7]. As at 31 March 2015, the Relocated Business had estimated gross (and net) claims reserves (including IBNR) of $51.7 million (of which around 90% was in relation to APH claims, with the remaining around 10% arising from workers' compensation and other essentially long-tail claims).

3.25. SJNKI does not have any outwards reinsurance cover in respect of the Relocated Business.

3.26. Following its relocation to the UK, the Relocated Business is now administered in the UK by Resolute on behalf of SJNKI and will continue to be administered by Resolute on behalf of Transfercom post-Scheme. To the extent that the Historic Branch Business requires any administration by Transfercom post-Scheme, this will be done by Resolute on Transfercom's behalf.

3.27. As per the UK Branch's Returns to the PRA as at 31 March 2015, SJNKI does not hold any claims reserves for the Historic UK Branch Business (and has not held any reserves for at least the last 10 years).

3.28. As at 31 March 2015, the Available Capital (capital resources) of the UK Branch amounted to £8,306k[8], compared with Required Capital (statutory MCR) for the business of £1,451k[9], i.e. Available Capital in excess of Required Capital as at 31 March 2015 was £6,855k. This implied cover for the MCR (Available Capital ÷ Required Capital) of 571% as at 31 March 2015 (on a Solvency I basis).

3.29. As the Transferring Business is written in the UK Branch rather than a subsidiary of SJNKI, the policyholders are subject to the security and risks of SJNKI.

Framework Agreement

3.30. SJNKI has entered into a Framework Agreement dated 28 April 2014, with NICO and Transfercom. The Framework Agreement was entered into to secure run-off management in the UK for SJNKI in respect of the Transferring Business until such time as the Scheme becomes effective so as to cut off the future liabilities of SJNKI attributable to the Transferring Business. Prior to the execution of the Framework Agreement, SJNKI undertook the run-off management of the business (without any involvement from Resolute).

3.31. The Framework Agreement also provides for NICO to provide cover of up to $150 million to Transfercom in respect of the settlement of claims attributable to the Transferring Business on or after the Effective Date and applies at a level net of any other reinsurance recoveries. Any emerging reinsurance bad debt is also covered by NICO.

3.32. Under the Framework Agreement, NICO and Transfercom are obliged to enter into the NICO Agreement with effect from the Effective Date on a date before that of the final Court hearing in relation to the Scheme. Therefore, the NICO Agreement must come into effect when the Scheme takes effect, or else Transfercom and NICO would be in breach of the Framework Agreement.

3.33. While SJNKI remains responsible for administering the run-off of the business prior to the Effective Date, which includes administering, settling and paying claims, under the terms of the Framework Agreement, SJNKI is obliged to delegate the administration to Resolute, an affiliate of NICO within the Berkshire Hathaway Group, to conduct the administration of the run-off from the date of the relocation of the Relocated Business (i.e. 6 March 2015).

3.34. As described in paragraph 3.33 above, SJNKI is responsible for administering the run-off of the business under the direction of NICO and it assigns/sub-contracts this work to Resolute pursuant to a Run-off Management Agreement. At the Effective Date, the Run-off Management Agreement will terminate, and the administration and servicing of the Transferring Business will continue to be undertaken by Resolute on behalf of Transfercom in accordance with the existing Berkshire Hathaway UK Group Shared Services and Cost Sharing Agreement.

[7] APH claims consist of: (A) bodily injury and products damage claims arising from exposure to asbestos; (P) pollution claims arising from exposure to hazardous waste sites; and (H) health hazard claims arising from exposure to other health perils such as AIDS, hearing loss etc. APH losses are characterized by their long latency period, often taking decades to emerge.

[8] Based on Form 1, Line 13 of the UK Branch's Returns to the PRA as at 31 March 2015

[9] Based on Form 1, Line 36 of the UK Branch's Returns to the PRA as at 31 March 2015

4. BACKGROUND ON TRANSFERCOM

4.1. Transfercom was formed in 2006, and is a UK insurance company registered in England (registered number: 5773175). It is authorised by the PRA and regulated by the PRA/FCA with permission under Part 4A of FSMA to carry out contracts of general insurance.

4.2. The principal activity of the company is to handle the run-off of the non-marine reinsurance account (see paragraph 4.3 below), and the aviation business originally underwritten by the Fortress Re agency (see paragraph 4.6 below). The company intends to continue to manage the run-off of the insurance assets and liabilities in an orderly manner.

4.3. Effective 1 March 2007, and with the approval of the UK Court and the Regulator, the company received a portfolio of insurance liabilities and associated reinsurances from SJNKI (SJII as was) under an insurance business transfer (the “First Transfer”). The gross claims portfolio was transferred with gross liabilities valued at $354.1m, and the underwriting risk fully-reinsured with NICO[10] (the company's parent undertaking). The liabilities consist of the then UK branch of SJII, namely the following blocks of business:

- A block of reinsurances of worldwide cedants, originally written by Yasuda from the late 1950s to 1999. This book contains substantial asbestos exposures;
- A block of reinsurances originally written by Nissan in Tokyo between 1967 and 1993, mostly comprising excess of loss reinsurance treaties. This block of business has exposures to many of the major US commercial carriers, their principal reinsurers and H S Weavers;
- A block of reinsurances originally written by Nissan in the London Market between 1972 and 1983. This block contains exposures to many of the major US commercial carriers, their primary reinsurance and London pools and reinsurers;
- A block of predominantly property reinsurance and retrocessional exposures, termed the ex-Nissan CAT book. This book contains risks mainly written between 1990 and 2001, and has been in run-off since the end of 2001. This account contained significant exposure to the World Trade Centre loss; and
- A block of ex-Nissan reciprocal treaties. These also contain asbestos exposures.

4.4. The bulk of the residual liabilities from the First Transfer stem from reinsurance of international liability business, including substantial amounts of US liability exposure. The residual liabilities mainly relate to business written before 1990.

4.5. As at 31 December 2014, Transfercom held reserves of $239m in respect of its liabilities from the First Transfer.

4.6. Effective 1 March 2011, and with the approval of the UK Court and the Regulator, the company received a further transfer of a portfolio of insurance liabilities and associated reinsurances from SJNKI (SJII as was) under an insurance business transfer (the “Second Transfer”). The gross claims portfolio was transferred with gross liabilities valued at $123m, and the underwriting risk fully-reinsured with NICO. The business comprises reinsurance contracts that were underwritten as a result of the agency arrangements Nissan (now SJNKI and formerly SJII) had with Fortress Re Inc. (“Fortress Re”) between 1981 and 2003. Fortress Re pooled the funds of several insurance companies (the “Fortress Re Pool”), with the participants mainly being Japanese insurers, as follows:

- The Fortress Re Pool mainly wrote aviation reinsurance business (both hull and liability) and property catastrophe business, together with some marine and non-marine reinsurance. Retrocession business was also written;
- Fortress Re typically wrote quite low layers of reinsurance and was badly hit by the events of 11 September 2001, together with the American Airlines Flight 587 event in November 2001. Fortress Re ceased writing business after these events.

[10] For the avoidance of doubt, there is no formal relationship between SJNKI and NICO (other than any reinsurance arrangements between the companies entered into on a commercial basis).

4.7. As at 31 December 2014, Transfercom held gross reserves of $68.9m in respect of its liabilities from the Fortress Re Pool.

4.8. The servicing of the run-off business of Transfercom is undertaken by Resolute under a Run-Off Services Agreement between Transfercom and Resolute, which operates according to service standards and claims handling procedures as set-out in the aforesaid run-off agreement.

4.9. As at 31 December 2014, the authorised share capital of Transfercom was $43,000,000 divided into 43,000,000 ordinary shares of $1 each, all of which was issued and fully paid. Further, as at 31 December 2014, on a Solvency I basis, the company's Available Capital (capital resources) was £37.1 million compared with a Required Capital (MCR) of £2.9 million, i.e. the Capital Cover Ratio (= Available Capital ÷ Required Capital) was 12.8 times.

4.10. Transfercom's immediate parent company is NICO, a company incorporated in the US state of Nebraska (further details on NICO are given in this Section 4 from paragraph 4.21 below). Its ultimate parent company is Berkshire Hathaway Inc. ("Berkshire Hathaway"), a company incorporated in the United States of America. Berkshire Hathaway is a multinational conglomerate holding company that oversees a number of subsidiaries across a range of industries, including approximately 70 insurance companies. In this Report I refer to Berkshire Hathaway and its subsidiary companies collectively as the "Berkshire Hathaway Group". As at the date of this Report, Berkshire Hathaway had a Standard and Poor's credit rating of AA+ (albeit on negative credit watch).

Reinsurance

4.11. Transfercom has two significant reinsurance contracts with NICO for its run-off business:

(1) A reinsurance policy to cover all claim payments and allocated loss adjustment expenses ("ALAE"), both net of inuring reinsurance (as appropriate), in respect of the transferring business (under the First Transfer) after 1 March 2007, up to a limit of $582m with no retention. The reinsurance policy also covers up to $50m of unallocated loss adjustment expenses ("ULAE"), from 1 March 2007 until either the limit of $50m is exhausted or the main policy limit of $582m is exhausted. As at 31 December 2014, over 85% of the indemnity limit remained to meet future losses; and

(2) A reinsurance policy to cover all claim payments and ALAE, both net of inuring reinsurance (as appropriate), in respect of the transferring business (under the Second Transfer) with a remaining limit of up to $161.8m with no retention from 1 March 2011. The reinsurance policy also covers up to $25m of ULAE, from 1 March 2011 until either the limit of $25m is exhausted or the remaining main policy limit of $161.8m is exhausted. As at 31 December 2014, over 85% of the indemnity limit remained to meet future losses.

4.12. These arrangements are such that given the underlying claims and the remaining cover limits, for all practical purposes the net of reinsurance reserves of Transfercom as at 31 December 2014 can be assumed to be zero, as booked by Transfercom.

Risks

4.13. Transfercom's principal risks and uncertainties relate to reserve risk, i.e. that the Technical Provisions may prove to be inadequate. The reserve risk for Transfercom is magnified at a gross of reinsurance level as it is exposed to very uncertain APH exposures that can give rise to large late reported claims. However, as noted in paragraph 4.11 above, reserve risk is substantially transferred to NICO by way of reinsurance.

4.14. Credit risk relates to the risk of default by counterparties such as reinsurers and on corporate and government bonds. Transfercom is extensively reinsured, in particular by NICO, and as such has a substantial exposure to credit risk.

4.15. Market risk arises from currency risk, interest rate risk and investment credit risk. The risk is controlled by the company through holding mainly US government securities, and an investment policy to hold interest bearing securities to maturity, and that assets represent at least 90% of liabilities in all currencies.

4.16. Operating risk relates to the risks to which Transfercom is exposed to during its day-to-day operations, mainly arising from possible failures of control and external events. The company is also exposed to risks from other parts of the Berkshire Hathaway Group on which it is reliant.

Governance – FCA Conduct Principles

4.17. Transfercom states that it is committed to the fair treatment of customers, and to ensure that fair outcomes are delivered to customers. The key components of this framework are culture and governance.

4.18. Staff are required to be fair in all their dealings with clients and others.

4.19. There are processes in place to report and deal with any shortcomings in maintaining the open and honest culture, of which the fair treatment of customers is an integral part.

4.20. The Board has overall responsibility for ensuring that the "fair treatment of customers" objective is met. A governance structure has been implemented to enable the objectives to be met and to embed a culture which ensures that the fair treatment of customers' objective is met throughout the business.

NICO

4.21. As stated in paragraph 4.10 above, Transfercom's immediate parent company is NICO, and as outlined in paragraph 4.11 above, NICO provides substantial reinsurance protection to Transfercom.

4.22. NICO is a major US insurer. It has 750,000 shares of $10 par value common stock authorised and 550,000 shares issued and outstanding, i.e. capital paid-up of $5.5 million.

4.23. NICO writes a wide variety of business, predominantly on a reinsurance assumed basis. During 2014, NICO wrote $27.0 billion of gross premiums of which over 99% was reinsurance assumed (with about 83% being reinsurance of affiliates). Written premiums were dominated by private passenger auto liability, auto physical damage, and non-proportional property and liability assumed reinsurance. The main direct lines written were commercial auto liability and aircraft.

4.24. As at 31 December 2014, NICO had admitted assets of $167.0 billion, and total liabilities of $73.0 billion. The excess admitted assets were therefore $94.0 billion.

5. THE PROPOSED SCHEME

Motivation for the Scheme

5.1. SJNKI is seeking the elimination of the future uncertainty associated with its UK Branch business (principally that arising from the relocated business as outlined in paragraph 1.6 above). This would provide a reduction in the risk of claim volatility; relief from the burden of run-off management; the opportunity to exit from UK Branch business; and allow the company to focus on its core ongoing business.

5.2. As per the Framework Agreement (outlined in paragraph 1.7 above) SJNKI wishes to transfer the entire business of the UK Branch to Transfercom via the Scheme. To accomplish this transfer the Court's consent is needed.

Outline

5.3. Under the proposed Scheme the Transferring Business will be transferred from SJNKI to Transfercom. All (re)insurance liabilities in respect of the Transferring Business will be transferred on the Effective Date, together with agreed related investments from SJNKI to Transfercom. No outwards reinsurance or any other assets are to be transferred.

5.4. From the Effective Date, as per the Framework Agreement, the NICO Agreement will commence, thereby wholly reinsuring the liabilities of the Transferring Business received by Transfercom under the Scheme. Further details of the NICO Agreement are given in paragraphs 5.11 and 5.13 below.

5.5. All future income and outgoings arising from the Transferring Business will pertain to Transfercom (together with all future income and outgoings of the existing Transfercom insurance business).

5.6. The liability for the policies issued by SJNKI that form part of the Transferring Business, which currently rests with SJNKI, will be transferred to Transfercom. Existing policyholders of SJNKI in respect of the Transferring Business will become policyholders of Transfercom.

5.7. Table 5.1 below illustrates the effect both of the Scheme and of the NICO Agreement on Transfercom's balance sheet at the Effective Date[11]. The "pre-Scheme" figures are as per Transfercom's 2015-2019 Business Plan. For the purpose of this illustration, the figures shown represent the projected position as at 31 December 2015. The "Transferring Business *plus* the NICO Agreement" figures show, approximately, the (essentially neutral) effect on the Transfercom balance sheet of the Scheme and simultaneously entering into the NICO Agreement. The "post-Scheme" figures reflect the transfer of Technical Provisions and the corresponding reinsurers' share of Technical Provisions to NICO as a result of the Scheme *plus* the NICO Agreement.

[11] The vast majority of the value of the assets supporting the liabilities of the Transferring Business that will transfer to Transfercom is provided by the NICO Agreement. There may also be some amounts owed to the UK Branch through the course of the branch's (re)insurance operations. These debts (that will be held by Transfercom after the Scheme) are anticipated to be small, and for simplicity have not been reflected in Table 5.1 above.

