Accountants &
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Proposed Part VII Insurance transfer of certain insurance business relating to certain Members at Lloyd's for any and all of the 1993 to 2020 (inclusive) years of accounts to

Lloyd's Insurance Company S.A.

Independent Expert Report of Carmine Papa

Dated: 1 May 2020

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1 Introduction

1.1 Background to the proposed transfer

1.1.1 On 23 June 2016, a majority of the people who voted in the European Union (EU) referendum voted for the UK to leave the EU. Following this vote, on 29 March 2017 the UK Government informed the Council of the European Union that it intended to leave the EU under Article 50 of the Lisbon Treaty. The original withdrawal date was to be 29 March 2019, but this date has been extended and on 24 January 2020 the UK and the EU signed an agreement (Withdrawal Agreement) which took the UK out of the EU with effect from 31 January 2020. The Withdrawal Agreement has a transition period which ends on 31 December 2020.

1.1.2 Following the transition period, absent any agreement otherwise, UK domiciled insurance entities (including Members at Lloyd's) will no longer be able to underwrite and service insurance contracts already written, throughout the European Economic Area (EEA) using their current Freedom of Services and/or Freedom of Establishment Permissions.

1.1.3 Servicing of insurance contracts will include the settlement of claims currently notified, or notified in the future, attaching to Lloyd's policies written between 1993 and 2020 where the Policyholder is located in the EEA and/or where all or part of the Policy relates to EEA risks.

1.1.4 Policies written prior to 1 January 1993 were transferred to Equitas Insurance Limited under a previous transfer under Part VII of the UK Financial Services and Markets Act 2000 (FSMA) and so do not form part of this transfer.

1.1.5 As a result of the above changes post the transition period, and subject to any new transitional measures agreed between the UK and the EEA, the Members of Lloyd's acting through their Syndicates, will no longer be able to service policies which fall within the jurisdiction of the EEA regulators without breaching legal or regulatory authorisation requirements in the EU (ignoring any temporary domestic permissions regimes). In particular, following the loss of passporting rights, the payment of claims to policyholders and other activities in respect of the Transferring Policies may be subject to regulatory or criminal sanctions.

1.1.6 Certain EEA member states have announced that they will apply a temporary national run off regime for policies of UK based insurers following Brexit (Temporary Run Off Regime). Such measures would mean that Transferring Policies subject to a Temporary Run Off Regime would not immediately need to be transferred under the Scheme. However, notwithstanding the operation of these Temporary Run Off Regimes, Lloyd's has decided to transfer all policies that would otherwise fall within the scope of a Temporary Run Off Regime on the basis that such an approach provides a more certain and permanent solution to Brexit.

1.1.7 **In my opinion, unravelling parts of the Scheme to take account of the Temporary Run Off Regimes would result in significant impracticality for Lloyd's and its Members and further uncertainty for policyholders (not least because of the differing approaches and time periods to such temporary regimes across EEA member states). This would leave open the risk that a further transfer would be required at a later stage to sweep up any residual policies which are no longer protected by a Temporary Run Off Regime. In my view there can be no certainty that any Temporary Run Off Regime will be sufficiently adequate and enduring to protect policyholders on a long term basis.**

1.1.8 Lloyd's has, therefore, decided to transfer those policies (or parts of policies) which fall within the definition of "Transferring Policy" to Lloyd's Insurance Company SA (LIC). LIC is a public limited insurance company registered in Belgium and regulated by the Banque Nationale de Belgique (NBB) and the Financial Services and Markets Authority (Belgian FSMA) (responsible for the equitable treatment of financial consumers and the integrity of the financial markets) to write certain classes of insurance business. Details of how the proposed Part VII transfer will operate are summarised in Section 4.

1.2 Scope of this report

1.2.1 Any proposed transfer of insurance business from a UK entity to another entity, whether resident in the UK or elsewhere, has to be sanctioned by the High Court of England and Wales (Court) pursuant to Part VII of FSMA. Section 109 of FSMA requires a report to be prepared for the Court by an expert (the Independent Expert) to aid it in its deliberation. The purpose of this report is also to inform the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) and Lloyd's Policyholders (including third party claimants against those Policyholders) of the impact of the proposed transfer on the security and service levels of both transferring and non-Transferring Policyholders.

1.2.2 This report has been prepared under Section 109 of the FSMA in a form approved by the PRA in consultation with the FCA. The report has been prepared in accordance with PRA guidance on Expert Reports published on 26 July 2018 and the FCA's approach to the review of Part VII insurance business transfers published on 29 May 2018. This report also complies with applicable rules on expert evidence and SUP18 of the FCA Handbook. Should other parties choose to rely in any way on the contents of this report, then they do so entirely at their own risk.

1.2.3 To the fullest extent permitted by law, PKF Littlejohn LLP and I will accept no responsibility or liability in respect of this report to any other party, other than as set out in my firm's engagement letter. This report is also subject to the terms and limitations of liabilities set out in the above engagement letter. An extract of my engagement letter which sets out the scope of my work is contained in Appendix 2.

1.3 Transfer scope

1.3.1 This report covers the proposed Part VII transfer of certain insurance business of certain Members, former Members and estates of former Members at Lloyd's for any of the 1993 to 2020 years of account in respect of current and potential insurance liabilities attaching to policies, or parts thereof, written by those Members which, immediately after the transition end date, require an authorised EEA insurer to carry out or service such a Policy (or part thereof) in order to ensure no legal or regulatory insurance authorisation requirements in the EEA are breached.

1.3.2 Included in this Scheme will be certain EEA risks which do not require an authorised EEA insurer to administer these policies following the transition end date.

1.3.3 The majority of policies subject to the Part VII transfer were written with inception dates between 1 January 1993 and 31 December 2018. Lloyd's intention was to ensure all policies written from 1 January 2019 with an EEA element were written through LIC. However, the scope of the transfer was extended to cover a limited number of EEA policies written by Members for 2019 and 2020 for the following reasons:

- a number of Coverholders were not able to set up the required procedures by 31 December 2018 and Lloyd's granted an extension to certain Managing Agents to allow about 300 Coverholders to continue to write EEA business, the last extension expiring on 12 April 2019;
- as a result, Xchanging continued to accept EEA business under a Lloyd's Syndicate stamp up to 12 April 2019;
- certain in-scope inwards reinsurance business, but only where the cedant is domiciled in Germany, will continue to be written by Members in 2020.

1.3.4 The Part VII transfer does not cover the assets and liabilities, or potential liabilities, attaching to the following:

- policies that are Long-Term Insurance Contracts (life policies)
- Non-EEA Policies (as defined in the Scheme Document)
- policies not capable of being transferred pursuant to Section 111 of FSMA (if any)
- a policy, or part thereof, which would otherwise fall within the definition of an EEA Policy, but which was written subject to the Lloyd's licence in Australia, Canada, Hong Kong, Singapore, South Africa and/or Switzerland (the Excluded Jurisdiction Policies)
- any Non-Insurance Liabilities of the Members arising in connection with the Part VII transfer, such as Conduct Liabilities or Tax liabilities.

Excluded Non-Insurance Liabilities include, amongst others, the following:

- Liabilities of Members not arising in connection with the Transferring Business.
- Liabilities/obligations arising in connection with the sale, management or conduct of the Transferring Policies prior to the date of transfer including mis-selling liabilities, losses and obligations arising from:
  - complaints, claims, legal action or settlements
  - failure by Members to comply with applicable law/regulations or industry practise
  - penalty fines levied as a result of any judgement or arbitration in respect of the above.
- Legal costs in investigating and defending the above.
- Tax liabilities arising, or relating to the period, prior to the date of transfer arising in connection with the Transferring Business.

1.3.5 For clarification purposes, the proposed Part VII transfer is intended to cover the following policies (or parts thereof), if not excluded under the above paragraph:

- direct insurance policies written which relate to EEA situs risks or have been issued to Policyholders resident in the EEA
- multi-jurisdiction direct insurance policies which have been issued to Policyholders resident in the EEA or part of the risk situs is within the EEA. Only the EEA part of the Policy is subject to the Part VII transfer
- inward reinsurance policies written where the cedant is domiciled in Germany.

1.3.6 In summary, policies which will transfer under the Scheme are:

(a) policies (or parts thereof) identified as at the Effective Date which are not Excluded Policies and fall into one of the following categories:

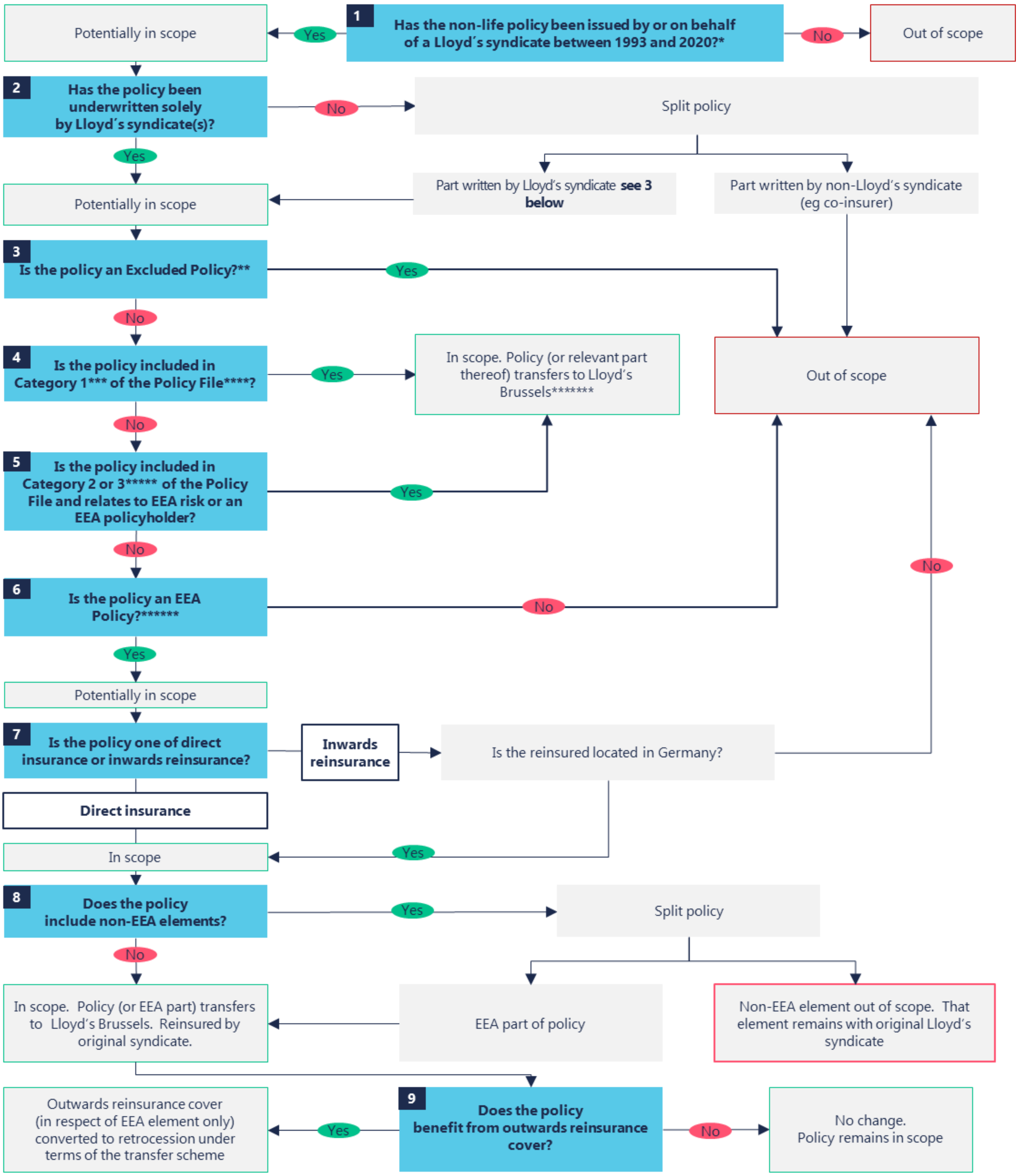
- Category 1: policies which have been identified as having a risk situated in the EEA and/or a policyholder resident in the EEA;
- Category 2: policies which have been identified as being multijurisdictional policies which may have EEA risk elements and the policyholder is either unknown or a non-EEA resident and it has not been possible to determine with sufficient certainty that they are Transferring Policies. Such policy will be a Transferring Policy if it is determined (at the point when sufficient information is available) that the policy relates to a risk situated in the EEA or was issued to a policyholder resident in the EEA;
- Category 3: policies which have been identified but Lloyd's has not yet determined whether or not the policy covers a risk situated in the EEA

and/or is issued to or is held by a policyholder resident in the EEA and it has not been possible to determine with sufficient certainty that they are Transferring Policies. Such policy will be a Transferring Policy if it is determined (at the point when sufficient information is available) that the policy relates to a risk situated in the EEA or was issued to a policyholder resident in the EEA

(b) policies (or parts thereof) which are not identified as falling within the above categories and which immediately after the Transition End Date will require an insurer authorised by an EEA regulator to carry out or service such policy in order to ensure no legal or regulatory insurance authorisation requirements in the EEA are breached and are not Excluded Policies.

1.3.7 An overview schematic of the policies in-scope of the proposed Lloyd's Part VII transfer is set out below.

In-scope policies for Lloyd's Part VII transfer



* Note: All life insurance policies are out of scope of the transfer.
** Note: Please refer to the Scheme Document for a definition of "Excluded Policy".
*** Note: "Category 1" policies means those policies included in the Policy File which have been identified prior to the Effective Date and it is possible to determine with sufficient certainty that they are Transferring Policies.
**** Note: Please refer to the Glossary of this Report for a definition of "Policy File".
***** Note: "Category 2 or 3" policies means those policies included in the Policy File which have been identified prior to the Effective Date but it has not been possible to determine with sufficient certainty that they are Transferring Policies.
****** Note: Please refer to the Scheme Document for a definition of "EEA Policy".
******* Note: Multijurisdictional policies with an EEA policyholder transfer as a whole. Multijurisdictional policies with a non-EEA policyholder, only the EEA risk part transfers.

1.4 Independent Expert – Statement of Independence

1.4.1 I, Carmine Papa, am a Partner of PKF Littlejohn LLP and a Fellow of the Institute of Chartered Accountants in England and Wales. My detailed curriculum vitae is included in Appendix 3.

1.4.2 I have been appointed by Lloyd's to act as the Independent Expert in connection with this transfer. My appointment has been approved by the PRA in consultation with the FCA. My fees will be met by Lloyd's directly and I have no financial interest in Lloyd's or LIC.

1.4.3 I have been involved with the Lloyd's insurance market in a number of capacities for the last 35 years, including assessment of the Lloyd's Syndicates insurance liabilities and assessing the quality of the actuarial projections to assess those liabilities.

1.4.4 My firm, PKF Littlejohn LLP, currently acts as auditors and professional advisers to a number of Syndicates. Currently I have no direct involvement with Syndicate audits nor do I currently advise Syndicates in a professional capacity. My firm's fees for those Syndicates we currently act for as Syndicate auditors and professional advisers represents less than 2% of PKF Littlejohn LLP's total fees for our last financial year. Neither PKF Littlejohn LLP nor I have acted for Lloyd's for at least the last 10 years and we have never acted for LIC in any capacity.

1.4.5 I have no reasons to believe that my independence is impaired as a result of any matter set out above.

1.4.6 In preparing this report I have been assisted by my team, however, any review or analysis from my team has been carried out under my supervision. Further, where appropriate, I have taken my own independent legal and actuarial advice. The report has been written in the first party singular and the opinions expressed therein are my own.

1.4.7 I have not independently verified the data and information provided to me by Lloyd's, or by any other parties, accordingly my work does not constitute an audit of the financial and other information. Where I believe it was appropriate, and as indicated in this report, I have applied certain review procedures to satisfy myself that the information provided is reasonable and consistent based on my experience and knowledge of the Lloyd's and wider insurance market. I have also met in person, or conducted telephone conference calls, with representatives of Lloyd's, LIC and their professional and legal advisers.

1.4.8 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.

1.4.9 Representation letters have been provided to me from officers of both Lloyd's and LIC (see Appendix 4) in respect of matters which could not be verified by other means. All information I have requested has been made available to me by both Lloyd's and LIC, provided such information was in their possession.

1.4.10 In coming to the opinions I have expressed in this report, I have taken the following approach:

- obtaining an understanding of the potential effect of Brexit on the insurance industry and, in particular, on how it may impact on future passporting arrangements
- gaining an understanding of how Lloyd's and LIC operate within Lloyd's and the wider insurance market
- obtaining an understanding of how the regulatory and solvency requirements are applied to both the Lloyd's market in the UK and to LIC under Belgium regulations
- identifying the group of Policyholders who may be impacted by the proposed Part VII transfer
- obtaining an understanding on how the proposed transfer will impact financially and non-financially on affected Policyholder groups
- considering the reasonableness of any assumptions made by Lloyd's and LIC in order to assess the impact of the proposed approach
- I have conducted certain review procedures and stress testing, as I believe to be appropriate, to satisfy myself of the veracity of my opinion.

1.4.11 Throughout this report I make reference to financial items or events which have no material adverse effect. I consider an event or outcome to not have a material adverse effect if, in my opinion, the expected impact of the event is very small, such that it would not influence the decisions of a reader either on its own or in conjunction with other similar defined events. In assessing whether an event impact is very small, I have considered the following:

- the very low probability of the event occurring
- a very low financial impact of the event
- a combination of the two matters above.

Similarly, I consider an event to have low probability if, in my opinion, the chance of it occurring is so small that it would not influence the decisions of a reader of this report. I consider an event to be unlikely if it has a low probability of occurring.

1.4.12 Throughout this report sections highlighted in bold reflect my opinion on the subject matter. Definitions for capitalised terms may be found in the Glossary.

1.4.13 In reporting to the Court on the proposed transfer, my overriding duty is to the Court.

1.4.14 I confirm that I am aware of the requirements of Part 35 of the Civil Procedure Rules, Practice Direction 35 and the Protocol for Instruction of Experts to give Evidence in Civil Claims.

1.5 Structure of this report

1.5.1 This report must be read in its entirety. Reading individual sections in isolation may be misleading. I will publish a supplementary report confirming (or not) my findings prior to the final Court hearing planned to be heard in October 2020.

1.5.2 Section 2 includes my executive summary which summarises the key points of the proposed Part VII transfer and my conclusions on those points.

1.5.3 The remaining sections of the report deal with the following matters:

Section 3	An overview on how the Lloyd's market operates.
Section 4	A brief description of the structure of the proposed Part VII transfer and my opinion and conclusion on its key terms and risks.
Section 5	The actuarial projections of the liabilities attaching to the Transferring Policies.
Section 6	The impact of the proposed Part VII transfer on non-Transferring Policyholders, including the impact on Lloyd's solvency capital and my conclusion thereon.
Section 7	The impact of the proposed Part VII transfer on Transferring Policyholders, including the impact on LIC's solvency capital and the details of the operational procedures planned to be put in place by LIC following the transfer and my conclusion thereon. This section also deals with the impact on LIC's current policyholders.
Section 8	Details of Lloyd's Policyholders notification strategy, including the waivers to be sought from the Court and my conclusion thereon.
Section 9	Other matters not covered by the above sections, including COVID-19.

2 Executive summary

2.1 Background

2.1.1 On 23 June 2016, a majority of the people who voted in the European Union (EU) referendum voted for the UK to leave the EU. Following this vote, on 24 January 2020 the UK and the EU signed an agreement (Withdrawal Agreement) which took the UK out of the EU with effect from 31 January 2020. The Withdrawal Agreement has a transition period which ends on 31 December 2020.

2.1.2 Following the transition period, absent any agreement otherwise, UK domiciled insurance entities (including Members at Lloyd's) will no longer be able to underwrite and service insurance contracts already written, throughout the European Economic Area (EEA) using their current Freedom of Services and/or Freedom of Establishment Permissions without breaching legal or regulatory authorisation requirements in the EU (ignoring any temporary domestic permissions regimes).

2.1.3 Servicing of insurance contracts will include the settlement of claims currently notified, or notified in the future, attaching to Lloyd's policies written between 1993 and 2020 where the Policyholder is located in the EEA and/or where all or part of the Policy relates to EEA risks.

2.1.4 Lloyd's has, therefore, decided to transfer certain policies (or parts of policies) which fall within the definition of "Transferring Policy" to Lloyd's Insurance Company SA (LIC) a wholly owned subsidiary of Lloyd's. LIC is a public limited insurance company registered in Belgium and regulated by the Banque Nationale de Belgique (NBB) and the Financial Services and Markets Authority (Belgian FSMA).

2.1.5 Lloyd's has considered alternatives to the proposed Part VII transfer including taking advantage of Temporary Run Off Regimes that certain EEA member states have announced will apply. Such measures would mean that Transferring Policies subject to a Temporary Run Off Regime would not immediately need to be transferred under the Scheme. However, unravelling parts of the Scheme to take account of the Temporary Run Off Regimes would result in significant impracticality for Lloyd's and its Members and further uncertainty for policyholders, especially given the non-uniform manner in which Temporary Run Off Regimes have been set up across EEA member states and their limited time duration.

2.2 Lloyd's Background

2.2.1 Lloyd's is a society incorporated as a statutory corporation by the Lloyd's Act 1871. Lloyd's does not underwrite risks on its own behalf. Lloyd's is a market, run by the Council of Lloyd's, where Members acting through insurance Syndicates, arrange insurance for their customers. A Lloyd's Syndicate is made up of a group of underwriters (Members) who can be individuals, partnerships or corporate entities which put up the underwriting capital against their share of the insurance risk accepted and are liable for any subsequent profit or loss.

2.2.2 The operations of a syndicate are managed by a Managing Agent, an independently owned company set up to manage the Syndicate on behalf of the Members of that Syndicate. Managing Agents may manage the affairs of more than one Syndicate.

2.2.3 Lloyd's Syndicates have no separate legal personality and, therefore, it is the Members themselves who underwrite risk and remain liable for business written by the Syndicate.

2.2.4 Members join a Syndicate only for a calendar year with the Syndicate accepting risks incepting in that calendar year only. Thereafter, if a member wishes to continue to underwrite they must join the subsequent calendar year of that, or another, Syndicate.

2.2.5 Lloyd's is responsible for the oversight of the market in which syndicates and other entities operate within.

2.2.6 When a Syndicate accepts a risk from a Policyholder, each member of the Syndicate for that particular underwriting year is legally liable for their share of any claims which attach to those policies. Members are only liable for their share of the risk and have no liability for other Members' share of the risk.

2.2.7 The capital structure which provides security to Policyholders of the Lloyd's market is unique in the global insurance market.

2.2.8 There are three links to this security:

1st link £53.4bn	**Syndicate level assets**
2nd link £26.5bn	**Members' funds held by Lloyd's**
3rd link £4.1bn	**Central Funds**

Figures in billions as at 31 December 2018

2.2.9 The first two links are held in trust primarily for the benefit of Policyholders. They can only be used to settle a Member's liability for policies either directly written by that member or reinsured by the Reinsurance to Close process. A Member's assets are only at risk for policies written on their own account and are not available to settle other Members' losses.

2.2.10 The third link contains mutual assets held by Lloyd's which are available, subject to the Council of Lloyd's approval, to meet any Members' liabilities, which cannot be met out of the Members own funds.

2.3 Lloyd's Insurance Company SA (LIC)

2.3.1 LIC was authorised to write new insurance business from 1 January 2019. LIC has an insurance and reinsurance license at the NBB for all of the non-life classes of business that will be transferred to it under the proposed Part VII transfer.

2.3.2 LIC is a vehicle which was established by Lloyd's to allow EEA policyholders continued access to Lloyd's market expertise in a manner compliant with EU regulation post Brexit.

2.3.3 LIC reinsures 100% of the insurance business it underwrites with Syndicates in the Lloyd's market under current reinsurance agreements. Each insurance risk is reinsured with the same Syndicate managed by the Managing Agent that has bound the insurance risk on behalf of LIC. An outsourcing agreement, by which underwriting services (and other activities) are provided by a Managing Agent as a service provider to LIC, has been entered into between LIC and each Managing Agent.

