

**Report of the Independent Expert on the
Proposed Insurance Business Transfer
Scheme from the UK Branch of Sampo
Japan Insurance Inc. to Transfercom
Limited under Part VII of the Financial
Services & Markets Act 2000**

21 January 2010

Prepared by:

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TOWERS WATSON The logo for Towers Watson, featuring the company name in a bold, sans-serif font followed by a stylized, handwritten-style 'w' in a reddish-brown color.

Table of Contents

| | |
|--|-----------|
| Section 1 : Introduction & Scope | 1 |
| <i>The Independent Expert</i> | 1 |
| <i>Statement of independence</i> | 1 |
| <i>Scope of my report</i> | 2 |
| <i>Terms of reference</i> | 3 |
| <i>Reliances & limitations</i> | 3 |
| <i>Legal jurisdiction</i> | 4 |
| <i>Structure of this report</i> | 4 |
| Section 2 : Summary & Opinion | 5 |
| <i>Summary of the Proposed Scheme</i> | 5 |
| <i>Summary of findings</i> | 5 |
| <i>Duty to the Court</i> | 7 |
| <i>Statement of truth</i> | 7 |
| Section 3 : Background | 9 |
| <i>Purpose of the Proposed Scheme</i> | 9 |
| <i>Sompo Japan Insurance Inc.</i> | 10 |
| <i>UK Branch of Sompo</i> | 12 |
| <i>Transfercom</i> | 13 |
| Section 4 : Security Considerations | 17 |
| <i>Introduction</i> | 17 |
| <i>Security of policyholders remaining with Sompo – comments and conclusion</i> | 18 |
| <i>Security of policyholders transferring from Sompo to Transfercom – general comments</i> | 18 |
| <i>Security of current policyholders of Transfercom – general comments</i> | 19 |
| <i>Modelling of security</i> | 20 |
| <i>Security of policyholders transferring from Sompo to Transfercom – conclusion</i> | 26 |
| <i>Security of current policyholders of Transfercom – conclusion</i> | 27 |
| Section 5 : Other Considerations | 29 |
| <i>Introduction</i> | 29 |
| <i>Other considerations for policyholders remaining with Sompo</i> | 29 |
| <i>Other considerations for policyholders transferring from Sompo to Transfercom</i> | 29 |
| <i>Other considerations for current policyholders of Transfercom</i> | 30 |
| Appendix A: Glossary of Terms | 33 |
| Appendix B: Curriculum Vitae of the Independent Expert | 35 |
| Appendix C: Information Considered | 37 |
| Appendix D: Extract from Terms of Engagement | 39 |

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Section 1: Introduction & Scope

The Independent Expert

- 1.1 When a scheme for transferring insurance business from one company to another is put to the Court for approval it has to be accompanied by a report on the terms of the scheme from an independent expert ("the Independent Expert"). This is a requirement under Part VII of the Financial Services and Markets Act 2000 ("FSMA").
- 1.2 I have been appointed by Sompo Japan Insurance Inc. ("Sompo") as the Independent Expert in connection with the proposed transfer ("the Proposed Scheme") of the vast majority of the business of the UK Branch of Sompo Japan Insurance Inc. ("Sompo UK") to Transfercom Limited ("Transfercom"), which is part of the Berkshire Hathaway group.
- 1.3 My appointment as the Independent Expert in connection with the Proposed Scheme was approved by the Financial Services Authority ("FSA") on 2 November 2009. In connection with this appointment there is an engagement letter in place between Watson Wyatt and Sompo, although the costs and expenses relating to my appointment are ultimately being borne by Transfercom.
- 1.4 I am a Fellow of the Institute of Actuaries, having qualified in 1993. I am a Principal Actuary in the firm of Watson Wyatt Limited of Watson House, London Road, Reigate, Surrey RH2 9PQ ("Watson Wyatt"). My detailed curriculum vitae is attached as Appendix B.
- 1.5 I am required to comply with professional guidance adopted by the Board for Actuarial Standards in the UK, including the current version of Guidance Note 12. I have complied with UK professional guidance, subject to the principles of proportionality and practicability where these principles are applicable.

Statement of independence

- 1.6 Neither I, nor any member of my immediate family, hold any shares in Sompo, Transfercom or any of their group companies. Neither I, nor any member of my immediate family, have any contracts of insurance with Sompo, Transfercom or any of their group companies, or have any other financial interest in Sompo, Transfercom or any of their group companies.
- 1.7 I have not carried out any consulting work for Sompo, Transfercom or any of their group companies during the last 5 years, other than a small element of peer review work (a total of 3 hours with fees of around £1,500) for a Solvency II project for Sompo Japan Insurance Company of Europe Limited.

- 1.8 Other associates in the Insurance & Financial Services Practice of Watson Wyatt Limited have worked on a number of projects for Sompo, Transfercom and their group companies during the last three years. The total revenue to Watson Wyatt Limited from these projects over the last three years represents less than 0.5% of the annual revenue of the worldwide Insurance & Financial Services Practice. Other than the small element of peer review work mentioned above, I have not been involved in the provision of any of this advice. The team supporting me when opining on the Proposed Scheme do not have any overlap with any of the above teams.
- 1.9 For the wider Berkshire Hathaway group of companies, Watson Wyatt has performed a number of assignments over the last 3 years. I do not consider that this work compromises my independence as I am operationally independent of the other practices.
- 1.10 In addition to the above:
- My colleague Richard Bulmer acted as expert witness (including giving testimony) in respect of the recent *Equitas v R&Q* court proceedings. I had no involvement in this case due to my previous employment until mid 2008 by ACE European Group (who transferred the Brandywine business to R&Q).
 - Catherine Cresswell (then of Watson Wyatt) acted as Independent Expert in the previous insurance business transfer between Sompo and Transfercom, which was sanctioned in 2007.
 - Between 1996 and 1998 I worked for General and Cologne Re, which was acquired by Berkshire Hathaway shortly after I left in 1998. I retain no form of interest in General and Cologne Re.
- 1.11 I do not consider that any of the matters disclosed above affect my suitability to act as the Independent Expert for the proposed insurance business transfer.

Scope of my report

- 1.12 This report considers the likely effects of the Proposed Scheme for the following groups of policyholders:
- The policyholders remaining with Sompo
 - The policyholders transferring from the UK Branch of Sompo to Transfercom
 - The current policyholders of Transfercom.
- 1.13 For each group of policyholders I have considered the likely effects of the Proposed Scheme on:
- The security of policyholders' contractual rights
 - The levels of service provided to policyholders.

1.14 This report does not consider any possible alternative schemes.

Terms of reference

1.15 Terms of reference for my review of the Proposed Scheme have been agreed by Sompo and seen by the FSA. Extracts from these terms of reference are set out in Appendix D of this report.

1.16 This report is intended to aid the Court's deliberations as to whether the Proposed Scheme should be approved. In reporting on the Proposed Scheme in accordance with Part VII of the FSMA, I owe a duty to the Court to help the Court on matters within my expertise. This duty overrides any obligation to any person from whom I have received instructions or by whom I am paid. I have complied, and continue to comply, with this duty.

1.17 In preparing this report I have taken account of the following:

- Part 35 of the Civil Procedure Rules
- The Practice Direction supplement to Part 35 of the Civil Procedure Rules
- The protocol for the instruction of experts to give evidence in civil claims drafted by the Civil Justice Council
- Guidance in paragraphs 18.2.31 to 18.2.41 inclusive of the FSA's Supervision Manual which sets out the FSA's guidance on the form of the scheme report.

1.18 This review does not comprise an audit of the financial resources and liabilities of Sompo, Transfercom or National Indemnity Company ("NICO"), or any other associated or group company.

1.19 I have not reviewed the systems and controls currently operated by Sompo, Transfercom or NICO, or any other associated or group company.

Reliances & limitations

1.20 In carrying out my review and producing this report I have relied without independent verification upon the accuracy and completeness of the data and information provided to me, both in written and oral form. Where possible, I have reviewed the information provided for reasonableness and consistency with my knowledge of the insurance and reinsurance industry. Reliance has been placed upon, but not limited to, the information detailed in Appendix C.

1.21 A draft of this Report has been made available to the FSA, whose comments have been taken into account. The FSA has approved the form of this Report in its final form.