Table 5.1
Simplified Balance Sheets for Transfercom as at the Effective Date

$000	Pre-Scheme	Transferring Business *plus* NICO Agreement	Post-Scheme
Assets			
Investments	140,296	-	140,296
Reinsurers' share of technical provisions	319,989	54,000	373,989
Debtors	8,653	-	8,653
Cash in hand	2,718	-	2,718
	471,656	54,000	525,656
Liabilities			
Capital and reserves	57,009	-	57,009
Technical provisions	319,989	54,000	373,989
Creditors	94,658	-	94,658
	471,656	54,000	525,656

5.8. While SJNKI has no expectation of a claim arising from the Historic UK Branch Business (see paragraphs 3.22 and 3.27 above) the company is to provide reinsurance protection in respect of this business such that in the very unlikely event that one or more claims were to arise, they would, for all practical purposes, be met by SJNKI. Accordingly, on and from the Effective Date, the Tokyo head office of SJNKI will reinsure the Historic UK Branch Business under a 100% quota share reinsurance contract (subject to a £10m per claim limit, which would apply to all claims except in certain specified and exceptional circumstances). The excess of any claim (if any) over and above the £10m per claim limit will form part of the protection provided under the NICO Agreement (see paragraphs 5.11 and 5.13 below).

5.9. Post the proposed transfer, the administration and management of the Transferring Business will continue to be undertaken by Resolute in the same manner as currently (see paragraph 3.33 above).

5.10. No compensation will be paid to the policyholders (or to the shareholders) of SJNKI in consideration of the transfer of the Transferring Business to Transfercom, although Transfercom will assume the (re)insurance liabilities in respect of the Transferring Business.

NICO Agreement

5.11. On the proposed Scheme becoming effective a new reinsurance policy will come into force (in addition to the reinsurance policies presently in-force between Transfercom and NICO, as outlined in paragraph 4.11 above). This reinsurance policy will also be written by NICO and will cover all future claim payments and ALAE, both net of inuring reinsurance (as appropriate), in respect of the Transferring Business on and from the Effective Date, up to a limit of $150m with no retention. The reinsurance policy also covers up to $15m of ULAE from the Effective Date until either the limit of $15m is exhausted or the main policy limit of $150m is exhausted.

5.12. On the NICO Agreement becoming effective, NICO will undertake not to avoid or seek to avoid the reinsurance agreement or decline any indemnity thereunder on grounds of non-disclosure or misrepresentation (whether innocent or negligent in either case) by Transfercom or by any agent (including SJNKI) of Transfercom in the absence of fraud on the part of Transfercom itself. Further, the terms of the NICO Agreement will provide that the reinsurance agreement is not to be cancelled by ether party for any reason whatsoever.

5.13. A previously agreed amount will be payable by SJNKI to Transfercom in conjunction with the proposed Scheme. This amount will then be paid immediately to NICO as the premium for the new reinsurance policy. This amount was established between SJNKI and Berkshire Hathaway, as part of their wider negotiations around the proposed Scheme. In my evaluation of the effects of the Scheme I have not carried out any specific work to consider the reasonableness (or otherwise) of this amount. Rather I have allowed for the effect of the NICO Agreement (and the amount paid) as one of the elements in considering the proposed Scheme (in its totality) on the different groups of policyholders.

Policyholders Affected

5.14. I have considered the effects of the Scheme on three main groups of policyholders, namely:

1. those policyholders of SJNKI whose policies are to be transferred;
2. those policyholders remaining in SJNKI; and
3. the current policyholders of Transfercom.

Compensation and Complaints

5.15. Prior to the Scheme, SJNKI (generally) will participate in the Non-Life Insurance Policyholder Protection Corporation of Japan. However, as this body does not provide any protection for reinsurance policyholders, the relocated policyholders of the UK Branch would not be afforded such protection.

5.16. After the implementation of the Scheme, as with all other insurance companies with an establishment in the UK, Transfercom will continue to be required to participate in the FSCS. Therefore, to the extent they currently meet the qualifying criteria (as set out in paragraphs 2.10 to 2.12 above), the policyholders under the Transferring Business will continue to be protected by the FSCS if the Scheme is sanctioned. However, as stated in paragraph 2.11 above, the FSCS does not provide any protection for reinsurance policyholders, so the reinsured policyholders of the Transferring Business would not be afforded protection under the FSCS. For the avoidance of doubt, there is no loss of the protection afforded by the FSCS to the eligible policyholders of Transfercom as a result of the Scheme or, since Transfercom is a UK insurer, to the protection afforded by the FSCS to any policyholder under the Transferred Business who currently benefits from such protection.

5.17. Pre- and post-Scheme, policyholders of SJNKI (generally) are able to bring complaints to the General Insurance ADR Center (see paragraph 2.55 above) for mediation. However, this body is not designed to provide services for reinsurance policyholders. Therefore pre-Scheme, the relocated policyholders of the UK Branch would not participate in these mediation services.

5.18. The Scheme will have no effect on the eligibility of any group of policyholders to bring complaints to the FOS. If, as described in Section 2, they are currently able to bring complaints to the FOS, this will remain the case after the implementation of the Scheme. If they are currently not eligible to complain to the FOS (as is the case for the reinsured policyholders under the Transferring Business) this will also remain the case after the implementation of the Scheme. For the avoidance of doubt, the eligible policyholders of Transfercom have rights of access to the FOS, and those rights will not be affected by the Scheme nor, since Transfercom is a UK insurer, will any current rights of access to FOS of SJNKI's policyholders be affected.

FCA Conduct Principles

5.19. As noted in Section 2 the FCA places great emphasis on firms achieving fair outcomes for consumers, i.e. in this case that UK branch of SJNKI and Transfercom provide fair treatment to their respective customers. This fair treatment requirement will still apply with respect to policyholders (including the transferring policyholders) in Transfercom after the proposed Scheme.

5.20. Under the separate SJNKI (generally) and Transfercom approaches to the fair treatment of customers, service delivery involves:

- Claims being handled fairly, consistently and promptly in line with customer expectations and product promises;
- Products performing as designed and as expected by third parties and customers; and
- Sales and service being in line with customer expectations and product promises.

5.21. SJNKI's current approach to the fair treatment of customers (including the UK Branch) is outlined in Section 2 (requirements under the IBA) and Section 3 (as part of CSR), and that of Transfercom is outlined in Section 4.

Administration

5.22. After implementation of the proposed Scheme, the remaining business of SJNKI will continue to operate as it currently does. This includes underwriting, claims, operations, risk management and systems.

5.23. Following the proposed transfer under the Scheme, there will be no change of approach to managing and administering Transfercom's existing business, and the Transferring Business will continue to be administered by Resolute Management Limited (see paragraph 3.34 above).

Excluded policies

5.24. Any policies which are not capable of being transferred for legal reasons will be treated as Excluded Policies and will remain with SJNKI. It is not expected that there will be any such policies.

The Capital Policy after the Scheme

5.25. Capital in Transfercom is currently maintained (subject to the minimum requirements of Solvency I) using a risk-based approach in line with the ICA, as set out in Section 2, such that the company remains solvent relative to regulatory confidence levels over a one year (trading) time horizon. Capital in the UK branch of SJNKI is currently maintained to satisfy EU solvency requirements under Solvency I.

5.26. Following the implementation of the Scheme (which is expected to be on 28 February 2016, i.e. after the implementation of Solvency II on 1 January 2016), Transfercom and the UK branch of SJNKI will have replaced their present capital policies with policies to meet the requirements of Solvency II (these are described in Section 10).

The Approach to Communication with Policyholders

5.27. SJNKI and Transfercom have set out the approach they intend to take in communicating information about the proposed transfer of business to the affected policyholders and other parties.

5.28. The main objectives of the SJNKI and Transfercom communications are to:

- Give policyholders the information they need to understand the proposed changes;
- Inform affected policyholders about the implications for them of the proposed changes;
- Give affected policyholders access to further information (beyond that in the communications pack);
- Let affected policyholders know how to object to the proposed changes;
- Maintain customers' confidence in SJNKI and Transfercom (as appropriate) to continue to meet their obligations under transferring and non-transferring policies; and
- Meet legal and regulatory requirements.

5.29. I comment on this proposed approach to communications with policyholders and other parties in Section 10.

6. GENERAL CONSIDERATIONS OF THE INDEPENDENT EXPERT

Introduction

6.1. I have compiled my report in accordance with the PRA's Policy Statement PS7/15 and SUP 18.

6.2. PS7/15 and SUP 18 require me to consider the terms of the Scheme generally and how the different groups of policyholders are likely to be affected by the Scheme. In particular I am required to give my views on:

- The effect of the Scheme on the security of the policyholders' contractual rights, including the likelihood and potential effects of the insolvency of the insurer; and
- The likely effects of the Scheme on policyholder servicing levels (e.g. claims administration).

Materiality

6.3. After considering the effects of the Scheme on each of the different groups of policyholders, I have concluded whether I believe the Scheme will materially adversely affect that group of policyholders. It should be recognised that the Scheme will affect different policyholders in different ways, and, for any one group of policyholders, there may be some effects of the Scheme that are positive, and others that are adverse. If some effects of the Scheme are adverse, that does not necessarily mean that the Scheme is unreasonable or unfair, as those adverse effects may be insignificant or they may be outweighed by positive effects.

6.4. In order to determine whether any effects of the Scheme on any group of policyholders are materially adverse it has been necessary for me to exercise my professional judgement in the light of the information that I have reviewed.

6.5. When assessing the financial security of policyholders, I have looked at the solvency position of the companies involved in the Scheme, on both pre- and post-transfer bases, relative to regulatory solvency requirements. It should be noted that a company may have capital considerably in excess of its regulatory requirements, but that the directors of a company could legitimately reduce that level of capital (for example through the payment of dividends) and still leave the company appropriately capitalised. In circumstances where the Scheme has adversely affected the financial security of a group of policyholders, in order to determine whether that impact is material, I have considered whether the degree of financial security afforded after the transfer would have been acceptable and permissible before the transfer had taken place. I would determine that any adverse impact to a particular group of policyholders is material if the level of financial security afforded to them after the transfer would not have been acceptable under the normal constraints under which the company's capital position was managed before the Scheme.

Security of Policyholder Benefits

6.6. As noted above, I need to consider the security of policyholder benefits; that is, the likelihood that policyholders will receive their benefits when due, e.g. the payment of claims.

6.7. In considering and commenting upon policyholder security I shall consider the financial strength of each entity. Financial strength is provided by the margins for prudence in the assumptions used to calculate the Technical Provisions, by the shareholder capital and by any specific arrangements for the provision of financial support. In considering policyholder security it is also necessary to take into account the potential variability of future experience (including claim frequency and severity). Security is also affected by the nature and volume of future new business.

6.8. As described in Sections 3 and 4 of this Report, there are 2 insurance companies involved in the Scheme, each of which has a different mix of business.

6.9. It is therefore important that I consider whether this change in the size and nature of the companies involved will have any impact on the security of benefits or the fair treatment of affected policyholders.

6.10. The main factors that determine the risks to which a policyholder of an insurance company is exposed are:

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

6.11. The nature of the assets which constitute each company's capital and surplus is also relevant. The shareholder is able to withdraw surplus shareholder assets (i.e. retained profits, but not share capital) in the form of realised profits, provided minimum capital requirements are met. The security provided by such assets may therefore be temporary.

Policyholder Servicing Levels

6.12. PS7/15 requires me, as Independent Expert, to consider the likely effects of the Scheme on levels of service provided to policyholders.

6.13. This includes consideration of the likely effects of the Scheme on matters such as claims management, investment management, new business, administration, expense levels and valuation bases impacting levels of service to policyholders.

Treating Customers Fairly

6.14. As Independent Expert for the Scheme I need also to consider the proposals in the context of the FCA's conduct principles and in particular the impact on levels of service provided to policyholders.

6.15. This involves consideration of areas where discretion is involved on behalf of the relevant insurance company with regard to charges applied to a policy and the benefits granted to the policyholder, and also to service standards applied.

Consumer (Policyholder) Protection

6.16. Further, as Independent Expert for the Scheme I need also to consider the proposals in the context of consumer protection and in particular the impact on policyholders in the event of the default of an insurer, and the resolution of complaints between an insurer and its customers (policyholders).

6.17. This involves consideration of the protection afforded to policyholders of the relevant insurance company with regard to compensation granted to such policyholders in the event of the default of the insurer, and/or the resolution of complaints between the insurer and its policyholders.

Other Considerations

6.18. PS7/15 requires me, as the Independent Expert, to consider the likely effects of the Scheme on matters such as investment management, new business, administration, expense levels and valuation bases insofar as they might impact on levels of service to policyholders or on the security of policyholders' contractual rights.

6.19. I am also required to consider the cost of the Scheme and the tax effects of the Scheme insofar as they might impact on the security of policyholders' contractual rights.

Development of the Scheme

6.20. In the following sections I comment on the Scheme as it will be presented to the Court. During the development of the proposed terms of the transfer I have commented on drafts of the Scheme.

7. THE EFFECT OF THE SCHEME ON THE TRANSFERRING POLICYHOLDERS

Introduction

7.1. Under the Scheme, the Transferring Business will be transferred from SJNKI to Transfercom.

7.2. The main issues affecting the transferring policyholders of SJNKI as a result of the Scheme arise from relative differences in:

- The financial strength of Transfercom after the transfer compared to that of SJNKI currently. Financial strength is derived from the strength of the reserves held, excess assets or capital, and specific capital support arrangements (and the calls on that capital support).
- The risk exposures in Transfercom compared to those in SJNKI.
- The policy servicing levels provided by Transfercom after the transfer compared to those enjoyed by the policyholders of SJNKI currently.

7.3. In this section I address each of the issues.

The Change in Financial Strength due to the Scheme

RESERVE STRENGTH OF SJNKI

7.4. The proposed Scheme will result in a very small decrease to the liabilities of SJNKI (generally) with the transferring liabilities representing circa 0.7% of the SJNKI reserves for outstanding losses and claims. Therefore, in my opinion the financial effect of the proposed Scheme on the reserve strength enjoyed by the policyholders of SJNKI (generally) will be de minimis and their reserve strength is effectively unchanged on both pre- and post-Scheme positions.

UK Branch business

7.5. I have been provided with an external actuarial analysis on the unpaid claims (technical reserves) for the Relocated Business (essentially the Transferring Business) as at 30 September 2013. I have also been provided with an ORSA report for the UK Branch as at 31 December 2014 prepared by (a second firm of) external consultants, which includes a review of the liabilities of the Historic UK Branch Business.

7.6. The liabilities of the Relocated Business are in respect of inwards reinsurance contracts, which are dominated by APH claims (about 83% of the reported outstanding claims). The remaining 17% of the reported outstanding claims is made-up of workers' compensation and other (non-APH) losses.

7.7. I have reviewed the work carried out by the external actuaries in estimating reserves for the Relocated Business, in order to satisfy myself that it is reasonable for me to rely on their work. This included reviewing the report and assessing the appropriateness of the methodologies and major assumptions used.

7.8. I have not attempted to review in detail the calculations performed by the external actuaries. Instead, I have reviewed the process by which reserves are set, the approach followed to assess the key areas of reserve uncertainty and the apparent strength of the reserves based on this review.