2.3.4 Each year Managing Agents wishing to reinsure EEA business must propose a business plan to LIC. These plans are reviewed and approved by LIC's Chief Underwriting Officer and Underwriting Committee and the business plan considered and adopted by the LIC Board. Under the current reinsurance agreements with Lloyd's Syndicates, LIC is entitled to a commission calculated by applying a percentage to the gross written premium receivable by LIC.

2.3.5 LIC has been given the same ratings as those for the Lloyd's market in the UK as Lloyd's Syndicates reinsure 100% of the risks underwritten through LIC. These ratings are AM Best (A Excellent), Standard & Poor's (A+ Strong) and Fitch Ratings (AA- Very Strong).

2.4 Details of the Scheme

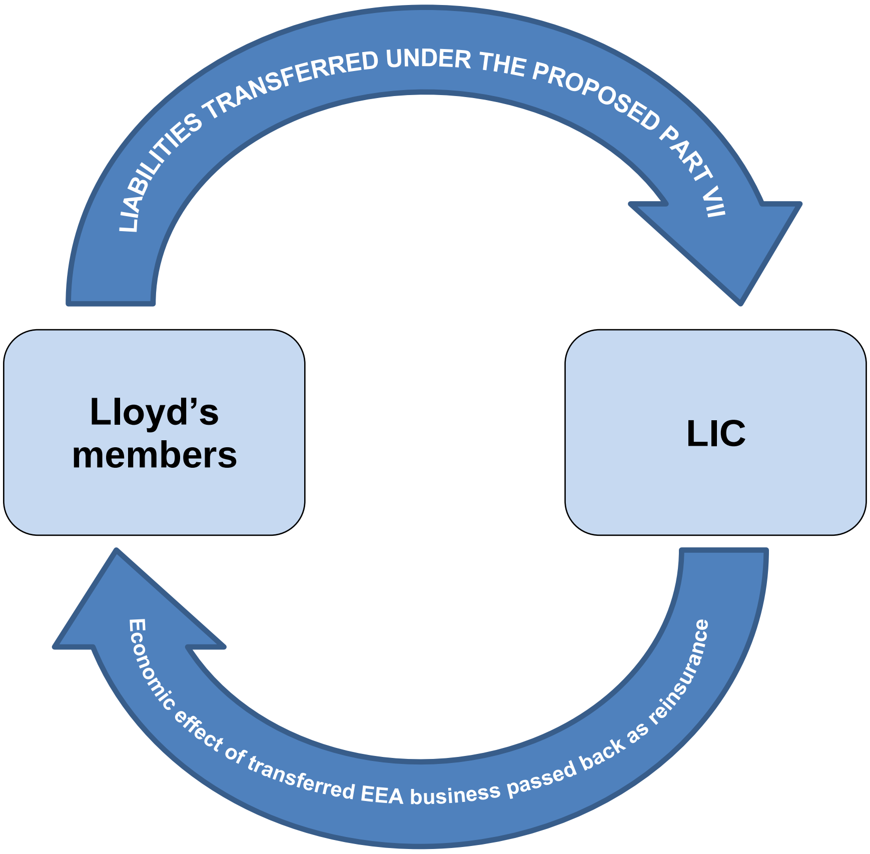
2.4.1 The scheme covers the proposed Part VII transfer of certain insurance business of certain Members, former Members and estates of former Members at Lloyd's for any of the 1993 to 2020 years of account in respect of current and potential insurance liabilities attaching to policies, or parts thereof, written by those Members which, immediately after the transition end date, require an authorised EEA insurer to carry out or service such a Policy (or part thereof) in order to ensure no legal or regulatory insurance authorisation requirements in the EEA are breached.

2.4.2 Details of how the Scheme will operate are as follows:

- Each Transferring Policy will be transferred from the current Lloyd's Syndicates to LIC.
- Liabilities (other than Excluded Liabilities) attaching to the Transferring Policies will be transferred and become a liability of LIC. Accordingly, these liabilities will cease to be a direct liability of the Syndicate Members.
- All rights, benefits, powers and obligations of the Members exercised through the Syndicate, in connection with the Transferring Business, will also transfer to LIC.
- Any Transferring Policyholder will have rights against LIC instead of the member(s) of the Syndicate; LIC will effectively step into the shoes of the Members.

2.4.3 Prior to the Effective Date of the Scheme, LIC and in each case, the Members of each relevant Syndicate will enter into 100% quota share reinsurance contract agreements to cover the business transferred to LIC (together, referred to as the QS Reinsurance Contracts). When the QS Reinsurance Contracts become effective the insurance liabilities under the Transferring Policies transferred to LIC, by the proposed Part VII Scheme, will be fully reinsured back to the Members of the same Syndicate, that originally underwrote the policy.

2.4.4 **As result of the QS Reinsurance Contract, economically the liabilities attaching to the Transferring Policies will, in my opinion, continue to rest with those Members who originally underwrote those policies, or subsequently assumed those liabilities through the Reinsurance to Close process. I have represented this schematically as follows:**



2.4.5 Each Syndicate on behalf of its Members has purchased different reinsurance programmes (Outward Reinsurance) to protect the business the syndicate writes. These policies will therefore cover some of the liabilities attaching to the Transferring Policies. These Outward Reinsurance programmes will vary annually both in coverage and in reinsurer participation.

2.4.6 Under the proposed Scheme, the existing Syndicate Outwards Reinsurance Agreements will not be transferred with the Transferring Policies to LIC. Accordingly, Lloyd's intend to seek Court approval to convert, as part of the terms of the Scheme, these existing Outwards Reinsurance Agreements to attach to all or any part of each Syndicate's QS Reinsurance Contract with LIC. This effectively converts the existing Syndicate Outwards Reinsurance to retrocessional cover.

2.5 Methodology Adopted

2.5.1 I have not independently verified the data and information provided to me by Lloyd's, or by any other parties, accordingly my work does not constitute an audit of the financial and other information. Where I believe it was appropriate, I have applied certain review procedures to satisfy myself that the information provided is reasonable and consistent based on my experience and knowledge of the Lloyd's and wider insurance market. I have also met in person, or conducted telephone conference calls, with representatives of Lloyd's, LIC and their professional and legal advisers.

2.5.2 **In coming to my opinions expressed in this report, I have taken the following approach:**

- **obtaining an understanding of the potential effect of Brexit on the insurance industry and, in particular, how it may impact on future passporting arrangements**
- **gaining an understanding of how Lloyd's and LIC operate within Lloyd's and the wider insurance market**
- **obtaining an understanding of how the regulatory and solvency requirements are applied to the Lloyd's market in the UK and to LIC under Belgium regulations**
- **identifying the group of Policyholders who may be impacted by the proposed Part VII transfer**
- **obtaining an understanding on how the proposed Part VII transfer will impact financially and non-financially on affected Policyholder groups**
- **considering the reasonableness of any assumptions made by Lloyd's and LIC in order to assess the impact of the proposed approach**
- **I have conducted certain review procedures and stress testing, as I believe to be appropriate, to satisfy myself of the veracity of my opinion.**

2.5.3 In completing the above work my team, where appropriate, has complied with TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance as issued by the UK Financial Reporting Council. My team has also complied with the Institute and Faculty of Actuaries professional standards APS X1 and APS X2.

2.6 Key Risks

2.6.1 **In my opinion, the key risks attaching to this proposed Part VII transfer are:**

- **The risk that the QS Reinsurance Contract will not fully reinsure the risk attaching to the Transferring Policies back to the applicable Lloyd's Syndicate;**
- **The risk that Court does not have the power under the FSMA to convert the existing Syndicate Outward Reinsurance into retrocessional cover;**
- **The risk that for the Syndicate reinsurers, domiciled outside the UK, the court system in their country of domicile will not recognise the Court Order.**

2.6.2 **Based on the independent legal advice I have received, and my understanding of the willingness of all parties to rectify any future misunderstanding in the terms of the pro-forma QS Reinsurance Contract, I have concluded the failure of the QS Reinsurance Contract is not a material risk.**

2.6.3 I have also obtained legal advice in relation to the scope of the Court's powers under section 112 of FSMA including the power to convert the existing Syndicate outward reinsurance into retrocessional cover pursuant to the terms of the transfer Scheme. The advice I have received supports Lloyd's and its own advisers view that the Court does have the power to make such a Court Order.

2.6.4 **In my opinion, the effect of the proposed Court Order should mean that the same Outwards Reinsurance is in place for Members pre and post transfer and that all Policyholders, after the transfer, will benefit from the same ability of Members to make recoveries on their Outwards Reinsurance as is currently in place.**

2.6.5 In order to assess the risk whether non-UK Courts are likely not to recognise the Court Order in respect of reinsurers not domiciled in the UK, Lloyd's has taken advice, which I have relied on, from their legal representatives in the United States, Bermuda and Germany. These countries together with the UK represent approximately 83% of the Member Outward Reinsurance exposure.

2.6.6 **Based on this legal advice, I have been able to conclude that the risk that a reinsurer in an overseas jurisdiction will succeed in challenging a Court Order, which converts the existing Syndicate Outwards Reinsurance to retrocessional cover, is not a material risk.**

2.6.7 **I have further concluded that, as the economic exposure of the Outwards Reinsurers to policies written by the Members remains the same pre and post Transfer and there will be no material adverse effect on the Outwards Reinsurers as a result of this proposed Part VII.**

2.7 Impact on Lloyd's

2.7.1 Lloyd's has estimated that the total insurance liability which will transfer at the effective date of the scheme will be €4.7bn on an ultimate basis excluding ULAE. Most of these liabilities relate to three classes of business as follows:

	Amount €bn	% of total
Class of business		
Casualty financial and professional liabilities	1.4	29
All other casualty, excluding Treaty	1.2	26
Marine	0.7	16
Other classes	1.4	29
	4.7	**100**

Based on my work, I have been able to conclude that the above estimate reflects the current best estimate of the value of the liabilities attaching to the Transferring Policies at the time of the Effective Date.

2.7.2 Throughout this report as LIC's solvency is determined in Euros and all amounts referred to are in Euros (unless otherwise stated). As at 31 December 2019 the rate used to convert Euros to Pounds Sterling was €1 = £0.85 or alternatively £1 = €1.18.

2.7.3 The Solvency Capital Requirements (SCR) is a measure of the regulatory capital requirement insurers are required to maintain by the appropriate Solvency II regulations and is an estimate of the capital required to ensure that an insurer is able to meet its obligations over the next 12 months. Given the uniqueness of the Lloyd's market, Lloyd's is required to calculate the two SCR's as follows:

- The Market Wide SCR ("MWSCR") – this includes all risks of Members of Lloyd's across the market and can be covered by eligible funds from all three links in Lloyd's chain of security, including those arising from Syndicate activities, Members' funds at Lloyd's and the Central Fund.

- The Lloyd's Central SCR ("CSCR") – this captures only risks faced by the Central Fund, in the event that Members fail to meet their liabilities even having complied with Lloyd's capital setting rules. Only eligible capital available to Lloyd's centrally may be used to cover the CSCR.

Eligible funds (both market level and centrally held) exclude any assets which are ringfenced for Lloyd's overseas subsidiaries, including LIC.

2.7.4 **I have estimated the impact on both Lloyd's MWSCR and CSCR Solvency Ratio's as a result of the proposed Part VII transfer to be as follows:**

	MWSCR £bn A	CSCR £bn B
Pre-transfer		
Gross claims Reserves*	80.0	0
Net claims Reserves*	55.0	0
SCR	**17.8**	**1.4**
Available capital	29.0	3.6
Solvency surplus	11.3	2.3
Solvency ratio (Available capital/SCR as %)	163%	258%
Impact of transfer & 100% QS Reinsurance Contract		
Gross claims Reserves	0	0
Net claims Reserves	0	0
SCR	**0**	**0**
Available capital	(0.3)	(0.3)
Solvency surplus	(0.3)	(0.3)
Post-transfer		
Gross claims Reserves	80.0	0
Net claims Reserves	55.0	0
SCR	**17.8**	**1.4**
Available capital	28.7	3.3
Solvency surplus	11.0	2.0
Solvency Ratio	**161%**	**236%**
Change in Solvency Ratio	**(2%)**	**(22%)**
Lloyd's risk appetite	**125%**	**200%**

**As at 30 June 2019*

2.7.5 There is no material impact on the gross or net claims Reserves in column A of the above table, as the gross liabilities attaching to the Transferring Policies are replaced on a like for like basis, with liabilities under the QS Reinsurance Contract with LIC.

2.7.6 Following the Part VII transfer there is a reduction in the Central Fund assets of £0.3bn due to funding the extra costs to be incurred by LIC arising as part of the transfer of the business and the capital injection required to enable LIC to meet its solvency requirements. This impacts the solvency ratios as follows:

- A 2% decrease in the MWSCR. However, the revised solvency ratio of 161% is still well above Lloyd's risk appetite of 125%.

- A 22% decrease in the CSCR to 236%. Even after this reduction, the Central Fund solvency ratio is well above the Lloyd's risk appetite of 200%.

2.7.7 Following the proposed Part VII transfer, I have concluded that the Lloyd's and Members available capital to meet liabilities reduces by £0.3bn to £28.7bn (column A). However, this amount includes the surplus of Syndicate net assets and a surplus of Members' funds at Lloyd's, which at 31 December 2018 amounted to £23.4bn. This latter element cannot be used to pay the loss of one Member out of the assets of another Member. Therefore, the actual resources available to settle Policyholders claims are, in my opinion, significantly more restricted than the £28.7bn of available capital shown in paragraph 2.7.4.

2.7.8 **Lloyd's has stated in its Solvency and Financial Condition Report as at 31 December 2018 that all of the Members were solvent. However, I have concluded that if any future stresses to solvency fall unevenly across Members, then certain Members could become insolvent whilst other Members remain solvent but their assets cannot be used to meet the insolvent Members shortfall.**

2.7.9 Lloyd's seeks to protect against this by having in aggregate a 35% uplift of solvency assets for each Members above their individual SCR capital requirement. In addition, following the proposed Part VII transfer, Central Fund assets of £3.4bn, will still be available to meet Policyholders liabilities should individual members not have sufficient funds to do so.

2.7.10 **The only change, in my opinion, impacting the Members as a result of this proposed Part VII transfer is that their liabilities to claims arising on the Transferring Policies will be replaced by an identical liability to LIC.**

2.7.11 Individual Members of Lloyd's underwrite on their own behalf and therefore whether a Policyholder's valid claims are met will, in my opinion, primarily rest with the financial security of the individual Members. Only once a Member is unable to settle a valid claim will Lloyd's, subject to their discretion, use the assets of the Central Fund to meet the Policyholder's liabilities.

2.7.12 As a result of the proposed Part VII transfer and the Members entering into the proposed QS Reinsurance Contracts, the exposure of Members to Policyholder's claims is, in my view, unchanged pre and post this proposed Part VII transfer. **None of the Members current assets will be used to fund LIC, and therefore the security of Members funds to settle potential claims for non-Transferring Policyholders claims is not materially affected by this proposed Part VII transfer.**

2.7.13 **The non-Transferring Policyholders security will however, in my view, be impacted as €388m (£328m) of Central Fund assets will be used to fund the Solvency Capital Requirement of LIC and the additional running costs of LIC to process the transferred liabilities. These funds will no longer be available to settle non-Transferring Policyholders claims should the individual Members, not have the necessary funds to settle their claim.**

2.7.14 **I have concluded that the MWSCR calculated by Lloyd's is a measure of how robust the Members, in aggregate, could handle a substantial claim or series of claims which would otherwise require a substantial call on the assets of the Central Fund. The MWSCR Solvency Ratio, following the proposed Part VII transfer, remains well above the risk appetite set by Lloyd's and therefore the security available for non-Transferring Policyholders following the proposed Part VII transfer will, in my opinion, continue to remain strong.**

2.7.15 **I have reviewed the process and procedures Lloyd's has adopted to assess current and future risks and I am satisfied that the risk of a major cash call on the Central Fund is unlikely in the foreseeable future and would require a series of catastrophic events to occur in the same financial year. Lloyd's has estimated that it would require a Lloyd's market wide loss of £20.2bn which the internal model Lloyd's uses to calculate it Solvency Capital Requirement (LIM) predicts to be a 1 in 450 year event to reduce the Central Fund assets by £2.9bn.**

2.7.16 **Accordingly, I have concluded that Policyholders whose risks are not being transferred to LIC will not suffer a material adverse effect as a result of the proposed Part VII transfer, as the Central Fund, subject to Lloyd's discretion, will have sufficient funds to meet Policyholders' claims (in the event of a Members default) for all reasonably foreseeable events.**

2.8 Impact on LIC's Solvency

2.8.1 In order to calculate its solvency requirement, LIC uses the standard formula to calculate its solvency capital. I have estimated the impact of the Part VII transfer on LIC Solvency Ratio at 31 December 2020 to be as follows:

LIC Solvency	Before Part VII €m	After Part VII €m	Movement €m
Underwriting risk	10	18	8
Market risk	17	23	6
Counterparty risk	131	289	158
Diversification credit	(17)	(25)	(8)
Operational risk	42	91	49
Pillar 2 adjustment	6	11	5
SCR	**189**	**407**	**218**
Capital injection	0	313	313
Other own funds	249	222	(27)
Pillar 2 adjustment	(1)	(1)	-
Total own funds	**248**	**534**	**286**
Solvency surplus	**59**	**127**	**68**
Solvency Ratio	**131%**	**131%**	**0%**

2.8.2 The most significant change arises on the assessment of counterparty risk. Counterparty risk is the risk of a counterparty not settling amounts fully when due. The increase is due to the additional gross liabilities transferred to LIC under the proposed Part VII transfer and the recoverability of those liabilities from the Members under the QS Reinsurance Contract.

2.8.3 Overall there is no material change in the Solvency Ratio for LIC as a result of the Part VII transfer as Lloyd's intends to increase LIC's Own Funds in order to mitigate any adverse impact on LICs Solvency II capital requirements as a result of the Part VII transfer.

2.8.4 The board of LIC has modelled the company's solvency position based on the forecast profit and loss and balance sheets to 31 December 2022.

2.8.5 The projected SCR requirement is expected to gradually reduce, primarily due to the counterparty risk decreasing as Part VII liabilities decrease at a faster rate than new business liabilities are added. The reason for this reduction is as part of LIC's assumptions in projecting its SCR requirement it is expected that loss ratios for new business, which is supported by Lloyd's market data, are slightly lower than the loss ratios of the Part VII Transferring Liabilities which gives rise to reduced future Reserves and therefore a lower counterparty risk in the future. The own funds gradually increase mainly through retained cash from the LIC retained commission on new business exceeding expenses and the release of the Part VII expense reserve established to run off the liabilities attaching to the Transferring Policies. The resultant Solvency Ratio improves over the period and stays well above the 125% target risk appetite set out by the board.

2.8.6 **I have compared the results of the SCR produced by LIC with the results of re-performing their calculation using an alternative standard formula model, both before and after the transfer. I have also stress tested some of the more significant components of the SCR calculation. Therefore I am satisfied that LIC's current solvency capital and its projected solvency capital following the Part VII transfer have been calculated on a reasonable basis.**

2.8.7 **In my opinion, the key risks in forecasting LIC's solvency capital is the counterparty risk. This is the risk that the Syndicate and the Lloyd's Central Fund will be unable to meet valid claims from LIC's current underwriting and the liabilities arising from the proposed Part VII transfer.**

2.8.8 The SCR loading for counterparty risk following the transfer of the proposed Part VII transfer is an increase of €158m based on an increase in ultimate insurance liabilities of €4.7bn which are then 100% reinsured back to the Members.

2.8.9 In the table below, I have calculated the effect on LIC's Solvency Ratio resulting from a potential 5, 10 and 15 percent underestimate of the insurance liabilities being transferred under this proposed Part VII:

Percentage increase in PVII liabilities %	Reduction in Solvency Ratio %
5	-4
10	-8
15	-11

2.8.10 The above table shows even if the quantum of projected liabilities on the actuarial projections are understated by 15%, then LIC's Solvency Ratio, at the Effective Date, will reduce to 120% which is below LIC's risk appetite but above the minimum capital requirement. In my opinion, as claims relating to the Part VII Transferred Liabilities are settled and recovered from the Members the counterparty risk reduces and the Solvency Ratio will increase and will likely exceed the 125% risk appetite by 31 December 2021.

2.8.11 **The proposed capital injection by Lloyd's of €313m will, in my view, cater for any currently reasonably foreseeable underestimation in the calculation of insurance liabilities being transferred to LIC. In arriving at the above opinion, I have also taken into account Lloyd's current intention to provide enough funding to LIC to enable it to operate and meet its Solvency Capital Requirement going forward.**

2.8.12 The board of LIC have identified the following additional potential risks which the company faces following the Part VII transfer:

- Decrease in gross premium written
- Increase in expenses (including Part VII expenses)
- Increase in exchange rate
- GDPR breach fine
- Rating down grade of the Lloyd's market to BBB.

2.8.13 The above risks together with the risk of the liabilities attaching to the proposed Part VII transfer proving to be under reserved have been stressed by LIC in their latest ORSA.

2.8.14 For most of the scenarios LIC's solvency ratio remains above the minimum SCR and the risk appetite. In some scenarios the solvency ratio is still above the minimum SCR but below the risk appetite but recovers in future years. The only two scenarios where they fall below the minimum SCR is a rating downgrade, in Lloyd's credit rating, to BBB and not being able to take credit for the diversification of risks. **In my opinion the risk of not being able to take credit for the diversification of risks, as defined in the EIOPA regulations, is an extreme and unrealistic scenario.**

2.8.15 Lloyd's current credit rating by the various credit agencies is as follows:

Agencies	Rating	Comments	EIOPA rating
Standard and Poor's	A+	Strong	2
Fitch Ratings	AA-	Very Strong	1
Best	A	Excellent	2

2.8.16 During the second half of 2019 Best and S&P rated Lloyd's outlook as stable. Fitch also upgraded Lloyd's from a negative to a stable outlook in November 2019 based on insurance pricing improvements and the ongoing Lloyd's profitability initiatives, although this has returned to a negative outlook in April 2020 following the emergence of the COVID-19 pandemic. A reduction down to EIOPA credit quality step 3 being a rating reduction to a BBB rating.

2.8.17 Although the Part VII transfer potentially increases the risk for LIC in many scenarios there is no major solvency impact created by any of the stress scenarios modelled by Lloyd's, which I have re-performed, that are considered likely. The greatest impact, although I consider it to be unlikely, is that arising from a downgrading of Lloyd's credit risk.

2.8.18 **However, in my opinion, ultimately whether a Policyholder's valid claim is met will depend on the strength of Lloyd's Central Fund rather than a downgrade in Lloyd's credit risk. Lloyd's modelling shows that it would need a Lloyd's market wide loss of £20.2bn which the LIM predicts to be a 1 in 450 years event for the Central Fund to come under significant pressure which, I believe it is not a material risk. Should the Lloyd's market suffer a future loss of the size set out set out above, the Transferring Policyholders would still face the impact of a depleted Central Fund if the proposed Part VII transfer does not go ahead. Accordingly, the Transferring Policyholder's ability to recover any claim from the Central Fund in the event of such a potential future loss would be no worse off than before the proposed Part VII transfer.**

2.9 Regulation and conduct

2.9.1 Lloyd's primary regulators are currently the PRA and the FCA, and there will be no supervisory change for non-Transferring Policyholders as a result of the transfer. Following the transfer there will be a change in regulatory environment for Transferring Policyholders as LIC's primary regulator is the NBB together with the Financial Services and Market Authority (Belgium).