1.22 No limitations have been imposed on the scope of my work and the opinions in this report about the Proposed Scheme are mine, based on the information provided and the answers to any questions I have raised.

- 1.23 This report has been prepared on an agreed basis for the purpose of reporting on the Proposed Scheme, and must not be relied upon for any other purpose. It must be considered in its entirety as individual sections, if considered in isolation, may be misleading. This report is subject to the terms and limitations, including limitation of liability, set out in my firm's engagement letter of 2 November 2009, an extract of which is included as Appendix D.
- 1.24 This report must not be construed as investment advice.

Legal jurisdiction

- 1.25 This report is governed by and shall be construed in accordance with English law and the parties submit to the exclusive jurisdiction of the English courts in connection with all disputes and differences arising out of, under or in connection with this Report. If any part of a provision of this Report is held invalid, illegal or unenforceable then the remainder of such provision shall remain valid and enforceable to the fullest extent permitted by law.

Structure of this report

- 1.26 The structure of this report is as follows:
- Section 1 summarises the scope of my work as the Independent Expert
 - Section 2 summarises my overall conclusions
 - Section 3 summarises
 - The terms of the Proposed Scheme
 - The business of Sompo Japan Insurance Inc.
 - The business of the UK Branch of Sompo Japan Insurance Inc which is the subject of the Proposed Scheme
 - The existing business of Transfercom
 - Section 4 considers in detail the likely effects of the Proposed Scheme on the three affected groups of policyholders in respect of security considerations
 - Section 5 considers the likely effects of the Proposed Scheme on the three affected groups of policyholders in respect of other factors which can impact security or service levels.

Section 2: Summary & Opinion

Summary of the Proposed Scheme

- 2.1 The effect of the Proposed Scheme would be to transfer the vast majority of the business of the UK Branch of Sompo Japan Insurance Inc. ("Sompo UK") to Transfercom Limited ("Transfercom"), a subsidiary of the Berkshire Hathaway group.
- 2.2 This business is already administered by Resolute Management Limited ("Resolute"), a subsidiary of Berkshire Hathaway, but with the financial risk remaining with Sompo.
- 2.3 I understand from Sompo that the purpose of the Proposed Scheme is for Sompo to achieve financial finality in respect of the transferring business, allowing Sompo to focus on its core, ongoing business.
- 2.4 In this report I have considered the likely effects of the Proposed Scheme on three distinct sets of affected policyholders:
 - The policyholders remaining with Sompo
 - The policyholders transferring from the UK Branch of Sompo to Transfercom
 - The current policyholders of Transfercom
- 2.5 The intended effective date of the Proposed Scheme is 31 March 2010 (the "Effective Date").

Summary of findings

- 2.6 In forming my view on the effect of the Proposed Scheme, I have considered the likely effects of the Proposed Scheme on the level of security enjoyed by the affected policyholders. I have also considered the potential effects of the Proposed Scheme on the other factors which can impact security or service levels to the affected policyholders.

Security of policyholders remaining in Sompo

- 2.7 In my opinion the financial effect of the Proposed Scheme on the security of the policyholders remaining in Sompo will be de minimis and their security levels will remain effectively unchanged, given the small decrease to the total liabilities of Sompo as a result of the Proposed Scheme and the minimal net effect on capital.

Security of policyholders transferring from Sompo UK to Transfercom

- 2.8 The transferring policyholders are moving from a large, well diversified and strongly capitalised company, whose rating level implies a security level well beyond the FSA's ICA solvency criterion of 99.5% value-at-risk over a one year time horizon.
- 2.9 After the Proposed Scheme, it is my opinion that the likelihood of Transfercom being able to pay all future claims is 97.5%.
- 2.10 While I therefore consider that the level of security for the transferring policyholders will reduce if the Proposed Scheme is approved, I believe that the level of security of the transferring policyholders will remain satisfactory after the Proposed Scheme.

Security of current policyholders of Transfercom

- 2.11 In conjunction with the Proposed Scheme the limit of the reinsurance with NICO which protects the current business of Transfercom will increase by \$75 million, although there are some factors which offset the benefit of this reinsurance, to some extent.
- 2.12 However, on balance it is my opinion that the Proposed Scheme will result in an improved level of security for the current policyholders of Transfercom and therefore I believe that the current policyholders of Transfercom will be advantaged by the Proposed Scheme.

Other considerations for policyholders remaining with Sompo

- 2.13 I do not expect the Proposed Scheme to have any effect on the investment management, new business strategy, administration and expense levels of Sompo and hence no resulting effect on either security considerations or service levels for the policyholders remaining with Sompo.

Other considerations for policyholders transferring from Sompo UK to Transfercom

- 2.14 In respect of transferring policyholders my view is that the effect of the Proposed Scheme will be: no effect on the administration levels; a small improvement in expense levels; a small reduction in investment risk; a reduction in exposure to underwriting risk; no significant increased new business risk.

Other considerations for the current policyholders of Transfercom

- 2.15 In respect of the current policyholders of Transfercom, my view is that the effect of the Proposed Scheme will be: no impact on service levels; a small improvement in expense levels; no impact on investment risk; no effect on new business strategy.

Duty to the Court

- 2.16 As required by Part 35 of the Civil Procedure Rules, I hereby confirm that I understand my duty to the Court, I have complied with that duty and I will continue to comply with that duty.

Statement of truth

- 2.17 I confirm that insofar as the facts stated in my report are within my own knowledge I have made clear which they are and I believe them to be true, and that the opinions I have expressed represent my true and complete professional opinion.



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21 January 2010

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Section 3: Background

Purpose of the Proposed Scheme

- 3.1 The effect of the Proposed Scheme would be to transfer the vast majority of the business within the UK Branch of Sompo Japan Insurance Inc. to Transfercom Limited.
- 3.2 I understand that the purpose of the Proposed Scheme is for Sompo to achieve finality in respect of the transferring business, and allow the company to focus on its core, ongoing business.

Effective Date

- 3.3 The intended effective date of the Proposed Scheme is 31 March 2010 (the "Effective Date").

Transferring business

- 3.4 The transferring business comprises the vast majority of the business which is within the UK Branch of Sompo Japan Insurance Inc. This comprises solely liabilities which were underwritten as a result of agency arrangements of Nissan Fire and Marine Insurance Company Limited (now Sompo) with Fortress Re Inc. between 1981 and 2003. Further background to this business is provided from Section 3.20.

Supporting assets

- 3.5 On the Proposed Scheme becoming effective the limit of the existing reinsurance policy written by NICO, covering the existing business of Transfercom, will be extended. This reinsurance policy written by NICO, the parent company of Transfercom, covers all net claim payments in respect of the existing business in Transfercom paid from 1 March 2007 until the limit of US\$482 million is exhausted. The reinsurance policy also covers up to US\$50 million of unallocated loss adjustment expenses paid from 1 March 2007 until either the limit of US\$50 million is exhausted or the main policy limit of US\$482 million is exhausted.
- 3.6 The limit of the existing reinsurance policy written by NICO, covering the existing business of Transfercom, will be extended by US\$75 million, from US\$482 million to US\$557 million, on the Proposed Scheme becoming effective. If the Transfer does not proceed, the reinsurance limit will not be increased by the additional amount of US\$75 million.
- 3.7 As at 31 December 2008, claim payments totalling US\$25.0 million (net of other reinsurance) had been paid by Transfercom in respect of the reinsured business. Hence, as at this date, the amount of the reinsurance limit remaining was US\$457 million.