7.9. Due to the nature of APH claims that dominate the Relocated Business the external actuaries have used a benchmarking[12] approach to estimate gross IBNR claims by Subject Contract[13], taking into account the type of loss and the years in which business was written. The benchmark used (by reserving segment) was the ratio of IBNR to outstanding claims (e.g. if the ratio of IBNR to outstanding was selected to be (say) 3, the resulting estimate of unpaid claims would be 4 × the outstanding claim reserve). The strength of the unpaid claim reserves (by reserving segment) was tested using a "survival" ratio approach, i.e. for how many years would the estimated unpaid claim reserves last, based on average claim payments (over say the 3 most recent years).

7.10. I believe the actuarial methods adopted by the external actuaries in relation to the Relocated Business to be in line with normal market practice.

7.11. Based on assessments by SJNKI's external actuaries the value (as at 30 September 2013) of the unpaid losses and ALAE of the Relocated Business that will be transferred to Transfercom is estimated to be $45.1 million (i.e. ¥4,409 million converted to US dollars at $1 = ¥97.75). This assessment (point estimate) is intended to represent an expected value over a range of reasonably foreseeable outcomes was made gross of reinsurance and does not reflect the time value of money (the latter provides a potential safety margin that increases the security of the policyholders).

7.12. I interpret the point estimate of unpaid losses, as defined in paragraph 7.11 above, as conceptually equivalent to the mean (average) value of the unpaid losses, and therefore on a basis higher than a 50% confidence level[14] (as the claim distribution is expected to be positively skewed[15]).

7.13. In addition to their point estimate, the external actuaries also developed a range of unpaid losses and ALAE that were intended to present outcomes that were unlikely, but that are not remote (i.e. a guide to uncertainty). The range in question was $32.7 million (low estimate) to $64.5 million (high estimate).

7.14. The second firm of external consultants undertook an exploratory exercise to understand the nature of the risks arising from the Historic UK Branch Business and to consider whether a zero best estimate for the Technical Provisions was and continues to be sensible.

7.15. The approach undertaken by the external consultants was essentially to review underlying exposures and past claim experience. The most recent policy written by the UK Branch is over 24 years old, and as such any potential claim emerging would have to have a very long latency period (e.g. a mesothelioma claim associated with exposure to asbestos). Furthermore, there is no record of there ever having been a claim under such policies for at least 13 years. The last claim settlement being in 1996 in respect of a 1978 liability claim. The external consultants concluded that based on their assessment a zero best estimate for Technical Provisions was not unreasonable.

7.16. Based on my review of the work of the external consultants on the zero best estimate for Technical Provisions in relation to the Historic UK Branch Business, I believe their conclusion to be acceptable.

[12] Benchmarking is an approach to estimating ultimate claims based on market experience and data. Often a market-based ratio is applied to the (re)insurer's claims data, e.g. IBNR to outstanding ratios applied to outstanding claims. Benchmark-based estimates tend to be used in situations where the claims data does not lend itself to standard actuarial methods (e.g. APH claims that are characterised by the emergence of claims across years-of-origin simultaneously; claim emergence is driven by calendar year phenomena, rather than the time elapsed since a policy was written) and/or the (re)insurer has limited claims experience applicable to the business to be projected.

[13] Each Subject Contract is made up of one or more policies (as explained in paragraph 3.24 above). The external actuaries have valued each Subject Contract based on the accumulated outstanding claims (summed over the underlying policies). In this manner, the resulting IBNR amount per Subject Contract is designed to cover both future claims on policies whether or not a claim has been advised, and potential deterioration in the reported claim amounts.

[14]A 50% confidence level, in relation to the claim reserve, is the likelihood that the claim reserve estimate will prove adequate to meet the corresponding claims in half of the outcomes. For a symmetrical claims distribution the average corresponds to the 50% confidence level.

[15] A claims distribution of potential losses is said to be positively skewed as the loss cannot be less than zero, but can be many times larger than the average loss (alternatively, this may be viewed as a distribution of potential losses having a higher frequency of lower value losses, and a lower frequency of higher value losses, e.g. observed losses of: 1, 2, 3, 4, 100).

Conclusion

7.17. ***Notwithstanding the significant degree of uncertainty in the APH claims, I am satisfied that the methodologies, major assumptions and results of the external actuaries in relation to the Relocated Business as at 30 September 2013 appear reasonable***.

7.18. ***The zero best estimate for Technical Provisions in relation to the Historic UK Branch Business as at 31 December 2014 does not appear unreasonable***.

RESERVE STRENGTH OF TRANSFERCOM

7.19. I have been provided with an internal actuarial review for Transfercom as at 30 June 2013 (based on claims data as at 31 May 2013) and a reserve roll-forward exercise – 31 May 2013 to end-November 2014.

7.20. I have reviewed the work carried out by the internal actuaries in estimating reserves for Transfercom, in order to satisfy myself that it is reasonable for me to rely on their work. This included reviewing the report and assessing the appropriateness of the methodologies and major assumptions used.

7.21. I have not attempted to review in detail the calculations performed by the internal actuaries. Instead, I have reviewed the process by which reserves are set, the approach followed to assess the key areas of reserve uncertainty and the apparent strength of the reserves based on this review.

7.22. The actuarial review is divided between the two portfolios arising respectively from the First and Second Transfers. The two portfolios are very different in nature, i.e. the portfolio arising from the First Transfer is a very long-tail book, whereas the portfolio arising from the Second Transfer (the Fortress Re book) is short-tail aviation hull and passenger losses.

7.23. While the Fortress Re book is a reinsurance run-off portfolio, which would typically lead to the view that the book should not be short-tail in nature, the specific characteristics of the portfolio indicate otherwise:

- The contracts associated with the World Trade Centre loss[16] (on which the greatest liabilities remain) are mostly reserved in full or it is felt (by Transfercom management) that further deterioration beyond current reserves is highly unlikely. By necessity, Transfercom has applied judgement in allowing for the likelihood of prevailing legal proceedings. I have checked that the claims reserve for the WTC loss is set on a reasonable basis. Based on my understanding and market knowledge of the underlying legal proceedings I believe that this is the case;
- All contracts have limited reinstatements and were exposed to catastrophic type losses with little or no casualty business written, therefore exposure to long-tail claims is believed (by Transfercom management) to be minimal with very little chance of further notifications being received;
- Passenger liability in relation to aviation losses are reported promptly (and the retrocession, as opposed to reinsurance, element of outstanding claims is currently low) and the underlying passenger liabilities in connection with the World Trade Centre loss have all been settled;
- The Transfercom management are confident that the scope for the current booked gross reserves to be insufficient is extremely small (a position with which I concur as expressed in paragraph 7.25 below).

7.24. Based on the factors discussed in paragraph 7.23 above, the judgement of the internal actuaries (while identifying uncertainties in general and specifically on reinstatement premiums and profit commissions) was that an IBNR amount may not be needed in addition to the known amounts already booked as at 30 June 2013.

[16] There have been long legal disputes over the settlement of insurance claims from the World Trade Centre ("WTC") loss, and this process is now at an advanced stage. The future claims cost to Transfercom depends on the outcome of legal judgements.

7.25. The roll-forward exercise to end November 2014 indicated a substantial incurred release on the Fortress Re book, further supporting the opinion that an IBNR may not be needed. Nonetheless, Transfercom carried a gross IBNR of $20.7 million in addition to case reserves of $48.2 million as at 31 December 2014. In my view, the gross reserves booked by Transfercom as at 31 December 2014 for the Fortress Re book are stronger than a best estimate.

7.26. While there is uncertainty attached to the Fortress Re book at a gross level, this is greatly limited by the reinsurance arrangement in place with NICO covering this book. As at 31 December 2014, over 85% of the reinsurance limit remained to cover future losses arising from the Fortress Re book. Therefore, while a theoretical best estimate should be greater than zero at a net level, I am satisfied that for all practical purposes a zero net reserve is not unreasonable for the Fortress Re book.

7.27. Turning to the other Transfercom portfolio, i.e. the book associated with the First Transfer (the "non-Fortress Re" book), the liabilities are very long-tail arising in the main from reinsurance of casualty liabilities. The dominant claim type being asbestos.

7.28. A benchmark approach has been used by the internal actuaries taking into account the type of loss and the insurance chain (direct, reinsurance, retro and long-retro), in two main ways. The first is a "survival" ratio, where the internal actuaries have applied a multiplier to an estimate of the current annual rate at which claims are settled. The second is a simple multiplier applied to booked outstanding claims. In selecting the final estimates the internal actuaries have given equal weights to the two approaches.

7.29. I believe the actuarial methods adopted by the internal actuaries in relation to the non-Fortress Re book to be in line with normal market practice.

7.30. Based on assessments by the internal actuaries the value (as at 30 June 2013) of the gross unpaid losses and ALAE of the non-Fortress Re book is estimated to be $213.5 million. This assessment (point estimate) is not explicitly defined in the actuarial review report, but is assumed to be the mean (average) of a claim distribution when illustrating the uncertainty of the emerging gross losses. I therefore interpret the point estimate on a basis higher than a 50% confidence level (as the claim distribution is expected to be positively skewed).

7.31. As mentioned in paragraph 7.30 above, in addition to their point estimate, the internal actuaries also developed a distribution of unpaid losses and ALAE (as a guide to uncertainty). The analysis, which is based on the position as at 30 June 2013, involves fitting a statistical (log-normal) distribution to the reserves of the non-Fortress Re book from which confidence levels (or percentiles) could be determined.

7.32. The method employed by the internal actuaries in estimating the distribution of the reserves of the non-Fortress Re book has limitations and relies on subjective assumptions. It does however indicate that the carried reserve in the management accounts of Transfercom as at 30 June 2013 is significantly above a 50% confidence level, and that the likelihood of the NICO reinsurance contract exhausting is remote (i.e. less than a 1 in 200 likelihood).

7.33. The roll-forward exercise to end-November 2014 indicated that paid and incurred movements in the 18 month period were broadly in line with expectations within each reserving class of the non-Fortress Re book. The internal actuaries also indicated that they were not aware of any developments that would suggest that the reserves determined above as at 30 June 2013 were not appropriate. The rolled-forward estimated gross reserves as at end-November 2014 was therefore simply calculated by reducing the position as at 30 June 2013 by paid gross claims in the period. I also note that the corresponding gross reserves booked by Transfercom as at 31 December 2014 contained a substantial margin over the rolled-forward assessment of the internal actuaries. In my view, the gross reserves booked by Transfercom as at 31 December 2014 for the non-Fortress Re book are stronger than a best estimate.

7.34. While there is a considerable degree of uncertainty attached to the non-Fortress Re book at a gross level, this is greatly limited by the reinsurance arrangement in place with NICO covering this book. As at 31 December 2014, over 85% of the reinsurance limit remained to cover future losses arising from the non-Fortress Re book. Therefore, while a theoretical best estimate should be greater than zero at a net level, I am satisfied that for all practical purposes a zero net reserve is not unreasonable for the non-Fortress Re book.

7.35. Finally, in relation to reserve strength, Transfercom does not reflect the time value of money in its gross reserves, which provides a potential safety margin (that increases the security of the policyholders).

Conclusions

7.36. ***I am satisfied that the methodologies, major assumptions and results developed by the internal actuaries as at 30 June 2013 and end-November 2014 for 2014 for determining reserve estimates in respect of the Fortress Re book appear reasonable.***

7.37. ***Notwithstanding the significant degree of uncertainty in the APH claims associated with the non-Fortress Re book, I am satisfied that the methodologies, major assumptions and results developed by the internal actuaries as at 30 June 2013 and end-November 2014 for determining reserve estimates in respect of the non-Fortress Re book appear reasonable***.

7.38. ***Overall, based on my review (effectively as at 31 December 2014) as described above, the reserves of Transfercom on both a gross and net (of reinsurance) basis appear reasonable at present.***

TRANSFERCOM RESERVE STRENGTH POST TRANSFER

7.39. The main risk to consider is the risk that the liabilities of the transferring policies, or of Transfercom, deteriorate post-transfer to such an extent that Transfercom's solvency is threatened. This event could disadvantage policyholders of Transfercom and/or the transferring policyholders of SJNKI that might have remained secure had the Scheme not taken place.

7.40. Reserves in respect of UK Branch liabilities to be transferred under the Scheme were assessed by the external actuaries at $45.1 million gross (of reinsurance) as at 30 September 2013, subsequently projected by Transfercom to be circa $50 million at the Effective Date. As explained in paragraph 5.11 above, Transfercom will enter into a reinsurance agreement with NICO on the Effective Date, under which NICO reinsures the gross and net liabilities (which are equivalent as no outwards reinsurance transfers under the Scheme) up to a limit of $150 million, i.e. at the Effective Date, the NICO Agreement will provide more than $100 million of additional protection to Transfercom, in excess of its reserves (gross and net of reinsurance).

7.41. Therefore, while Transfercom's gross outstanding claims reserves will increase by around $50 million (about 15%); net of reinsurance they are estimated to remain unchanged. Further, the liabilities reinsured under the NICO Agreement represent a very small proportion (considerably less than 1%) of NICO's net carried reserve as at 31 December 2014. Therefore, the NICO Agreement is very unlikely of itself to have a material impact on the financial position of NICO.

7.42. The reserving basis adopted by Transfercom after the Effective Date will not change as a result of the Scheme, i.e. it will continue to be on a conservative best estimate basis. I am satisfied, therefore, that the reserving levels adopted by Transfercom after the Effective Date will continue to be established on a basis stronger than a 50% confidence level.

7.43. Overall, therefore, I would expect Transfercom to be reasonably reserved after the Effective Date.

Conclusion

7.44. ***I believe that the Scheme will not have a materially adverse effect on the reserve strength provided to the transferring policyholders of SJNKI compared to both their current position and their projected position at the Effective Date***.

EXCESS ASSETS

7.45. For the purposes of my comparative analysis of the excess assets/capital levels of Transfercom and SJNKI pre and post the proposed Scheme, I have considered the extent to which each company holds capital in excess of its regulatory solvency level, in which case the actual capital that the company under consideration holds (the "Available Capital") will be greater than the "Required Capital" calculated. I refer to the ratio of Available Capital to Required Capital as the "Capital Cover Ratio". For the purposes of the terms I use in this Report, a company with sufficient capital (relative to the regulatory capital requirement under consideration) will have a Capital Cover Ratio just greater than 100%. I describe a company as well capitalised if it has a Capital Cover Ratio greater than 150%, and very well capitalised if it has a Capital Cover Ratio in excess of 200%.

7.46. If the Capital Cover Ratio increases after the Scheme for a group of policyholders, then there is an increase in security for those policyholders. If the Capital Cover Ratio reduces then there is a reduction in security and I need to consider whether the reduction is likely to be material to those policyholders.

7.47. I have used these Capital Cover Ratios to understand the level of policyholder security for each group of policyholders affected by the Scheme (i.e. for the policyholders of SJNKI that will transfer under the Scheme, and for the non-transferring policyholders of both SJNKI and Transfercom). This enabled me to understand not just their level of security if the Scheme is approved, but additionally how this compares against the level of security if the Scheme is not approved.

7.48. I comment further on these levels of security in the paragraphs below. I discuss the Capital Cover Ratios in qualitative (and where appropriate quantitative) terms that I believe to be appropriate to explain the implications for policyholder security.