2.9.2 **I have concluded that although there will be a change in the prudential and conduct supervisor of the Transferring Policyholders, I do not believe the effect of any of these changes will be material, particularly as both Lloyd's and LIC are likely to continue to comply with the requirements of Solvency II, the EIOPA Guidelines and the European Insurance Distribution Directive for the foreseeable future.**

2.10 Service levels post-transfer

2.10.1 Most of the Policyholders are currently introduced to Lloyd's Members through intermediaries (Brokers, Coverholders, Service Companies). Following the transfer, the Policyholders will continue to contact these intermediaries with regards to their policies. **Although there are additional operational requirements for LIC and Lloyd's Members, I have concluded that the Policyholder does not need to navigate any new or unfamiliar processes as a consequence of the operating model following the Part VII transfer. Accordingly, I have also concluded that there will be no material adverse effect on the service levels provided to policyholders, both transferring and non-transferring following the Part VII transfer.**

2.10.2 **Based on my review and analysis, set out above, of the impact of the proposed Part VII on LIC's Solvency Requirements and on my understanding of the operating systems and procedures LIC intends to introduce, I am able to conclude the following in respect of service levels post transfer:**

- **There will be no material adverse effect on those Policyholders that are transferring under the proposed Part VII; and**
- **There will be no material adverse effect on the current policyholders of LIC as a result of the proposed Part VII transfer.**

2.11 FSCS and FOS

2.11.1 So far as it is relevant to this transfer, the Financial Services Compensation Scheme (FSCS) in the UK provides consumer protection and compensation for individuals and small businesses. The Financial Ombudsman Service (FOS) provides private individuals and microenterprises with a free, independent service for resolving disputes with financial companies.

2.11.2 **In respect of the FSCS and the FOS, I have also concluded the following:**

- **Transferring Policies which were protected by the FSCS prior to the proposed Part VII transfer will continue to be protected by the FSCS post-transfer in respect of claims relating to acts or omissions which arise prior to the transfer. Where, as is expected, LIC has an authorised branch in the UK then Transferring Policies which were protected by the FSCS prior to the transfer will also continue to be protected post-transfer in respect of claims relating to acts or omissions occurring after the transfer. Should LIC fail to establish or cease to have an authorised branch in the UK after the transfer then Transferring Policyholders will lose the benefit of FSCS protection in respect of acts or omissions which occur after LIC ceases to have an authorised branch.**
- **In my opinion the risk that LIC fails to establish, or ceases to have, an authorised branch in the UK and becomes insolvent is not a**

material risk. Therefore I have concluded that the risk that Transferring Policyholders which had the protection of the FSCS prior to the proposed Part VII transfer of losing that protection after the proposed Part VII in respect of acts or omissions which occur after LIC ceases to have an authorised branch is not a material risk.

- **Transferring Policyholders who currently can access the FOS Voluntary and Compulsory Jurisdiction schemes will continue to have access to those schemes following the proposed Part VII transfer in respect of complaints relating to acts or omissions occurring prior to the Transfer.**

- **Transferring Policyholders who currently are able to access the FOS Compulsory Jurisdiction scheme for activities falling within the scope of the Compulsory Jurisdiction, will lose the benefit of the FOS scheme in relation to acts or omissions occurring after the Transfer where activities which were previously carried on in the UK are, after the Transfer, carried out by LIC in Belgium (or elsewhere in the EEA) unless those activities are directed at the UK. Access to the Compulsory Jurisdiction will be lost if the LIC UK branch ceases to be authorised under the Temporary Permissions Regime in the UK or is not authorised at any point after the end of the Temporary Permissions Regime.**

- **In my opinion, the loss of access to the FOS Compulsory Jurisdiction scheme only applies in the circumstances set out above and is somewhat mitigated by the complaints management scheme which LIC is intending to implement following the proposed Part VII transfer. I have further concluded that the risk of a loss of access to the FOS Compulsory Jurisdiction scheme in the limited circumstances set out above is not a material risk when compared to the risk that it may become illegal for Members to pay valid claims if this proposed Part VII transfer does not proceed.**

2.12 Access to the Central Fund

2.12.1 **All Transferring Policyholders will cease to be policyholders of the Members and become Policyholders of LIC. However, as a result of the QS Reinsurance Contract, LIC will become a Policyholder of the Members (and fall within the Lloyd's security framework) and will have the assurance that Lloyd's may, at its discretion, continue to apply the Central Fund to support Members with whom they have entered into the QS Reinsurance Contract. I have obtained confirmation from Lloyd's that in exercising its discretion Lloyd's does not intend to distinguish between Members' liabilities to Policyholders (including LIC) or prioritise the use of assets to prefer one group of Policyholders over any other group of Policyholder.**

2.12.2 **At the effective date, all Transferring Policyholders will lose the security of the Central Fund should a Member of Lloyd's be unable to meet his or her insurance liabilities to claims arising on insurance policies they have**

written in full. However as explained above, LIC will now gain that security as a result of it becoming a Policyholder of the Members through the QS Reinsurance Contract. This means that the Transferring Policyholders' access to the security provided by the Central Fund, subject to Lloyd's discretion, will be the same for all practical purposes, pre and post the proposed Part VII transfer.

2.12.3 **Therefore, I have been able to conclude that the loss of the Transferring Policyholders direct access to the security provided by the Central Fund will have no material adverse effect on the Transferring Policyholders ability to have their claims settled post transfer as LIC will gain the security of the Central Fund as a Policyholder of the Members, through the QS Reinsurance Contracts. Therefore for all practical purposes Transferring Policyholders will continue to have access to the security provided by the Central Fund.**

2.13 Interaction of the FSCS with the Central Fund in case of Default

2.13.1 Prior to the Effective Date, where a Member is unable to meet its liability to the Transferring Policyholders, and the Central Fund is unable to settle that liability on behalf of the Member, the Transferring Policyholder would have access to the FSCS if all relevant conditions apply. After the Effective Date as the Transferring Policyholder is not a Policyholder of the Member, as explained above, the right of access to the FSCS through this channel is lost. However if LIC is in default then the Transferring Policyholders would have access to the FSCS if all relevant conditions apply (i) in respect of claims relating to acts or omissions arising after the Transfer because LIC has established a passported branch in the UK; or (ii) in respect of claims relating to acts or omissions arising after the Transfer, provided LIC has established a branch with full UK authorisation once the Temporary Permissions Regime ends; or (iii) in respect of claims relating to acts or omissions arising before the Transfer, under the "successor" rules if LIC ceases to have or does not establish a UK branch.

2.13.2 Successor rules are included in the PRA's Policyholder Protection Rules and provide protection where a "successor" (i.e. LIC) has assumed responsibility for acts and omissions of an authorised insurer (i.e. a Member). In this case, a policyholder who is an eligible claimant can also claim compensation from the FSCS in respect of an eligible claim when the successor (i.e. LIC) is in default.

2.13.3 LIC has established a passported branch in the UK and, post exit, the intention is for LIC to seek full UK authorisation for this branch before the end of the Temporary Permissions Regime. Although the authorisation is not guaranteed, there is no reason to date to suggest that the branch will not be authorised. The loss of access to the FSCS for claims relating to acts or omissions arising after the Transfer only applies where LIC is insolvent and is unable to settle its liability to the Transferring Policyholders and has failed to establish or ceases to have a UK authorised branch. **Therefore I have concluded that the potential loss of access to the FSCS is not a material risk to the Transferring Policyholders in the circumstance described above.**

2.14 Taxation and Costs

2.14.1 **I do not believe that there are any tax implications which will have a materially adverse effect on the policyholders of either Lloyd's or LIC as the Transfer will not give rise to any significant VAT liabilities and not give rise to any significant accounting profit or losses which would be subject to corporation tax.**

2.14.2 **I understand that most costs associated with the Transfer will be incurred whether or not the Transfer proceeds, as the majority of these costs relate to activities occurring prior to the Sanctions Hearing (for example, with respect to legal and professional fees and policyholder communications). These costs have been incurred by both LIC and Lloyd's.**

2.15 Notifications

2.15.1 **Based on my review of Lloyd's overall communication strategy and associated documents, I am satisfied that Lloyd's overall approach is a proportional approach and will ensure adequate coverage of all parties affected by the transfer.**

2.16 COVID-19

2.16.1 The impact of COVID-19 virus on the Lloyd's market will result in significant claims arising on certain classes of businesses that are likely to respond to losses suffered by Policyholders. COVID-19 has also resulted in a significant decrease in the valuation of the investment portfolios of Lloyd's and the syndicates operating within the Lloyd's market. This in turn has led to downward pressure on Lloyd's Solvency Ratios.

2.16.2 Lloyd's is closely monitoring the situation and is collecting the full extent of the 1st quarter 2020 asset losses and incurred liabilities from the Members for the June 2020 coming into line exercise. Further capital collections will be used if appropriate given the development of the situation. Lloyd's plans to publish a preliminary estimate of the impact of COVID-19 on the Lloyd's market in early May.

2.16.3 **The impact of COVID-19 on the Lloyd's market is at an early stage and it is difficult to assess the financial impact it may have with any degree of certainty. Nevertheless based on the information made available to me to date, my provisional conclusion is that neither the Transferring Policyholders nor the non-Transferring Policyholders will suffer any material adverse effect as a result of the proposed Part VII Transfer in respect of the impact COVID-19 may have on the Lloyd's market. I intend to review my conclusion as more information becomes available prior to the Sanctions Hearing and include my findings in my supplementary report. For further details, please refer to paragraphs 9.1.1 to 9.1.14 of this report.**

2.17 Scope and Limitations of Report

2.17.1 Any proposed transfer of insurance business from a UK entity to another entity, whether resident in the UK or elsewhere, has to be sanctioned by the High Court of England and Wales (Court) pursuant to Part VII of FSMA. Section 109 of FSMA requires a report to be prepared for the Court by an expert (the Independent Expert) to aid it in its deliberation. The purpose of this report is also to inform the Prudential Regulation Authority (PRA), the Financial Conduct Authority (FCA) and Lloyd's Policyholders (including third party claimants against those Policyholders) of the impact of the proposed transfer on the security and service levels of both transferring and non-Transferring Policyholders.

2.18 Overall Conclusion

2.18.1 **My overall conclusion is as follows:**

- **Transferring Policyholders will not be materially adversely affected by the proposed Scheme, and the security of Policyholders' contractual rights would not be materially disadvantaged by the Scheme;**
- **the Scheme will not have a material adverse effect on Transferring Policyholders in respect of matters such as administration, claims handling, governance arrangements, expense levels and valuation bases in relation to how they may affect the security of Policyholders' contractual rights and levels of service provided to Policyholders;**
- **the non-Transferring Policyholders (including Policyholders of the Excluded Jurisdiction Policies) will be insured by the same legal entities, with exactly the same governance structures, regulatory framework, policy terms and conditions, and their policies will be serviced in the same manner as prior to the Transfer. Accordingly, there will be no material adverse effect on non-Transferring Policyholders as a result of this proposed Part VII transfer;**
- **the cost and tax effects of the Scheme will have no material adverse effect on the security of all Policyholders' contractual rights;**
- **the current Policyholders of LIC will suffer no material adverse effect as a result of the proposed Part VII transfer;**
- **there will be no material adverse effect on the Outwards Reinsurers as a result of this proposed Part VII;**
- **I am satisfied that the proposed notification material to be presented to policyholders is appropriate and Lloyd's approach to communication with Policyholders, including the waivers to the**

standard communications approach, are appropriate and proportionate.

2.19 Duty to the Court

2.19.1 **I confirm that I fully understand that my overriding duty is to the Court, which overrides any obligations I may have to any other party including those from whom I am paid.**

I confirm that the content of my report correctly reflects my opinion and I am not aware of any inaccuracies contained therein.

3 Lloyd's market

3.1 Background

3.1.1 Lloyd's is a society incorporated as a statutory corporation by Lloyd's Act 1871 (Lloyd's). Lloyd's is not a company incorporated under the Companies Act 2006 or any of its predecessors and does not underwrite risks on its own behalf. Lloyd's is a marketplace, run by the Council of Lloyd's, where Members acting through insurance Syndicates, arrange insurance for their customers.

3.1.2 A Managing Agent is an independently owned company set up to manage the Syndicate on behalf of the Members of that Syndicate. Managing Agents may manage the affairs of more than one Syndicate. A Lloyd's Syndicate is made up of a group of underwriters (Members) who can be individuals, partnerships or corporate entities which put up the underwriting capital against their share of the insurance risk accepted and is liable for any subsequence profit or loss.

3.1.3 Managing Agents carry out all the underwriting functions on behalf of the Members of a Lloyd's Syndicate. These functions will include:

- entering into contracts of insurance
- effecting reinsurance and paying claims
- developing a Syndicate business plan and setting its risk appetite
- employment of relevant staff for carrying out the above functions.

Managing Agents are subject to Lloyd's regulatory overview and are authorised by the PRA and regulated by the PRA and the FCA.

3.1.4 Lloyd's Syndicates have no separate legal personality and, therefore, it is the Members themselves who underwrite risk and remain liable for business written by the Syndicate.

3.1.5 Members join a Syndicate only for an underwriting year with the Syndicate accepting risks incepting in that calendar year only. Thereafter, if a member wishes to continue to underwrite, they must join the subsequent calendar year of that, or another, Syndicate.

3.1.6 Lloyd's is responsible for the oversight of the market which includes the following activities amongst others:

- setting minimum standards and monitoring compliance with those minimum standards which Syndicates and Managing Agents must comply with
- agreeing Syndicate business plans and capital requirements and evaluating performance against business plans
- maintaining market stability, protecting its credit rating and preventing underwriting behaviour which threatens the Central Fund
- providing services that the underwriters in the Lloyd's market require to trade. This includes the infrastructure for processing risks that have been accepted by the Syndicates and maintaining the Lloyd's international network of trading licences and offices.

3.1.7 When a Syndicate accepts a risk from a Policyholder, each member of the Syndicate for that particular underwriting year is legally liable for his share of any claims which attach to those policies. Members are only liable for their several share of the risk and have no liability for other Members' share of the risk.

3.1.8 Members agents are entities who are responsible for providing certain duties to Lloyd's Members such as advising Members on which Syndicate they should participate on, the level of participation and liaising with Managing Agents and Lloyd's on certain matters.

3.1.9 A majority of the risks a Syndicate underwrites originate from the following main sources:

- Lloyd's Broker
- Line Slips
- an approved Coverholder
- a Service Company controlled by the Managing Agent.

3.1.10 The majority of risks written by the Syndicate generally are placed by Lloyd's Brokers, either directly with a Syndicate or via a Line Slip.

3.1.11 Line Slips are used to underwrite risk where a Managing Agent, on behalf of Members, delegates authority to enter into insurance contracts to be underwritten to another Managing Agent or authorised insurance company.

3.2 Distribution network

3.2.1 A Policyholder wishing to insure (or place) a risk with one or more Lloyd's Syndicates normally approaches one of the following entities to act on his behalf:

- Retail Broker
- Lloyd's Broker
- Coverholder
- Service Company

3.2.2 A Retail Broker is an entity authorised under the FSMA to advise individuals or corporate entities on their insurance needs and to negotiate insurance contracts on their behalf with insurers in return for a fee or commission. A Retail Broker cannot place a risk with a Lloyd's Syndicate unless they are an authorised Lloyd's Broker. Often, a Retail Broker will contact a Lloyd's Broker in order for that Lloyd's Broker to approach and negotiate directly with the Syndicate. In these cases, the fee or commission paid by the Policyholder to the Retail Broker is shared with the Lloyd's Broker.

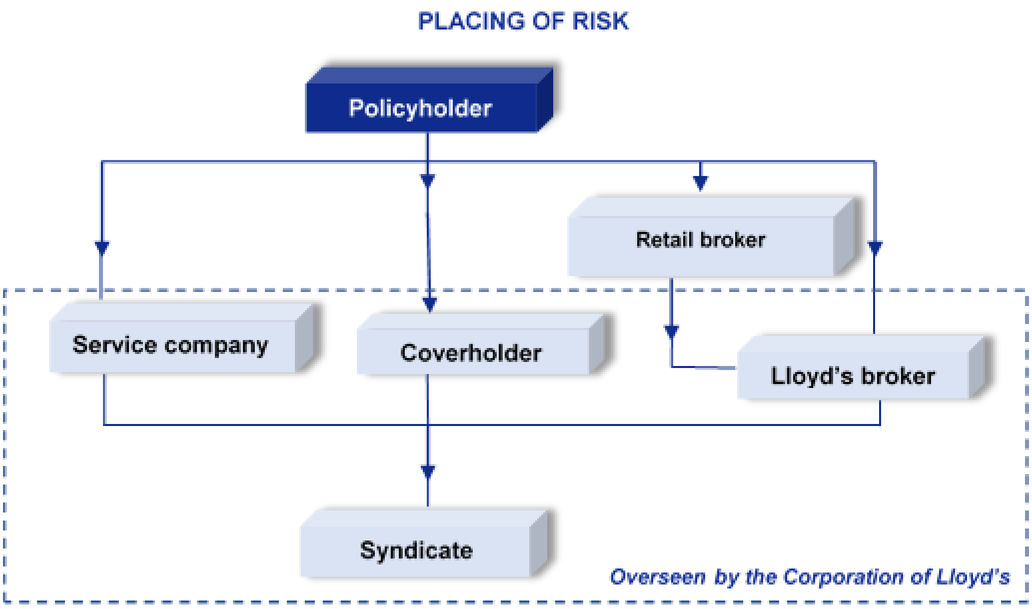
3.2.3 A Lloyd's Broker is a Retail Broker authorised by Lloyd's to facilitate the risk transfer between Policyholders and Syndicates. Normally, this will involve face to face negotiations between the Lloyd's Broker and Syndicate underwriters.

3.2.4 A Syndicate may also authorise third parties (Coverholder) to accept insurance risks directly on behalf of the Syndicate. These businesses are known as Coverholders and form a vital distribution channel for the Lloyd's market. The agreement between the Syndicate and the Coverholder is known as a Binding Authority and the business written is referred to as Coverholder business.

3.2.5 A Service Company operates in the same way as a Coverholder but is a wholly owned subsidiary of either the Managing Agent, or the Managing Agent holding company.

3.2.6 For more complex risks, a Lloyd's Broker may approach a number of Syndicates, across a number of Managing Agents, in order to place the risk. Each Syndicate will then take a percentage of the risk which will be scaled back if more than 100% placed, but may not always be fully placed.

3.2.7 A simplified schematic diagram of how a Policyholder places a risk at Lloyd's is set out below.



3.2.8 Often Policyholder's details are only held at Coverholder or Retail Broker level and not necessarily maintained by the Syndicates, Managing Agents or Lloyd's Brokers.

3.3 Allocation of risk and reinsurance to close (RITC)

3.3.1 When a Syndicate places a risk, that risk is allocated to the calendar year when that risk incepts (underwriting year). Each underwriting year of a Syndicate remains open for a minimum of three years when that underwriting year's results are finalised.

3.3.2 At the end of the third year, the underwriting year is normally closed by reinsuring the risks allocated to that year into a later year of account of that, or another, Syndicate. The premium payable by the year to the later year accepting the risk is determined by the Managing Agent. This process is known as a Reinsurance to Close (RITC).

3.3.3 Any subsequent variation in the ultimate liability attaching to an underwriting year which has been closed by the RITC process is borne by the underwriting year into which it is reinsured.

3.3.4 When the underwriting year of account cannot be closed into a later year it becomes a run-off year of account. As such, the Members of that year continue to bear the economic liability for variations in claims Reserves on policies allocated to that year until an RITC is completed.

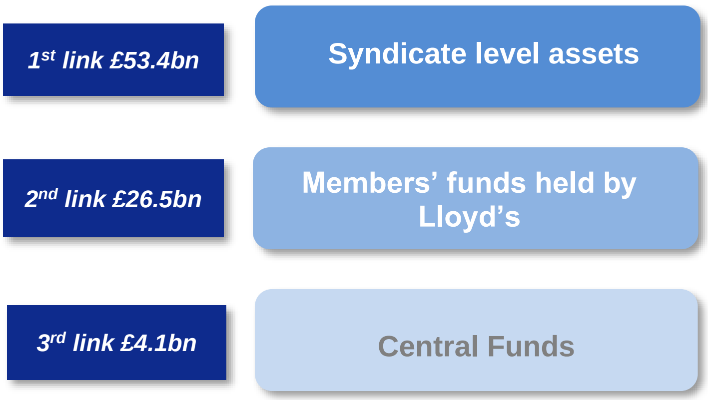
3.3.5 The reasons a year cannot be closed are varied but the main ones are that the RITC premium to be charged cannot be assessed by the Managing Agent with the required degree of certainty or that no successor year or Syndicate exists.

3.3.6 The payment of the RITC premium does not eliminate the liabilities of the Members writing on an underwriting year. Should the Members on the reinsuring year be unable to meet their obligations, and other elements of the Lloyd's chain of security were to fail, then the Members on the closed underwriting year would have to settle any outstanding claims.

3.4 Lloyd's chain of security

3.4.1 The capital structure which provides security to Policyholders of the Lloyd's market is unique in the global insurance market.

3.4.2 There are three links to this security:



Figures in billions as at 31 December 2018

3.4.3 The first two links are held in trust primarily for the benefit of Policyholders. They can only be used to settle a Member's liability for policies either directly written by that member or reinsured by the RITC process. A Member's assets are only at risk for policies written on their own account and are not available to settle other Members' losses.

3.4.4 The third link contains mutual assets held by Lloyd's which are available, subject to Lloyd's discretion, to meet any Members' liabilities, which cannot be met out of any of the Members own funds.

3.4.5 The level of funds is set by Lloyd's as follows:

SYNDICATE LEVEL	**Premiums, less claims and expenses, received or paid by the syndicate. Profits only released once all liabilities are provided for and audited.**
MEMBERS' LEVEL	**Managing agents are required to assess the Solvency Capital Requirement (SCR) on an annual basis. The SCR is required to be calculated at 99.5% confidence level to cover all liabilities attaching to policies written.** **Lloyd's will uplift this to support its credit rating (2020 uplift applied was 35%). Members are required to deposit sufficient funds with Lloyd's to meet the members' level funds set by Lloyd's.**
CENTRAL FUNDS	**These are set by the Council of Lloyd's and are available to meet valid claims, subject to the discretion of the Council, for liabilities that cannot be met from the member's own resources including, but not limited to, members' level funds above.**

4 Structure of the Part VII Transfer

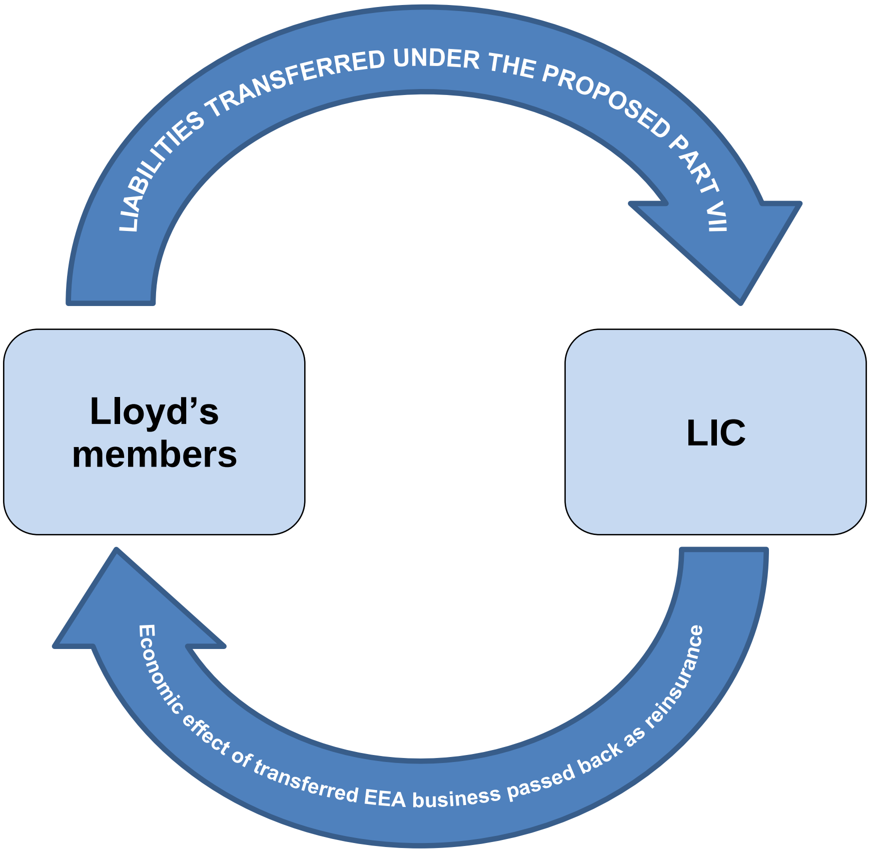
4.1 Key terms of the proposed transfer Scheme

4.1.1 In order to ensure the Part VII transfer is expedient and economically efficient, Lloyd's has designed a single transfer Scheme applicable to all Members which can be considered by the regulators, the Court, the Policyholders and other stakeholders. **This will, in my opinion, ensure a uniform approach to the transfer of policies under the proposed Part VII transfer.**

4.1.2 Lloyd's has the authority, under regulations 3 to 5 of the Financial Services and Markets Act 2000 (Control of Transfers of Business Done at Lloyd's) Order 2001, Lloyd's Act 1982 and Paragraphs 40 and 42 of the Membership Byelaw, to undertake this course of action. Lloyd's tested these rights at a preliminary Court hearing in November 2018.