- 3.8 In addition, on the Proposed Scheme becoming effective a new reinsurance policy will come into force. This reinsurance policy will also be written by NICO and will cover all future net claim payments in respect of the transferring business. The reinsurance policy will cover all net claims paid in respect of the transferring business after 31 March 2009, up to a limit of US\$277.1 million with no retention. The reinsurance policy will also cover up to US\$25 million unallocated loss adjustment expenses, from the effective date of the Proposed Scheme until either the limit of US\$25 million is exhausted or the main policy limit of \$277.1 million is exhausted.
- 3.9 A previously agreed amount will be payable by Sompo 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 premium was established based on a commercial negotiation between Sompo and Berkshire Hathaway, as part of their wider negotiations around the Proposed Scheme. In my evaluation of the effects of the Proposed Scheme I have not carried out any specific work to consider the reasonableness (or otherwise) of this premium. Rather I have allowed for the effect of the proposed reinsurance policy (and the premium paid) as one of the elements in considering the effect of the Proposed Scheme (in its totality) on the different sets of policyholders.
- 3.10 Finally, in conjunction with the Proposed Scheme an asset of US\$4.5 million will transfer from Sompo to Transfercom. This asset relates to funds withheld in respect of Sompo's share of certain business written by the Fortress Re Pool during 1999, 2000 and 2001. This asset will then be assigned to NICO.
- 3.11 No further assets will be transferred as part of the Proposed Scheme. In particular, no outwards reinsurance will be transferred. I understand that as at 31 March 2009 the remaining recoverables in respect of outstanding losses were around 0.2% of total outstanding losses and therefore the effect of not transferring the outwards reinsurance is de minimis.

Sompo Japan Insurance Inc.

- 3.12 In this section I set out a description of the business of Sompo.

Background

- 3.13 Sompo is a substantial non-life insurance company listed on the Tokyo stock exchange, which was formed in 2002 from the merger of the Yasuda Fire and Marine Insurance Company Limited ("Yasuda") and Nissan Fire and Marine Insurance Company Limited ("Nissan"). Yasuda and Nissan wrote general insurance business, in particular specialising in motor insurance.
- 3.14 Sompo is rated AA3 by Moody's and AA- by Standard & Poor's. Sompo has a market share of around 20% of the Japanese domestic market for non-life business with net written premium for the financial year ending 31 March 2009 of 1,308,195 million yen (US\$13.3 billion). Written premium has been fairly stable over the last 5 years.
- 3.15 Sompo writes all lines of non-life insurance and reinsurance, although the business is dominated by personal lines with about 65% of the premium income coming from motor

insurance (voluntary and compulsory). The remainder of the business consists of Fire (11%), Personal Accident (10%), Marine (2%) and Other (12%).

- 3.16 In 2010 a new joint holding company is due to be created following the impending integration of Sompo with Nipponkoa, Japan's third oldest non-life insurer. Nipponkoa writes a similar mix of business to Sompo and currently has a 10% share of the Japanese non-life domestic market. The two companies will co-exist under the new joint holding company with the integration expected to generate 30 billion yen in synergy savings. The aim of the integration is to maintain the strong market position and to accelerate current strategies to enhance profitability in the face of changing socio-economic trends. The holding company will consist of both non-life and life business as well as asset management and healthcare business. I have not taken any account of this future integration in my analysis.

Economic effect of Proposed Scheme

- 3.17 The table below shows the financial position of Sompo as at 31 March 2009.

| <i>All figures in US\$ 000s</i> | Pre-Transfer |
|---|---------------------|
| Investments | 45,233,493 |
| Reinsurers' share of technical provisions | |
| Claims outstanding | 0 |
| Provision for run-off expenses | 0 |
| | 0 |
| Debtors | |
| Arising out of reinsurance operations | 1,101,028 |
| Others | 6,442,346 |
| Other assets | 7,267,464 |
| Prepayments and accrued income | 136,607 |
| TOTAL ASSETS | 60,180,938 |
| Capital and reserves | 6,054,814 |
| Gross technical provisions | |
| Claims outstanding | 50,870,924 |
| Provision for run-off expenses | 0 |
| | 50,870,924 |
| Creditors | 722,481 |
| Accruals and deferred income | 1,073,865 |
| Other Liabilities | 1,458,854 |
| TOTAL LIABILITIES | 60,180,938 |

3.18 The economic effect of the Proposed Scheme on Sompo will be as follows:

- A reduction in gross claims reserves of US\$237.1 million, which represents less than 0.5% of the current gross claims reserves of Sompo.
- A reduction in debtors of US\$4.51 million, which represents less than 0.1% of the current debtors of Sompo.
- In addition, Sompo will pay a previously agreed amount to Transfercom in conjunction with the Proposed Scheme, which will reduce the assets of Sompo. Due to confidentiality reasons this amount is not stated in this report. The net effect of the transfer will be an immaterial change to the capital and reserves of Sompo.

UK Branch of Sompo

- 3.19 In this section I set out a description of the business of the UK Branch of Sompo. As the transferring business is written in a UK branch rather than a UK subsidiary of Sompo, the policyholders are subject to the security of Sompo.
- 3.20 The UK Branch of Sompo comprises reinsurance contracts which were underwritten as a result of the agency arrangements Nissan (now Sompo) 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. The UK Branch of Sompo also includes a small amount of other business, although this is not transferring to Transfercom under the Proposed Scheme.
- 3.21 The Fortress Re Pool mainly wrote aviation reinsurance business (both hull and liability) and property cat business, together with some marine and non-marine reinsurance. Retrocession business was also underwritten.
- 3.22 Fortress Re typically wrote quite low layers of reinsurance and was badly hit by the events on 11 September 2001, together with the American Airlines Flight 587 event in November of the same year. Fortress Re ceased writing business after these events.
- 3.23 As at 31 March 2009, Sompo held reserves of US\$237.1 million in respect of its liabilities from the Fortress Re Pool and assets of US\$4.5 million in respect of the funds withheld described in Section 3.10 above.

Servicing

- 3.24 With effect from 1 April 2008, Sompo appointed Resolute as its run-off agent for the transferring business. The services provided under this appointment are set out in a Run-Off Services Agreement between Sompo and Resolute dated 3 April 2008. It is my understanding that the intention of the Proposed Scheme is for the servicing of the transferring business to remain with Resolute and to proceed in the future according to existing standards of service and existing claims handling procedures.

Transfercom

3.25 In this section I set out a description of the business of Transfercom.

Background

3.26 Transfercom was formed in 2006 in order to accept insurance liabilities from Sampo Japan Insurance Inc. under a previous insurance business transfer (the "Previous Transfer"). This Previous Transfer became effective on 1 March 2007. The liabilities transferred under the Previous Transfer remain as the only business in Transfercom.

3.27 Transfercom is a wholly owned subsidiary of National Indemnity Company ("NICO"), the ultimate parent company of which is Berkshire Hathaway Inc. Both NICO and Berkshire Hathaway Inc. are US companies. NICO is rated A++ (Superior) by A M Best and AAA / Watch Negative by Standard & Poor's. Transfercom does not have its own credit rating.

3.28 NICO's AAA rating from Standard & Poor's was put on "CreditWatch with negative implications" in the wake of Berkshire Hathaway's announcement on 3 November 2009 that it is to buy railroad operator Burlington Northern Santa Fe. A significant part of the cash to enable the purchase of Burlington Northern Santa Fe is likely to come from Berkshire Hathaway's core insurance operations, including NICO. As a result, the acquisition may decrease the liquidity and capital adequacy of NICO.

Existing business

3.29 The existing business of Transfercom was transferred into that company under the Previous Transfer. The liabilities consist of the then business of the UK Branch of Sampo, 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 business originally written by Nissan in the London market, termed the Non Marine Underwriting Agreement ("NMUA") account. It was written 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 contains significant exposure to the World Trade Centre loss.
- A block of ex-Nissan reciprocal treaties. These also contain asbestos exposures.

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

Capital resources

- 3.30 The capital resources of Transfercom consist of (in order of importance) a stop-loss reinsurance policy with its parent company NICO, US\$43 million of fully-paid share capital, US\$2 million of retained profit and some limited outwards reinsurance protection with various companies.
- 3.31 The reinsurance policy written by NICO in respect of the existing business in Transfercom became effective on 1 March 2007. The policy covers all net claims paid in respect of the existing Transfercom portfolio since 1 March 2007, up to a limit of US\$482 million. There is no retention in place. The reinsurance policy also covers up to US\$50 million unallocated loss adjustment expenses, from the effective date until either the main policy limit of \$482 million is exhausted or the expenses limit of US\$50 million is exhausted.
- 3.32 As at 31 December 2008, the reinsurance limit had been eroded by net paid claims of US\$25.0 million, leaving a remaining unpaid limit of US\$457 million.
- 3.33 As explained in Section 3.8 above, as part of the Proposed Scheme the upper limit of cover on this existing arrangement will be extended by US\$75 million, so that the limit increases from US\$482 million to US\$557 million.
- 3.34 During 2008, Transfercom invested US\$30 million (of its net assets of US\$45 million) in a 10 year fixed interest debt security, with the intention of holding the investment to maturity. This bond was issued privately and attracted a NAIC SVO rating of 4, the equivalent Standard & Poor's rating being B.