EXCESS ASSETS OF SJNKI (PRE-SCHEME)

7.49. Prior to the Scheme, the transferring policyholders are subject to the security levels of SJNKI (generally), and not to the security of the UK Branch in isolation (while noting that the UK Branch maintains regulatory minimum capital levels in line with the requirements of the PRA, i.e. as at 31 March 2015, the UK Branch, including the Relocated Business, had capital resources of £8.3 million compared to an MCR of £1.5 million).

7.50. In assessing this security level I have taken account of the balance sheet strength of SJNKI as set-out in its unaudited financial accounts as at 30 September 2014 and to its credit rating.

7.51. SJNKI (generally) had Available Capital of ¥2,464 billion relative to Required (Risk-Based) Capital of ¥704 billion as at 30 September 2014, generating a Capital Cover Ratio of 350%. SJNKI (generally) is also strongly rated by both Standard & Poor's and A M Best each giving it an A+ financial strength rating as of 8 January 2015.

7.52. Based on my review of the financial statements of SJNKI (generally), as outlined above, my view is that SJNKI is a large, very well-capitalised and diversified company.

Conclusion

7.53. ***Overall, based on my review as described above concerning the excess assets of SJNKI, I believe the policyholders of SJNKI, including those transferring to Transfercom under the proposed Scheme, currently enjoy a level of security associated with a very well-capitalised company.***

EXCESS ASSETS OF TRANSFERCOM (PRE-SCHEME)

7.54. As at 31 December 2014, Transfercom's PRA return indicated that it had Available Capital (capital resources) of £37.1 million relative to Required Capital (MCR) of £2.9 million, giving it a Capital Cover Ratio of 12.8 (on a Solvency I basis).

7.55. As stated in paragraphs 7.26 and 7.34 above, the uncertainty attached to the net position of Transfercom is greatly limited by the reinsurance arrangements in place with NICO. The reinsurers' share of the Technical Provisions of Transfercom, as at 31 December 2014, represented 100% of the Gross Technical Provisions, with the vast majority (nearly 100%) of this asset provided by NICO (its immediate parent company). It follows therefore that any risk-based capital assessment (such as the ICA or the SCR under Solvency II) will be very strongly dependent on counterparty risk.

7.56. Transfercom has made estimates of its capital requirements under Solvency II rules using the standard formula. Transfercom has made these estimates as at year-end 2014, and has provided me with the results.

7.57. I have performed a review of the standard formula analysis produced by Transfercom. Discussions on the methodology and assumptions used in the SCR calculations have also been undertaken with relevant personnel from Transfercom in order to ensure my understanding of the analyses conducted and I have received satisfactory answers to these questions.

7.58. The key component of Transfercom's SCR as at 31 December 2014 was counterparty risk, which contributed approximately 50% to the overall diversified SCR. The next largest component was operational risk, which contributed approximately 25%.

7.59. The Solvency II standard formula calculation as at 31 December 2014 produced results for Available Capital (Own Funds in Solvency II terminology) and Required Capital (i.e. the SCR) to give a Capital Cover Ratio that indicated that Transfercom would have been a very well-capitalised company (on a Solvency II basis).

7.60. Transfercom has also provided me with an ICA commentary and accompanying figures as at 31 December 2014. These set out the main risks (i.e. counterparty risk) to which Transfercom is exposed and outline the approach taken to setting its capital requirement. The ICA indicated that Transfercom had excess Available Capital relative to its Required Capital, such that it could be considered a very well-capitalised company (on an ICA basis).

7.61. A fundamental ingredient to my analysis above is the ongoing ability of NICO to meet and make reinsurance payments under its reinsurance treaties with Transfercom. I therefore need to consider the risk of ultimate exhaustion of the assets of NICO.

Excess Assets of NICO

7.62. The gross carried loss and loss expense reserves of NICO as at 31 December 2014 totalled $48.0 billion ($47.4 billion net of reinsurance). These consist of reserves, under Schedule P of its return to the US National Association of Insurance Commissioners ("NAIC"), for unpaid losses and loss adjustment expenses of $23.4 billion ($22.8 billion net), retroactive reinsurance reserves of $23.2 billion (gross and net) and deposits of $1.4 billion (gross and net).

7.63. The liabilities of NICO include significant exposures to asbestos & environmental risks. Much of this is in respect of the retroactive reinsurance contracts NICO have entered into. The purpose of these contracts has, in many cases, been to substantially remove the risks associated with asbestos, environmental and other long tailed liabilities of the ceding insurers. While these liabilities are subject to significantly greater uncertainty than typical insurance liabilities, the retroactive reinsurance contracts have all been written with an aggregate limit, therefore capping NICO's exposure to these liabilities.

7.64. Of the liabilities NICO reports in its Schedule P return, asbestos & environmental related claims accounted for $1.2 billion net (of reinsurance) as at 31 December 2014. As for the retroactive reinsurance contracts the risk factors associated with asbestos & environmental liabilities make the associated Schedule P reserves carried by NICO subject to significant variability. However, as these reserves represent around 5% of the overall Schedule P carried reserves of NICO net of reinsurance as at 31 December 2014, any adverse claims development is very unlikely to have a material impact on the overall carried reserves of NICO.

7.65. The liabilities of NICO are subject to an annual statement of actuarial opinion ("SAO"). I have reviewed the SAO for NICO as at 31 December 2014, as provided by the appointed actuary. SAOs must cover items set out in instructions issued by the NAIC (refer to Appendix 6 for full details). The main items to be covered in a SAO are: (1) the scope of the opinion, in particular an examination of the actuarial assumptions and methods used in determining the opined upon reserves, and a review of the information provided to the appointed actuary; (2) the opinion itself; and (3) relevant comments.

7.66. In addition to the SAO, the appointed actuary provided an actuarial opinion summary ("AOS") in respect of NICO as at 31 December 2014. This summary shows the appointed actuary's indicated lower and higher combined reserves (both gross and net of reinsurance) and compares them with the total carried reserves of NICO as at 31 December 2014. In order to give an opinion in the SAO that the carried reserves make a "reasonable provision" for the liabilities associated with the reserves, the carried reserves must be within the appointed actuary's range of reasonable reserve estimates.

7.67. The SAO (and AOS) were provided by the appointed actuary for regulatory purposes only, and as such I am not able to provide details of the SAO (and AOS) in this Report. Nonetheless, nothing emerged from my review of the SAO (and AOS) to give me concerns as to the financial strength of NICO, or to conclude that the SAO (and AOS) do not form a reasonable basis for assessing at a high level the reserve strength of NICO. In particular, the carried reserve amount lies within the appointed actuary's range of reasonable reserve estimates.

7.68. As at 31 December 2014, the admitted assets (excluding protected cell business) of NICO amounted to $167 billion, made up of cash and bonds (14%), common and preferred stocks (57%) and investments in its parent, subsidiaries and affiliates (29%).

7.69. As at 31 December 2014 the policyholders of NICO enjoyed the security of total adjusted capital (i.e. Available Capital) of $94.4 billion (this surplus includes a $0.4 billion adjustment for dividends from life subsidiaries), relative to a risk-based capital requirement of $40.4 billion (determined as outlined in Appendix 5), i.e. the Capital Cover Ratio was 234% (= Available Capital ÷ Required Capital) and the free assets were $54 billion (= Available Capital – Required Capital). Relative to the authorised control level of risk-based capital of $20.2 billion, the Capital Cover Ratio was circa 470%. By either measure, NICO was a very well capitalised company as at 31 December 2014.

7.70. Further, as at 31 December 2014, the ratio of free assets to carried loss reserves net of reinsurance (of $47.4 billion) was approximately 114%, i.e. claim reserves net of reinsurance could deteriorate by 114% before NICO's free assets were exhausted.

7.71. The admitted assets held by NICO as at 31 December 2014 are dominated by common and preferred stocks, and by investments in its parent, subsidiaries and affiliates. As such they are not managed to a target duration which is based on the expected cash-flows of the underlying liabilities. The common and preferred stocks held by NICO are subject to significant market variability. Nonetheless, the ratio of free assets (of $54 billion, see paragraph 7.69 above) to admitted assets (of $167 billion) is 32%, i.e. the value of admitted assets could fall by up to 32% before NICO's free assets would be exhausted.

7.72. In addition to reviewing the NAIC Annual Statement (US regulatory return) and the SAO/AOS as at 31 December 2014, I have had communications with key personnel from Transfercom and NICO on the assets and liabilities held by NICO, and have been informed that, broadly speaking: (1) the equity investments are held in such a way that the expected dividend income covers the expected claims payment profile; (2) that liabilities are matched to assets in such a way that if insurance liabilities increase then they could be matched, to a certain extent over a long period, by increases in equity valuations; and (3) liquidity is provided at the Berkshire Hathaway Inc. consolidated level of at least an absolute $10 billion minimum in liquid short-term assets (cash or cash equivalents) and NICO has a reciprocal loan arrangement with Berkshire Hathaway Inc. to draw upon up to $10 billion of that cash on an immediate basis to be able to meet immediate unforeseen needs.

7.73. In my view, the approach adopted by NICO to matching assets and liabilities appears reasonable given: (1) the long-term nature of both the assets and liabilities; (2) the very high level of liquidity available to NICO to meet immediate unforeseen needs; and (3) the substantial policyholder surplus of $94 billion in excess of total carried liabilities of $73 billion.

7.74. The excess admitted assets of NICO are substantial and, while they cannot be assumed to provide an absolute guarantee, provide a very significant safety margin.

Conclusion with regard to the Excess Assets of NICO

7.75. ***Based on the excess admitted assets of NICO and the reserves carried by NICO (as opined on by the appointed actuary for year-end 2014), I have concluded that, although it is impossible to foresee every eventuality, the risk of ultimate exhaustion of the assets is small***.

Conclusion with regard to the pre-Scheme Excess Assets of Transfercom

7.76. ***I am satisfied that the excess assets of Transfercom currently afford the policyholders of Transfercom a level of security consistent with my definition of a very well-capitalised company. This security is under-pinned by its reinsurance arrangements with NICO, and the excess assets of NICO as described above***.

EXCESS ASSETS OF TRANSFERCOM (POST-SCHEME)

7.77. If the proposed Scheme is sanctioned, the gross liabilities of Transfercom will increase by around $54 million (based on Transfercom's figures as at the Effective Date, including $4 million for unallocated loss adjustment expenses). Net of reinsurance however (given that the NICO Agreement will become effective on the Effective Date) the liabilities are estimated to be unchanged.

7.78. The NICO Agreement is a key asset backing the liabilities of the Transferring Business. I have therefore considered whether it would be possible for NICO to terminate the agreement or to avoid paying claims under it. As described in paragraph 5.12 above the agreement contains clauses limiting NICOs ability to avoid paying claims or the ability to terminate the agreement. Based on my review of these clauses, I am satisfied that they effectively limit NICO's ability to terminate the agreement or to avoid paying claims under it.

7.79. I have approximated Transfercom's capital requirements under Solvency II using the standard formula including the Transferring Business. The effect on the Required Capital (SCR) as at 31 December 2014 is a slightly higher capital requirement and slightly reduced surplus, resulting mainly from a larger counterparty default risk charge due to the increased reinsurance asset with NICO. Nonetheless, my estimate continues to show a surplus of Available Capital over the Required Capital when the Transferring Business is included, such that it continues to be a very well-capitalised company (on a Solvency II basis).

7.80. Further, in order to help me assess the post-Scheme position of the policyholders transferring from SJNKI to Transfercom (and the pre- and post-Scheme position of the current policyholders of Transfercom) I have built a simple model (similar to that outlined in paragraph 7.31 above) that allows for a distribution of possible outcomes under the NICO Agreement and assesses whether the claims will be paid in full (pre counterparty risk considerations). Key assumptions used in the modelling were:

- As discussed above in relation to the reserve uncertainty in relation to both the Fortress Re and non-Fortress Re portfolios, the risk of either of the NICO reinsurance contracts protecting these portfolios exhausting is remote (i.e. less than a 1 in 200 likelihood). I have thus modelled and considered the NICO Agreement in isolation;
- The indemnity limit on the NICO Agreement is $150m, while the starting estimate for unpaid claims and ALAE is circa $50m. Thus, from my judgemental perspective, while it is impossible to foresee every eventuality, the likelihood of the NICO Agreement being exhausted is very remote;
- I have assumed that the Transferring Business can be modelled as two portfolios – asbestos related claims and non-asbestos claims. There will be limited overlap between these two portfolios, although this cannot be assumed to be zero as both books would be exposed to inflation. I have assumed a weak correlation between the portfolios and used a correlation of 30% (which is in line with that adopted by Transfercom when illustrating uncertainty for the non-Fortress Re book);
- The results of my modelling support my judgement perspective above, i.e. they indicate that the likelihood of the NICO Agreement exhausting is very remote (i.e. much less than a 1 in 200 likelihood). I am therefore satisfied that the indemnity limit of $150m put forward by NICO provides adequate reinsurance cover in relation to the UK Branch business of SJNKI transferring to Transfercom.

7.81. As per my pre-Scheme analysis (and as mentioned in paragraph 7.61 above), a fundamental ingredient to my analysis of the post-Scheme position is the ongoing ability of NICO to meet and make reinsurance payments under its reinsurance treaties with Transfercom. The addition of the NICO Agreement will of itself have a very small impact on the financial position of NICO (given its excess assets of $94 billion as at 31 December 2014). In my view therefore, the post-Scheme position of the policyholders transferring from SJNKI to Transfercom (and the post-Scheme position of the current policyholders of Transfercom) will not be materially adversely impacted as a result of the Scheme.

Conclusion with regard to the post-Scheme Excess Assets of Transfercom

7.82. ***I am satisfied that the policyholders of Transfercom, including those transferring under the Scheme, will enjoy a level of security afforded by a very well-capitalised company if the Scheme is sanctioned***.

Relative Financial Strength of Transferring Policyholders pre- and post-Scheme

7.83. I have concluded above, based on my review of excess assets held relative to Solvency I and Solvency II capital requirements, that SJNKI was, as at 31 December 2014, a very well-capitalised company, and that Transfercom was also a very well-capitalised company (both pre- and post-Scheme). Transfercom had, on the measures considered, a greater degree of excess assets relative to its capital requirements (both pre- and post-Scheme). This would suggest that, in terms of excess assets and the security that they afford policyholders, the policyholders of the Transferring Business would likely benefit from the Scheme being sanctioned. It should be borne in mind, however, that while the excess assets in SJNKI are, in relative terms, less than those in Transfercom, in absolute terms the amount of excess assets is far greater in SJNKI, and policyholders of SJNKI also benefit from being part of a much larger and more diversified insurance company, compared to Transfercom.

7.84. Pre-Scheme, were SJNKI to become insolvent, the policyholders of the Transferring Business would continue to access the remaining assets of SJNKI. Under Japanese law, direct and reinsurance policyholders have equal priority in the event that a firm is subject to insolvency as described in paragraph 2.54 above.

7.85. Pre-Scheme, were Transfercom to become insolvent, the policyholders of the Transferring Business would continue to have their claims paid by SJNKI. Post-Scheme, were Transfercom to become insolvent, the policyholders of the Transferring Business would not have any recourse to SJNKI.