4.1.3 Prior to the Effective Date of the Scheme, LIC and the Members of each Syndicate will enter into 100% quota share reinsurance contract agreements to cover the business transferred to LIC (together, referred to as the QS Reinsurance Contracts). When the QS Reinsurance Contract becomes effective the insurance liabilities under the Transferring Policies transferred to LIC, by the proposed Part VII Scheme, will be fully reinsured back to the Members of the Syndicate, that originally underwrote the policy or assumed the liabilities through reinsurance to close.

4.1.4 As result of the QS Reinsurance Contracts, economically the liabilities attaching to the Transferring Policies will continue to rest with those Members who originally underwrote those policies, or subsequently assumed those liabilities through the Reinsurance to Close process. This can be represented schematically as follows:



4.1.5 Each Syndicate on behalf of its current and past Members has purchased different reinsurance programmes (Outward Reinsurance) to cover some of the liabilities attaching to the Transferring Policies. These Outward Reinsurance programmes will vary annually both in coverage and in reinsurer participation.

4.1.6 Under the proposed Scheme, the existing Syndicate Outwards Reinsurance will not be transferred with the Transferring Policies to LIC. Accordingly, Lloyd's intends to seek Court approval to convert, as part of the terms of the Scheme, this existing Outwards Reinsurance to attach to all or any part of each Syndicate's QS Reinsurance Contract with LIC. This effectively converts the existing Syndicate Outwards Reinsurance to retrocessional cover.

4.1.7 Retrocessional cover is a type of insurance whereby a reinsurer assumes part of the risk of another reinsurer. In this scenario, the risk intended to be covered, by the Syndicate Outwards Reinsurance, will be the reinsurance of LIC's liabilities in respect of the Transferring Policies.

4.1.8 The intention of the Scheme is designed to result in as little change as possible for Policyholders and as far as possible to ensure that the Transferring Policies will continue to be serviced in the manner which they are currently serviced without breaching legal or regulatory insurance authorisation requirements in the EEA.

4.1.9 The proposed transfer arrangement (Scheme) will operate as follows:

- Each Transferring Policy will be transferred from the current Lloyd's Syndicates to LIC.
- Liabilities attaching to the Transferring Policies (other than the "Excluded Liabilities") will be transferred and become a liability of LIC. Accordingly, these liabilities will cease to be a direct liability of the Syndicate Members.
- All rights, benefits, powers and obligations of the Members exercised through the Syndicate, in connection with the Transferring Business, will also transfer to LIC.
- Any Transferring Policyholder will have rights against LIC instead of the Member(s) of the Syndicate; LIC will effectively step into the shoes of the Members.
- For Transferring Policies which are split between EEA and Non-EEA business, the above rights, benefits and obligations of the Non-EEA business will not transfer to LIC where the Policyholder is domiciled in a Non-EEA country. In this case, both the Syndicate and LIC will owe separate and individual (but not joint or double) obligations and duties under, and be liable for the performance of, their respective elements of the Policy only.
- The Members existing Outwards Reinsurance arrangements will convert to retrocessional cover to all or any part of each Syndicate's QS Reinsurance Contract with LIC.

4.1.10 **Therefore, in my view, based on the 100% QS Reinsurance Contracts to be entered into by LIC and with each Syndicate and the conversion of the Outwards Reinsurance to outwards retrocessional cover, the risk that the actuarial projections of the Transferring Liabilities are either under or overstated will have no material adverse effect on the Transferring Policyholders or non-Transferring Policyholders.**

4.1.11 **Therefore, I have concluded that the only potentially material adverse effect of a variation of Reserves attaching to the Transferring Policies will be on LIC's Solvency Capital Requirements (SCR). One element which goes into calculating the SCR is "counterparty risk", i.e. risk that the recovery under the QS Reinsurance Contract will not be fully realised. My further analysis of this impact on LIC solvency requirements is set out in Section 7.**

4.1.12 **In my opinion, the key risks attaching to this proposed Part VII transfer are:**

- **The risk that the QS Reinsurance Contract will not fully reinsure the risks attaching to the Transferring Policies back to the applicable Lloyd's Syndicate;**

- **The risk that Court does not have the power under the FSMA to convert the existing Syndicate outward reinsurance into retrocessional cover;**

- **The risk that for the Syndicate reinsurers, domiciled outside the UK, the court system in their country of domicile will not recognise the Court Order.**

4.1.13 In order to assess the risks of the possible failure of the proposed QS Reinsurance Contract to transfer the liabilities attaching to the Transferring Policies back to the appropriate Syndicate, I have obtained my own independent legal advice.

4.1.14 With my legal advisers, I have had a number of contacts with Lloyd's and their external legal advisers regarding the drafting of the QS Reinsurance Contract. The purpose of these contacts was to understand the terms of the QS Reinsurance Contract and how it was designed to work in practice. As a result of my interaction, together with my legal advisers, with Lloyd's and their legal advisers I have made several recommendations how the wording of the QS Reinsurance Contract could be strengthened. Lloyd's have adopted most of these recommendations and changed the original draft of the QS Reinsurance Contract accordingly.

4.1.15 As a result of the legal advice I have received, I have been able to assess that there were three potential risks which may give rise to the QS Reinsurance Contract not fully reinsuring the economic effect of the transferring liabilities back to the applicable Lloyd's syndicate. These risks were as follows:

- Illegality – either it is unlawful for LIC and the Members (via the syndicate) to enter into the QS Reinsurance Contract or the QS Reinsurance Contract is capable of being set aside for being in breach of any applicable law or regulation;

- Unenforceability - the members (or certain of them) seeking to avoid the QS Reinsurance Contract on the grounds of unfair presentation of the risk, misrepresentation or non-disclosure and therefore the QS Reinsurance Contract is rendered invalid; and

- Contract wording – the drafting of the QS Reinsurance Contract is deficient, such that it does not cover all of the liabilities of all of the Transferring Policies so that the liabilities will remain with LIC.

4.1.16 For the QS Reinsurance Contract to be enforceable the parties entering into it will need authority and capacity. I have concluded that:

- The Managing Agents of the applicable Syndicates have the power to enter into the QS Reinsurance Contract under the standard Managing Agent agreement prescribed by Lloyd's.

- LIC’s board will be required to approve the scheme as part of the Part VII transfer and I am satisfied the board of LIC has the authority to bind LIC to the QS Reinsurance Contract.

- Lloyd’s has confirmed that LIC is able to enter into the QS Reinsurance Contract under applicable Belgium law.

- I am satisfied that the QS Reinsurance Contract is not illegal, void or otherwise unenforceable under English Law.

Accordingly, I have concluded that there is no material risk that the QS Reinsurance Contract is illegal or enforceable on grounds of lack of authority or capacity.

4.1.17 Based on the independent legal advice I have received, I understand the Insurance Act 2015 includes an array of remedies available to the insurer, including avoidance and variations to the terms of the applicable contract in the event that the (re)insured or its agents unfairly presented the applicable risk. In respect of this risk I have concluded the following:

- The QS Reinsurance Contract includes wide-ranging and carefully drafted provisions which seeks so far as possible, to exclude the application of the above remedies. While such provisions have not been tested in court, I am of the view that they would more likely than not be effective to ensure that the members are unable to avoid liability under the QS Reinsurance Contract.

- Further, whilst LIC is the entity technically presenting the risk, the members are transferring policies which they themselves originally underwrote. In my view, it would be challenging for them to assert that risk they have assumed under the QS Reinsurance Contract has not been fairly stated.

For the above reasons I have concluded that there is no material risk that the Members could avoid the liabilities due to unenforceability of the QS Reinsurance Contract on the grounds of unfair presentation.

4.1.18 The interpretation of the meaning and legal effect of any particular provision of the QS Reinsurance Contract will be a matter of judgement to be determined by a tribunal and one tribunal may have a different view to another tribunal. It is therefore impossible to say with certainty that there are no circumstances in which Reinsurers may not be able to establish that they are not liable for certain Transferring Liabilities for which, on the face of the Reinsurance Agreement, they ought to be liable. However, based on the independent legal advice I have received, in my opinion:

- The reinsurance obligation of the proposed QS Reinsurance Contract states clearly that the members are liable for one hundred percent of the Transferring Liabilities.

- The QS Reinsurance Contract contains a customary "follow the fortunes" clause (that a reinsurer is bound by the reinsured's decisions regarding payment of settled claims so long as the decision was made reasonably and in good faith), which extends expressly contractual obligations and losses in excess of policy limits.
- In the unlikely event that a tribunal will interpret the QS Reinsurance Contract so it does not give effect to its intended purpose I understand that both LIC and Lloyd's, acting on behalf of the Members, will be willing to rectify any terms of the QS Reinsurance Contract should it be necessary, to give effect to the purpose of the QS Reinsurance Contract in the future.

Therefore, I have concluded that the QS Reinsurance Contract is drafted in a manner which should give effect to its intended purpose.

4.1.19 **In arriving in my opinions set out above, I have relied on the Independent legal advice I have received, and I have concluded that the risk of failure of the QS Reinsurance Contract is not a material adverse risk.**

4.1.20 I have also obtained independent legal advice in relation to the scope of the Court's powers under section 112 of FSMA including the power to convert the existing Syndicate outward reinsurance into retrocessional cover pursuant to the terms of the transfer Scheme.

4.1.21 The power of the courts under section 112 of FSMA is extensive and the court generally has the power to make wide ranging orders, including in relation to non-transferring business, if it is persuaded of the commercial necessity for them in the context of the transfer and they do not unduly prejudice the position of policyholders of the transferor or the transferee.

4.1.22 My understanding is that recent case law has established a broad consensus that section 112 of the FSMA gives the court a wide power which can be used by the court to sanction proposals that are necessary not just from a narrow technical or legal perspective but to ensure the scheme is fully carried out in substance.

4.1.23 I have relied both on the legal advice received by Lloyd's as to the powers of the court and independent legal advice I have obtained, which supports the separate legal advice Lloyd's has received in respect of this matter .

4.1.24 **Accordingly, I have concluded that the risk that the court does not have the power under section 112 of the FSMA to make a court order to convert the syndicates outward reinsurance into retrocessional cover pursuant to the terms of the Transfer Scheme is not a material risk.**

4.1.25 The impact of the order that the court is being asked to consider, will result in the economic exposure of the affected outward reinsurers remaining the same pre and post transfer.

4.1.26 **Therefore, in my opinion, the effect of the proposed Court Order should mean that the same Outwards Reinsurance will be in place for Members pre and post transfer and that all Policyholders, after the transfer, will benefit from the same ability of Members to make recoveries on their Outwards Reinsurance as is currently in place.**

4.1.27 **I have further concluded that, as the economic exposure of the Outwards Reinsurers to policies written by the Members remains the same pre and post Transfer, there is no material adverse effect on the Outwards Reinsurers as a result of this proposed Part VII transfer.**

4.1.28 Lloyd's has no central data available to estimate the potential exposure of Members to reinsurers not domiciled in the UK. I have used, as a proxy for this exposure, the Syndicate total reinsurance recoverable by the Lloyd's market, as at 30 June 2019, analysed by country of domicile of the outward reinsurers. **In my opinion, using the amount recoverable from reinsurance as a proxy for the exposure of the Lloyd's market to reinsurances domiciled outside the UK is a reasonable assumption to make. I am not aware of any other better proxy that could be used for which data is held centrally by Lloyd's.**

4.1.29 An analysis of the reinsurance recoverable, as at 30 June 2019, analysed by the country in which the reinsurer is domiciled is set out below:

Reinsurers by domicile	**Amount recoverable %**	**Cumulative proportion recoverable %**
Bermuda	35.00	35.00
United Kingdom	23.43	58.43
United States	13.95	72.38
Germany	10.85	83.23
EEA (excluding UK & Germany)	4.48	87.71
Others	12.29	100.00
Total	100	

4.1.30 In order to assess the risk of whether non-UK Courts are likely not to recognise the Court Order in respect of reinsurers not domiciled in the UK, Lloyd's has taken advice, which I have relied on, from legal counsel in the United States and Bermuda. The United States and Bermuda were selected as the reinsurers domiciled in these countries, represent the largest reinsurers exposure for Lloyd's Syndicates' outside the UK.

4.1.31 The Unites States and Bermuda counsel have, in summary, concluded that:

Bermuda	There is a strong likelihood that a Bermuda Court would decline to hear an application brought by a Bermuda reinsurer to set aside the Court Order.

United States	There are good grounds and it is reasonable to conclude the US Courts would recognise the Court Order.

4.1.32 Lloyd's has also received legal advice that the High Court order sanctioning the Part VII transfer should be recognised by the German courts provided the order is obtained before the expiry of the transition period set out in the Brexit Withdrawal Agreement.

4.1.33 The US and Bermuda counsel opinions obtained by Lloyd's, together with the UK exposure, represents some 72.38% of the Syndicate exposure to reinsurers in these three jurisdictions, with a further 10.85% represented by Germany. Therefore, Lloyd's have received legal advice that in countries that represent circa 83% of the Members Outwards Reinsurance exposure, the above Court Order is likely to be effective.

4.1.34 The legal advice received by Lloyd's in relation to the above jurisdictions was clear and concise and did not raise, in my opinion, any material doubt as to whether courts in the above jurisdiction would adopt the approach set out in that advice. I have also asked my independent legal advisers to conduct a high-level review of that advice and to make recommendations to Lloyd's on how that advice could be enhanced. Lloyd's has adopted the key recommendations. I have also considered that the fact that the exposure of the Outward Reinsurers is identical pre and post the proposed Part VII transfer and, therefore it's difficult to foresee the basis on which a challenge to the Court Order could be made in their country of domicile. As a result of the above matters, I do not consider it necessary for me to obtain legal advice on this matter in order to formulate my conclusion.

4.1.35 Should a reinsurer successfully challenge the Court Order then Members would be unable to make a recovery against claims paid to LIC. In a worst case scenario, a Transferring Policyholder would still likely have his claim paid as the Central Fund, subject to Lloyd's discretion, would meet LIC's claim under the QS Reinsurance Contract if any individual member did not have sufficient funds to meet his share of LIC's claim in full out of his own resources. I have considered the availability of the Central Fund to meet claims at Section 7.10.

4.1.36 **Accordingly, in my opinion, the risk that a reinsurer in an overseas jurisdiction will succeed in challenging the Court Order, which converts the existing Syndicate Outwards Reinsurance to retrocessional cover, is unlikely to be a material risk.**

4.1.37 I have come to the above view based on the following matters:

- My review of the legal advice obtained by Lloyd's.
- The strength of the United States and Bermuda comity opinions.
- The legal and professional advice Lloyd's has received in respect of the German domiciled insurers.

- The reinsurers, domiciled in Germany, Bermuda and the United States, will have to overcome a number of significant issues to successfully challenge the effect of the Court Order.

- The Members' outward reinsurance exposure to an individual country that is not covered by the legal advice received by Lloyd's is not material.

- The reinsurers' exposure to claims arising from the Lloyd's market is identical pre and post the proposed Part VII transfer: and

- The reputational damage to those reinsurers who are currently active in the Lloyd's and the wider insurance market appearing not to be willing to meet valid claims following a successful challenge to the Court Order.

4.1.38 **In arriving at my opinion, I have also considered that Lloyd's has historically paid all valid claims and it is likely that the Central Fund will step in to ensure Policyholders' valid claims continue to be met if the result of any reinsurers successfully challenging the Court Order leads to a member being unable to meet their liability to the Policyholder.**

4.1.39 **Based on my analysis of the key risks attaching to the scheme as set out above, I have been able to conclude that the key risks I have identified in paragraph 4.1.12 are not material risks to the scheme operating in the manner it is intended to.**

4.2 Accounting and Tax implications

4.2.1 I have received an analysis completed by Lloyd's and LIC regarding the potential tax and accounting implications of the Scheme. In completing this analysis Lloyd's has obtained external professional advice both in the UK and Belgium.

4.2.2 I have reviewed both Lloyd's analysis and the external professional advice Lloyd's has received. I have also completed my own analysis of any potential accountancy and tax implication of the scheme including any exposure to significant VAT liabilities.

4.2.3 LIC prepares its statutory financial statements under Belgium GAAP. I have been provided with an analysis of the accounting for this Transfer. Due to the nature of the Scheme (the Transfer is 100% reinsured back to the original syndicates) and the way Transfers are accounted for under Belgium GAAP, no significant accounting profits or losses will arise in LIC which would be subject to corporation tax. Similarly, Lloyd's do not expect the Transfer to impact Members' accounting profits or losses for UK corporation and income tax purposes.

4.2.4 **Based on my work and my understanding of the Transfer I do not believe that there are any tax implications which will have a material adverse effect on the Transferring Policyholders and non-Transferring policyholders of Lloyd's or the current policyholders of LIC as I consider it unlikely that the Transfer will give rise to any significant VAT liabilities or give rise to any significant accounting profit or losses which would be subject to corporation tax.**

4.3 Costs of the Scheme

4.3.1 I understand that most costs associated with the Transfer will be incurred whether or not the Transfer proceeds, as the majority of these costs relate to activities occurring prior to the Sanctions Hearing (for example, with respect to legal and professional fees and policyholder communications). These costs have been incurred by both LIC and Lloyd's and will not be passed on to Policyholders, i.e. Policyholders will not pay any of the costs of implementing the Scheme.

4.4 Data availability

4.4.1 The unique structure and operational procedures of the Lloyd's market provides a number of challenges to Lloyd's in respect of data availability.

4.4.2 Lloyd's itself does not underwrite risks and therefore does not hold, control or own the rights to full Policyholder details such as names, addresses and contact details. In some cases, some of the data will be held by the Managing Agent but this data is not complete. Full Policyholder details, for certain policies, may only be held (and owned) by a Broker or a Coverholder.

4.4.3 Reliable data is required in relation to the Part VII transfer in order:

- to identify Transferring Policies
- to carry out the Policyholder notification exercise
- to provide the data for the actuarial analysis in connection with estimating the liabilities attaching to the policies being transferred
- for LIC's operational implementation purposes.

4.4.4 Lloyd's has access to some limited data depending on how the risk was placed as follows.

Open Market Business:

Risk categories covered on the policy, location of the insured domicile, detail of premium and claims value

Coverholders Business (Binding Authorities and lineslips):

Binding Authority / delegated authority information including risk classes covered and summary-level premium and claim information. However, no information is held on the individual declarations (i.e. the policies under a Binding Authority or lineslip) of the Policyholders covered under such Binding Authorities or lineslips.

4.4.5 The Lloyd's market uses an outsource provider, Xchanging, to host the Insurance Market Repository (IMR), which is a central store for core policy, claims and endorsements information for Open Market business and holds limited data for Coverholder business. The IMR is not a structured database but a repository largely containing scanned PDF documents, which is designed to be accessed on a case-by-case basis, for example, by claims handlers. It is not designed to be machine readable (and as a result it needs to be manually searched) and does not contain a complete record of all Policy documentation for the period from 2008. The IMR currently contains 50 million documents for the period since 2008.

4.4.6 Under the terms of the contract between Xchanging and each Managing Agent, Xchanging provides access to the IMR in relation to each Lloyd's Syndicate that they manage. This restricted access is required because the IMR includes attorney reports on claims over which privilege must not be lost. As a consequence, Lloyd's itself does not have access to the IMR.

4.4.7 For those risks not processed by Xchanging, Lloyd's collects data direct from the Syndicate (Lloyd's Direct Reporting).

4.4.8 A small percentage (estimated to be around 2%, measured by gross premium, of the transferring portfolio) of Lloyd's market business is processed outside of Xchanging and outside of Lloyd's Direct Reporting system ('non-XIS business').

4.4.9 Lloyd's has undertaken a data extraction exercise from the centrally held data to identify:

- the policies In-scope for this Part VII transfer and,
- to obtain the full history of the premiums and claims (including claims notified but not settled), attaching to the Transferring Polices.

4.4.10 The selection parameters applied to the central data were as follows:

1. Foreign Insurance Legislation (FIL) Code
2. Risk country code
3. Insured Domicile

FIL codes are a regulatory jurisdiction code used by the market to identify the location of the risk, for Tax and regulatory purposes.

4.4.11 These parameters were applied separately to both the premium element of the Policy and to any claims attaching to those policies.

4.4.12 The logic used by Lloyd's to identify if a Policy is In-scope as a Transferring Policy is as follows:

Direct Business

LBS Flag	Insured Domicile	Risk Country Code	FIL Code	Transferring/ Non-Transferring
Yes	(not used)	(not used)	(not used)	*Non-Transferring*
No	**EEA**	(not used)	(not used)	*Transferring*
No	**Non-EEA**	**EEA**	(not used)	*Transferring*
No	**Non-EEA**	**Both EEA and non-EEA**	(not used)	*Mixed*
No	**Unknown**	**Non-EEA**	(not used)	*Non-transferring*
No	**Non-EEA**	**Unknown**	**EEA**	*Transferring*
No	**Non-EEA**	**Unknown**	**Unknown**	*Non-transferring*
No	**Unknown**	**Unknown**	**EEA**	*Transferring*
No	**Unknown**	**Unknown**	**Non-EEA**	*Non-transferring*
No	**Unknown**	**Unknown**	**Unknown**	*Unknown*
Else				*Non-Transferring*

Reinsurance Business

LBS Flag	Cedant Domicile	FIL Code	Transferring/ Non-Transferring
Yes	(not used)	(not used)	Non-Transferring
No	**Germany**	(not used)	Transferring
No	**Not Germany**	(not used)	Non-Transferring
No	**Unknown**	**Germany**	Transferring
No	**Unknown**	**Not Germany**	Non-Transferring

Field Definitions

Attribute	Definition	Application
LBS Flag	Identifies whether the policy or risk is written to Lloyd's Brussels. This only applies for business written after the setup of Lloyd's Brussels (from 2019).	Used to identify whether a policy is already written to Lloyd's Brussels and therefore does not need to be transferred.
Insured or Cedant Domicile	The country of domicile of the Insured or Cedant. *For Lloyd's centrally held data, the country of origin is used as a proxy in the absence of insured domicile.*	Used to identify whether the insured is an EEA policyholder.

Attribute	Definition	Application
Risk Country	The country where the physical risk is located.	Used to identify whether the risk is located within the EEA.
FIL Code	Coding applied to transactions to identify the regulatory and tax location of risk.	Used as a proxy where Risk Country is unavailable. For reinsurance business, it is used as a proxy where insured domicile is unavailable.

4.4.13 For mixed policies, the Policy is split between EEA and Non-EEA business and only the EEA element is transferred, but only if the insured is domiciled in a Non-EEA country.

4.4.14 The above logic was applied to the Lloyd's centrally held data to produce a database of all policies and claims analysed into Transferring, Non-Transferring, Mixed and Unknown. This database forms the basis on which Lloyd's calculated the actuarial projections of the insurance liabilities being transferred to LIC.