Previous ICA

- 3.35 An Individual Capital Assessment ("ICA") was produced by Transfercom in June 2006, around the time that Transfercom was established. The consideration of insurance risk for that ICA was based on a detailed reserve report produced by Tillinghast, which had an effective date of 30 September 2004.
- 3.36 Since that date, Transfercom commissioned a more recent reserve report from Ronald Wilson of Beneficial Consultant, LLC. This more recent report is titled "Transfercom 31 December 2008 Reserves for Losses and Loss Expense" and was dated 28 March 2009. Both of the reserve reports are discussed further in Section 4, where I consider the reserve uncertainty on the current business within Transfercom.

Economic effect of Proposed Scheme

- 3.37 The table below shows the economic effect of the Proposed Scheme on Transfercom as at 31 December 2008.

| <i>All figures in US\$ 000s</i> | Pre-Transfer | Effect of Transfer | Post-Transfer |
|---|----------------|--------------------|----------------|
| Investments | 36,985 | 0 | 36,985 |
| Reinsurers' share of technical provisions | | | |
| Claims outstanding | 325,717 | 237,100 | 562,817 |
| Provision for run-off expenses | 21,020 | 0 | 21,020 |
| | 346,737 | 237,100 | 583,837 |
| Debtors | | | |
| Arising out of reinsurance operations | 163 | 0 | 163 |
| Others | 3,393 | 4,510 | 7,903 |
| Other assets | 4,458 | 0 | 4,458 |
| Prepayments and accrued income | 819 | 0 | 819 |
| TOTAL ASSETS | 392,555 | 241,610 | 634,165 |
| Capital and reserves | 44,952 | 0 | 44,952 |
| Gross technical provisions | | | |
| Claims outstanding | 325,717 | 237,100 | 562,817 |
| Provision for run-off expenses | 21,020 | 0 | 21,020 |
| | 346,737 | 237,100 | 583,837 |
| Creditors | 786 | 4,510 | 5,296 |
| Accruals and deferred income | 80 | 0 | 80 |
| TOTAL LIABILITIES | 392,555 | 241,610 | 634,165 |

- 3.38 Transfercom has outsourced various functions to other group companies, the provision and performance of these functions being governed by various legal agreements. This included outsourcing IT services to Marlborough Underwriting Agency Limited ("Marlborough"), which left the Berkshire Hathaway Group in November 2008. Marlborough continues to provide IT services, however, under a formal agreement.

Servicing

- 3.39 Resolute currently acts as the run-off service provider for the current policyholders of Transfercom and it is my understanding that there is no proposal as part of the Proposed Scheme to alter any aspect of the administration arrangement.

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Section 4: Security Considerations

Introduction

- 4.1 In this section I discuss considerations arising from the effect of the Proposed Scheme on the security of policyholders' contractual rights. In other words I have considered whether the Proposed Scheme will make it more or less likely that policyholders' claims will be paid and to what extent it will affect that likelihood.
- 4.2 I have considered the likely effects of the Proposed Scheme on:
- The policyholders remaining with Sampo
 - The policyholders transferring from the UK Branch of Sampo to Transfercom
 - The current policyholders of Transfercom.
- 4.3 In each case I have considered the security of the policyholders on two bases:
- The current position which corresponds to the position should the Proposed Scheme not proceed ("the Pre Scheme Position")
 - The position should the Proposed Scheme proceed ("the Post Scheme Position").
- 4.4 In general security for policyholders is provided by a combination of:
- Assets backing the technical reserves
 - Reinsurance protections
 - Net shareholder assets.
- 4.5 In respect of Transfercom (and hence to the Post Scheme Position of the policyholders transferring from Sampo UK to Transfercom and to the Pre and Post Scheme Position of the current policyholders of Transfercom) security is provided in the first instance by the specific reinsurance arrangements in place with NICO (which in turn are subject to the general security levels of NICO) for each set of policyholders, with further security provided by the net shareholder assets/free capital of Transfercom. There are no other assets backing the technical reserves. The free capital will be available for both sets of policyholders to utilise, after, and if, the Proposed Scheme is sanctioned, if claims exceed the upper limit of the applicable reinsurance protection with NICO. This capital also covers other risks of Transfercom, of which the largest is counterparty credit risk on the NICO reinsurance protections.

- 4.6 Given the relative payment tails of the two sets of business, if both reinsurance protections with NICO are breached then it is very likely that the transferring business would erode the capital before the existing business, since the transferring business is likely to result in claim payments being made sooner.
- 4.7 If one of the books of business stayed within its reinsurance protection while the other eroded not just the full extent of the applicable reinsurance protection but also the entire capital of Transfercom, then Transfercom would be insolvent. It is possible that in such an insolvency the full assets of Transfercom (including reinsurance recoveries) would be made available to settle, as far as possible on a pro-rata basis, the full liabilities of Transfercom. In this event, therefore, the payouts to policyholders of both books of business may be reduced.

Security of policyholders remaining with Sompo – comments and conclusion

- 4.8 In my opinion the financial effect of the Proposed Scheme on the security of the policyholders remaining in Sompo will be de minimis and their security levels are effectively unchanged on both the Pre Scheme Position and Post Scheme Position.
- 4.9 I have based this opinion on my assessment that the Proposed Scheme will result in a very small decrease to the liabilities of Sompo (with the transferring liabilities representing less than 0.5% of the total reserves of Sompo) and with a de minimis net effect on the capital of Sompo. I do not expect the Proposed Scheme to have any effect on the credit rating or regulatory capital position of Sompo.
- 4.10 The Proposed Scheme represents the separation of run-off London market aviation (and to a lesser extent marine and non-marine) exposures, involving in some cases large and complex legal cases, from Sompo's remaining portfolio of pre-dominantly personal lines exposures. In my opinion this is in the interests of the remaining policyholders.

Security of policyholders transferring from Sompo to Transfercom – general comments

Pre Scheme Position

- 4.11 Prior to the transfer the transferring policyholders are subject to the security levels of Sompo Japan Insurance Inc, and not to the security of the UK branch in isolation.
- 4.12 In assessing this security level I have taken account of the balance sheet strength of Sompo as set out in its financial accounts at 31 March 2009 and to its credit rating.
- 4.13 Based on my review of the financial statements of Sompo, my view is that Sompo is a large, well diversified and strongly capitalised group with a conservative policy for reserving and for dividend payments. It is very strongly rated by both Moody's and Standard & Poor's at a rating level which would imply a security level well beyond the FSA's ICA solvency criterion of 99.5% value-at-risk over a one year time horizon.

- 4.14 There is additional risk to this security from the possibility of adverse impacts on capital levels from future strategic decisions. I have not taken any account at this stage of the proposed integration in 2010 with Nipponkoa.

Post Scheme Position

- 4.15 For the Post Scheme Position, the general discussion above, from Section 4.5 onwards, sets out the key considerations for the transferring policyholders.
- 4.16 Key considerations in assessing this security level include:
- An assessment of the risk that the claims on the transferring business exceed the upper limit of the applicable reinsurance policy with NICO and (if they do) that they exceed the further buffer provided by the capital of Transfercom. Given the relative payment tail of the two sets of business in Transfercom after the Proposed Scheme, if both reinsurance protections were breached then it is very likely that the transferring business would erode the capital before the existing business.
 - An assessment of the risk that the claims on the existing business exhaust on an actual basis or are projected on a future best estimate basis to exhaust both the applicable reinsurance policy with NICO and the capital levels of Transfercom. In this situation Transfercom would become insolvent. Such insolvency is likely to be at best a severe inconvenience to the transferring policyholders leading to a reduction in service standards and delay in claim payments. Further it may adversely impact the ultimate payout to the transferring policyholders, even if claims on the transferring business do not exceed the upper limit of the applicable reinsurance arrangement with NICO.
 - Counterparty credit risk in respect of the reinsurance arrangements with NICO.
 - The additional risks associated with the form of the capital of Transfercom. In particular, the credit risk associated with the funds withheld asset of US\$4.5 million and both the credit risk and liquidity risk associated with the US\$30 million bond holding.