7.86. As described in paragraph 2.30 above, under English law direct policyholders receive priority over reinsurance policyholders in the event that a firm is subject to insolvency. Further, no direct business is included in the Relocated Business (and no claims are expected from the Historic UK Branch Business). This means that following the Scheme all the liabilities will be reinsurance liabilities of Transfercom and have a lower priority than the liabilities of the direct policyholders to the assets of Transfercom were it to become insolvent.

7.87. It follows that were Transfercom to become insolvent post-Scheme the policyholders of the Transferring Business would, all other things being equal, be in a less favourable position than that pre-Scheme were SJNKI to become insolvent.

7.88. However, the ongoing solvency of Transfercom is very substantially provided (through reinsurance contracts) by NICO, a very well capitalised company with excess assets of $94 billion as at 31 December 2014. Therefore, given the reserve strength and the level of excess assets within each company, the insolvency of either SJNKI or Transfercom would presently appear to be a remote possibility, and one that would not be materially affected by the Scheme.

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

The Change in Risk Exposure due to the Scheme

7.90. The portfolio to be transferred under the proposed Scheme consists mainly of APH claims, principally related to asbestos. The transferring policyholders are currently exposed to the other liabilities of SJNKI which, as set out above, are in respect of the various property and liability insurance lines written by SJNKI.

7.91. If the Scheme is sanctioned the transferring policyholders will become exposed to the business written by Transfercom. As described in Section 4 above, this business includes some very uncertain lines including US casualty (APH) losses. This exposes Transfercom to potentially very large gross losses.

7.92. While this business may be considered more uncertain than that to which the transferring policyholders are currently exposed within SJNKI, Transfercom's reinsurance arrangements with NICO significantly limit its net exposures.

7.93. As the security of the Transferring Business will be derived in large part from the NICO Agreement, it is the other risk exposures within NICO that are particularly pertinent to the transferring policyholders. These existing risk exposures will be unchanged as a result of the Scheme.

Conclusion

7.94. ***I am satisfied that, although the proposed Scheme will lead to a change to the risk exposures of the transferring business of SJNKI, this will not have a materially adverse effect on the security of policyholders***.

The Change in Policy Servicing due to the Scheme

7.95. Under the terms of the Framework Agreement, the administration of the UK Branch business liabilities was out-sourced from SJNKI to Resolute. Resolute will continue to handle the administration of claims and policies following the sanctioning of the proposed Scheme (refer to paragraph 3.33 above).

7.96. The administration of the UK Branch business liabilities will have been undertaken by Resolute for almost one year at the Effective Date. During this period of outsourced administration, together with Resolute's experience and expertise of handling claims of the type arising from Transferring Business (essentially the relocated reinsurance contracts) – see paragraph 4.3 above, I am satisfied that the policyholders of the Transferring Business will not experience a material change in servicing standards.

Conclusion

7.97. ***I believe that the proposed Scheme will not have a materially adverse effect on the policy servicing levels enjoyed by the transferring policyholders of SJNKI compared to both their current position and their projected position at the Effective Date***.

Conclusion for the Policyholders of SJNKI transferring under the Scheme

7.98. ***I am satisfied that the proposed Scheme does not affect in a materially adverse way either the security or the policy servicing levels of the policyholders of SJNKI transferring under the proposed Scheme***.

8. THE EFFECT OF THE SCHEME ON THE TRANSFERCOM POLICYHOLDERS

Introduction

8.1. Under the Scheme, Transfercom's policyholders will remain in Transfercom, and will be joined by the transferring UK branch policyholders of SJNKI.

8.2. The key issues affecting existing Transfercom policyholders as a result of the Scheme arise from changes in:

- The financial strength of Transfercom as a result of the transfer;
- The risk exposures in Transfercom;
- The policy servicing levels of the business of Transfercom.

8.3. In this section I deal with each of these in turn.

The Change in Financial Strength due to the Scheme

8.4. In Section 7, I considered the current reserve strength and excess assets of Transfercom. I concluded that Transfercom is currently reasonably reserved and should continue to be so after the implementation of the Scheme.

8.5. I also considered in Section 7 the excess assets of Transfercom post the transfer, from the perspective of the transferring policyholders. As I explained, as the Transferring Business is to be reinsured into NICO on the Effective Date, the net liabilities of Transfercom are estimated to not increase as a result of the Scheme, and Transfercom will continue to maintain a Capital Cover Ratio consistent with my definition of a very well-capitalised company (on both Solvency I and Solvency II bases).

8.6. As NICO reinsures the Transferring Business, the solvency of Transfercom post-Scheme will depend to a large extent on the financial strength of NICO, as it does currently given the extent to which NICO already reinsures Transfercom.

8.7. If the Scheme is sanctioned, in the event of the post-Scheme insolvency of Transfercom the position of the current direct policyholders would be unchanged relative to the transferring policyholders from SJNKI as they are all policyholders in respect of inwards reinsurance.

Conclusion

8.8. ***I believe that the Scheme is unlikely to have a materially adverse effect on the financial strength (derived from excess assets and reserve strength) enjoyed by the current policyholders of Transfercom after the proposed Scheme compared to both their current position and their projected position at the Effective Date***.

The Change in Risk Exposure due to the Scheme

8.9. If the Scheme is sanctioned, the gross Technical Provisions of Transfercom will increase by approximately 16%. Net of reinsurance there is expected to be no increase in Technical Provisions.

8.10. The extent to which the existing business of Transfercom will be exposed to the Transferring Business will be limited by the NICO Agreement which, as described above, can be regarded as very unlikely to exhaust.

8.11. Furthermore, an amalgam of the transferred portfolio from SJNKI with that of Transfercom would be expected to suffer proportionately smaller gross reserve deteriorations than any one portfolio taken individually. I note, however, that at a net of reinsurance level there is no expected change as a result of an amalgam of the transferred portfolio from SJNKI with that of Transfercom because of the NICO Agreement.

8.12. Therefore, all other things being equal, the risk profile of the combined portfolio (gross of reinsurance) within Transfercom post-Scheme will benefit from a diversification of the portfolio of risks. Although again I note that there is expected to be no benefit from diversification at a net (of reinsurance) level.

Conclusion

8.13. ***I am satisfied that any change to the risk exposures of the current business of Transfercom after the proposed Scheme will not have a materially adverse effect on the security of policyholder benefits***.

The Change in Policy Servicing due to the Scheme

8.14. The administration of the existing business of Transfercom will be unchanged as a result of the Scheme.

Conclusion for Transfercom Policyholders

8.15. ***For the reasons discussed above, I am satisfied that the proposed Scheme will not have a materially adverse effect on the security of existing Transfercom policyholders. Further, the service levels provided to the policyholders in Transfercom will not be adversely affected by the proposed Scheme***.

9. THE EFFECT OF THE SCHEME ON THE NON-TRANSFERRING POLICYHOLDERS OF SJNKI

9.1. If the Scheme is sanctioned the liabilities pertaining to the Transferring Business will be removed from the balance sheet of SJNKI, along with agreed investments. No other assets will be transferred to Transfercom.

9.2. As a result of the Scheme, SJNKI's assets and net liabilities will both reduce by circa 0.7%, i.e. a very small proportion of the overall assets and liabilities of SJNKI.

9.3. SJNKI's "Risk" (see paragraph 2.51 above) will reduce as a result of the removal of these liabilities and related risks from SJNKI's balance sheet under the proposed Scheme. As the "Solvency Margin" (see paragraph 2.50 above) will be essentially unchanged (as the assets of SJNKI will reduce very slightly), SJNKI's solvency margin ratio will likewise be essentially unchanged.

9.4. The remaining policyholders will also benefit from no longer having any exposure to the risks associated with the liabilities of the Transferring Business, i.e. predominantly very uncertain APH exposures. In my opinion this would not be to the detriment of the remaining policyholders of SJNKI.

9.5. There will be no changes to the administration of the remaining business as a result of the Scheme.

Conclusion for SJNKI Policyholders not transferring under the Scheme

9.6. ***For the reasons discussed above, I am satisfied that the proposed Scheme will not materially adversely effect on the security of SJNKI policyholders not transferring under the Scheme, and further, the service levels provided to these policyholders will not be affected by the proposed Scheme***.

10. OTHER CONSIDERATIONS

The approach to communication with policyholders

10.1. Regulations made under the FSMA require a communication regarding the proposed transfer to be sent to every policyholder of the parties to the Scheme unless the Court waives this requirement. However, consideration may be given to the practicality and costs of sending notices against the likely benefits for policyholders of receiving such communications. In order to comply with PS7/15, the companies would be expected to notify the policyholders, and/or other interested persons, at least six weeks before the date of the Court hearing at which the application to sanction the Scheme will be heard. The companies intend to comply with this guidance.

10.2. The companies' approach to communicating the proposed Scheme to affected policyholders is outlined in Section 5, and explained further below:

- SJNKI will notify all those transferring policyholders whose name and address appear in SJNKI's computerised records;
- SJNKI will not notify policyholders of SJNKI who are not transferring under the Scheme;
- Transfercom will notify all those policyholders of Transfercom whose name and address appear in Transfercom's computerised records;
- SJNKI will send a letter outlining the proposed Scheme to each of the brokers of transferring policies whose name and address appear in its computerised records;
- Transfercom will send a letter outlining the proposed Scheme to each of those brokers of Transfercom's policies whose name and address appear in Transfercom's computerised records.

10.3. Regulations made under the FSMA also require all reinsurers of the transferring business to be notified of a proposed transfer. As there is no reinsurance protecting the SJNKI (re)insurance business transferring under the Scheme, there are no reinsurers for SJNKI to notify.

10.4. Furthermore, SJNKI/Transfercom will provide notification of the proposed Scheme through advertisements in: the London, Edinburgh and Belfast Gazettes; the Times and the Financial Times.

10.5. It will ultimately be for the Court to decide what notifications are required. This will be decided at a court hearing after this Report is finalised and will be subject to any amendments required by the Court. It is possible, therefore, that the actual approach to policyholder notification may differ in some respects from that proposed and outlined above.

10.6. When thinking through the proposed approach to notifications, I have considered a number of factors, including whether the policyholders in either SJNKI or Transfercom are likely to be interested in being informed of the proposed Scheme. In this context, I believe that the approach to policyholder notifications needs to consider the likelihood of a policyholder having a claim, whether the policyholder's policy is transferring and the impact of the Scheme on security. These issues need to be weighed-up against the risk of policyholder notifications causing confusion or annoyance in relation to an issue that policyholders may consider to be insignificant. The practicability of notifying policyholders also needs to be taken into account.

10.7. ***I am satisfied that the proposed approach to communication with policyholders is not unreasonable***.

The Effect of the Scheme on the Reinsurance Asset

10.8. No outwards reinsurance contracts are to be transferred under the Scheme. Therefore, I have not considered this matter further.

Policyholders located outside the EEA

10.9. Certain policies comprised in the Relocated Business reinsure policyholders who are located outside the EEA, for example in the United States. Such policies are typically governed by the law of the location of the policyholder, for example the law of a US state, under which it may not be clear how a transfer pursuant to Part VII of FSMA is to be treated. I have considered whether from the point of view of such policyholders, the Scheme is likely to make it any more difficult to bring a claim against Transfercom than it would be to do so against SJNKI should the Scheme not go ahead. I believe this would only be an issue if Transfercom were to assert that the Scheme was not effective in such jurisdiction. As this would be in breach of the terms of the Court's order approving the Scheme I do not consider this to be a realistic scenario. I therefore consider that there is no real risk of the Scheme making it more difficult for a non-EEA policyholder to bring a claim under a transferring policy.

10.10. I have considered whether the fact that policies included in the Scheme are governed by the law of a non-EEA jurisdiction would prevent the Court from sanctioning the Scheme. I have seen advice from the lawyers to SJNKI (in relation to the Scheme) that:

> *The English Court has jurisdiction under section 105 of FSMA to approve the transfer of all the business, since all the business is carried on in the UK.*
>
> *On the question of whether the Court will exercise its discretion to make an order approving the Scheme:*
>
> *In a previous Part VII transfer from Sompo in 2007, there was also a significant number of non-EEA policyholders. The Court asked Sompo whether if it made the order requested, it would have any effect as a Court will not "make an order in vain" (i.e. having no effect).*
>
> *To answer that question Sompo produced evidence that a number of its policies were English law governed. On that basis the Court was able to conclude that its order would have some effect, at least with respect to those English law policies, without needing to determine whether its order would be recognised under other laws.*
>
> *In subsequent Part VII transfers by overseas insurers, the Court has followed the approach taken in the 2007 Sompo case and approved the Part VII transfer on the basis that a proportion of the transferring policies were governed by a law of the UK.*
>
> *In the present case there is a proportion of policies that are governed by a law of the UK. UK laws will certainly recognise the Court's order, and so the Court's order will have some effect.*
>
> *Therefore, the lawyers to SJNKI (in relation to the Scheme) see no reason why the Court would refuse to make the order sought on the grounds that a large proportion of the policies are not subject to English law.*

10.11. The advice from the lawyers to SJNKI (in relation to the Scheme) as summarised in paragraph 10.10 above, is understandable and consistent with my expectations. As such I consider it reasonable to rely on this advice in forming my opinion.

Assets and Liabilities of SJNKI and Transfercom

10.12. As at the Effective Date, the unpaid losses and ALAE (gross and net of reinsurance) of SJNKI to be transferred under the proposed Scheme to Transfercom are projected (by Transfercom) to be circa $50 million. In addition unallocated loss adjustment expenses are expected to be circa $4 million.

10.13. The assets that will be transferred from SJNKI to Transfercom will consist solely of a cash payment (which will fund the reinsurance premium payable to NICO under the NICO Agreement), and no outwards reinsurance or any other assets are to be transferred. The cash payment represents less than 0.5% of the total assets of SJNKI, i.e. the assets of SJNKI are effectively unchanged on both the pre- and post-Scheme position.

10.14. ***In my view the type and nature of the assets associated with the Transferring Business does not generate any material additional risk to the security of the policyholders of Transfercom, including the policyholders of the Transferring Business, or the remaining policyholders of SJNKI.***

Operational Plans and Changes in Assets and Liabilities up to the Effective Date

10.15. I expect that the current activities of SJNKI will continue between 31 March 2015 and the Effective Date (and, as appropriate, after the Effective Date). SJNKI will continue to write new and renewal business and the company will continue to settle claims and reassess reserves in the light of experience. I do not consider that any material additional risk to any group of affected policyholders will emerge as a result of the continuation of normal business.

10.16. Likewise, I expect that the current activities of Transfercom will continue between 31 December 2014 and the Effective Date (and, as appropriate, after the Effective Date). Transfercom will continue to settle claims and reassess reserves in the light of experience. I do not consider that any material additional risk to any group of affected policyholders will emerge as a result of the continuation of normal business.

10.17. Further to considering the continuation of normal business, I have discussed separately with Transfercom and SJNKI the possibility of management actions that could affect the financial position of Transfercom and SJNKI (such as corporate restructuring or significant changes in new business strategy or operational plans). I have been informed that the Berkshire Hathaway Group is considering consolidating some of the run-off portfolios it administers in London, including those of Transfercom, although, at the time of writing, it had no firm plans in place to do so. Were any such consolidation to take place, this would likely require a further insurance business transfer under Section 105 of FSMA and, as such, the proposals would need to be opined upon by an independent expert and sanctioned by the Court. I have not been informed of any other planned activities that would have a material effect on the security of its policyholders, either for those that were policyholders as at 31 December 2014 or those that have become policyholders since then up to the Effective Date.