4.4.15 **In order for me to assess whether the resulting database extracted by Lloyd's from its centrally held data forms a reliable basis to meet the objectives set out in paragraph 4.4.3, I have undertaken the following procedures:**

- I have reviewed the logic applied to the Lloyd's central data as set out above, by which the "EEA" data was extracted. I have also had meetings with representatives of Lloyd's to discuss and query the logic and its application in practice.
- I have reviewed the data template and the data import facilities used by Lloyd's to extract the EEA data.
- I have reviewed the data validation processes adopted by Lloyd's to ensure the EEA data is correctly extracted.
- I have made enquiries regarding the suitability and experience of Lloyd's personnel involved in this exercise.

4.4.16 **As a result of the above procedures I have been able to conclude that:**

- **The Lloyd's personnel involved in this project are competent and suitably experienced.**
- **The data import facilities and data template and the validation processes are well designed and suitable for this process.**
- **The EEA data basis extracted from Lloyd's centrally held data forms a reliable source of data to form the basis of the actuarial projections to support the proposed Part VII transfer.**

4.4.17 A validation exercise was undertaken, by Lloyd's, to try to match the data centrally held by Lloyd's to the data held by 11 Managing Agents for all policies. As part of this validation exercise Lloyd's engaged in two pilot studies with the Managing Agents. These pilot studies were undertaken between May 2019 and July 2019 and included attempted detailed reconciliations between the data held by the Managing Agents community and the data held centrally.

4.4.18 The purpose of the pilot studies was to confirm that the centrally held data had correctly identified:

- the In-scope policies for Open Market business and binders
- the history of premiums and claims attaching to those policies

4.4.19 Managing Agents, who were part of the pilot studies, were requested to produce data files with both Transferring Policies and non-Transferring Policies. Lloyd's then applied the same parameters as in Section 4.4.12 to the Managing Agent data to identify data relating to the transfer policies. The data, extracted from the Managing Agent's data files, was then reconciled to the centrally extracted data for the Transferring Policies.

4.4.20 Immediately after pilot 2 completed, the full data validation exercise commenced. The approach taken considered the lessons learned from pilots 1 and 2. It included all Managing Agents and included two stages of data quality check and validation followed by reconciliation. A high-level reconciliation activity was performed initially across all managing agents.

4.4.21 The Managing Agent data files included the history of claims and premiums attaching to transferring polices stratified by Lloyd's class of business. This data was used to validate that the centrally extracted data was suitable to form the basis for the actuarial projections of the liabilities attaching to the Transferring Policies.

4.4.22 Although the Lloyd's centrally held data does not include all the individual Policy details written under binding authorities, individual premiums and claims relating to those policies are recorded centrally either individually or in aggregate. These individual premiums and claims settlements, or notifications, will be tagged with the appropriate FIL codes and the EEA element of the related business can be identified. **Accordingly, any liabilities attaching to In-scope business will include business written under binding authorities, and therefore will, in my opinion, be included in the Lloyd's actuarial projections of the In-scope liabilities.**

4.4.23 The above matching exercise was not entirely successful, a number of issues arose as follows:

- different aggregation logic was used by the Managing Agents to that requested by Lloyd's
- underlying data was not in the expected format

- different reporting periods to the periods requested by Lloyd's were used
- cut-off issues
- missing or incomplete data from Managing Agents
- inconsistent data such as analysis of lead underwriter not correct etc
- the use of internal references to classify claims which are not consistent with Lloyd's references.

4.4.24 **I have reviewed the errors arising from the matching exercise and, in my opinion, most of the above problems relate to misunderstandings made by Managing Agents either in not correctly following the instructions issued by Lloyd's or in extracting data from their systems. During my review of the above issues, nothing came to my attention which indicated that there were any material problems with the Part VII data extracted from the centrally held database.**

4.4.25 **A considerable amount of time was spent by Lloyd's in assisting Managing Agents to correct their data for this pilot study. I have concluded that for Lloyd's to reconcile all 57 Managing Agents data would involve a considerable resource and time commitment both by the Corporation and the wider Managing Agents community. Accordingly, I have agreed with Lloyd's, that in order to validate the Part VII data, that they should concentrate their time and resources on 18 Managing Agents reflecting a cross section of the market, to ascertain whether the reconciliations highlighted any flaws within the centrally extracted data.**

4.4.26 In order to ensure the 18 Managing Agents selected by Lloyd's represent a fair cross section of the market, I discussed the selection criteria used by Lloyd's prior to the selection of the 18 Managing Agents. The 18 Managing Agents selection criteria included the following type of Managing Agents:

- A selection of the larger, more sophisticated Managing Agents who have resources available to assist Lloyd's in their reconciliation exercise.
- A selection of medium and smaller sized agents who have limited resources available to assist Lloyds with this exercise.
- A selection of Managing Agents whose syndicates are in run-off and had limited data on the operations of the syndicate when the business being transferred was underwritten.
- A selection of some agents which initially showed the largest differences between their data and Lloyd's central extracted data.
- The number of Agents selected was set at 18 to ensure the above selection criteria was accommodated within the sample size.

4.4.27 **Based on the above, I am satisfied that the 18 Managing Agents selected by Lloyd's are a fair reflection of a cross section of the Lloyd's market.**

4.5 Conclusion on data availability

4.5.1 The centrally held data is the same database which Lloyd's uses, for all overseas reporting and actuarial calculations for international licences.

4.5.2 I have not audited, nor have I independently verified, the data that Lloyd's has extracted from its centrally held data in respect of the Transferring Policies or the information supplied to me to support this data. However, I have carried out the following procedures on this data:

- review of the process by which the details of the In-scope policies have been extracted from Lloyd's centrally held data.
- review of the procedures adopted by Lloyd's to reconcile the In-scope policies to data held by the 18 Managing Agents referred to above.
- I selected a sample of numbers of underwriting years spread across several syndicates and Managing Agents for which I was able to replicate Lloyd's data reconciliation.
- review of the history of paid claims, outstanding claims and premiums attaching to the In-scope policies for internal consistency and reasonableness. I have also received a statement of data accuracy from Lloyd's.

4.5.3 The two main findings from the data reconciliation exercise were as follows:

- The data from the Managing Agents contains more detailed geographical information than can be extracted from the data Lloyd's maintains centrally.
- The financial data submitted by Managing Agents, i.e. such as premiums, outstanding, paid claims, are of a lower quality than the centrally held data. Further there are significant inconsistencies between Managing Agents in the way they present this data.

4.5.4 Therefore, Lloyd's has concluded the following:

- The Managing Agents data cannot be used in its current state to project the liabilities attaching to the Transferring Policies or for the calculations of the look-back period.
- The centrally held data does not always contain the optimal fields to apply the logic set out in paragraph 4.4.12 to identify policies transferring under the proposed Part VII transfer. Without any adjustment, this limitation on the Lloyd's centrally held data introduces a further element of uncertainty to the valuation of transferring liabilities.
- The Managing Agents data contains more detailed geographic information which can be used as a supplementary source of data to mitigate the above limitation of the centrally held data.

4.5.5 Lloyd's has concluded based on the results of the data validation exercise completed, in respect of the limitation of the central data regarding the identification of the transferring policies, that currently there is no evidence that this uncertainty is significantly more material than the other uncertainties inherent in the calculation of the liabilities associated with the Transferring Policies, such as uncertainty arising from the projection of reserves between the Assessment Date and the Scheme Effective Date. From a best estimate perspective, no further loading has been applied to estimated Transferring reserves in relation to this specific uncertainty. Accordingly, the central data has been used to estimate the liability attaching to the Transferring Policies for the Directions Hearing.

4.5.6 Any movement in gross liabilities (either up or down) associated with using the Managing Agent data as an additional source of information to identify additional policies for the Part VII transfer will be mitigated by the QS Reinsurance Contract which will reduce the gross liabilities to a net nil following the proposed transfer. Any movement on the gross liability will impact on LIC's counterparty risk and this will affect LIC's Solvency Capital Requirement. Lloyd's has stated its intention not to see a reduction of LIC's solvency requirements as a result of this proposed Part VII transfer. My understanding is that additional funds will be transferred from the Central Fund to LIC to cover any additional increase in LIC's counterparty risk should it be required.

4.5.7 In order to assess the levels of funds that could be potentially required from the Central Fund I requested that Lloyd's carry out a scenario test of the potential impact the above uncertainty may have on the transferring liabilities. In order to do this Lloyd's has matched Managing Agents' geographic information (available to date) to data Lloyd's holds centrally (covering around 40% of the transactions held on the central database based on the transaction original signing date and number) The results of the testing vary depending on the level at which Managing Agents' geographic data are matched to the central data. This indicated a range of possible movements in the liabilities associated with the proposed Part VII of less than 20%. Lloyd's has therefore assumed a 20% increase in the quantum of premium and claims within the centrally held data used to calculate the liabilities attaching to the Transferring Policies and a further 1% increase of premium and claims for the non-Transferring Policies and assuming no changes to the selected reserving assumptions (e.g. development patterns, initial expected loss ratios). The scenario test results in an increase in the Transferring Liabilities of 19.2%, with relatively lower impact on shorter-tailed classes (e.g. Property, Marine) which tend to have proportionately less reserves projected compared to longer-tailed classes (assuming a similar level of signed premium and incurred claims) as well as higher proportion of reserves projected to be paid out between the Valuation and the Transfer Date.

4.5.8 There is a significant uncertainty over the change in data that will result by using the Managing Agents own data as an additional source to identify Transferring Policies and which will be used to project the Transferring Liabilities for the Sanctions Hearing. The aim of this scenario test was to assess the maximum possible range of the uncertainty associated with the liabilities as currently calculated in Section 5 of this report. Although a 19.2% increase in the

Transferring Liabilities is relatively material, this will only result in potentially an additional €65m being transferred from the Central Fund to cover LIC's increase in counterparty risk in respect of this uncertainty. This level of uncertainty does not impact on the conclusions I have reached elsewhere in this report.

4.5.9 In order to mitigate the limitation to the Lloyd's centrally held data geographic information as described at 4.5.4 between the Directions Hearing and Effective Date, Lloyd's Managing Agents will be requested to refresh their data as at 31 December 2019. That data will then be matched to the central data as a supplementary source of information in order to identify Transferring Policies. Accordingly, any adjustment required to the valuation of liabilities attaching to the Transferring Policies will inform my supplementary report for the Sanctions Hearing.

4.5.10 Further all policies that fall within the definition of Transferring Policies in the Scheme will transfer on the Effective Date pursuant to the Scheme, regardless of whether they have been as a practical matter identified by that date as falling within the definition of a Transferring Policy on the Effective Date or not. As it will not be possible to identify in advance or at the time of transfer every single policy that transfers, this means that certain policies will only be identified after the Effective Date as having been transferred pursuant to the Scheme. If a policy is subsequently identified as a Transferring Policy (e.g. because the policyholder brings a claim after the Effective Date), the effect of the Scheme will nonetheless have been to transfer such policy to LIC on the Effective Date (even though the policy was not identified as having transferred until after the Effective Date).

4.5.11 **Based on the above procedures, I have concluded that the data extracted from Lloyd's central systems is suitable to be used to calculate:**

- **The valuation of the Transferring Liabilities (see section 5) attaching to the policies transferring to LIC, and;**
- **The look-back period (see section 8) to be used for the direct notification to Policyholders whose Policies have expired at the Effective Date of the Part VII transfer.**

5 Transferring Liabilities

5.1 Introduction

5.1.1 The Transferring Liabilities will initially be the largest items on LIC's balance sheet and are the largest source of risk in LIC's solvency calculation. This section will provide:

- A high level overview of the Transferring Liabilities
- An outline of the matters that I have reviewed and my conclusions from reviewing the Transferring Liabilities
- A description of the main sources of uncertainty associated with the Transferring Liabilities.

5.1.2 As described in section 4.1 the Transferring Liabilities in respect of the Transferring Policies will be fully reinsured back to Lloyd's Syndicates from LIC under the 100% QS Reinsurance Contracts. As a result, the net liability in respect of the Transferring Liabilities to LIC, after applying the QS Reinsurance Contracts, will be zero.

5.1.3 The economic effect of the Transfer and the associated QS Reinsurance Contracts is that the gross and net (of reinsurance) liabilities to Lloyd's Syndicates does not change post Transfer. The only impact is to change the insurance type from direct (or reinsurance business) to reinsurance (or retrocession) business underwritten by the Syndicates. Additionally, as explained in Section 4, under the Terms of the Scheme, the Outwards Reinsurance currently held by the Lloyd's Syndicates converts into retrocession cover. Consequently, the risk profile of Lloyd's Syndicates individually and the market in aggregate remains unchanged.

5.2 Background

5.2.1 The data used to arrive at the value of the Transferring Liabilities is the Lloyd's centrally held data as at 31 December 2018 and the supplementary data supplied by the Managing Agents as at 30 September 2019 (non-XIS data only). These dates are collectively the Assessment Date for Lloyd's analysis.

5.2.2 The insurance liabilities attaching to the Transferring Policies have been calculated, by the Lloyd's actuarial team, as at the Assessment Date. In order to arrive at the liabilities as at the Effective Date or Transfer Date (which has been assumed to be 29 October 2020), Lloyd's has estimated the rate at which the liabilities on Transferring Policies that will reduce between the Assessment Date and 29 October 2020, on a class by class basis. Some 43%, in aggregate, of the liabilities attaching to the Transferring Policies are expected to be settled in this period.

5.2.3 The insurance liabilities have been calculated on an individual class of business basis based on 72 business classes. In order to calculate the gross liabilities transferring the Lloyd's actuarial team has used a number of standard actuarial techniques to project both the ultimate premiums and the ultimate claims (net of acquisition costs).

5.2.4 During 2019 Lloyd's engaged a firm of independent actuaries to carry out an external assessment of the effectiveness of the central reserving process. These actuaries reviewed the reserves at a more granular class level than the 72 business classes used by Lloyd's and determined that the market aggregate-level reserves held by Lloyd's were within 5% of their own view on a gross basis and within 2% on a net basis.

5.2.5 The data used for the projection of ultimate premium and ultimate claims can be categorised as follows:

- Transferring Business: uses data from the Lloyd's Regulatory Reporting Data for business which has been classified as relating to EEA territories
- Unclear business: uses data from the Lloyd's Regulatory Reporting Data for business for which it is unclear if it relates to EEA territories or Policyholders due to a lack of, or conflicting data.
- Non-XIS Transferring Business: uses data provided by Managing Agents for business relating to EEA territories for which the data would not be captured within the Lloyd's Regulatory Reporting Data
- Non-XIS Unclear business: uses data provided by Managing Agents for business for which the data would not be captured within the Lloyd's Regulatory Reporting Data and for which it is unclear if it relates to EEA territories or Policyholders
- Non-Transferring Business encompasses all business that has been classified as not transferring
- Business with no EEA Indication is assumed to be non-Transferring.

5.2.6 I have been informed that geographical fields within the data has been used to identify Transferring and Non-Transferring Business. Where the quality of the data has prevented this identification, business has been classified as having an Unclear EEA Indication ("Unclear business" or "Non-XIS Unclear business"). Premium estimates for Unclear business and for Non-XIS Unclear business have been assumed to be distributed between the categories Non-Transferring Business and Transferring Business in line with the same proportions for each underwriting year and for each class of business as the business for which the segmentation is clear, excluding Non-XIS business as Lloyd's do not have sight of the non-transferring portions. **I consider this to be a reasonable assumption.**

5.2.7 I have also been informed by Lloyd's that premiums and claims relating to mixed policies have been split based on codes within the data which informs the geographical locations relating to each record. Therefore, each mixed Policy is effectively treated as two separate policies – one Transferring and one Non-transferring – for the purposes of projection of ultimate premium and ultimate claims.

5.2.8 The below table shows a split of the gross of reinsurance ultimate premium and claims that are estimated to be transferring for each of the segments as at 31 December 2018 for RRD data and as at 30 September 2019 for Non-XIS data:

Gross of reinsurance results by Data source and segmentation Total - All Figures 000s - Converted EUR								
Data source	**Segmentation**	**Total ultimate premium**	**% Transferring**	**Transferring Ultimate premium**	**Total ultimate claims***	**% Transferring**	**Transferring ultimate claims**
RRD	Transferring	40,042,289	100%	40,042,289	21,449,313	100%	21,449,313
	Unclear EEA indication	843,090	11%	113,712	1,526,247	21%	323,640
	No EEA Indication	-	0%	-	-	0%	-
Non-XIS	Transferring	365,541	100%	365,541	692,879	100%	692,879
	Unclear EEA indication	35,037	23%	8,065	122,348	20%	25,017
TOTAL		**41,285,957**		**40,529,607**	**23,790,788**		**22,490,850**

Ultimate claims excludes claims payments made prior to the 2009 underwriting year as these are unavailable in RRD data

5.2.9 As can be seen above the majority of the Transferring Liabilities falls within the RRD transferring segment as projected using standard actuarial techniques.

5.2.10 For all but three classes the selected methods, development patterns and Initial Expected Loss Ratios (IELRs) derived from the RRD Transferring data were then applied to the other segments (i.e. RRD Unclear EEA Indication, Non-XIS Transferring and Non-XIS Unclear EEA Indication). **I consider this to be a reasonable approach to take.**

5.2.10.1 For three classes where the Non-XIS Transferring Liabilities are estimated to be more significant (Non-Marine General Liability non-US Direct, Motor XL and Employers Liability/Workers' Compensation non-US Direct), specific Non-XIS benchmarks have been used appropriately.

5.2.11 There are two other adjustments to the data that I consider to be material:

- The valuation data for the RRD database is only up to 31 December 2018, however as explained in Section 1.3, transferring business was written on the 2019 underwriting year and in addition inwards German RI is being written on the 2019 and 2020 underwriting years. An estimate of this premium and the resulting Reserves are also included in the projections.
- In order to calculate an estimate of ultimate claims and Reserves as at the Assessment Date, an adjustment has been made to the premium on the 2018 underwriting year to reflect the early closures of binders.

5.2.12 Some policies within the Transferring Business have recently been determined to be out of scope of the transfer (the Excluded Jurisdiction Policies) but have remained within the Transferring Business data for the purpose of these projections. **I have concluded that these liabilities are not material in the context of the liabilities that are being transferred.**

5.2.13 For my analysis of the data used by Lloyd's please see section 4.4.

5.2.14 Lloyd's will revisit the valuations of the Transferring Liabilities using updated data as at 31 December 2019 (which is not currently available). My supplementary report will include my review of this further work.

5.3 Review process

5.3.1 The review process carried out by Lloyd's for the projections of the Reserves has involved three levels of review:

- At least one qualified actuary performed a review of the draft projections completed by the Lloyd's analysts
- The Chief Actuary of Lloyd's subsequently reviewed the projections
- The Senior Manager of Syndicate Reserving completed an independent peer review of the estimation of the gross ultimate Transferring Reserves as at the Assessment Date.
- An independent actuarial consultant completed an independent peer review of the work pertaining to the conversion of the gross ultimate Transferring Reserves as at the Assessment Date to the gross earned Transferring Reserves at the Scheme Effective Date and the Lookback Periods analysis.

5.3.2 I consider this to be a robust review process, performed by appropriately skilled individuals.

5.4 Transferring Liabilities

5.4.1 The total estimated insurance liabilities transferring under the proposed Part VII transfer, on a high level class of business basis is set out in the table below:

Estimate Reserves by High Level Class of Business – Gross of reinsurance Total - All Figures 000s - Converted EUR - by High Level Reserving Class				
	Ultimate Signed Premium	**Ultimate Reserves as at Assessment Date**	**Ultimate Reserves as at the Transfer Date**	**Reserves as % of Total as at the Transfer Date**
Accident & Health	2,412,551	422,999	196,730	4%
Aviation	4,348,249	328,182	145,161	3%
Casualty FinPro	5,104,448	1,860,218	1,368,823	29%
Casualty Other	4,516,533	1,755,677	1,225,136	26%
Casualty Treaty	379,464	231,089	172,629	4%
Energy	3,130,937	419,120	203,623	4%
Marine	11,544,591	1,823,330	745,384	16%
Property (D&F)	3,046,981	290,496	80,920	2%
Property Treaty	1,943,553	406,649	192,052	4%
Specialty Other	4,102,300	800,293	396,175	8%
TOTAL	**40,512,520**	**8,338,053**	**4,726,633**	

5.4.2 A small proportion of the Transferring Liabilities is expected to remain unearned at the Transfer Date, leading to a slightly lower earned reserves estimate of €4.47bn at the Transfer Date. Including the provision for ULAE of €59m total earned reserves and the unearned premium reserve of €270m are estimated to be €4.8n at the Transfer Date.

5.4.3 For the purposes of our analysis and comments we have considered the Ultimate Reserves of €4.7bn being transferred. Further when converted to sterling we have used the exchange rate at 31 December 2019 of £1:€1.18. In order to calculate LIC's Solvency Capital Requirement the Ultimate Reserves amount of €4.7bn has been used.

5.4.4 A fuller analysis of the Reserves at the Transfer Date by individual class of business is set out in Appendix 5.

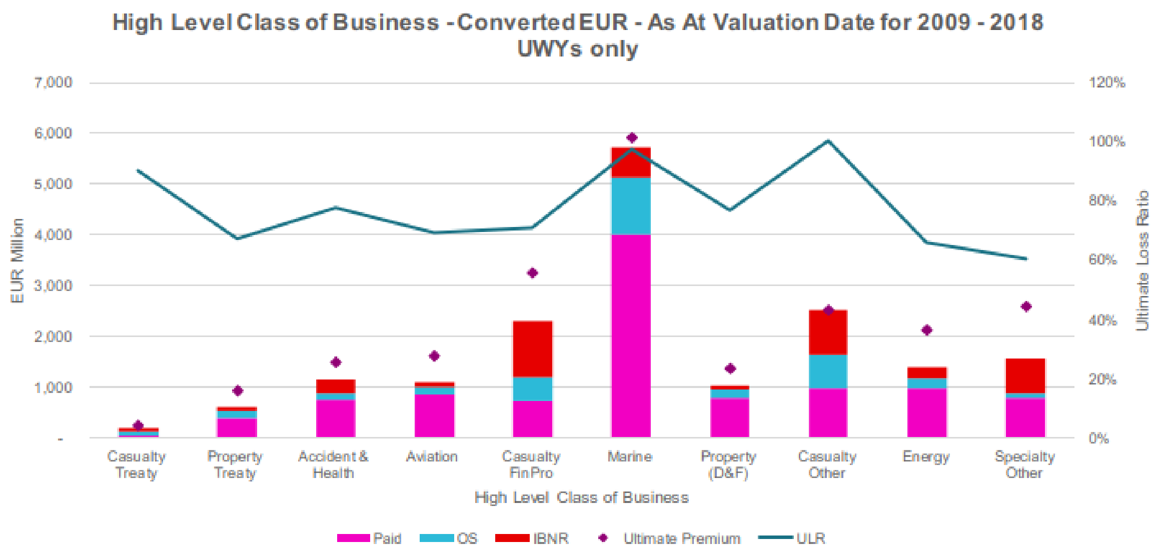
5.4.5 The major classes of business contributing to the Transferring Liabilities are as follows:

Class of business	Percentage	Comments
Casualty FinPro (Casualty: Financial and Professional Liability)	28	These classes contain a large proportion of long tailed business and have both written notable amounts of Transferring Business since inception, leading to significant reserve estimates. Casualty FinPro and Casualty Other both see an increase in their percentage share of the Reserves as at the Transfer Date compared to the Assessment Date due to being longer-tailed than the other high level classes.
Casualty other	25	
Marine	16	The majority of the Reserves for this class are held against Marine Hull, which represents 58% of the Marine Reserves. This is by far the largest class by ultimate premium out of the Transferring Business, so the quantum of the Reserves is relatively high at the Transfer Date despite Marine not being a relatively long-tailed class. Marine's share of the total Reserves decreases from 22% at the Valuation date to an estimated 16% at the estimated Transfer Date owing to the relatively short-tailed nature of the class.