Security of current policyholders of Transfercom – general comments

- 4.17 The general discussion above sets out the considerations in assessing the security of current Transfercom policyholders on both a Pre Scheme and Post Scheme Position.
- 4.18 The specific effects of the Proposed Scheme on the security of the current policyholders of Transfercom are:
- An increase in the upper limit of the reinsurance protection protecting the book from US\$482 million to US\$557 million (although with a small offset from increased counterparty credit risk to NICO).

- The US\$45 million of free capital in Transfercom, which previously acted as a buffer in the event that claims from the existing business breached the upper limit of the reinsurance arrangement, will now be exposed to the risk that claims from the transferring business exceed the upper limit of the reinsurance arrangement to be put in place to cover that business. Given the relative payment tail of the two sets of business, if both reinsurance protections were breached then it is very likely that the transferring business would erode the capital before the existing business.
- Further, as explained above, if deterioration on the transferring business beyond the limit of the applicable reinsurance exhausts the free capital of Transfercom then there may be a reduction in the claims payable to existing policyholders, even if the claims on that business do not exceed the upper limit of the existing reinsurance arrangements.

Modelling of security

4.19 In order to assess the Post Scheme Position of the policyholders transferring from Sompo UK to Transfercom and the Pre and Post Scheme Position of the current policyholders of Transfercom, I have built a simple capital model which allows for a distribution of possible outcomes and for each group of policyholders assesses whether the claims will be paid in full.

4.20 The key drivers of this capital model are:

- Reserve uncertainty on the book of business transferring from Sompo UK
- Reserve uncertainty on the existing book of business in Transfercom
- Correlations between the reserve uncertainty on the two books of business

Reserve uncertainty on the transferring book of business

4.21 In assessing the reserve uncertainty on the transferring book of business from Sompo UK to Transfercom I have relied on a report titled "Sompo Japan Insurance Inc. IBNR and Related Amounts as of 31, March 2009 (Supplemental Report)" prepared for Sompo on 22 June 2009 under the direction of Donald Faman of PricewaterhouseCoopers ("the PwC Report").

4.22 I have carried out a thorough review of this report and of the extremely detailed underlying supporting schedules which accompany this report. I have also held detailed conversations with Marc Oberholzer and Paul Delbridge of PricewaterhouseCoopers ("PwC"), both of whom were intrinsically involved in the preparation of the report, to check my understanding of the methods used and to clarify various areas of my understanding around the report.

4.23 In carrying out this review I have satisfied myself that this report, together with some additional work performed at my request by PwC and the claims department of Resolute, is reliable and both fit and fully adequate for my purpose.

- 4.24 The report was specifically written to assist Sompo in its considerations around a possible Part VII transfer. Further I understand that it was used by Berkshire Hathaway as part of their due diligence in negotiating the Proposed Scheme to Transfercom and the reinsurance arrangements with NICO. I also understand that PwC have performed a similar review for a number of years now and therefore have an excellent understanding of the transferring business and of the key remaining reserving issues. They are aided in this understanding by the claims department of Resolute and by various sources of market information on the major market events which dominate the reserves of Sompo (not least the events of 11 September 2001 and the American Airlines Flight 587 crash on 12 November 2001).
- 4.25 The table below summarises the reserve estimates in PwC's report as at 31 March 2009.

| <i>All figures in US\$ 000s</i> | |
|---|--------------|
| Case reserves for losses and LAE | 239.3 |
| IBNR & related amounts | |
| Reserve for IBNR losses and LAE | 22.5 |
| Additional premiums relating to case reserves and IBNR | - 57.1 |
| Profit commissions | 9.9 |
| | - 24.7 |
| Expected recoveries from Taisei Re on fronted contracts | - 3.6 |
| TOTAL CASE RESERVES PLUS IBNR & RELATED AMOUNTS | 211.0 |
| Unpaid paid loss amounts | |
| Unpaid paid losses | 39.7 |
| Additional premiums relating to unpaid paid losses | - 14.0 |
| Unpaid paid profit commissions | 0.3 |
| | 26.1 |
| TOTAL CASE RESERVES, IBNR & RELATED AMOUNTS AND UNPAID PAID LOSS AMOUNTS | 237.1 |

- 4.26 The large amount of additional premiums shown in the table above is predominantly in respect of outstanding claims. Since PwC's report was completed, the expected recoveries from Taisei Re have been received.
- 4.27 In the two years since 31 March 2007, the case reserves (and associated additional premiums) have substantially reduced to around 40-45% of their 31 March 2007 values, reflecting a number of settlements and commutations. Further many of the larger market events have stabilised in terms of the market loss estimate and the market view on how the claims will be attributed (e.g. between airlines and product manufacturers). All of these factors mean that the reserve uncertainty in the book has reduced significantly over time and this stabilisation is one of the factors that have facilitated the possibility of a Part VII transfer.

- 4.28 PwC's methodology relies on a number of different approaches, as described in the following sections.
- 4.29 For 2000 and prior contracts (which strictly are those contracts which were not expected to be exposed to the events of 2001 and post when PwC's methodology was established), the analysis was split into aviation, marine and non-marine and for each class of business a selection made based on three approaches:
- A standard actuarial projection of aggregate incurred claims triangles (by development year and pool year). These triangles are all now exhibiting stable development and PwC have selected in my view a reasonable but conservative approach to selecting loss development patterns.
 - Individual event by event loss development factors applied to the individual large events which dominate claims on the more recent pool years. In the majority of cases it is now assumed that market loss estimates are stable and that cedants have reported at market loss levels so that no development is assumed but in a small number of cases PwC have assumed some development based on the advices of Resolute's claims experts.
 - For the Marine book in Pool Years 9-12 a benchmark IBNR/Case reserve approach was used to assess potential asbestos liabilities. Although this could give rise to material uncertainty at the aggregate level, Sompo's share of the Fortress Re pool was much reduced in these years. As a result, these liabilities do not give rise to material uncertainty in Sompo's reserves.
- 4.30 For contracts exposed to the effects of 2001 and post events extremely detailed contract by contract modelling is performed separately for aviation, marine and non-marine contracts.
- 4.31 The most complex modelling applies to aviation contracts due mainly to the complex cover underwritten by Fortress Re. On recent pool years this commonly included layers and back-up layers with profit commissions and paid reinstatements, but with profit commission protections ("PCP") and a series of reinstatement premium protection ("RPP") coverages (including RPPs on the RPPs), all written to the same cedant for the same basic layers of protection.
- 4.32 The input to these models includes ultimate losses by event by cedant/layer which are based on actual incurred losses and an assumption (by event and by cedant/layer) of loss development factors. The vast majority of entries in this two-way matrix of factors now assume no future development with a small number of exceptions.
- 4.33 These inputs are then run through the contract terms allowing for vertical and horizontal exhaustion as well as the myriad of back-ups, PCPs and RPPs, all assessed on a consistent basis. A comparison is made of claims on an ultimate level compared to on a paid level (to assist in the assessment of future additional premiums receivable) and compared to zero claims (to assist in the assessment of the ultimate levels of profit commissions payable).
- 4.34 The marine and non-marine models are conceptually similar but simpler. They rely as a base assumption on ultimate layer erosion by cedant-layer/event compared to incurred layer erosion. Again there are now only a limited number of cases where ultimate erosion is assumed to be different to incurred erosion.