10.18. I believe that it is unlikely that any events occurring between 31 December 2014 (or for SJNKI, 31 March 2015) and the Effective Date would affect any conclusion that I reach based on my review as at 31 December 2014 (or for SJNKI, 31 March 2015).

10.19. A short time before the final Court hearing, I will consider the extent to which the operational plans of Transfercom and/or SJNKI have altered (relative to the position at the date of this Report) and the actual changes in assets and liabilities (relative to the position as at 31 December 2014, or for SJNKI, 31 March 2015) and hence whether there have been any changes (including those associated with current economic conditions) that would affect my overall opinion, and will report on these as part of my supplementary/update report (see paragraph 1.28 above).

Solvency II

10.20. As described in paragraphs 2.31 to 2.36 above, the regulatory solvency reporting requirements for EU insurers and reinsurers will undergo a major overhaul with effect from 1 January 2016.

10.21. As the Scheme may become effective after the Solvency II regime comes into force (i.e. on 1 January 2016), both the UK Branch and Transfercom may be required to comply with Solvency II requirements.

10.22. I am informed that SJNKI and Transfercom are each progressing with their preparation for Solvency II. Transfercom and SJNKI currently plan to both be in a position to implement requirements for Solvency II compliance by 1 January 2016.

THE UK BRANCH (OF SJNKI)

10.23. The governance structure of the UK Branch is presently operated through the UK Branch manager who is responsible for the UK Branch business, and reports directly to SJNKI's head office in Tokyo.

10.24. SJNKI's current risk management strategy in respect of the UK Branch is to continue the orderly run-off of the UK Branch business, including the prompt payment of any valid claims. In the event that additional funds were necessary for solvency purposes (be it Solvency I or Solvency II) or asset localisation purposes, these would be requested by the UK Branch manager and provided by SJNKI's head office.

10.25. SJNKI has a Solvency II project plan for the UK Branch that envisages the requirements of Pillars 1 and 2 being implemented by 1 January 2016. The requirements of Pillar 3 (disclosure and reporting of risks and capital levels) are presently scheduled to be implemented by 1 June 2016 (in line with the PRA's expectation that Tier 4/5 firms will submit such Pillar 3 reporting by that date).

10.26. The Solvency II project plan within SJNKI in respect of the UK Branch is structured around the three pillars of Solvency II broadly as follows:

- Pillar 1 (quantitative) requirements: SJNKI intends to use the standard formula to calculate the SCR of the UK Branch. SJNKI will prepare its SCR calculations with the assistance of external consultants. I have reviewed the UK Branch's assessment of the appropriateness of the standard formula. The assessment considers the methodology, calibration and the quantifiable risks covered by the standard formula. Based on my understanding and knowledge of the assumptions underlying the standard formula, I believe that the UK Branch's assessment that the standard formula is appropriate and proportionate for use by the branch to be not unreasonable;
- Pillar 2 requirements: the UK Branch's business is small and therefore, based on the principle of proportionally, SJNKI believe a lighter system of governance and risk management is appropriate (building on those presently in place as outlined respectively in paragraphs 10.23 and 10.24 above) than would be the case if new business, or material run-off liabilities, were being managed by the UK Branch. Further, SJNKI plans to build and implement (in consultation with its external consultants) an ORSA process for the UK Branch by 31 October 2015; and
- Pillar 3 reporting requirements: SJNKI anticipates that it will be required to meet the reporting needs in respect of the UK Branch, and expects to be able to meet these as outlined in paragraph 10.25 above.

10.27. While I have not reviewed these plans, or the UK Branch's progress, the wider descriptions provided to me by the management of the UK Branch indicates that they are actively preparing for the new regulatory regime, including having a plan, governance process and outside assistance in place to support its preparations for this major regulatory change. I have therefore formed the view that the UK Branch's progress is satisfactory, Nonetheless, I intend to revisit the preparedness of the UK Branch in relation to Solvency II implementation and report my findings in my Supplementary Report to the Court (see paragraph 1.28 above).

TRANSFERCOM

10.28. Resolute has advised me that they have a Solvency II committee that serves Berkshire Hathaway's UK operations. It meets regularly and updates individual company boards (including that of Transfercom). Progress is monitored against a central Solvency II plan. I also note that Transfercom's Finance Director, Risk Officer, and Actuary are all members of the Resolute Solvency II project team.

10.29. Resolute has further advised me that it is considerably advanced on its project for the implementation of Solvency II for Berkshire Hathaway International Insurance Limited (the live company in Berkshire Hathaway's UK operations), and the knowledge gained on this development is being used in the implementation for Transfercom.

10.30. The Solvency II project within Transfercom is managed around the three pillars of Solvency II broadly as follows:

- Pillar 1 (quantitative) requirements: Transfercom intends to use the standard formula to calculate the SCR of the company. Transfercom will prepare its SCR calculations using its internal resources, and has run several iterations of the standard formula and assessed likely capital requirements under Solvency II. An assessment of appropriateness of standard formula has been developed and Resolute/Transfercom has concluded that this is appropriate for Transfercom. The Solvency II balance sheets are being redeveloped on a best estimate basis for Transfercom and it is anticipated by the company that this is readily achievable. I have reviewed Transfercom's assessment of the appropriateness of the standard formula. The assessment considers the assumptions relating to diversification effects, correlation, the quantifiable risks covered by the standard formula, and how the calibration assumptions have been made. Based on my understanding and knowledge of the assumptions underlying the standard formula, I believe that Transfercom's assessment that the standard formula is appropriate and proportionate for use by the company to be reasonable. I also consider this to be the case post-Scheme, as the largest capital charge continues to be that arising from counterparty risk (associated with the reinsurance provided by NICO);

- Pillar 2 (governance) requirements: Based on discussions with relevant personnel within Transfercom (and review of relevant materials), the Pillar 2 qualitative items (risk and governance policies) appear to be progressing satisfactorily. During 2014, Resolute/Transfercom prepared and submitted their ORSA (based on its 31 December 2013 balance sheet) to the PRA. Resolute/Transfercom have continued to develop their ORSA in 2015 and a second version was submitted to the PRA in September 2015, addressing the points raised by the PRA in relation to Transfercom's 2014 ORSA submission. Further, Resolute/Transfercom continue to develop and improve the risk management system which is operational and this has the ability to be extended in order to react to changing circumstances; and
- Pillar 3 reporting requirements: Resolute has selected the software platform for producing the QRTs for Berkshire Hathaway's UK operations (including Transfercom). Transfercom is presently using a test version of the system and has completed a dry run of the QRTs with no reported issues or problems. Resolute/Transfercom do not anticipate any problems in meeting the requirements of Pillar 3.

10.31. While I have not reviewed these plans, the progress of Transfercom as described to me by Resolute, in implementing the requirements of Solvency II indicates that they are actively preparing for the new regulatory regime, including having a plan and governance process in place to support its preparations for this major regulatory change. I have therefore formed the view that Transfercom's progress is satisfactory. Nonetheless, I will revisit the preparedness of Transfercom in relation to Solvency II implementation and report on my findings in my Supplementary Report to the Court (see paragraph 1.28 above).

Conclusion

10.32. ***I am satisfied that SJNKI and Transfercom are both presently preparing to meet their respective requirements of Solvency II on its introduction. I do not believe the Scheme will impact in a materially adverse manner on the separate approaches of SJNKI and Transfercom to meeting and complying with their respective Solvency II requirements.***

Tax and Cost of the Scheme

10.33. I am informed by Transfercom that the proposed Scheme is not expected to have tax implications that would affect the existing policyholders of Transfercom or the policyholders of the Transferring Business under the Scheme. For the policyholders of SJNKI remaining post-transfer there is not expected to be any tax implications since, all other things being equal, the Scheme has an essentially neutral impact on the net financial position of SJNKI.

10.34. The external costs of the transfer will be met by SJNKI.

11. CONCLUSIONS

11.1. In summary, in my opinion, provided the proposed Scheme operates as intended, and I have no grounds for believing it will not do so:

- The security of benefits of the transferring policyholders of SJNKI, the non-transferring policyholders of SJNKI and the policyholders of Transfercom will not be materially adversely affected by the implementation of the Scheme on the Effective Date;
- The Scheme will not have an impact on the service experienced by the transferring policyholders of SJNKI, the non-transferring policyholders of SJNKI and the policyholders of Transfercom.

11.2. In reaching this opinion I have applied the following principles (as set out in the Transformations TAS):

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

Gary Wells 28 October 2015

Fellow of the Institute and Faculty of Actuaries

APPENDIX 1. DEFINED TERMS

Admissible Assets	Assets valued in accordance with applicable regulations, which can be taken into account for the purposes of demonstrating that a general insurance company meets its solvency requirements.
Capital Charge	In relation to a risk identified by a firm to which it is exposed, e.g. market risk, the amount of capital calculated to mitigate appropriately that risk that could otherwise cause the firm to be unable to meet its liabilities as they fall due.
Correlation	Correlation (in the context of this Report) is a number that describes the statistical relationship between two variables (e.g. equity prices and interest rates).
Enhanced Capital Requirement ("ECR")	A more risk sensitive capital requirement (than the MCR) for UK insurers as measured by the PRA.
Equalisation Provisions	An equalisation reserve is a reserve built-up (generally from profitable years) as a cushion against periods with worse than average claims experience.
PRA Returns	Accounts, balance sheets, abstracts and statements relating to the business of an insurance company required under PRA rules to be submitted periodically to the PRA.
Individual Capital Assessment ("ICA")	An insurance company's own assessment of the capital it needs for regulatory purposes in order to mitigate appropriately the risks to which it is exposed and that could otherwise cause it to be unable to meet its liabilities as they fall due.
Individual Capital Guidance ("ICG")	The PRA's assessment of the minimum level of capital that it would expect an insurance company to hold based on its view of the insurance company's ICA and risk management framework.
Minimum Capital Requirement ("MCR")	Required minimum level of capital under Solvency I rules. See Appendix 5 for further details.
Reinsurance	An arrangement with another insurer whereby risks are shared (or passed on).
Solvency I	The system for establishing minimum capital requirements for EU insurers under relevant EU Directives presently in force.
Technical Provisions	Liabilities determined for regulatory purposes. In particular, the provisions for the ultimate costs of settling all claims arising from events which have occurred up to the balance sheet date, including provision for claims incurred but not yet reported, less any amounts paid in respect of these claims; plus the provisions for future claims arising on unexpired periods of risk.
Underwriting Year	The year to which a claim is allocated based on the date the policy is written.

APPENDIX 2. LIST OF PREVIOUS TRANSFERS FOR WHICH I HAVE ACTED AS THE INDEPENDENT EXPERT OR EQUIVALENT

1997: Transfer of the PHI business from Norwich Union Limited to Norwich Union Life & Pensions Limited

1997: Transfer of business from Security Assurance Limited to Norwich Union Life & Pensions Limited

1999: Transfer of the business of London & Edinburgh Life to Norwich Union Life & Pensions Limited

2004: Transfer of the business of the Continental Reinsurance Company (UK) Limited to Continental Management Services Limited

2005: Transfer of the business of the UK branch of the Continental Insurance Company to Continental Management Services Limited

2006: Transfer of the IGI portfolio of CX Reinsurance Company Limited to CNA Insurance Company Limited

2008: Transfer of the Irish branch business of Royal & Sun Alliance Insurance plc to Europa General Insurance Company Limited

2009: Transfer of business from Arran Insurance Company Limited to Chevanstell Limited

2010: Transfer of business from Euler Hermes Guarantee plc to Euler Hermes UK plc

2011: Transfer of business from Euler Hermes UK plc to Euler Hermes Credit Insurance Belgium SA (NV)

2011: Transfers of business from PA(GI) Ltd to Royal & Sun Alliance Insurance plc and Marine Insurance Company Limited

2011: Rationalisation of 22 UK regulated entities of Royal & Sun Alliance Insurance plc to 5 UK companies via 3 Part VII transfer schemes (effective 1 January 2012)

2013: Transfer of certain business of the Italian branch of Sompo Japan Insurance Company of Europe Limited to Berkshire Hathaway International Insurance Limited.

2013: Transfer of the European branch business of Mitsui Sumitomo Insurance Company (Europe) Limited to MSIG Insurance Europe AG.

2013: Transfer of the business of Chevanstell Limited to R&Q Insurance (Malta) Limited.

2015: Transfer of the business of Nipponkoa Insurance Company (Europe) Limited to Sompo Japan Nipponkoa Insurance Company of Europe Limited.

APPENDIX 3. TERMS OF REFERENCE

The Independent Expert's Report will consider the terms of the Scheme generally and the effect which the Scheme will have on the holders of insurance policies issued by SJNKI and Transfercom. In particular, the Independent Expert will consider the following specific matters:

- The likely scope for deteriorations in each of the Companies' claims reserves (i.e. the likelihood and extent to which each of the Companies' reserves may prove inadequate);
- The impact of the Scheme on the security/financial strength of the different groups of policyholders of the Companies involved in the Scheme;
- The impact of the Scheme on the levels of service provided to the different groups of policyholders of the Companies involved in the Scheme;
- The existing and proposed agreements (if any) between the Companies and their reinsurers;
- Guarantees and/or agreements (if any) between the Companies;
- Guarantees and/or agreements (if any) between each of the Companies and their respective parent company;
- Transactions (including other portfolio transfers and commutations) that impact upon the Companies;
- The terms and conditions (if any) expected to be imposed by the Scheme to be presented to the Court.

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

The Independent Expert will not provide any advice with respect to the merits of the proposed Scheme.

APPENDIX 4. KEY SOURCES OF DATA

In writing this report, I relied upon the accuracy of certain documents and spreadsheets provided by SJNKI and Transfercom. These included, but were not limited to the following:

Transfercom

- The 2014 financial statements.
- The 2014 PRA returns.
- Standard formula and ICA calculations as at 31 December 2014.
- Transfercom's ECR spreadsheet as at 31 December 2014.
- Letters from the PRA to Transfercom dated 26 August 2014, 17 September 2014 and1 October 2014 relating to Periodic Summary Meetings.
- A document describing Transfercom's reinsurance programme, plus outline details of the proposed NICO Agreement.
- Minutes and associated papers from the Transfercom reserving and other committee meetings during 2014.
- An internal actuarial review as at 30 June 2013 and a note describing Transfercom's reserve roll-forward from 31 May 2013 to end-November 2014.
- An ORSA report (based on the balance sheet as at 31 December 2014).
- A spreadsheet showing business plan projections for Transfercom over the period 2015 to 2017.
- Details of investments as at 31 December 2014.
- An e-mail describing Resolute's Solvency II implementation plan for the Berkshire Hathaway's European operations, including Transfercom.

NICO

- NICO NAIC Annual Statement for the year ended 31 December 2014.
- SAO and AOS for NICO as at 31 December 2014.