5.4.6 A further analysis of the above figures by year in which policies incepted is shown below:

Total – All Figures 000s – Converted EUR – Results by Low Level Reserving Class		
	Gross Claims	
Year of Account	Reserves as at Transfer Date €	% of Reserves paid
2008 & Prior	318,857	42
2009	55,458	46
2010	52,334	53
2011	97,863	47
2012	125,890	42
2013	178,694	45
2014	552,630	48
2015	445,976	41
2016	637,823	43
2017	912,037	46
2018	1,012,321	43
2019	167,648	31
2020	169,101	5
Total	**4,726,633**	**43**

5.4.7 A breakdown of the figures by paid, outstanding and IBNR is as follows:



Paid	Liabilities settled, or expected to be settled, at the transfer date
Outstanding (OS)	Liabilities notified to Lloyd's Syndicates but not settled at the transfer date
Incurred but not reported (IBNR)	Liabilities expected to arise on Transferring Policies but not yet notified to Lloyd's Syndicates.

The Marine, Casualty FinPro and Casualty Other together amount to 60% of the total ultimate claim estimates and 53% of the total ultimate premiums across all high level classes for Underwriting years 2009 to 2018 inclusive. Over this period, Casualty Other and Marine were also the two worst performing classes with ultimate loss ratios of 103% and 97% respectively.

5.5 Approach taken to reviewing the Transferring Liabilities

5.5.1 The approach I have taken to satisfy myself that the liabilities calculated by Lloyd's are reasonable is as follows:

- A review of the relevant extracts of the draft Chief Actuary's Report to understand the methodology and approach adopted by Lloyd's to value the Transferring Liabilities on a gross basis. I have reviewed this for reasonableness;
- An assessment of the approach adopted by Lloyd's to allow for reinsurance on Germany exposures within the valuation of the Transferring Liabilities on a gross basis;
- I have also selected the following ten classes of business on the basis of materiality of gross written premiums or gross outstanding claims or due to the need for special consideration. For these classes, I have

reviewed the assumptions and methodology in more detail and reviewed the results of the valuation of the Transferring Liabilities on a gross basis for reasonableness. Details of my selection criteria are as follows:

Class of Business	Rationale for Selection
Marine Hull	Top 5 by gross written premium and gross outstanding claims and large unknown/investigative outstanding claims
Energy Offshore Property	Top 5 by gross written premium
Professional Indemnity (non-US)	Top 5 by gross written premium and gross outstanding claims
Political Risks, Credit & Financial Guarantee	Top 5 by gross written premium
Cargo	Top 5 by gross written premium and large unknown/investigative gross outstanding claims
Non-Marine General Liability (non-US direct)	Top 5 by gross outstanding claims
Medical Malpractice (non-US)	Top 5 by gross outstanding claims and potential for latency
Overseas Motor Other	Top 5 by gross outstanding claims and potential for latency
Cyber	Potential for latency
Property Direct & Facultative D&F (US Open Market)	Large unknown/investigative outstanding claims

5.5.2 For each of the above classes, I have undertaken a review of the assumptions and methodology used by Lloyd's to determine the value of the Transferring Liabilities. I have also sense-checked the results for reasonableness as follows:

- The selected development patterns (including benchmarked development patterns)
- The selected Initial Expected Loss Ratio ("IELR") including the Technical Provisions Data returns ("TPD") from the Syndicates and Syndicate Business Forecast ("SBF") loss ratios or other benchmarks used
- The methodology to derive adjustments for the truncation of the binder business for the 2018 year of account
- The results of the projection of ultimate claims and ultimate premiums
- The projection methods used

- The adjustments made (or lack thereof) for special features, such as for the potential for latent or annuity claims
- The benchmarks used where there are data limitations
- The stability of business mix within the data used to derive development patterns
- The appropriateness of applying methodology and assumptions, derived from analysing Transferring Business, to Unclear business and Non-XIS business
- A comparison of the appropriateness of the valuation of the Transferring Policies as held against the Global market
- The appropriateness of the segmentation of data for projection

5.5.3 In completing the above work my team has complied with TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance as issued by the UK Financial Reporting Council. My team has also complied with the Institute and Faculty of Actuaries professional standards APS X1 and APS X2.

5.6 Uncertainties

5.6.1 The projections have been carried out on a best estimate basis and represent the mean of all reasonably foreseeable outcomes. These projections are subject to considerable uncertainty and the results may be materially better or worse than expected.

5.6.2 There are a number of areas of uncertainty highlighted by Lloyd’s in the draft Chief Actuary’s Report:

- Where data is unavailable or not sufficiently credible, Lloyd’s has relied on benchmarks. This introduces additional uncertainty in the appropriateness of the benchmarks used. For example, use of benchmarks implicitly assumes that the business transferring to LIC is similar to the business in the Lloyd’s market as a whole.
- Lloyd’s has relied on benchmarks from the global central reserving exercise to uplift incurred catastrophe claims to ultimate as it does not separately estimate the Reserves for catastrophe events.
- The valuation uses Lloyd’s centrally held data (RRD data) rather than Managing Agents’ data.
- The business under the No EEA Indication segment is assumed to be non-Transferring.
- Soft market conditions operating in the insurance market increase the uncertainty of the estimation of claims Reserves based on prior experience.

- No allowance has been made for the emergence of new latent claims or Events Not In Data (ENIDs) within the Lloyd's projections.

- No allowance has been made for future inflation or currency devaluations, there is an implicit assumption that future inflation will be similar to past inflation and has been built into the actuarial projections.

- No allowance is made for unearned catastrophe exposures in respect of events above £200m at the Market level as these are expected to be immaterial within the Transferring business at the Transfer Date. This approach does not allow for catastrophe exposures earned between the Assessment Date and the Transfer Date which is a limitation.

- No allowance has been made for the impact of COVID-19.

- The ultimate claims reserves at the Assessment Date have been rolled forward to the Transfer Date using claims payment projections which is uncertain due to the extended period over which this has been performed for the current valuation – 22 months for the centrally held date and 13 months for the Non-XIS segments.

- The scope of the transfer which currently includes German reinsurance business. There is a potential for German reinsurance business to be excluded from the scheme which increases the uncertainty in the valuation of the Transferring Reserves.

5.6.3 Additionally, the reserving exercise has been based on data which includes data for business that Lloyd's has recently excluded from the transfer. Lloyd's has decided to exclude EEA business that would otherwise fall within the definition of an EEA Policy within the Scheme but that is also subject to the requirements of a local regulatory licence or other insurance approval granted to Lloyd's in the following jurisdictions: Canada, South Africa, Switzerland, Australia, Singapore and Hong Kong. None of these countries have material EEA business – the estimated total annual signed premium averages to around £40m only. Therefore, I do not consider the uncertainty in relation to the transfer scope of the Excluded Jurisdiction Policies to be material.

5.6.4 I note that an update to the actuarial projections and the Lloyd's Chief Actuary's Report using data as at 31 December 2019 will be prepared and that a number of these limitations will be resolved.

5.7 Analysis of reserve uncertainty

5.7.1 As a part of the valuation of liabilities exercise, Lloyd's has completed some sensitivity analysis into several key sources of reserve uncertainty. The sensitivity tests have been split into four main areas of uncertainty:

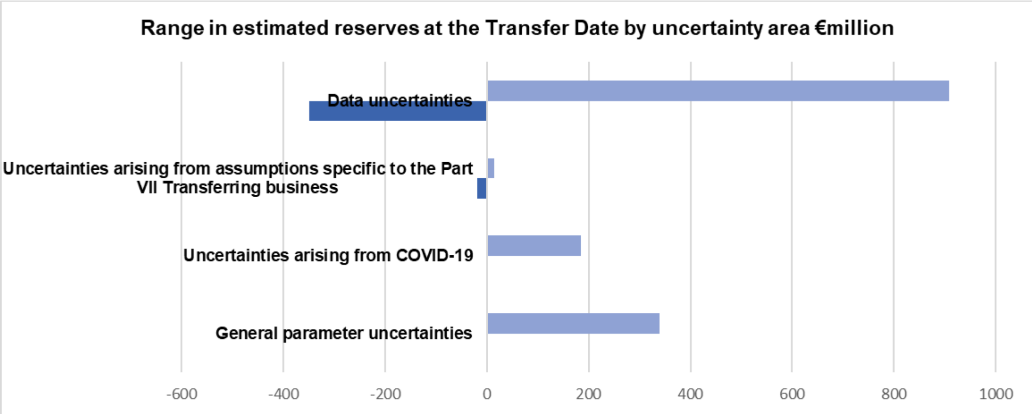
- Data uncertainties, for example using Lloyd's centrally held data compared to using Managing Agents' data,

- Uncertainties arising from assumptions specific to the Part VII Transferring business, for example the adjustment made to the premium on the 2018 underwriting year to reflect the early closures of binders,

- Uncertainties arising from COVID-19; and

- General parameter uncertainties, for example the roll-forward of reserves between the Assessment Date and the Transfer Date.

5.7.2 Where the uncertainty is quantifiable, Lloyd's has carried out scenario testing to assess the materiality of the impact on their Reserve estimates. The chart below shows the range in the estimated ultimate reserves excluding ULAE at the Transfer date for each the main areas of uncertainty.



5.7.3 The most significant areas of uncertainty in the amount of the Reserves relate to data uncertainties, particularly the change in segmentation results (i.e. identifying Transferring, Non-Transferring, Unclear Policies) using Managing Agents' data rather than Lloyd's central data that has been discussed in Section 4.5.5.

5.7.4 The next most significant area of uncertainty relates to the payment patterns used to project reserves to the Transfer Date. This uncertainty reduces significantly when the data is refreshed for the valuation exercise using data as at 31 December 2019.

5.7.5 Together with my actuarial team I have reviewed and challenged these sensitivities to ensure that the methodologies and assumptions selected for the Reserves are reasonable. The particular uncertainties arising from COVID-19 have been discussed in Section 9.1.

5.7.6 Based on this analysis of reserve uncertainty I have concluded that the portfolios are exposed to a diverse range of risks associated with the Transferring Liabilities. I have taken account of these uncertainties when considering the capital requirements of Lloyd's and LIC as well as the overall impact of the liabilities attaching to the Part VII transfer below and in Sections 6 and 7.

5.8 Impact of the liabilities attaching to the Part VII transfer

5.8.1 The economic effect of the Part VII transfer (and the 100% quota share reinsurance) is that liabilities attaching to the Transferring Policies are transferred back to the Lloyd's Members by the effect of QS Reinsurance Contracts that LIC will enter into with the Members. The resultant liabilities attached to the Transferring Policies will ultimately rest with the member who originally underwrote those risks. Accordingly, the impact of the transferring policies on LIC's Balance Sheet will be a net zero. Therefore, I have concluded that the quantum of the liabilities attached to the transferring policies will have no material adverse effect on either the Transferring, or non-Transferring, policyholders.

5.8.2 The quantum of the liabilities being transferred will impact on the LIC Solvency Capital Requirement, even though, after taking into account the effect of the QS Reinsurance Contract, the net liabilities transferred to LIC are effectively nil. The Part VII transfer will result in LIC's balance sheet including the gross liability, attaching to the policies being transferred, as a credit balance and an equal and opposite debit balance representing the amount recoverable under the QS Reinsurance Contract. The amount recoverable under the QS will be subject to an additional load in LIC's Solvency Capital Requirement to recognise the risk that the amount may not prove to be recoverable in full (this additional risk is referred to as "the Counterparty Risk"). Therefore, any variation in the gross liabilities will impact on LIC's Solvency Capital Requirement.

5.8.3 Ultimately the amount of capital carried by LIC will have no impact on LIC's ability to recover under the QS Reinsurance Contract. The key factor regarding the recoverability of amounts due will be the financial security of Lloyd's. Elsewhere in this report I have concluded that the Part VII transfer will not materially adversely affect the members ability to meet valid claims.

5.9 Results of my Review of the Transferring Liabilities

5.9.1 **The approach used by the Chief Actuary of Lloyd's to determine the best estimate Reserves as described in the report appear to me to be appropriate and consistent with market practice. Standard techniques appear to be consistently applied and where they are likely to be unsuitable, alternative approaches have been adopted.**

5.10 Conclusions

5.10.1 Transferring policyholders

5.10.1.1 I have concluded that an appropriate level of Reserves has been calculated in respect of the Transferring Policies and the Transferring Policyholders will not be materially adversely affected by the reserving aspects of the proposed Part VII transfer.

5.10.1.2 **I have also concluded the overall reserving approach used by the Chief Actuary of Lloyd's to determine the best estimate Reserves is reasonable.**

5.10.2 Non-Transferring policyholders

5.10.2.1 **I have concluded that the Non-Transferring Policyholders will not be materially adversely affected by the Reserving aspects of the proposed Part VII transfer.**

5.10.2.2 I have reached this conclusion for the following reasons:

5.10.2.2.1 The reserving process to assess the value of Reserves for the Non-Transferring Policyholders is unchanged following the Transfer;

5.10.2.2.2 The economic effect of the Transferring insurance liabilities will be fully reinsured back to Lloyd's Syndicates from LIC under the 100% Quota Share Reinsurance Contracts. The only impact of this is to change the insurance type from direct (or reinsurance business) to reinsurance (or retrocession) business underwritten

5.10.2.2.3 Overall the risk profile of the Lloyd's syndicates, individually and the market in aggregate, for the Non-Transferring Policyholders, remains unchanged.

5.11 Update to this analysis

5.11.1 A further update to my analysis will be included in my Supplementary Report following the update to the actuarial projections and the Lloyd's Chief Actuary's Report using data as at 31 December 2019.

6 Impact on Non-Transferring Policyholders

6.1 Solvency background

6.1.1 This section deals with the financial impact of the Part VII transfer on the Non-Transferring Policyholders.

6.1.2 The UK has now left the EU and is in a transition period until 31 December 2020. During this period the existing Solvency II rules continue to apply throughout the EU and the UK. It is unclear after that date what will happen with regard to a vast array of UK regulations including Solvency II.

6.1.3 **I anticipate that as the UK was a main architect of Solvency II, any immediate change to UK insurance solvency regulations is unlikely. I expect that there will be a desire for UK regulations to be considered to have equivalence with Solvency II, a status that is currently held by Switzerland and Bermuda with a similar bilateral agreement with the USA. Under such circumstances there would be limitations on the extent of any change in UK solvency requirements for both Lloyd's and potentially LIC's assets and liabilities in its UK branch. In the event of non-equivalence there could be greater changes and possibly different solvency loads for Lloyd's and LIC.**

6.1.4 The EU's Solvency II regime for insurers was adopted into UK law and the PRA handbook and became effective from 1 January 2016. These requirements include detailed guidance regarding the amount of capital required to be held based upon the risks to the insurer. This is known as the Solvency Capital Requirement ("SCR") and is the amount of capital required to withstand a 1 in 200 year loss event over a one year time horizon (a 99.5% confidence level). This may be calculated by reference to a standard formula or based upon an approved internal model.

6.1.5 The steps an insurer needs to take to arrive at its solvency position under the Solvency II regime are as follows:

A review of its assets and liabilities to ensure they are valued under Solvency II rules in order to calculate the net assets available to meet its solvency requirements. (Own Funds)

↓

A review and quantification in accordance with Solvency II rules of the potential risks that the insurer is exposed to in order to ascertain its regulatory capital requirement. (SCR)

↓

A comparison of the regulatory risk assessed capital requirement against the insurers net Solvency II assets to ensure it meets its regulatory capital requirement.

↓

An assessment of the Solvency Ratio that the insurer wishes to maintain based on its own assessment of risks and appetite to maintain solvency. (ORSA)

6.1.6 As part of the above steps a risk margin is calculated based upon the cost of capital required to meet the SCR amount. The amount of the risk margin is then added to the best estimate technical provisions as a deduction in calculating the entities Own Funds.

6.1.7 An insurer is required under Solvency II to perform an Own Risk Solvency Assessment ("ORSA") at least annually and after any significant change in its circumstances. Such a review will take into account its regulatory capital requirements and any additional risks considered to be relevant. This will often lead to an additional solvency margin above the regulatory requirement that the insurer wishes to carry. This may be to provide a buffer before regulatory capital margins are breached or a desire to demonstrate a strong solvency position such as to support a rating agency assessment.

6.1.8 Lloyd's and the Managing Agents are regulated by the PRA in accordance with the requirements of the EU Solvency II regime. Lloyd's, as a body, is the regulated entity for Solvency II, rather than the individual Syndicates or Members. Lloyd's however is required to ensure that the operations and capital relating to the underlying Syndicates and their Members are overseen in such a way that the overall market complies with the requirements of Solvency II.

6.1.9 Should an insurer's capital fall below its SCR this will trigger regulatory intervention and a requirement for a plan to remedy the situation. There is a further lower solvency requirement called the Minimum Capital Requirement ("MCR") a level below which the regulator will take action to potentially stop the insurer from continuing to accept risks.

6.1.10 By number, most insurers in the EU use the standard formula to assess their perceived risk. However, this is considered unlikely to be suitable to assess the risks faced by larger insurers and/or those with more complex risks such as reinsurers. Therefore, most of the larger insurers or reinsurers in the EU, including Lloyd's, use an approved internal model.

6.1.11 For LIC in Belgium, where the majority of its risks are transferred back to Lloyd's in the UK by reinsurance, a standard formula basis of calculation has been used to calculate its solvency as set out in section 7.

6.2 The Lloyd's Internal Model

6.2.1 This section of my report addresses how Lloyd's uses an approved internal model to calculate its regulatory solvency requirements.

6.2.2 The Lloyd's Internal Model ("LIM") is a purpose built model designed to address all the types of risk that Syndicates and Lloyd's are exposed to through the business written and assets and liabilities of the Syndicates and their aggregation and link to Lloyd's. This is used to calculate the SCR for the Lloyd's market as a whole.

6.2.3 The LIM reflects the Lloyd's market's unique capital structure, and has three main components:

- the Lloyd's Investment Risk Model which simulates economic variables and asset returns;
- the Lloyd's Catastrophe Model which models catastrophes using Syndicates' views of risks;
- the Capital Calculation Kernel which is the main element of the LIM where all other risks are simulated and then all risks are combined.

6.2.4 Managing Agents are required to calculate a notional SCR and MCR for each managed syndicate over a one year time horizon. The Corporation then reviews these at a Syndicate level and uses the ultimate figure (with an economic capital uplift) as the basis for the capital required to be held by members. LIM uses a methodology where losses from insurance and other risks are simulated by line of business and allocated to Syndicates and then through to Members to assess their capital erosion over a range of scenarios.

6.2.5 Syndicates are the source of the majority of the Lloyd's market's risk as they source all of the insurance business and hold the majority of the asset portfolios and counterparty exposures as well as conducting most of the day to day operational activity. The Syndicate risks include underwriting, reserving, catastrophe insurance risks, market risk on Syndicate assets, reinsurance risk and other credit risk, and Syndicate operational risk. In addition, there are the market risks on Members' funds and, central assets and central operational risks including pension fund risk.

6.2.6 The calculation applies rules regarding the valuation of assets and liabilities and the assessment of risks facing the Lloyd's market. Components of the calculation of the SCR include the following risk elements.

Risk	Description
Underwriting risk	This includes risks arising from exposures for business committed with future exposure to risk including catastrophes and the risk that the Reserves for claims arising from past exposures are inadequate.
Market risk	This is based upon the risks arising from assets held due to changes in interest rates, equity values, property values, credit spreads, currency exchange rates and the concentration of exposures to particular entities.
Counterparty risk	This risk arises from exposures to insurers/reinsurers failing to fully meet their repayment obligations.
Operational risk	This is the risk of losses arising from poorly operating controls or IT systems within the business.
Diversification credit	The SCR is set at the overall 1 in 200 level which does not assume that all risks manifest at the same time. Diversification credit is the level of reduction from the individual risks to get to the aggregate 1 in 200.

6.2.7 Given the uniqueness of the Lloyd's market, Lloyd's is required to calculate two SCR's under the Solvency II regime as follows:

- The Market Wide SCR ("MWSCR") – this includes all risks of Members of Lloyd's across the market and can be covered by eligible funds from all three links in Lloyd's chain of security, including those arising from Syndicate activities, Members' Funds at Lloyd's and the Central Fund.
- The Lloyd's Central SCR ("CSCR") – this captures only risks faced by the Central Fund, in the event that Members fail to meet their liabilities even having complied with Lloyd's capital setting rules. Only eligible capital available to Lloyd's centrally may be used to cover the CSCR.

Eligible funds (both market level and centrally held) exclude any assets which are ringfenced for Lloyd's overseas subsidiaries, including LIC.

6.2.8 The MWSCR is calculated to cover all the risks of the market, i.e. those arising on Members' underwriting, Members' capital provided at Lloyd's and the Society taken together, at a 99.5% confidence level over a one-year time horizon as provided for in Solvency II legislation.

6.2.9 The MWSCR and CSCR are both calculated in accordance with LIM which was approved by the PRA in December 2015 and has since been modified in accordance with the major model change applications approved by the PRA in December 2017 and in December 2018.

6.2.10 The inputs into the calculation of the MWSCR and CSCR are as follows:

- returns submitted from Syndicates in the format specified by Lloyd's
- details of the Members' funds, held centrally by Lloyd's on behalf of the Members, and reported upon by Lloyd's own auditors
- other data in respect of Lloyd's and which is partly reported upon by Lloyd's own auditor.

6.2.11 The Board of Lloyd's is the owner of the LIM and also has overall responsibility for the review and approval of the Own Risk and Solvency Assessment ("ORSA") process and report. Underneath the Board is a framework of committees including a Board Risk Committee, an Executive Risk Committee and an Internal Model Oversight Committee. The Solvency II regulations require any internal model used for Solvency purposes to be subject to a validation process in order for the regulator to continue to approve the model.

6.2.12 The Lloyd's validation team comprises an Independent Validator and Primary Validators of individual components, with roles and responsibilities allocated to ensure that they have appropriate expertise. The validators agree the scope and coverage of testing and perform the tests.

6.2.13 In addition, all operations at Lloyd's are subject to internal controls and internal audit as well as Data Quality Management policies and annual checks of controls over data and its risks and usage.

6.2.14 I have seen evidence of the checks and reviews operated within the LIM process, including identified weakness and future enhancements. The nature of these did not undermine the results produced by LIM.

6.2.15 In June 2019 a Model Validation Report was received by Lloyd's from the independent validation team comprising internal resources from the Risk management function and supported by external actuarial consultants. Its scope was quantitative and qualitative. For components of the validation process where the internal validation team are not independent such as model use and governance, the external consultants performed the validation without internal support. The external consultants were able to confirm the following:

- The internal model is reliable.
- The results of the internal model are appropriate to Lloyd's risk profile.
- The internal model materially meets the requirements of supervisory requirements.
- The validation was completed materially in line with the validation policy.

- An appropriate level of independence has been maintained throughout the validation process.

The CSCR was noted to be more sensitive than the MWSCR to variations in the model. No issues were identified that would invalidate the SCR calculations. Although there were improvements noted during the 2019 validation there were three major areas noted for future improvement although additional analysis of these areas provided comfort for the 2019 validation. These areas were:

- The visibility and reconciliation of expected profits from the Syndicates to ensure movements are understood and in line with expectations.

- Model stability, although improved slightly with more changes to the model planned for 2020, the effect of any changes will need additional testing and verification.

- Comparison to syndicate models, which has been subject to a deep dive review by the external consultants and is subject to further deep dive review. This is part of Lloyd's ongoing commitment to better understand how syndicate assessments compare over time to those of Lloyd's centrally.

6.2.16 In order to gain an understanding of the LIM model I have undertaken the following procedures:

- A review the LIM process, including its governance and controls by holding discussions with individuals at Lloyd's involved in the LIM, particularly Lloyds actuarial team. This included gaining an understanding of the key issues and assumptions behind the model, including a review of the key risk scenarios, in order to assess the financial impact of the proposed Part VII transfer.

- A review of the Lloyd's Solvency and Financial Condition Report as at 31 December 2018.

- A review of Lloyd's Annual Report as at 31 December 2018.

- A review of Lloyd's ORSAs dated July 2018 and October 2019.

- A review of Lloyd's Internal Model Validation Report dated June 2019 (including the supporting report from the external validators).

- A review of LIM Capital Calculation Kernel Model Design dated January 2019.