- 4.35 The one area in which PwC's original report was not entirely adequate for my purpose is in the quantification of uncertainty. Accordingly I requested and received detailed additional analysis and commentary from PwC and the claims department of Resolute to enable me to understand:
- The legal uncertainty surrounding some of the key claims (particularly those relating to the events of 11 September 2001)
 - The potential for deterioration on some of the other large outstanding individual events which dominate the remaining IBNR
 - The legal background to a number of ongoing disputes in which Sompo is involved in respect of the transferring business
 - The financial impacts of different outcomes for individual claims and disputes.
- 4.36 I have placed reliance on this analysis and commentary in forming my opinion on the distribution for potential outcomes for the transferring book. Many of the individual claims and legal issues are confidential, but in summary my views on the reserve uncertainty are as follows:
- The case reserving and PwC IBNR reserving approach is conservative and in many cases takes a worst case or at least pessimistic view of the possible outcomes on individual claims or legal issues. I have assumed that the PwC IBNR analysis represents the 75th percentile of the distribution of possible outcomes.
 - There were a number of areas where I was able to identify the possibility for deterioration beyond the reserves recommended by PwC. In each of these individual cases the view of Resolute's claims department is that such deterioration is unlikely, nevertheless I asked PwC and Resolute to quantify the effects of these deteriorations. Aggregating the worst case on all the areas I identified would give an aggregate deterioration to reserves of US\$20.5 million. I have assumed that this level of deterioration on all such claims at the same time represents a 97.5th percentile of the distribution of possible outcomes.
 - Given the occurrence liability nature of the book there is a possibility of some form of latent claims development, although I would place this probability in the extreme tail of the distribution as the nature of a predominantly aviation reinsurance book is that large claims normally originate from a headline event (and all such events have been considered by Resolute in their advices to PwC).
- 4.37 Finally in respect of unallocated loss adjustment expenses I understand that the current projection for unallocated claims handling expenses to ultimate run-off is US\$12.5 million, considerably less than the reinsurance limit for ULAE of US\$25 million. In my opinion it is very unlikely that this limit will be breached and even if it is the effect would be immaterial compared to the potential for breach of the indemnity limit of the reinsurance. I have therefore not considered ULAE amounts in my high level modelling.

Reserve uncertainty on the current book

- 4.38 In assessing the reserve uncertainty on the current business within Transfercom I have relied on a report titled "Transfercom 31 December 2008 Reserves for Losses and Loss

Expense" prepared for Transfercom on 28 March 2009 by Ronald Wilson of Beneficial Consultant, LLC ("The Wilson Report"), together with some further information providing additional percentiles of the loss distribution described in Section 4.42 below.

4.39 I understand that this report was mainly prepared for the purpose of demonstrating that it was appropriate that Transfercom held no net claims reserves, as gross claims were unlikely to exceed the limit of the NICO reinsurance protection. As such, although the report does include mean reserves and a distribution of potential claim outcomes, these were not deliberately designed to be used in some form of capital assessment.

4.40 The report applies two benchmark methods:

- Survival ratios (future claims expressed as a ratio of normalised annual paid claims)
- IBNR/case ratios (IBNR claims expressed as a ratio of current outstanding claims)

4.41 In each case the benchmarks are:

- Set separately for four main books of business: asbestos direct, asbestos reinsurance, all other losses direct and all other losses reinsurance – so that there are 8 benchmarks in total
- Estimated for a 10th percentile, mean and 90th percentile (which are then used to set a distribution for each of the 8 benchmarks)

4.42 The two benchmark methods are each run on a stochastic basis, with for each simulation random selections made for the eight benchmarks from the distributions assumed as well as a random assumption made on the limited outwards reinsurance protection available to net down claims (on average only 1.5% reinsurance recoveries as a percentage of gross claims is assumed). Some of the key percentiles on the loss distribution produced by this stochastic model are set out in the table below.

| Percentile on loss distribution for existing business in Transfercom | US\$ millions |
|--|---------------|
| 50% | 304.3 |
| 59% ¹ | 325.7 |
| 70% | 356.5 |
| 80% | 392.6 |
| 90% | 456.1 |
| 95% | 516.8 |
| 97.5% | 581.5 |
| 99% | 654.6 |
| 99.5% | 722.5 |

¹ This percentile equates to the level of reserves held by Transfercom at 31 December 2008.

- 4.43 Based on our experience on benchmark survival and IBNR/case ratios used by companies with US asbestos and environmental pollution/health hazard claims (which dominate the other losses in the current business of Transfercom) the mean selected benchmarks in the Wilson Report appear to be at or even above the high end of the typical range of factors used for best estimates.
- 4.44 This would appear to be supported by the fact that the Wilson Report estimates that the booked gross Transfercom reserves (before all reinsurance) at 31 December 2008 of \$325.7 million represent a 59th percentile of the distribution which (given the skew of possible outcomes) may be close to or below a mean of the distribution. These booked reserves were based on a roll-forward to the time of establishment of Transfercom of a detailed reserve report produced by Tillinghast with effective date 30 September 2004.
- 4.45 The Tillinghast report produced a "Best Point Estimate" reserve amount and a "High Estimate" which (on a roll forward basis) was twice the level of the Best Point Estimate. For prudence Transfercom based their gross reserve estimate on the High Estimate although both the ICA assessment produced by Transfercom in June 2006 and the Independent Expert's report in respect of the Previous Transfer used the Best Point Estimate as the expected value of future liabilities.
- 4.46 The Independent Expert's report in respect of the Previous Transfer commented that the then aggregate resources in Transfercom (of the net assets plus reinsurance cover of US\$525 million) was approximately three times the value of the Best Point Estimate reserve amount. The report then stated that *"it is considered that for this kind of portfolio with a substantial asbestos component, an amount of twice the reserves held might prove to be sufficient approximately 90% to 95% of the time. I consider the reinsurance provided should result in substantial protection for the transferring policyholders so that the likelihood of their liabilities not being met in full is reasonably remote"*.
- 4.47 As far as I am aware experience since the date of Tillinghast's report has been in line with or better than expectations.
- 4.48 I am aware that Martin White and his actuarial team at Resolute are preparing their own assessment of the reserves of Transfercom. Martin White's report will concentrate on a best estimate reserve but will also identify potential uncertainties. At the time of finalising this report, Martin White's report was not yet available. I will therefore produce a supplementary report in due course which will incorporate the findings of Martin White's report. My supplementary report will also cover any relevant developments since finalising this report, together with consideration of any updated financials which are available for the companies involved.
- 4.49 As Martin White's report is not yet available I have used the distribution of outcomes produced from the Wilson Report, without adjustment, as the basis for this report.
- 4.50 As at 31 December 2008, the capital resources in Transfercom amount to US\$502 million. This amount consists of US\$457 million of unpaid limit on the NICO reinsurance protection (US\$482 million original limit, less US\$25 million in paid claims) plus US\$45 million of free capital. Ignoring the implications of the credit and liquidity risks associated with the capital resources of Transfercom, these capital resources equate to the 93.8th percentile of the loss distribution produced in the Wilson Report.

- 4.51 If the Wilson Report proves to be conservative then this will underestimate the post scheme security of both the existing Transfercom policyholders and the transferring policyholders, by overestimating the chance of a breach of reinsurance and ultimately capital levels.
- 4.52 Finally in respect of unallocated loss adjustment expenses I understand that the current projection for unallocated claims handling expenses to ultimate run-off is lower than originally planned in the Previous Transfer and considerably less than the reinsurance limit for ULAE of US\$50 million. In my opinion it is very unlikely that this limit will be breached and even if it is the effect would be immaterial compared to the potential for breach of the indemnity limit of the reinsurance. I have therefore not considered ULAE amounts in my high level modelling.

Modelling approach

- 4.53 I have assessed the Post Scheme Position of the policyholders transferring from Sompo UK to Transfercom and the Pre and Post Scheme Position of the current policyholders of Transfercom using:
- The reserve distribution assumptions discussed above
 - An assumption as to the correlation between the two books of business. I have assumed that this would be low as, notwithstanding the small amount of asbestos reserves in the transferring book and the small amount of World Trade Centre reserves in the existing Transfercom book, there is limited overlap between the two books. Even excluding this, in my opinion, the correlation would not be zero as both books are exposed to inflation risk (including the risk of inflation in court compensation awards). I have therefore assumed a correlation of 0.30 which is a small increase on the factor used by CEIOPS in the QIS 4 standard formula for reserve risk correlation between marine aviation & transport and third party liability business.
- 4.54 In my modelling I have made no allowance for the investment return to be earned on the capital levels of Transfercom during the run-off of claims as in my view this positive impact on security is counterbalanced by the additional risk factors which I have not considered in my modelling, in particular:
- Counterparty credit risk in respect of the reinsurance arrangements with NICO.
 - The additional risks associated with the form of the capital of Transfercom. In particular, the credit risk associated with the funds withheld asset of US\$4.5 million and both the credit risk and liquidity risk associated with the US\$30 million bond holding.
- 4.55 The results of this analysis are described in the following sections.