SJNKI

- The 2015 financial statements (as at 31 March 2015 and 30 June 2015).
- The 31 March 2015 PRA returns for the UK branch.
- Outline details of the relocated business (and the historic UK branch business).
- An external ORSA report for the UK branch (as at 31 December 2013).
- An external reserve review of the relocated business as at 30 September 2013.
- Financial strength ratings from Standard and Poor's (and other major rating agencies) for SJNKI.
- A document giving the scheme of operations for the UK branch.
- A document giving the business plan for the UK branch over the next 3 years.
- A spreadsheet detailing the Solvency II implementation plan for the UK Branch.

Documents relating to the Scheme and NICO Agreement

- A document summarising the proposed Scheme.
- Framework Agreement between SJNKI, NICO and Transfercom.
- Payment Obligation document between SJNKI, NICO and Transfercom.
- Run off management agreement between SJNKI, Resolute Management Limited and NICO.

APPENDIX 5. MINIMUM CAPITAL REQUIREMENT

UK

A5.1 In the UK the process of setting minimum solvency margins changed with effect from 2005. Nonetheless, UK general insurers continue to have to meet statutory requirements based on EU Directives and, for the time being, provide their risk-based enhanced capital requirement (ECR) calculation to the PRA in private. In addition, all UK general insurers are required to make their own individual capital assessment (ICA) of their own capital needs which will be used by the PRA when giving individual capital guidance.

A5.2 The minimum capital requirement (MCR) based on EU Directives is outlined below.

A5.3 The MCR is the greater of a premium measure; a claims incurred measure and a prior year MCR measure, subject to a minimum amount of currently €3.7 million. The premium measure (A) is based on gross adjusted premiums (P) as follows:

- If $P \leq$ €57.5 million then $A_1 = P \times 18\%$, $A_2 = 0$
- If $P >$ €57.5 million then $A_1 =$ €10.4 million, $A_2 = (P -$ €57.5 million$) \times 16\%$
- $A = A_1 + A_2$

A5.4 The loss provision measure (B) for other than health insurance is based on gross adjusted claims (C) as follows:

- If $C \leq$ €40.3 million then $B_1 = C \times 26\%$, $B_2 = 0$
- If $C >$ €40.3 million then $B_1 =$ €10.5 million, $B_2 = (C -$ €40.3 million$) \times 23\%$
- $B = B_1 + B_2$

A5.5 A credit for reinsurance factor (r) is then determined as the ratio of net incurred claims over the 3 year period (to the valuation date) to gross incurred claims ratio over the same 3 year period. If $r < 0.5$ then r is set to 0.5.

A5.6 Prior year amount (M) is based on the prior year MCR and changes in outstanding claims:

- Where net outstanding claims are greater than zero as at the end of the current and previous financial years:

  M = Prior year MCR × min(1, net outstanding claims as at the end of the current financial year divided by the net outstanding claims as at the end of the previous financial year);

- Where net outstanding claims are zero as at the end of the current and previous financial years:

  M = Prior year MCR × min(1, gross outstanding claims as at the end of the current financial year divided by the gross outstanding claims as at the end of the previous financial year);

- Where gross outstanding claims are zero as at the end of the current and previous financial year:

  M = MCR as at the end of the previous financial year.

A5.7 Minimum solvency margin = max {max (A,B) × r, M, €3.7 million}

A5.8 The monetary amounts stated above are those applicable as at 31 December 2014 and subject to an annual increase by the percentage change in the European index of consumer prices.

USA

A5.9 In the US the minimum solvency margin is calculated using a risk-based capital (RBC) methodology based on the various risks of an insurer. The RBC methodology defines six categories of risk, labelled R_0 to R_5 as follows:

- R_0 – asset risk in subsidiary insurance companies
- R_1 – asset risk – fixed income
- R_2 – asset risk – equity
- R_3 – asset risk – credit
- R_4 – underwriting risk – reserves
- R_5 – underwriting risk – net written premium

A5.10 The quantification of R_0 to R_5 is determined by applying a series of pre-determined percentages to specific items provided in the annual statement, filed by the entity to the NAIC.

A5.11 The RBC amount (for regulatory purposes) is determined as the sum of R_0 to R_5 together with a covariance adjustment (as it is unlikely that all types of catastrophic events will occur simultaneously). The authorised control level RBC (c.f. the minimum solvency margin) is set at 50% of the calculated RBC amount.

Japan

A5.12 In Japan the total amount of "Risks" is calculated using a risk-based capital (RBC) methodology based on the various risks of an insurer. The RBC methodology defines six categories of risk, labelled R_1 to R_6 as follows:

- R_1 – underwriting risk
- R_2 – underwriting risk for accident and sickness business
- R_3 – guaranteed interest rate risk
- R_4 – investment risk
- R_5 – business management risk
- R_6 – catastrophe risk

A5.13 The quantification of R_1 to R_6 is determined by applying a different formulae to specific items provided in the annual statement, filed by the entity to the JFSA.

A5.14 The RBC amount (for regulatory purposes) is determined as:

$$\sqrt{(R_1^2 + R_2^2)} + \sqrt{(R_3^2 + R_4^2)} + R_5 + R_6$$

A5.15 This is essentially the sum of R_1 to R_6 together with a covariance adjustment for underwriting and investment risks (as it is unlikely that all types of catastrophic underwriting events will occur simultaneously, and likewise it is unlikely that all types of catastrophic investment and interest rate events will occur simultaneously). The authorised control level RBC (c.f. the minimum solvency margin) is set at 50% of the calculated RBC amount

APPENDIX 6. NAIC ACTUARIAL OPINION INSTRUCTIONS

The NAIC requires all property and casualty insurance companies to have an actuary provide an opinion on the company's reserves on an annual basis. The following is the NAIC's instructions for actuaries providing such statements of actuarial opinion in 2014. Note that this document is marked-up to show changes to the instructions since the 2010 version.

Property and Casualty Practice Note
2014

Appendix 1a

2014 STATEMENT OF ACTUARIAL OPINION INSTRUCTIONS

ACTUARIAL OPINION

1. There is to be included or attached to Page 1 of the Annual Statement, the statement of a Qualified Actuary, entitled "Statement of Actuarial Opinion," setting forth his or her opinion relating to reserves specified in the SCOPE paragraph. The Actuarial Opinion, both the narrative and required Exhibits, shall be in the format of and contain the information required by this section of the *Annual Statement Instructions – Property and Casualty*.

   The Qualified Actuary must be appointed by the Board of Directors, or its equivalent, or by a committee of the Board, by December 31 of the calendar year for which the opinion is rendered. Upon initial appointment (or "retention"), the company shall notify the domiciliary commissioner within five business days of the appointment with the following information:

   a. Name and title (and, in the case of a consulting actuary, the name of the firm).
   b. Manner of appointment of the Appointed Actuary (e.g., who made the appointment and when).
   c. A statement that the person meets the requirements of a Qualified Actuary.

   Once this notification is furnished, no further notice is required with respect to this person unless the actuary ceases to be appointed or retained or ceases to meet the requirements of a Qualified Actuary.

   If an actuary who was the Appointed Actuary for the immediately preceding filed Actuarial Opinion is replaced by an action of the Board of Directors, the insurer shall within five (5) business days notify the Insurance Department of the state of domicile of this event. The insurer shall also furnish the domiciliary commissioner with a separate letter within ten (10) business days of the above notification stating whether in the twenty four (24) months preceding such event there were any disagreements with the former Appointed Actuary regarding the content of the opinion on matters of the risk of material adverse deviation, required disclosures, scopes, procedure, type of opinion issued, substantive wording of the opinion or data quality. The disagreements required to be reported in response to this paragraph include both those resolved to the former actuary's satisfaction and those not resolved to the former actuary's satisfaction. The letter should include a description of the disagreement and the nature of its resolution (or that it was not resolved). The insurer shall also in writing request such former actuary to furnish a letter addressed to the insurer stating whether the actuary agrees with the statements contained in the insurer's letter and, if not, stating the reasons for which he or she does not agree; and the insurer shall furnish such responsive letter from the former actuary to the domiciliary commissioner together with its own.

   The Appointed Actuary must report to the Board of Directors or the Audit Committee each year on the items within the scope of the Actuarial Opinion. The Actuarial Opinion and the Actuarial Report must be made available to the Board of Directors. The minutes of the Board of Directors should indicate that the Appointed Actuary has presented such information to the Board of Directors or the Audit Committee and that the Actuarial Opinion and the Actuarial Report were made available. A separate Actuarial Opinion is required for each company filing an Annual Statement. When there is an affiliated company pooling arrangement, one Actuarial Report for the aggregate pool is sufficient, but there must be addendums to the Actuarial Report to cover non-pooled reserves for individual companies.

   The Statement of Actuarial Opinion and the supporting Actuarial Report and Workpapers, should be consistent with the appropriate Actuarial Standards of Practice (ASOPs), including, but not limited to, ASOP No. 23, ASOP No. 36, ASOP No. 41 and ASOP No. 43, as promulgated by the Actuarial Standards Board, and Statements of Principles adopted by the Casualty Actuarial Society.

Property and Casualty Practice Note 2014

1A. Definitions

"Qualified Actuary" is a person who meets the basic education, experience and continuing education requirements of the Specific Qualification Standard for Statements of Actuarial Opinion, NAIC Property and Casualty Annual Statement, as set forth in the *Qualification Standards for Actuaries Issuing Statements of Actuarial Opinion in the United States*, promulgated by the American Academy of Actuaries, and is either:

(i) A member in good standing of the Casualty Actuarial Society; or

(ii) A member in good standing of the American Academy of Actuaries who has been approved as qualified for signing casualty loss reserve opinions by the Casualty Practice Council of the American Academy of Actuaries.

"Insurer" means an insurer or reinsurer authorized to write property and/or casualty insurance under the laws of any state and who files on the Property and Casualty Blank.

"Actuarial Report" means a document or other presentation, prepared as a formal means of conveying to the state regulatory authority and the Board of Directors, or its equivalent, the actuary's professional conclusions and recommendations, of recording and communicating the methods and procedures, of assuring that the parties addressed are aware of the significance of the actuary's opinion or findings and that documents the analysis underlying the opinion. The required content of the report is further described in paragraph 7. (Note that the inclusion of the Board of Directors as part of the intended audience for the Actuarial Report does not change the content of the Actuarial Report as described in paragraph 7. The Appointed Actuary should present findings to the Board of Directors in a manner deemed suitable for such audience.)

"Long Duration Contracts" refers to contracts (excluding financial guaranty contracts, mortgage guaranty contracts and surety contracts) that fulfill both of the following conditions: (1) the contract term is greater than or equal to thirteen months; and (2) the insurer can neither cancel nor increase the premium during the contract term.

1B. Exemptions

An insurer who intends to file for one of the exemptions under this Section must submit a letter of intent to its domiciliary commissioner no later than December 1 of the calendar year for which the exemption is to be claimed. The commissioner may deny the exemption prior to December 31 of the same year if he or she deems the exemption inappropriate.

A copy of the approved exemption must be filed with the Annual Statement in all jurisdictions in which the company is authorized.

Exemption for Small Companies

An insurer that has less than $1,000,000 total direct plus assumed written premiums during a calendar year, and less than $1,000,000 total direct plus assumed loss and loss adjustment expense reserves at year-end, in lieu of the Actuarial Opinion required for the calendar year, may submit an affidavit under oath of an officer of the insurer that specifies the amounts of direct plus assumed written premiums and direct plus assumed loss and loss adjustment reserves.

Exemption for Insurers under Supervision or Conservatorship

Unless ordered by the domiciliary commissioner, an insurer that is under supervision or conservatorship pursuant to statutory provision is exempt from the filing requirements contained herein.

Exemption for Nature of Business

Property and Casualty Practice Note
2014

An insurer otherwise subject to the requirement and not eligible for an exemption as enumerated above may apply to its domiciliary commissioner for an exemption based on the nature of business written.

Financial Hardship Exemption

An insurer otherwise subject to this requirement and not eligible for an exemption as enumerated above may apply to the commissioner for a financial hardship exemption. Financial hardship is presumed to exist if the projected reasonable cost of the Actuarial Opinion would exceed the lesser of:

(i) One percent (1%) of the insurer's capital and surplus reflected in the insurer's latest quarterly statement for the calendar year for that the exemption is sought; or

(ii) Three percent (3%) of the insurer's direct plus assumed premiums written during the calendar year for which the exemption is sought as projected from the insurer's latest quarterly statements filed with its domiciliary commissioner.

1C. Reporting Requirements for Pooled Companies

For each company in the pool, the actuary shall include a description of the pool, identification of the lead company and a listing of all companies in the pool, their state of domicile and their respective pooling percentages.

Exhibits A and B for each company in the pool should represent the company's share of the pool and should reconcile to the financial statement for that company.

The following paragraph applies to companies that have a 0% share of the pool (no reported Schedule P data). The company shall submit an Opinion that reads similar to that provided for the lead company. For example, the IRIS ratio and risk of material adverse deviation discussions, and other relevant comments shall relate to the risks of the lead company in the pool. The responses to question 5 should be $0 and to question 6 should be "not applicable." Exhibits A and Exhibits B of the lead company should be attached as an addendum to the PDF file and/or hard copy being filed (but would not be reported by the 0% companies in their data capture).

2. The Statement of Actuarial Opinion must consist of an IDENTIFICATION paragraph identifying the Appointed Actuary; a SCOPE paragraph identifying the subjects on which an opinion is to be expressed and describing the scope of the actuary's work; an OPINION paragraph expressing his or her opinion with respect to such subjects; and one or more additional RELEVANT COMMENTS paragraphs. These four Sections must be clearly designated.

3. The IDENTIFICATION paragraph should specifically indicate the Appointed Actuary's relationship to the company, qualifications for acting as Appointed Actuary, date of appointment, and specify that the appointment was made by the Board of Directors, or its equivalent, or by a committee of the Board.

A member of the American Academy of Actuaries qualifying under paragraph 1A(ii) must attach, each year, a copy of the approval letter from the Academy.

These Instructions require that a "Qualified Actuary" prepare the Opinion. Nevertheless, if a person who does not meet the definition of a "qualified actuary" has been approved by the insurance regulatory official of the domiciliary state, the company must attach, each year, a letter from that official stating that the individual meets the state's requirements for rendering the Opinion.

4. The SCOPE paragraph should contain a sentence such as the following:

"I have examined the actuarial assumptions and methods used in determining reserves listed in Exhibit A, as shown in the Annual Statement of the Company as prepared for filing with state regulatory officials, as of December 31, 20__, and reviewed information provided to me through XXX date."

51

Appendix 1a
2014 Statement of Actuarial Opinion Instructions

Property and Casualty Practice Note
2014

Exhibit A should list those items and amounts with respect to which the Appointed Actuary is expressing an opinion.

The Appointed Actuary should state that the items in the SCOPE, on which he or she is expressing an opinion, reflect the Loss Reserve Disclosure items (8 through 13) in Exhibit B.

The SCOPE paragraph should include a paragraph such as the following regarding the data used by the Appointed Actuary in forming the opinion:

"In forming my opinion on the loss and loss adjustment expense reserves, I relied upon data prepared by ___________ (name, affiliation and relation to company). I evaluated that data for reasonableness and consistency. I also reconciled that data to Schedule P, Part 1 of the company's current Annual Statement. In other respects, my examination included such review of the actuarial assumptions and methods used and such tests of the calculations as I considered necessary."