6.2.17 **As a result of the above procedures together with a review of the supporting documentation made available to me by Lloyd's, I have been able to form an assessment of the financial impact of the proposed Part VII transfer on Lloyd's Solvency Capital Requirement as calculated by LIM. On this basis, I have concluded that the process, including the risks identified and assessments made by LIM, is appropriate to the nature and scale of Lloyd's operations.**

6.2.18 **I have concluded in section 4, that the proposed Part VII transfer is a circular transaction whereby the liabilities and assets transferred to LIC under the proposed Court process and the economic effect of those liabilities and assets are returned to the Members via the individual 100% QS Reinsurance Contracts with each Syndicate.**

6.2.19 **In my opinion, the exposure of the Members to claims on policies written before and after this Part VII transfer are, for all material purposes, the same.**

6.2.20 **I have further concluded that the only impact on non-transferring Policyholders following the Part VII is the loss of funds from the Central Fund, amounting to €388m which is required to increase the capital of LIC and to meet LIC's additional running costs following the proposed Part VII transfer.**

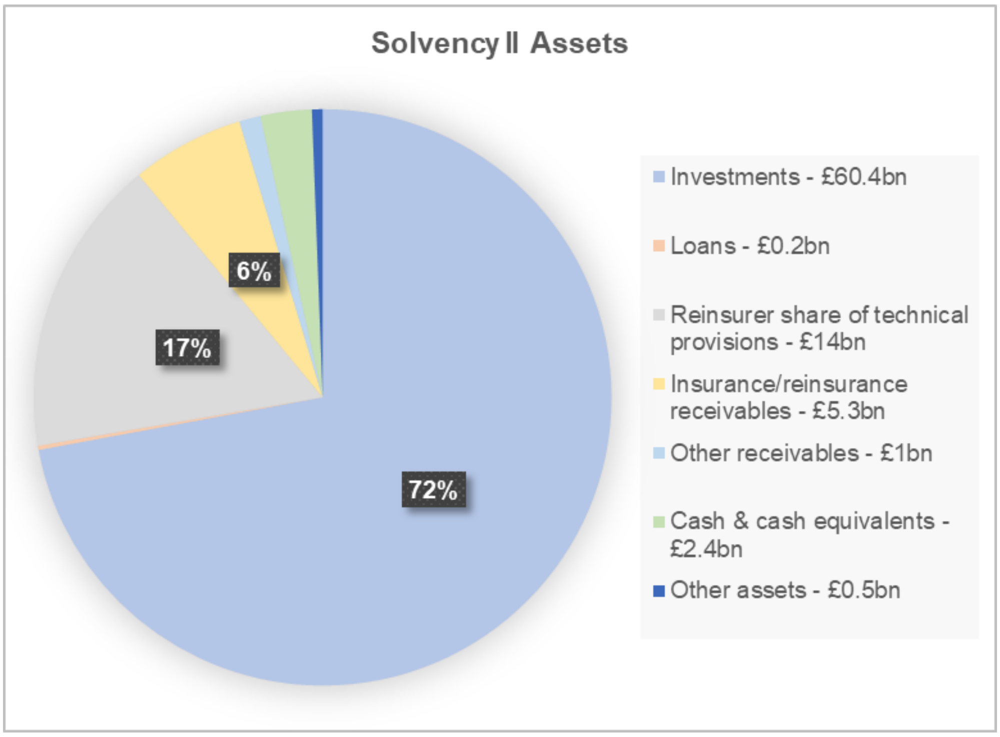
6.3 Lloyd's and Members' Assets and Liabilities

6.3.1 This section of my report deals with the calculation of the Lloyd's solvency position in more detail.

6.3.2 The table below shows the adjustments made to the Lloyd's UK GAAP balance sheet to ensure the assets and liabilities are stated on a basis consistent with the requirements of Solvency II.

Lloyd's Balance Sheet 31-12-18	UK GAAP £bn	Adjustment £bn	Solvency II £bn
Investments	60.2	0.2	60.4
Loans	0.2	-	0.2
Reinsurers' share Technical Provisions	*23.4*	*(9.4)*	*14.0*
Deferred acquisition costs (DAC)	4.7	(4.7)	0
Insurance/reinsurance receivables	17.2	(11.9)	5.3
Other receivables	1.0	0	1.0
Cash & cash equivalents	10.9	(8.5)	2.4
Other assets	0.4	0.1	0.5
Total assets	**118.0**	**(34.2)**	**83.8**
Technical Provisions	*78.3*	*(78.3)*	*0*
Technical Provisions - best estimate	*0*	*55.3*	*55.3*
Technical Provisions- risk margin	*0*	*3.4*	*3.4*
Deposits from reinsurers	0.2	0.2	0.4
Due to credit institutions	0.2	0	0.2
Insurance/reinsurance payables	7.9	(5.5)	2.4
Other payables	2.1	(0.4)	1.7
Subordinated debt	0	0.8	0.8
Other liabilities	1.1	0	1.1
Total liabilities	**89.8**	**(24.5)**	**65.3**
Excess of assets over liabilities	**28.2**	**(9.7)**	**18.5**

6.3.3 The total assets of £83.8bn calculated under the Solvency II basis, as at 31 December 2018 are as follows:

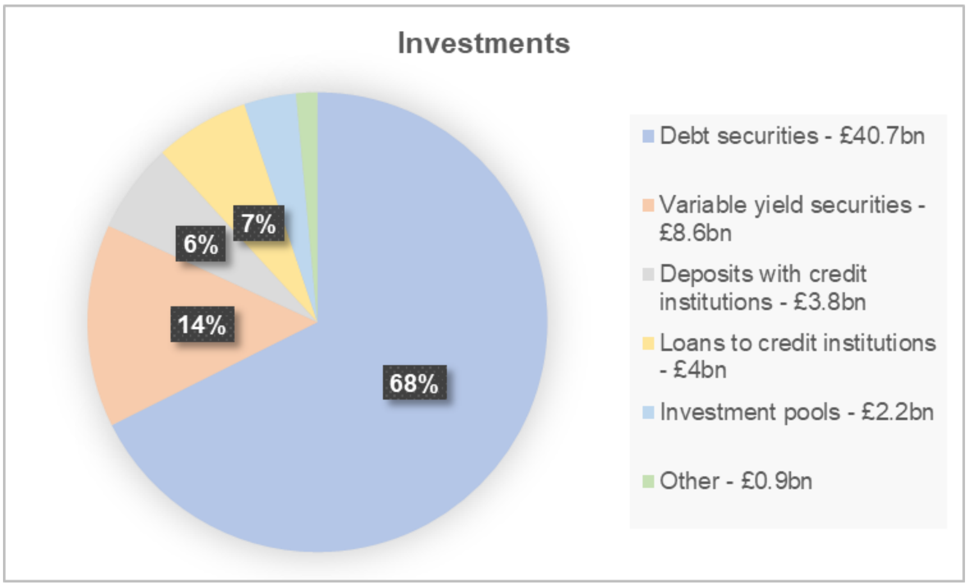


6.3.4 The majority of the assets held by the Members and by Lloyd's centrally consist of investments and amounts recoverable by Lloyd's Syndicates under their reinsurance arrangements (Reinsurers' share of the Technical Provisions).

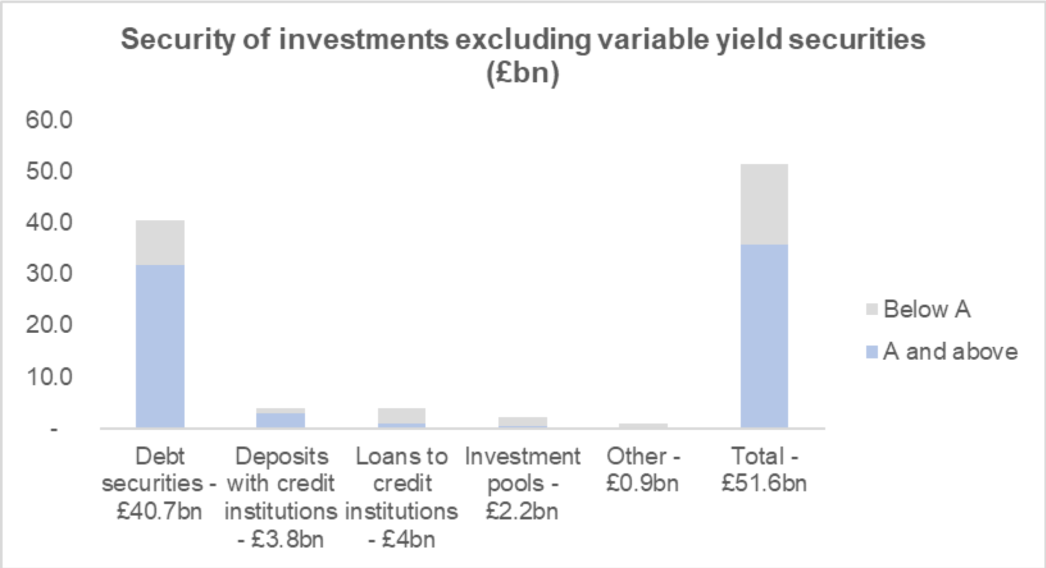
6.3.5 The majority of cash and cash equivalents are held with institutions with a credit rating of A or above. The reduction in cash and cash equivalents from the UK GAAP figure to the Solvency II basis is mainly due to the removal of £7.7bn of Lloyd's approved Letters of Credit provided by Members to support their underwriting.

6.3.6 Reinsurers' share of Technical Provisions includes approximately 88% of amounts due from reinsurers whose credit rating is A or above.

6.3.7 An analysis of the £60.2bn for the investments held at 31 December 2018 in the UK GAAP Balance Sheet is as follows:



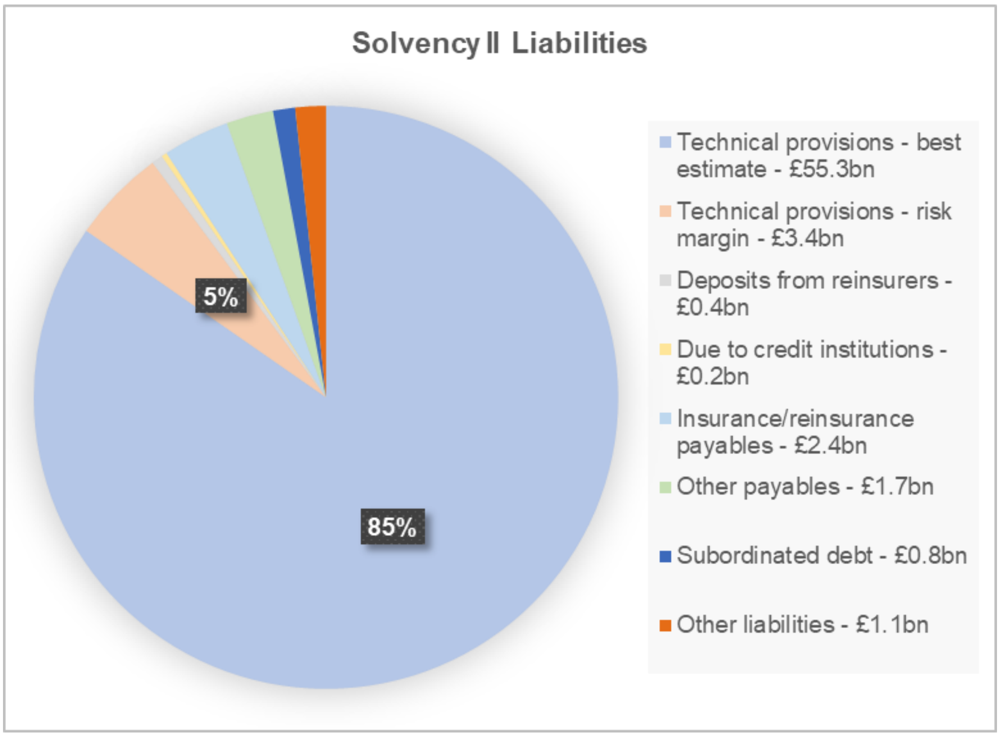
6.3.8 The majority of assets classified as variable yield securities are shares listed on a recognised exchange. The remaining assets security ratings are as follows:



6.3.9 Overall 70% of the investments, excluding shares and variable yield securities are rated A or better of which 48% are AA or better.

6.3.10 **In my opinion, both the cash and cash equivalents (excluding the £7.7bn of letters of credit) and the investments held by Syndicates and by Lloyd's have good security ratings and are mostly readily tradeable, and therefore, despite their scale, I do not believe cash and investments present a major source of risk to Lloyd's.**

6.3.11 The total Solvency II liabilities amounting to £65.3bn as at 31 December 2018 are as follows:



6.3.12 By far the largest liability on a UK GAAP and Solvency II basis is the Technical Provisions, representing 90%, which are derived from each Syndicate's own reserving processes. This process is subject to the Syndicates own controls and procedures. Each Syndicate produces a syndicate return which is signed off by the board of the Managing Agent, reporting actuaries (that have met Lloyd's requirements) and Syndicate auditors.

6.3.13 There were some 66 Syndicates reporting in 2018 across a range of business lines and no single Syndicate underwrote more than 7% of the market premium income total. Lloyd's also applies oversight over the process which includes briefings to the Lloyd's market on key issues and an oversight of Technical Provisions on a quarterly basis.

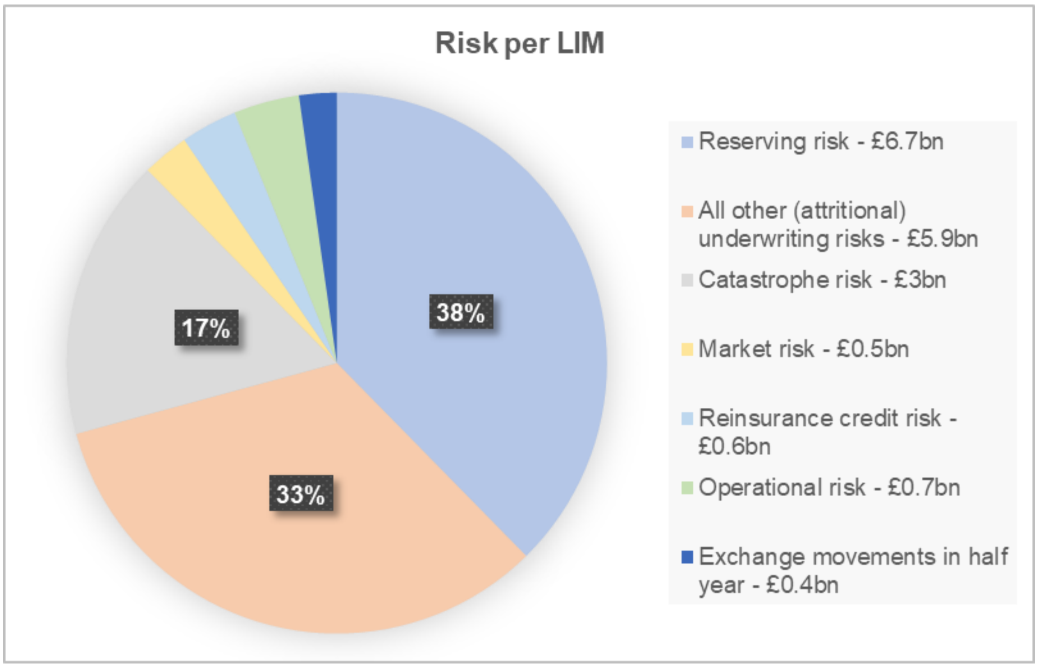
6.3.14 **In my opinion, the Syndicate returns provides a robust platform upon which Lloyd's builds its Solvency II capital calculation process. The different Syndicates reserving practices and controls in place across the Lloyd's market, are in turn controlled by Lloyd's central overview and calibration of the solvency reserving process.**

6.3.15 The 31 December 2019 Lloyd's Solvency and Financial Condition Report was issued on 21 April 2020. The assets and liabilities at that time are largely similar in mix to the previous year-end detailed above with the net available assets for the MWSCR having increased by around 6% and the CSCR by 2%. On the basis of this high level review of the 2019 SFCR I am satisfied the above analysis of the 2018 SFCR remains consistent and relevant to my conclusions notwithstanding the updated financial information now available. A further update to Lloyd's capital position, especially following the developments relating to the COVID-19 pandemic, will also be provided in my Supplementary Report.

6.4 Lloyd's Members' Solvency Calculations

6.4.1 Lloyd's separately calculates the MWSCR and CSCR.

6.4.2 The main risks within the MWSCR calculation are derived from the LIM amount to £17.8bn, as at 31 December 2018, the analysis of which is as follows:

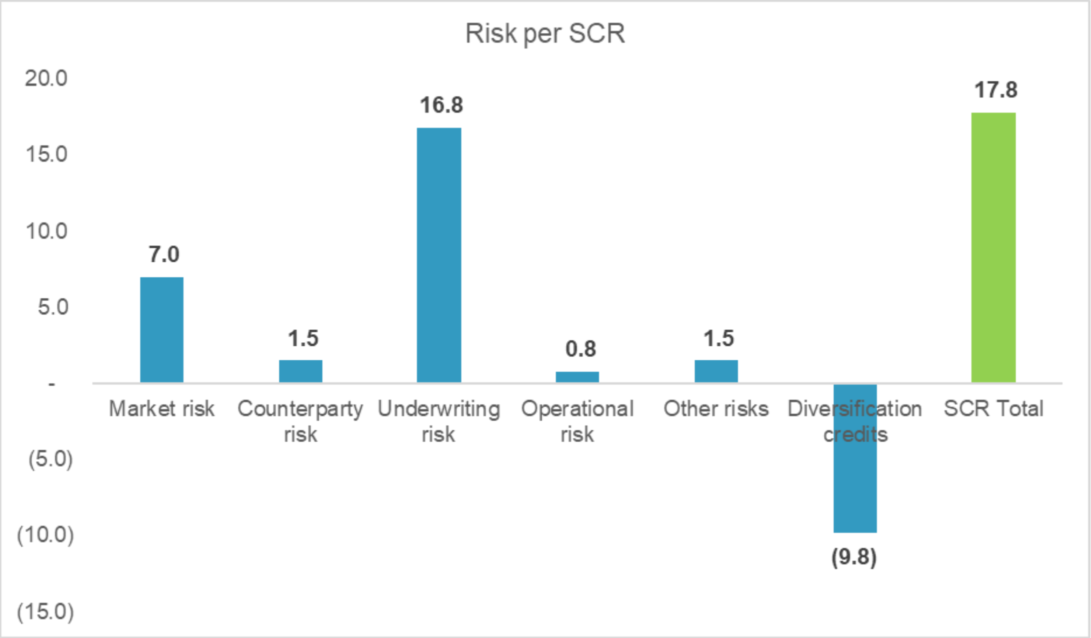


6.4.3 The three major risks, amounting to 88% of the total risk relate to underwriting risks and are the key source of risk to Lloyd's. The other risks on an individual basis are much less significant.

6.4.4 The major elements of underwriting risk are:

- The risk that, Claims arising from unexpired periods of exposure, are worse than expected.
- The risk that the Reserves held by the Syndicates are understated.
- The risk of future catastrophe claims arising on already committed business.

6.4.5 Although Lloyd's uses different components in the LIM calculation of the MWSCR as shown in the above chart, the chart below shows the risks derived from the LIM restated into the standard formula components and therefore on a more similar basis to the LIC risks.



6.4.6 The diversification credit shown in the above table recognises that all the risks set out in the table are unlikely to happen at the same time.

6.4.7 The main risk reflected in the CSCR is that individual Members projected losses will exceed their current funds and therefore the Central Fund will have to respond for those Members to ensure all Policyholders claims are met.

6.4.8 The SCR derived from the LIM, restated into the standard formula components, is then compared to Lloyd's Own Funds which will include the market's net assets of £18.5bn shown in paragraph 6.3.2 to derive the solvency surplus as follows:

31 December 2018	Lloyd's Members & Central Fund (MWSCR) £bn	Central Fund Only (CSCR) £bn
Market risk	7.0	0.4
Counterparty risk	1.5	0
Underwriting risk	16.8	0
Operating risk	0.8	0.4
Other risks	1.5	0.2
Members deficits	0	1.5
Diversification credit	(9.8)	(1.1)
SCR	**17.8**	**1.4**
Members' Funds at Lloyd's – cash & investments	18.5	0
Syndicate net assets/(liabilities) due to/(from) Members	(2.8)	0
Central net assets	2.0	2.0
Sub-ordinated debt	0.8	0.8
Callable amount	0	0.8
Ineligible solvency assets	0	(0.1)
Lloyd's Balance Sheet – Net assets	**18.5**	**3.5**
Members' Funds at Lloyd's – letters of credit	7.7	0
Own Funds	**26.2**	**3.5**
Solvency Surplus	**8.4**	**2.1**
Solvency Ratio (Own funds/SCR as a %)	**148%**	**249%**
Lloyd's risk appetite (as set out in the ORSA)	**125%**	**200%**

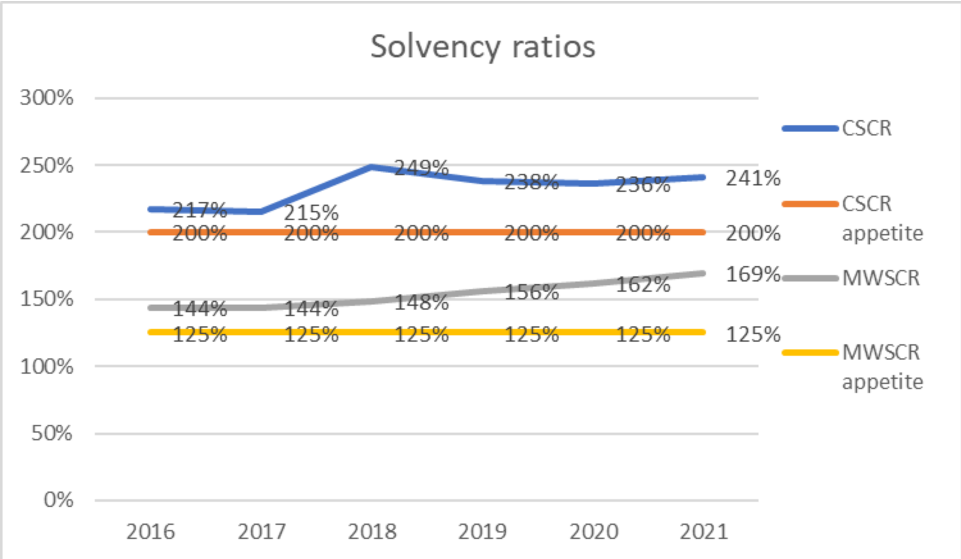
All figures in the above table are stated before the proposed Part VII transfer.

6.4.9 The above MWSCR of £17.8bn compares to a Minimum Capital Requirement on a market wide basis of £8.0bn for 2018.

6.4.10 Subordinated debt is the debt that Lloyd's has issued of £300m as 4.75% Sterling Notes in 2014 repayable in 2024 and £500m as £4.875% Sterling Notes in 2017 repayable in 2047.

6.4.11 The callable amount is the right that the Central Fund has to call an additional contribution from the Members of up to 3% of Members' overall premium income limits for a calendar year, to fund losses falling upon the Central Fund from certain Members being unable to meet their full share of liabilities payable by them. This amount would be funded from Syndicate funds in the first instance.

6.4.12 The variation in Solvency Ratios over the last 3 years, projected forwards to 2021, assuming that the proposed Part VII transfer takes place, as per the latest available ORSA and SFCRs, are shown below:



6.4.13 These Solvency Ratios have remained relatively stable over this period and well above the risk appetite set by Lloyd's despite the poor recent market results, including the large catastrophe losses impacting the 2017 year. The increase in the CSCR ratio in 2018 is due to a £0.2bn decrease in its SCR requirement to £1.4bn although this increased again by £0.1bn to £1.5bn in 2019.

6.4.14 For 2019 onwards, despite the proposed Part VII transfer occurring in 2020 both solvency ratios remain relatively stable and well above Lloyd's risk appetite.