Security of policyholders transferring from Sompo to Transfercom – conclusion

- 4.56 The transferring policyholders are moving from a large, well diversified and strongly capitalised company, whose rating level implies a security level well beyond the FSA's ICA solvency criterion of 99.5% value-at-risk over a one year time horizon.

- 4.57 In conjunction with the Proposed Scheme a reinsurance policy is being put in place to cover the transferring business, and my modelling estimates that the likelihood of the cost of claims from the transferring business remaining within the limit of the reinsurance with NICO is 99.5% (in line with the FSA's ICA solvency criterion although on a run-off to ultimate basis).
- 4.58 The most significant risk to the transferring business is the possibility that the claims on the existing business within Transfercom exhaust on an actual basis or are projected on a future best estimate basis to exhaust both the applicable reinsurance policy with NICO and the capital levels of Transfercom. In this situation Transfercom would become insolvent. Such insolvency is likely to be at best a severe inconvenience to the transferring policyholders leading to a reduction in service standards and delay in claims payments. Further it may adversely impact the ultimate payout to the transferring policyholders, even if claims on the transferring business do not exceed the upper limit of the applicable reinsurance arrangement with NICO.
- 4.59 Combining my selected distributions for the transferring business and the existing business within Transfercom, together with my chosen correlation, my modelling estimates that the likelihood of Transfercom being able to pay all future claims after the Proposed Scheme has been effected is 97.5%.
- 4.60 Based on my analysis, I consider that the level of security for the transferring policyholders will reduce if the Proposed Scheme is approved. However, I believe that the level of security of the transferring policyholders would remain satisfactory in that the probability of Transfercom being able to pay all future claims to the transferring policyholders (and avoiding insolvency) after the Proposed Scheme would be approximately 97.5%.

Security of current policyholders of Transfercom – conclusion

- 4.61 If the Proposed Scheme does not go ahead, my modelling estimates that the likelihood of the existing assets within Transfercom being sufficient to pay all claims from the existing business within Transfercom is 93.9%.
- 4.62 In conjunction with the Proposed Scheme the limit of the reinsurance with NICO which protects the current business of Transfercom will increase by \$75 million. The benefit of this increase in reinsurance is offset, but only to a limited extent, by the following:
- an increase in the counterparty credit risk in respect of the increase in the reinsurance arrangements with NICO; and
 - the possibility of the transferring business exceeding its applicable reinsurance protection, and accessing, or possibly exhausting, the free capital in Transfercom.
- 4.63 However, as stated in Section 4.59 above, I have estimated that the likelihood of Transfercom being able to pay all future claims after the Proposed Scheme has been effected is 97.5%.

- 4.64 This represents a significant improvement in security for the current policyholders of Transfercom and therefore I believe that the current policyholders of Transfercom will be advantaged by the Proposed Scheme.

Section 5: Other Considerations

Introduction

- 5.1 In this section I address the potential effects of the Proposed Scheme on matters such as investment management, new business strategy, administration and expense levels in so far as these will affect the security of policyholders' contractual rights or the levels of service provided to policyholders.
- 5.2 I have considered the likely effects of the Proposed Scheme on:
- The policyholders remaining with Sampo
 - The policyholders transferring from the UK Branch of Sampo to Transfercom
 - The current policyholders of Transfercom

Other considerations for policyholders remaining with Sampo

- 5.3 It is my understanding that the UK Branch of Sampo is almost entirely operationally independent of the remaining worldwide operations of Sampo, particularly due to the services agreement in place with Resolute to administer the UK branch business (see Section 5.5 below). The operations of Sampo UK are also small within the context of Sampo's worldwide operations.
- 5.4 As a result I do not expect the Proposed Scheme to have any effect on the investment management, new business strategy, administration and expense levels of Sampo and hence no resulting effect on either security considerations or service levels for the policyholders remaining with Sampo.

Other considerations for policyholders transferring from Sampo to Transfercom

- 5.5 As discussed in Section 3.24, with effect from 1 April 2008, Sampo appointed Resolute as its run-off agent for the transferring business. The services provided under this appointment are set out in a Run-Off Services Agreement between Sampo and Resolute dated 3 April 2008. As Resolute is, like Transfercom, a subsidiary of Berkshire Hathaway it is my understanding that the intention of the Proposed Scheme is for the servicing of the transferring business to remain with Resolute and to proceed in the future according to existing standards of service and existing claims handling procedures.
- 5.6 Accordingly I do not expect the Proposed Scheme to have any effect on the administration for the transferring policyholders and hence no resulting effect on security or service levels for those policyholders.

- 5.7 My understanding is that the administration undertaken by Resolute of the servicing for the transferring policyholders and current policyholders of Transfercom is largely separated and that this would not change as a result of the Proposed Scheme. The two books of business are very independent with few, if any, claims in common. However it is possible in my opinion that a small amount of synergies may be realised by the Proposed Scheme, with a small improvement in expense levels resulting from both books of business being located in the same legal entity and hence a small benefit to transferring policyholders' security.
- 5.8 A previously agreed amount will be payable by Sompo 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. As a result there will be no investment risk to transferring policyholders in respect of the assets covering the underlying liabilities as this risk will be borne by NICO. As a result it is my view that the transfer will lead to a small reduction in the investment risk to the transferring policyholders and hence a small benefit to security levels.
- 5.9 The UK Branch of Sompo is part of the worldwide operations of Sompo and therefore transferring policyholders are currently subject to underwriting risk from the new business being written by Sompo. Transfercom is currently in run-off and therefore the transferring policyholders' exposure to underwriting risk will be reduced in conjunction with the Proposed Scheme.
- 5.10 There is a possibility that Berkshire Hathaway will choose to use Transfercom as the receiving vehicle for future transfers of run-off business, which could potentially be seen as increasing the new business risk to the transferring policyholders. However any such transfers would themselves be subject to Court approval, including consideration of an Independent Expert's opinion as to the likely effect of that transfer on the then existing policyholders of Transfercom (including the transferring policyholders under this Proposed Scheme). Accordingly it is my view that there is no significant increased new business risk to the transferring policyholders and hence no resulting impact on security or service levels from this risk.

Other considerations for current policyholders of Transfercom

- 5.11 Resolute already acts as the run-off service provider for the current policyholders of Transfercom and I understand that there is no proposal as part of the Proposed Scheme to alter any aspect of the administration arrangement. As a result I expect no resulting impact on the service levels to be provided to existing Transfercom policyholders.
- 5.12 My understanding is that the administration by Resolute of the servicing for the transferring and current policyholders is largely separated and that this would not change as a result of the Proposed Scheme. The two books of business are very independent with few, if any, claims in common. However it is possible in my opinion that a small amount of synergies may be realised by the Proposed Scheme, with a small improvement in expense levels resulting from both books of business being located in the same legal entity and hence a small benefit to current policyholders' security.
- 5.13 There should be no impact on investment risk as a result of the Proposed Scheme.

- 5.14 The Proposed Scheme has in my opinion no effect on the new business strategy of Transfercom and hence no resulting impact on the contractual rights or levels of service to be provided to existing Transfercom policyholders from this risk.

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Appendix A: Glossary of Terms

| | |
|------------------------|---|
| Effective Date | The intended effective date of the Proposed Scheme, 31 March 2010 |
| The FSA | The Financial Services Authority |
| FSMA | The Financial Services & Markets Act 2000 |
| The Independent Expert | When a scheme for transferring insurance business from one company to another is put to the Court for approval it has to be accompanied by a report on the terms of the scheme from an independent expert ("the Independent Expert"). This is a requirement under Part VII of the Financial Services and Markets Act 2000 ("FSMA"). |
| Marlborough | Marlborough Underwriting Agency Limited |
| NICO | National Indemnity Company |
| Nissan | Nissan Fire and Marine Insurance Company Limited |
| Previous Transfer | The previous insurance business transfer from Sompo to Transfercom which became effective on 1 March 2007. |
| Report | Independent Expert's report on the Proposed Scheme |
| Resolute | Resolute Management Limited |
| Sompo | Sompo Japan Insurance Inc. |
| Sompo UK | The UK Branch of Sompo Japan Insurance Inc. |
| Transfercom | Transfercom Limited |
| Yasuda | The Yasuda Fire and Marine Insurance Company Limited |

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Appendix B: Curriculum Vitae of the Independent Expert

Specialist area of expertise

Graham Fulcher is a Principal Actuary in Watson Wyatt's non-life insurance team. His specialist areas include reserving, reinsurance and pricing in the Lloyd's and London market.