5. The OPINION paragraph should include a sentence that at least covers the points listed in the following illustration: "In my opinion, the amounts carried in Exhibit A on account of the items identified:

   A. Meet the requirements of the insurance laws of (state of domicile).

   B. Are computed in accordance with accepted actuarial standards and principles.

   C. Make a reasonable provision for all unpaid loss and loss adjustment expense obligations of the Company under the terms of its contracts and agreements."

If the Scope includes material Unearned Premium Reserves for Long Duration Contracts or Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion, the Opinion should cover the following illustration:

   D. Make a reasonable provision for the unearned premium reserves for long duration contracts and/or <insert Other Loss Reserve item on which the Appointed Actuary is expressing an Opinion> of the Company under the terms of its contracts and agreements.

If there is any aggregation or combination of items in Exhibit A, the opinion language should clearly identify the combined items.

Insurance laws and regulations shall at all times take precedence over the actuarial standards and principles.

If the actuary has made use of the work of another actuary (such as for pools and associations, for a subsidiary or for special lines of business) for a material portion of the reserves, the other actuary must be identified by name and affiliation within the OPINION paragraph.

A Statement of Actuarial Opinion should be made in accordance with one of the following sections (a through e). The actuary must explicitly identify in Exhibit B which type applies.

   a. Determination of Reasonable Provision. When the carried reserve amount is within the actuary's range of reasonable reserve estimates, the actuary should issue a Statement of Actuarial Opinion that the carried reserve amount makes a reasonable provision for the liabilities associated with the specified reserves.

   b. Determination of Deficient or Inadequate Provision. When the carried reserve amount is less than the minimum amount that the actuary believes is reasonable, the actuary should issue a Statement of Actuarial Opinion that the carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the actuary should disclose the minimum amount that the actuary believes is reasonable.

Property and Casualty Practice Note
2014

c. Determination of Redundant or Excessive Provision. When the carried reserve amount is greater than the maximum amount that the actuary believes is reasonable, the actuary should issue a Statement of Actuarial Opinion that the carried reserve amount does not make a reasonable provision for the liabilities associated with the specified reserves. In addition, the actuary should disclose the maximum amount that the actuary believes is reasonable.

d. Qualified Opinion. When, in the actuary's opinion, the reserves for a certain item or items are in question because they cannot be reasonably estimated or the actuary is unable to render an opinion on those items, the actuary should issue a qualified Statement of Actuarial Opinion. The actuary should disclose the item (or items) to which the qualification relates, the reason(s) for the qualification and the amounts for such item(s), if disclosed by the Company. Such a qualified opinion should state whether the carried reserve amount makes a reasonable provision for the liabilities associated with the specified reserves, *except for* the item (or items) to which the qualification relates. The actuary is not required to issue a qualified opinion if the actuary reasonably believes that the item (or items) in question are not likely to be material.

e. No Opinion. The actuary's ability to give an opinion is dependent upon data, analyses, assumptions, and related information that are sufficient to support a conclusion. If the actuary cannot reach a conclusion due to deficiencies or limitations in the data, analyses, assumptions, or related information, then the actuary may issue a statement of no opinion. A statement of no opinion should include a description of the reasons why no opinion could be given.

6. The Appointed Actuary must provide RELEVANT COMMENT paragraphs to address the following topics of regulatory importance.

   a. Risk of Material Adverse Deviation

   The Appointed Actuary must provide specific RELEVANT COMMENT paragraphs to address the risk of material adverse deviation. The actuary must identify the materiality standard and the basis for establishing this standard. The materiality standard must also be disclosed in U.S. dollars in Exhibit B: Disclosures. The actuary should include an explanatory paragraph to describe the major factors, combination of factors or particular conditions underlying the risks and uncertainties the actuary considers relevant. The explanatory paragraph should not include general, broad statements about risks and uncertainties due to economic changes, judicial decisions, regulatory actions, political or social forces, etc., nor is the actuary required to include an exhaustive list of all potential sources of risks and uncertainties. The actuary should explicitly state whether or not he or she reasonably believes that there are significant risks and uncertainties that could result in material adverse deviation. This determination is also to be disclosed in Exhibit B.

   b. Other Disclosures in Exhibit B

   RELEVANT COMMENT paragraphs should describe the significance of each of the remaining Disclosure items in Exhibit B. The actuary should address the items individually and in combination when commenting on a material impact.

   c. Reinsurance

   RELEVANT COMMENT paragraphs should address retroactive reinsurance, financial reinsurance and reinsurance collectibility. Before commenting on reinsurance collectibility, the actuary should solicit information from management on any actual collectibility problems, review ratings given to reinsurers by a recognized rating service, and examine Schedule F for the current year for indications of regulatory action or reinsurance recoverable on paid losses over ninety (90) days past due. The comment should also reflect any other information the actuary has received from management or that is publicly available about the capability or willingness of reinsurers to pay claims. The actuary's comments do not imply an opinion on the financial condition of any reinsurer.

53

Appendix 1a
2014 Statement of Actuarial Opinion Instructions

Property and Casualty Practice Note
2014

Retroactive reinsurance refers to agreements referenced in SSAP No. 62R, Property and Casualty Reinsurance of the NAIC *Accounting Practices and Procedures Manual*.

Financial reinsurance refers to contracts referenced in SSAP No. 62R in which credit is not allowed for the ceding insurer because the arrangements do not include a transfer of both timing and underwriting risk that the reinsurer undertakes in fact to indemnify the ceding insurer against loss or liability by reason of the original insurance.

d. IRIS Ratios

If the company reserves will create exceptional values using the NAIC IRIS Tests for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus and Estimated Current Reserve Deficiency to Surplus, the actuary must include RELEVANT COMMENT on the factors that led to the unusual value(s).

e. Methods and Assumptions

If there has been any significant change in the actuarial assumptions and/or methods from those previously employed, that change should be described in a RELEVANT COMMENT paragraph. If the actuary is unable to review the work of the prior Appointed Actuary, then the actuary should disclose this.

7. The Actuarial Opinion must include assurance that an Actuarial Report and underlying actuarial workpapers supporting the Actuarial Opinion will be maintained at the company and available for regulatory examination for seven (7) years. The Actuarial Report contains significant proprietary information. It is expected that the Report be held confidential and is not intended for public inspection. The Report must be available by May 1 of the year following the year-end for which the Opinion was rendered or within two (2) weeks after a request from an individual state commissioner.

The Actuarial Report should be consistent with the documentation and disclosure requirements of ASOP No. 41, Actuarial Communications. The Actuarial Report must contain both narrative and technical components. The narrative component should provide sufficient detail to clearly explain to company management, the Board of Directors, the regulator, or other authority the findings, recommendations and conclusions, as well as their significance. The technical component should provide sufficient documentation and disclosure for another actuary practicing in the same field to evaluate the work. This technical component must show the analysis from the basic data (e.g., loss triangles) to the conclusions.

The Report must also include:

- A description of the Appointed Actuary's relationship to the company, with clear presentation of the Actuary's role in advising the Board and/or management regarding the carried reserves. The Report should identify how and when the Appointed Actuary presents the analysis to the Board and, where applicable, to the officer(s) of the company responsible for determining the carried reserves.

- An exhibit that ties to the Annual Statement and compares the Actuary's conclusions to the carried amounts consistent with the segmentation of exposure or liability groupings used in the analysis. The Actuary's conclusions include the Actuary's point estimate(s), range(s) of reasonable estimates or both.

- An exhibit that reconciles and maps the data used by the Actuary, consistent with the segmentation of exposure or liability groupings used in their analysis, to the Annual Statement Schedule P line of business reporting.

Property and Casualty Practice Note
2014

- An exhibit or appendix showing the change in the Actuary's estimates from the prior Actuarial Report, including extended discussion of factors underlying any material changes. If the actuary is unable to review the work of the prior Appointed Actuary, then the actuary should disclose this.

- Extended comments on trends that indicate the presence or absence of risks and uncertainties that could result in material adverse deviation.

- Extended comments on factors that led to unusual IRIS ratios for One-Year Reserve Development to Surplus, Two-Year Reserve Development to Surplus, or Estimated Current Reserve Deficiency to Surplus, and how these factors were addressed in prior and current analyses.

8. The statement should conclude with the signature of the Appointed Actuary responsible for providing the Actuarial Opinion and the date when the Opinion was rendered. The signature and date should appear in the following format:

____
Signature of actuary
Printed name of actuary
Employer's name
Address of actuary
Telephone number of actuary
Email address of actuary
Date opinion was rendered

9. The insurer required to furnish an Actuarial Opinion shall require its Appointed Actuary to notify its Board of Directors or its audit committee in writing within five (5) business days after any determination by the Appointed Actuary that the Opinion submitted to the domiciliary commissioner was in error as a result of reliance on data or other information (other than assumptions) that, as of the balance sheet date, was factually incorrect. The Opinion shall be considered to be in error if the Opinion would have not been issued or would have been materially altered had the correct data or other information been used. The Opinion shall not be considered to be in error if it would have been materially altered or not issued solely because of data or information concerning events subsequent to the balance sheet date or because actual results differ from those projected.

   Notification shall be required for any such determination made between the issuance of the Opinion and the balance sheet date that the next Opinion will be issued. The notification should include a summary of such findings and an amended Opinion.

   An insurer who is notified pursuant to the preceding paragraphs shall forward a copy of the summary and the amended Opinion to the domiciliary commissioner within five (5) business days of receipt of such and shall provide the Appointed Actuary making the notification with a copy of the summary and amended Opinion being furnished to the domiciliary commissioner. If the Appointed Actuary fails to receive such copy within the five (5) business day period referred to in the previous sentence, the Appointed Actuary shall notify the domiciliary commissioner within the next five (5) business days that the submitted Opinion should no longer be relied upon or such other notification recommended by the actuary's attorney.

   If the Appointed Actuary learns that the data or other information relied upon was factually incorrect, but cannot immediately determine what, if any, changes are needed in the Actuarial Opinion, the actuary and the company should undertake as quickly as is reasonably practical those procedures necessary for the actuary to make the determination discussed above. If the insurer does not provide the necessary data corrections and other support (including financial support) within ten (10) business days, the actuary should proceed with the notification discussed above.

   No Appointed Actuary shall be liable in any manner to any person for any statement made in connection with the above paragraphs if such statement is made in a good faith effort to comply with the above paragraphs.

Property and Casualty Practice Note
2014

10. Data in Exhibits A and B are to be filed in both print and data capture format.

Exhibit A: SCOPE
DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS

Loss and Loss Adjustment Expense Reserves:		Amount
1. Reserve for Unpaid Losses (Liabilities, Surplus and Other Funds page, Col 1, Line 1)	$	________
2. Reserve for Unpaid Loss Adjustment Expenses (Liabilities, Surplus and Other Funds page, Col 1, Line 3)	$	________
3. Reserve for Unpaid Losses – Direct and Assumed (Should equal Schedule P, Part 1, Summary, Totals from Cols. 13 and 15, Line 12 * 1000)	$	________
4. Reserve for Unpaid Loss Adjustment Expenses – Direct and Assumed (Should equal Schedule P, Part 1, Summary, Totals from Cols. 17, 19 and 21, Line 12 * 1000)	$	________
5. The Page 3 write-in item reserve, "Retroactive Reinsurance Reserve Assumed"	$	________
6. Other Loss Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	$	________
Premium Reserves:		
7. Reserve for Direct and Assumed Unearned Premiums for Long Duration Contracts	$	________
8. Reserve for Net Unearned Premiums for Long Duration Contracts	$	________
9. Other Premium Reserve items on which the Appointed Actuary is expressing an Opinion (list separately)	$	________

Property and Casualty Practice Note
2014

Exhibit B: DISCLOSURES
DATA TO BE FILED IN BOTH PRINT AND DATA CAPTURE FORMATS

NOTE: Exhibit B should be completed for Net dollar amounts included in the SCOPE. If an answer would be different for Direct and Assumed amounts, identify and discuss the difference within RELEVANT COMMENTS.

1. Name of the Appointed Actuary		Last _______ First _____ Mid _____
2. The Appointed Actuary's relationship to the company. Enter E or C based upon the following: E if an Employee of the company or group; C if a Consultant		_________
3. The Appointed Actuary has the following designation (indicated by the letter code): F if a Fellow of the Casualty Actuarial Society (FCAS); A if an Associate of the Casualty Actuarial Society (ACAS); M if not a member of the Casualty Actuarial Society, but a Member of the American Academy of Actuaries (MAAA) approved by the Casualty Practice Council, as documented with the attached approval letter.; O for Other		_________
4. Type of Opinion, as identified in the OPINION paragraph. Enter R, I, E, Q, or N based upon the following: R if Reasonable; I if Inadequate or Deficient Provision; E if Excessive or Redundant Provision; Q if Qualified. Use Q when part of the OPINION is Qualified.; N if No Opinion		_________
5. Materiality Standard expressed in U.S. dollars (used to Answer Question #6)	$________	
6. Are there significant risks that could result in Material Adverse Deviation?		Yes [ ] No[ ] Not Applicable [ ]
7. Statutory Surplus (Liabilities, Col 1, Line 37)	$________	
8. Anticipated net salvage and subrogation included as a reduction to loss reserves as reported in Schedule P (should equal Part 1 Summary, Col 23, Line 12 * 1000)	$________	
9. Discount included as a reduction to loss reserves and loss expense reserves as reported in Schedule P		
9.1 Nontabular Discount [Notes, Line 32B23, (Amounts 1, 2, 3 & 4)], Electronic Filing Cols 1, 2, 3, & 4,	$________	
9.2 Tabular Discount [Notes, Line 32A23, (Amounts 1 & 2)], Electronic Filing Col 1 & 2.	$________	

Property and Casualty Practice Note
2014

10. The net reserves for losses and expenses for the company's share of voluntary and involuntary underwriting pools' and associations' unpaid losses and expenses that are included in reserves shown on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines.	$________
11. The net reserves for losses and loss adjustment expenses that the company carries for the following liabilities included on the Liabilities, Surplus and Other Funds page, Losses and Loss Adjustment Expenses lines. *	
11.1 Asbestos, as disclosed in the Notes to Financial Statements (Notes, Line 33A03D, ending net asbestos reserves for current year) Electronic Filing Col 5	$________
11.2 Environmental, as disclosed in the Notes to Financial Statements (Notes, Line 33D03D, ending net environmental reserves for current year), Electronic Filing Col 5	$________
12. The total claims made extended loss and expense reserve (Greater than or equal to Schedule P Interrogatories).	
12.1 Amount reported as loss reserves	$________
12.2 Amount reported as unearned premium reserves	$________
13. Other items on which the Appointed Actuary is providing relevant comment (list separately)	$________

* The reserves disclosed in item 11 above, should exclude amounts relating to contracts specifically written to cover asbestos and environmental exposures. Contracts specifically written to cover these exposures include Environmental Impairment Liability (post 1986), Asbestos Abatement, Pollution Legal Liability, Contractor's Pollution Liability, Consultant's Environmental Liability, and Pollution and Remediation Legal Liability.

58

Appendix 1a
2014 Statement of Actuarial Opinion Instructions