Selected relevant experience

Prior to joining Watson Wyatt in August 2008, Graham worked in a number of Group or Chief Actuary positions in the Lloyd's and London Market.

From 1996 to 1998 Graham was the Actuary of the UK subsidiary of Cologne Re with primary responsibilities for the design of rating tools and techniques and for the design and marketing of new reinsurance products.

From 1998 to 2002 Graham was the Group Actuary for the Integrated Lloyd's vehicle Cox Insurance Holdings PLC which managed a number of Lloyd's syndicates. He was a Member of the Managing Agency Board and of the Commercial Executive team. Key responsibilities included reserving, design of reinsurance programmes and R&D for new lines of business.

In 2002 he joined ACE Tempest Re, the reinsurance arm of ACE, as Chief Actuary for their European operations and with responsibility for the technical pricing, finance and reserving functions for all areas including the aviation reinsurance account.

In 2005 he was appointed Chief Actuary of ACE European Group, running a large actuarial team with responsibilities for all actuarial and catastrophe modelling work (including modelling of reinsurance buying) for ACE's European entities across a range of London market businesses, including ACE's aviation account which acted as a market leader in airline business writing up to a 10% line. Additional personal responsibilities included chairing the Catastrophe Management Committees; membership of the Risk Management committees; leading the reserving committees and acting as head of ACE Global Marine Actuarial Product Board.

Since joining Watson Wyatt Graham has worked on a variety of reserving and Solvency II related projects, and has also been appointed as Skilled Person for a Section 166 Report.

Credentials and professional experience

Graham has been a Fellow of the Institute of Actuaries since 1993. He is Chair of the London Market Actuaries Group.

Graham has been involved in chairing a number of Institute of Actuaries GIRO Working Parties in areas such as Securitisation and Catastrophe Modelling. He is currently chairing a GIRO Working Party on the Solvency II requirements for an actuarial sign-off on underwriting policy and reinsurance adequacy.

Graham is a member of the FSA's Solvency II Expert Groups for Non-Life, Internal Models and Pillar V.

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Appendix C: Information Considered

For the purposes of this report I have reviewed the following information:

- The proposed insurance business transfer scheme
- The Framework Agreement between Sompo, NICO and Transfercom
- The Management Agreement between Sompo and Transfercom
- Details of the contracts to be transferred from Sompo UK to Transfercom
- The 2008 and 2009 Annual Reports for Sompo
- Detailed financial information for Sompo
- The FSA returns for Sompo UK for the years ending 31 March 2008 and 31 March 2009
- A copy of the ECR calculation for Sompo UK as at 31 March 2009
- A copy of the IBNR report undertaken by PricewaterhouseCoopers as at 31 March 2009 for the transferring business
- Copies of correspondence with the FSA concerning the transferring business
- Details of disputes in respect of the transferring business
- The 2008 and 2009 Annual Reports for Transfercom
- The FSA returns for Transfercom for the years ending 31 December 2007 and 31 December 2008
- A copy of the ECR calculation for Transfercom as at 31 December 2008

- A copy of the actuarial report undertaken by Beneficial Consultants LLC as at 31 December 2008 for Transfercom
- A copy of Transfercom's latest ICAS
- Copies of the outsourcing agreements for Transfercom
- A copy of the reinsurance contract with NICO which covers the existing business within Transfercom
- The Annual Statements for NICO as at 31 December 2007 and 31 December 2008

Appendix D: Extract from Terms of Engagement

Set out below is an extract of the terms of engagement describing the scope of the work to be undertaken.

Strictly private & confidential

Mr Ken Tsukui
Associate Director
General Manager of Claims
Reinsurance Department
Sompo Japan Insurance Inc.
26-1, Nishi-Shinjuku 1chome
Shinjuku-ku, Tokyo 160-8338
Japan

Dear Mr Tsukui

Engagement Letter – Proposed Part VII Transfer

We understand that it is proposed that there will be a transfer of a book of aviation reinsurance business from Sompo Japan Insurance Inc. ("Sompo" or "you") to Transfercom Limited ("Transfercom") using a Part VII transfer ("the Scheme") pursuant to the Financial Services and Markets Act 2000 ("the Act"). This letter, together with the enclosed general terms and conditions of business ("the general terms") sets out the basis upon which we will act as professional advisers to you in connection with this project ("assignment").

Scope

We will provide the following consulting services ("services"). Any variations to the scope of the services to be provided are to be agreed in writing between us.

Graham Fulcher will act as the Independent Expert in relation to the Scheme. The Financial Services Authority ("the FSA") will need to approve his appointment, pursuant to section 109(2) (b) of the Act. The Scheme will be developed in the light of further advice, but the current intention is for the transfer of business to be made by 31 March 2010. Should there be any material amendments to the nature of the scheme that fall outside the scope of this description then we reserve the right to amend or alter the terms of engagement accordingly subject to your prior written agreement

We will prepare a report ("the Report") in connection with the Scheme. The Report will comply with the guidance in paragraphs 18.2.31 to 18.2.41 inclusive of the FSA's Supervision Manual. The preparation of the Report and its contents will also comply with the relevant rules of Court, the relevant applicable Practice Direction and the Code of Guidance on Expert Evidence, and any other relevant professional guidance. We will also prepare a summary of the Report for inclusion in the statement to policyholders.

We will, via your legal advisors Lovells, contact the FSA once a draft of the Scheme has been made available to them to establish whether there are any matters relating to the Scheme or the parties to the Scheme that the FSA wishes to draw to our attention. We will provide draft and final copies of the Report to the FSA, and will use reasonable endeavours to make ourselves available to discuss matters with the FSA throughout the period of this engagement.

We will also respond to any reasonable enquiries made to us by policyholders or other interested parties in connection with the Report and review any complaints or objections that are made in respect of the Scheme.

Graham Fulcher will attend the Sanction Hearing at Court concerning the Scheme and be available to provide such evidence as the Court may require in respect of the Report. However, it is your responsibility to obtain confirmation of the availability of Graham Fulcher for the Court date and to advise us of the same at the earliest possible opportunity.

We will adhere to the timetable or any amendments to it as agreed by us provided that you provide us with all relevant documentation and materials necessary to meet such deadlines.

Obligations

In accordance with Part VII of the Act, the Independent Expert owes a duty to the Court to help the Court on such matters which are within his expertise. This duty overrides any obligation to any person or organisation from whom we have received instructions or by whom we are paid.

We will comply with the confidentiality obligations set out in our general terms of business.

In performing his obligations as Independent Expert Graham will work with other associates of Watson Wyatt Limited.

Confidentiality

You acknowledge that the advice, opinions, letters or other information provided by Watson Wyatt are provided solely for the specific purposes indicated to us or envisaged in these terms of engagement. Except as provided in this letter or where we agree separately in writing, they will not be disclosed or provided to any third party. In the absence of our express written agreement to the contrary, Watson Wyatt does not accept any responsibility whatsoever for any consequences arising from any third party relying on the Report and any related advice, opinions, letters or other information provided by us.

Letter of representation

We will ask you to sign a management letter of representation indicating that the data and information provided by you is accurate and complete, confirming that there are no material

inaccuracies or omissions in the description of your business given in our reports and that we may rely upon this information without verification unless specifically told otherwise.

Acceptance

Please could you sign and return to us a copy of this letter indicating your acceptance of its terms.

If you ask us to commence the provision of the services or allow us to continue to provide services after the delivery of this letter without your having objected to the terms of this letter then we shall be entitled to treat you as having accepted this engagement letter, the enclosed general terms and appendices.

Yours sincerely

Graham Fulcher
Watson Wyatt Limited

Encs: Terms & Conditions of Business
Data request