6.4.15 Lloyd's tested their solvency model against various growth and remediation of poor performing business scenarios. The only scenario which shows a decrease in the CSCR Solvency Ratio to 217% is when the assumption is made that rates deteriorate, and no remedial action is taken.

6.4.16 The £3.5bn of assets held centrally would need to reduce by £2.9bn for the total assets to fall below the minimum capital requirement for the Central Fund. In this case, the PRA can remove the authorisation unless remedial action could be taken within a prescribed timeframe. Lloyd's has assessed that the most likely reason for such a reduction is a claim on the Central Fund to meet Policyholders claims where Members are unable to meet their share of the losses. Lloyd's has estimated that such a scenario would need a Lloyd's market wide loss of approximately £20.2bn. As per the LIM estimate the probability of such a loss would relate to a 1 in 450 years event probability. In order for a loss of this magnitude to occur this would require a catastrophe loss, or series of losses in the same calendar year, that are a multiple of the scale and/or number seen in recent years and probably at the same time as some significant reserving deterioration.

6.4.17 The following table shows the relationship between Central Fund losses, market wide losses and return periods:

Central Fund Loss (£m)	Central SCR Return period (one-year basis)	Corresponding Lloyd's Market Wide Loss (£m)	MW Return Period (one-year basis)
1,500	205	17,661	208
2,000	293	16,299	157
2,500	369	19,274	312
2,900	451	20,201	369
3,500	595	21,588	503

As can be seen a breach of the Central Fund minimum capital requirement of £0.6bn would take a £2.9bn loss to the Central Fund and is modelled to a Lloyd's market wide loss of £20.2bn. To completely wipe out the Central Fund of £3.5bn is modelled to a nearly 1 in 600 probability and take a market wide loss of £21.6bn according to Lloyd's modelling. The reason for the difference in probability between the market wide losses and the Central Fund losses arises because the market wide losses could fall upon some members who are more able to withstand a larger loss than others because of the syndicates which they support and the extent of their Funds at Lloyd's.

6.4.18 Lloyd's have modelled various scenarios that might create a £2.9bn loss to the Central Fund, but they consider the most likely based upon their modelling to be a combination of massive and unlikely events as described in the following three different scenarios:

- A combined insurance risk comprising: £15.4bn natural catastrophe (this is 4 times the realistic disaster scenario for a hurricane impacting Galveston, Texas or 3 times the realistic scenario for 2 US windstorms impacting in quick succession); plus a £3.7bn market loss equivalent to the 2008 credit crisis and a £1.3bn loss to the Central Fund from Syndicates or Lloyd's centrally having defective operational processes.

- A catastrophe dominated risk comprising a £16.1bn natural catastrophe, this compares to a cumulative loss for £3.3bn for Katrina, Wilma and

Rita hurricanes in 2005, although the market has grown since then. This would however require the loss to have a particularly severe impact on certain members to cause a significant impact on the Central Fund.

- An underwriting and reserving dominated risk comprising: £13.8bn reserve loss (compared to a £643m deterioration following the 2005 hurricanes, which makes the most likely cause to be extreme latent claims which to give an idea of scale would be more than 15% of the global loss of $100bn (£75bn) ultimate loss from asbestos to the US general insurance industry) and a £10.4bn non-catastrophe underwriting loss (this is estimated to be around 5 times the impact of a terrorist attack on the Rockefeller Centre in New York or double the impact of a cyber-attack on the power grid in the Northeast US causing a blackout).

6.4.19 **In my opinion, the oversight by Lloyd's of the operation of the market, ongoing risk assessment and solvency calculation and monitoring provide a reliable and rigorous framework for ensuring that the solvency of the Lloyd's market is maintained at or above the level required by its risk appetite. This analysis is supported by ratings agencies' assessment of a stable outlook for Lloyd's and clear signs that remedial action is taken when risks are identified.**

6.5 Lloyd's Members' Solvency before and after Part VII Transfer

6.5.1 The table below shows the pro-forma MWSCR and CSCR following the Part VII transfer. The SCR amounts have been obtained from the 2018 year-end SFCR:

	MWSCR £bn A	CSCR £bn B
Pre-transfer		
Gross claims Reserves*	80.0	0
Net claims Reserves*	55.0	0
SCR	**17.8**	**1.4**
Available capital	29.0	3.6
Solvency surplus	11.3	2.2
Solvency ratio (Available capital/SCR as %)	163%	258%
Impact of transfer & 100% QS Reinsurance Contract		
Gross claims Reserves	0	0
Net claims Reserves	0	0
SCR	**0**	**0**
Available capital	(0.3)	(0.3)
Solvency surplus	(0.3)	(0.3)

	MWSCR £bn A	CSCR £bn B
Post-transfer		
Gross claims Reserves	80.0	0
Net claims Reserves	55.0	0
SCR	**17.8**	**1.4**
Available capital	28.7	3.3
Solvency surplus	11.0	2.0
Solvency ratio	**161%**	**236%**
Change in Solvency ratio	**(2%)**	**(22%)**
Lloyd's risk appetite	**125%**	**200%**

*****_As at 30 June 2019_

6.5.2 There is no impact on the gross or net claims Reserves in column A of the above table, as the gross liabilities attaching to the Transferring Policies are replaced on a like for like basis, with liabilities under the QS Reinsurance Contracts with LIC.

6.5.3 As part of the Scheme there will be a capital injection to LIC from the Central Fund of £264m (€313m). There will also be an amount of £64m (€75m) transferred to LIC to administer the liabilities being transferred. The €75m is calculated to cover the additional administrative expenses that LIC will incur over the period the Transferring Liabilities are expected to be settled.

6.5.4 The estimated scale of the ultimate claims Reserves that are being transferred to LIC is £4.0bn (€4.7bn) which on a net basis reduces to nil after taking into account the 100% QS Reinsurance Contracts which economically transfers the gross liabilities back to the Members. The total gross claims Reserves transferred to LIC under the proposed Part VII transfer only represents approximately 4% of Lloyd's total gross claims Reserves.

6.5.5 The reduction of 2% in the MWSCR, column A of the above table, as a result of the transfer is due to the capital injection of £264m into LIC and the transfer of £64m to cover LIC's additional costs to service the Part VII transfer. At 161% the revised solvency ratio is still well above Lloyd's risk appetite of 125% for the MWSCR.

6.5.6 For the CSCR (column B) there is an 22% decrease in its Solvency Ratio to 236%. This reduction arises as a result of transferring £0.3bn, from the Central Fund, to LIC in order to maintain LIC's Solvency Ratio following the transfer of liabilities to LIC. Even after this reduction, the Central Fund solvency ratio is well above the Lloyd's risk appetite of 200% as set out in their latest ORSA.

6.5.7 The above analysis has been calculated using the euro sterling exchange rate, as at 31 December 2019 of £1:€1.18.

6.5.8 **Following the proposed Part VII transfer, I have concluded that the Lloyd's and Members available capital to meet liabilities reduces by £0.3bn to £28.7bn (column A). However, this amount includes the surplus of Syndicate net assets and a surplus of Members' funds at Lloyd's, which at 31 December 2018 amounted to £23.4bn. This latter element cannot be used to pay the loss of one Member out of the assets of another Member. Therefore, the actual resources available to settle Policyholders claims are, in my opinion, significantly more restricted than the £28.7bn of available assets shown in paragraph 6.5.1.**

6.5.9 **Lloyd's has stated in its Solvency and Financial Condition Report as at 31 December 2018 that all of the Members were solvent. However, I have concluded that if any future stresses to solvency fall unevenly across Members, then certain Members could become insolvent whilst other Members remain solvent but their assets cannot be used to meet the insolvent Members shortfall.**

6.5.10 Lloyd's seeks to protect against this by having in aggregate a 35% uplift of solvency assets for each Members above their individual SCR capital requirement. In addition, following the proposed Part VII transfer, Central Fund available capital of £3.4bn, will still be available to meet Members' obligations to Policyholders should individual members not have sufficient funds to do so.

6.6 Overall conclusion

6.6.1 **In my opinion, the only change impacting the Members as a result of this proposed Part VII transfer is that the Transferring Liabilities arising on the Transferring Policies will be replaced by an identical liability to LIC.**

6.6.2 **The proposed Part VII transfer will result in a reduction of €388m (£328m) in assets held by the Central Fund which will no longer be available to meet claims arising on the non-Transferring Policies, should the Members own funds prove to be inadequate. The €388m represents an increase in LICs capital of €313m (£264m) and €75m (£64m) to cover the expense expected to be incurred by LIC to administer the Transferring Liabilities.**

6.6.3 Following the Part VII transfer the MWSCR and the CSCR will remain significantly above the minimum ratio required under Solvency II regime and well above Lloyd's own risk appetite set out in it's the latest ORSA:

	MWSCR %	CSCR %
Solvency ratio pre transfer	163	258
Effect of the proposed Part VII	(2)	(22)
Solvency ratio post transfer	161	236
Lloyd's Risk Appetite	125	200

6.6.4 **Individual Members of Lloyd's underwrite on their own behalf and therefore whether Policyholders' valid claims are met will, in my opinion, primarily rest with the financial security of the individual Members. Only once a Member is unable to settle a valid claim will Lloyd's, subject to their discretion, use the assets of the Central Fund to meet the Policyholders' liabilities.**

6.6.5 **As a result of the proposed Part VII transfer and the Members entering into the proposed QS Reinsurance Contracts, the exposure of Members to Policyholders' claims is, in my view, unchanged pre and post this proposed Part VII transfer. None of the Members current assets will be used to fund LIC and therefore the security of Members' funds to settle potential claims for non-Transferring Policyholders claims is not materially adversely affected by this proposed Part VII transfer.**

6.6.6 **The non-Transferring Policyholders security will however, in my view, be impacted as €388m of Central Fund assets will be used to fund the Solvency Capital Requirement and expenses of LIC. These funds will no longer be available to settle non-Transferring Policyholders claims should the individual Members, not have the necessary funds to settle their claim.**

6.6.7 **I have concluded that the MWSCR calculated by Lloyd's is a measure of how robust the funds of Members are in aggregate, and therefore able to absorb a substantial claim or series of claims which would otherwise require a call on the assets of the Central Fund. The MWSCR Solvency Ratio, following the proposed Part VII transfer, remains well above the risk appetite set by Lloyd's and therefore the security available for non-Transferring Policyholders following the proposed Part VII will remain strong.**

6.6.8 I have reviewed the process and procedures Lloyd's has adopted to assess current and future risks and I am satisfied that the risk of a major cash call on the Central Fund is unlikely in the foreseeable future and would require a series of catastrophic events to occur in the same calendar year. Lloyd's modelling predicts that for this to occur it would require a Lloyd's market wide loss of £20.2bn for which the LIM predicts to be a 1 in 450 year event. Lloyd's is of the opinion that should the potential series of catastrophic events, referred to above, occur over a period of 2 to 3 years then the impact on the Central Fund would be no worse that if these events occur in the same calendar year. I agree with Lloyd's conclusion which is borne out by the fact that the only time in Lloyd's history that the Central Fund has come under substantial strain was in the late 1980's and early 1990's.

6.6.9 This was, in my view, the result of two major latent claims i.e. pollution and asbestos related diseases, manifesting themselves over this period, together with a large number of natural and man-made catastrophes. The impact of these events on the Central Fund was magnified by inherent flaws in the way the market reinsured themselves against such events both within the Lloyd's and outside in the wider global insurance market. Based on my experience of the Lloyds market I have come to the view that the systems and procedures Lloyd's has implemented since the 1990's, make the likelihood of a similar strain on the Central Fund less likely.

6.6.10 **Lloyd's central assets following the transfer will still amount to £3.4bn. This is well above the amount required to cater for a £20.2bn Lloyd's market wide loss, which could potentially reduce the Central Fund by £2.9bn. In my opinion, the remaining assets of the Central Fund, following the Part VII transfer, will be sufficient to meet, for all reasonably foreseeable circumstances, all non-Transferring Policyholders potential claims, should the Members own funds prove to be inadequate. Therefore, I believe that the level of security to meet future claims of the non-Transferring Policyholders will not be materially adversely affected by the proposed Part VII transfer.**

6.6.11 **Additionally the non-Transferring Policyholders will be insured by the same legal entities, with exactly the same governance structures, regulatory framework, policy terms and conditions, and their policies will be serviced in the same manner as prior to the Transfer.**

6.6.12 **Accordingly, I have concluded that the non-Transferring Policyholders will suffer no material adverse effect as a result of the proposed Part VII transfer.**

7 Impact on Transferring Policyholders

7.1 Background

7.1.1 This section covers the following:

- The solvency of Lloyd's Insurance Company SA (LIC) both pre and post transfer;
- The operating procedures LIC intends to adopt following the Part VII transfer;
- The regulatory regime that applies to LIC together with the recourse of Transferring Policyholders to compensation Schemes following the transfer.

7.1.2 In calculating LIC's solvency requirements LIC has used the standard formula under the Solvency II regulations. I have not audited the data used by LIC, to calculate its solvency capital however I have carried out the following procedures:

- A review of documents and data made available to me by representatives of LIC or Lloyd's;
- Discussions with representatives of LIC and Lloyd's to clarify the above data and documentation as I felt was appropriate;
- A re-performance of some of the LIC solvency calculations;
- A review of LIC solvency capital assumptions to identify those key assumptions being relied upon by LIC, and to identify those assumptions which have the greatest impact on LIC's Solvency Capital Requirements.

7.1.3 The section should be read in conjunction with section 5 (insurance liabilities attaching to Part VII transfer) and section 6 (impact on non-Transferring Policyholders) to obtain a fuller understanding of the effect of the Part VII transfer on Transferring Policyholders.

7.1.4 Throughout this section as LIC's solvency is determined in Euros and all amounts referred to are in Euros (unless otherwise stated). As at 31 December 2019 the rate used was €1 = £0.85 or alternatively £1 = €1.18.

7.1.5 LIC is authorised in Belgium and regulated by the National Bank of Belgium (NBB) together with the Belgium Financial Services and Market Authority. LIC is required to establish Technical Provisions for all the liabilities arising from the insurance contracts that have been written.

7.1.6 LIC was authorised to write new insurance business from 1 January 2019. LIC has an insurance and reinsurance license at the NBB for all of the non-life classes of business that will be transferred to it under this proposed Part VII transfer.

7.1.7 These classes, under the relevant Belgian insurance legislation, are: 1a (accidents, except accidents at work and occupational diseases), 1b (accidents at work and occupational diseases), 2 (health), 3 (land vehicles, except trains), 4 (trains), 5 (aircraft), 6 (sea, lake and river vessels), 7 (goods in transit), 8 (fire and natural elements), 9 (other damage to goods), 10a (civil liability arising from the use of motor vehicles), 10b (civil liability for transport), 11 (civil liability for aircraft), 12 (civil liability for sea, lake and river vessels), 13 (general civil liability), 14 (credit), 15 (cautions), 16 (various monetary loss), 17 (legal protection) and 18 (assistance). It has passports to undertake insurance and reinsurance business throughout the EEA under Solvency II on a freedom of services basis.

7.1.8 LIC is a vehicle which was established by Lloyd's to allow EEA policyholders continued access to Lloyd's market expertise in a manner compliant with EU regulation post Brexit.

7.1.9 LIC reinsures 100% of the insurance business it underwrites with Syndicates in the Lloyd's market under current reinsurance agreements. An outsourcing agreement, by which certain services are provided to LIC by Managing Agents in respect of the business LIC underwrites, has been entered into between LIC and each Managing Agent. The form of the outsourcing agreement is prescribed by LIC and is a Solvency II compliant outsourcing arrangement.

7.1.10 Each year every Managing Agent wishing to reinsure EEA business must propose a business plan to LIC. which outlines the classes and amount of insurance business to be written. These plans are reviewed and approved by LIC's Chief Underwriting Officer and Underwriting Committee and the business plan considered and adopted by the LIC Board.

7.1.11 Under the current reinsurance agreements with Lloyd's Syndicates, LIC is entitled to a commission calculated by applying a percentage to the gross written premium receivable by LIC. For the 2019 year of account the commission amount was 2.75%. The commission income generated is used to fund the ongoing business operations of LIC before the proposed Part VII transfer.

7.1.12 All Policy contracts for EEA business are required to be submitted to LIC electronically through the Structured Data Capture Service, which is a simple online service that converts the content of an insurance contract into consistent electronic data. This allows LIC to process these contracts in a highly automated way that cannot easily be replicated for the business transferred under the proposed Part VII.

7.1.13 LIC has been given the same ratings as those for the Lloyd's market in the UK as Lloyd's Syndicates reinsure 100% of the risks underwritten through LIC. These ratings are AM Best (A Excellent), Standard & Poor's (A+ Strong) and Fitch Ratings (AA- Very Strong).

7.2 LIC Business Plan

7.2.1 The key immediate goals that have been identified for LIC within its 2020 to 2022 Business Plan are to fully develop and implement its operations onto a business as usual basis, to complete the Part VII transfer and to integrate the operation of its various local offices across the EU.

7.2.2 The following is the forecast summary profit and loss for LIC produced in November 2019 for 4 years to 31 December 2022, based upon this Part VII transfer being completed in October 2020.

LIC Profit & Loss	2019 €m	2020 €m	2021 €m	2022 €m
Forecast gross written premium	2,700	2,800	2,900	3,000
2.75% commission (on earned)	30	65	77	81
Release of Part VII Reserves	0	16	7	7
Investment income	2	0	0	0
Expenses	(39)	(40)	(45)	(45)
Project & Part VII expenses	(8)	(12)	(4)	(1)
Taxation	0	(2)	(2)	(9)
Profit after Tax	(11)	27	33	33

7.2.3 The plan is based upon the business plans received from Syndicates by the Lloyd's Performance Management Directorate in London for 2019 and extracting the EU related element of the business expected to be underwritten through LIC. This has then been reviewed by Lloyd's in London and LIC to refine the numbers considered appropriate for the LIC business plan and solvency calculations and would need to be approved by the LIC Board.

7.2.4 The future income is forecast to arise from a similar mix of business to that currently underwritten with growth of around 3%. France at 17% and Italy at 14% are the only countries contributing more than 12% to this income. The business classes contributing more than 12% are:

	%
Casualty including financial products	23
Speciality other products	19
Marine	17

7.2.5 No Syndicate is forecast to generate more than 10% of the income and no broker is expected to introduce more than 11% of the business. **There is therefore, in my opinion, a wide spread of business mix expected to be underwritten within LIC, arising from several different brokers.**

7.2.6 **The various business classes are budgeted to produce gross combined ratios (claims plus expenses as a percentage of premiums) ranging between 83% and 92%. However, variations in these percentages will, in my opinion, have minimum impact on LIC business activities as all underwriting risks are reinsured into the Lloyd's market.**

7.2.7 The commission retained by LIC is recognised as the business is earned with around 40% of the potential written commission earned in its first year. This percentage recognised will rise in future years as calendar years commission will be earned mainly over a period of 2 to 3 years, i.e. the commission for 2021 will include policies written in 2019, 2020 and 2021.

7.2.8 Included within the assessment of the quantum of the insurance liabilities, to be transferred under this Part VII transfer, is €75m to administer those liabilities. The €75m is calculated to cover the administrative expenses over the period the claims are expected to be settled. LIC expects this period to be 10 years. The €75m will be held as a reserve by LIC and released back into the profit and loss account over the life of the Transferring Liabilities to match the expected expenses to settle the liabilities attaching to the Transferring Policies.

7.2.9 LIC's expenses are expected to be fairly stable between 2019 and 2020 although the individual components will vary though not significantly. The €5m increase for 2021 and 2022 reflects slightly higher staff, system and depreciation costs reflecting the additional resources necessary to process the Part VII business on an ongoing basis. The largest elements of total costs are staff related at around €12m from 2020, professional and regulatory at around €6m and systems at around €5m for most years.

7.2.10 The projected Part VII expenses reflect the cost to establish LIC's operational standards to deal with the Part VII transfer.

7.2.11 There is only a small amount of investment income expected to arise and this has been set to nil for years after €2m for 2019 in order to be prudent. The amount is not expected to be significant in any case on the circa €600m to €666m of cash and investments forecast between 2020 and 2022 including the injection of capital in following the Part VII transfer.

7.2.12 **As LIC is a new venture there is, in my opinion, some uncertainty about premium volumes and therefore commissions payable to LIC and the level of expenses that will be required to set-up and continue operations. However, Lloyd's intends for LIC to receive sufficient income to cover its costs and make a modest level of profits. In my view, having reviewed the budgets and forecasts included in the Business Plan, the current proposed commissions on new business written together with the €75m injection to cover the costs in dealing with the Transferring Liabilities will be sufficient to fund LIC's continuing operations for the foreseeable future.**

7.2.13 **Further, in my opinion, the financial forecast produced by the board of LIC does include the additional costs of dealing with the Part VII transfer. Lloyd's intended funding of the LIC's activity will allow LIC to have sufficient resources to implement the systems required to ensure Transferring Policyholders will not be materially adversely affected as a result of this proposed Part VII transfer in respect of LIC's funding requirements.**

7.3 LIC Balance Sheet

7.3.1 LIC's latest assessment of its Solvency Capital Requirement and balance sheets were included within LIC's Own Risk Solvency Assessment ("ORSA") prepared in November 2019. The solvency calculations were based upon the standard formula.

7.3.2 The ultimate loss ratios used in the ORSA for projections through to 2022 were based upon initial ULRs derived from an assessment of benchmarks as at the end of 2018. Although this was considered appropriate based upon the limitations of the EEA risk and claims history to date, it was recognised that as the claims history for the EEA business becomes more comprehensive it will become increasingly possible to use this data to project Technical Provisions for EEA business, which could lead to changes in the assessment of these ultimate claims.

7.3.3 The ORSA produced by LIC, as at 30 June 2019, included a balance sheet prepared on a Solvency II basis and projections of LIC's assets and liabilities as at 31 December 2019 and 31 December 2020:

LIC Balance Sheet (excluding Part VII transfer)	30-06-19 €m	31-12-19 €m	31-12-20 €m
Investments	165	265	265
Reinsurers' share Technical Provisions	397	1,080	2,219
Insurance/reinsurance receivables	435	616	908
Cash & cash equivalents	22	11	11
Deferred tax asset	28	17	18
Other assets	1	1	1
Total assets	**1,048**	**1,989**	**3,422**
Technical Provisions - best estimate	404	1,099	2,237
Technical Provisions- risk margin	16	25	34
Payables	439	614	899
Other liabilities	28	11	11
Total liabilities	**887**	**1,749**	**3,181**
Own funds (net assets)	**161**	**240**	**241**

7.3.4 The main increase in own funds for 2019 and 2020 is a €99m capital injection made in December 2019.

7.3.5 The significant assets, at 30 June 2019, consist of 71% sovereign bonds and 29% corporate bonds. The rating of these investment portfolios was AAA 22%, AA 50%, A 18% and BBB 10%. LIC is expected to retain a similar ratio of assets and security for future years.

7.3.6 Reinsurers' share of Technical Provision, which reflects the QS Reinsurance Contracts between syndicates and LIC, will increase or decrease in line with any increase or decrease in LIC's assessment of its Technical Provisions.

7.3.7 Following the proposed Part VII transfer LIC's has estimated the following impact on its balance sheet as at 31 December 2020:

LIC Balance Sheet	Before Transfer €m	After Transfer €m	Movement €m
Investments	265	578	313
Reinsurers' share Technical Provisions	2,219	6,547	4,328
Insurance/reinsurance receivables	908	908	0
Cash & cash equivalents	11	86	75
Deferred tax asset	18	23	5
Other assets	1	1	0
Total assets	**3,422**	**8,143**	**4,721**
Technical Provisions - best estimate	2,237	6,609	4,372
Technical Provisions- risk margin	34	89	55
Payables	899	899	0
Other liabilities	11	11	0
Total liabilities	**3,181**	**7,608**	**4,427**
Own funds (net assets)	**241**	**535**	**294**

7.3.8 The above table highlights that there is an increase in Technical Provisions of €4,372m of best estimate liabilities as a result of the Part VII transfer plus €55m of risk margin. These liabilities are reinsured back to Lloyd's syndicates hence the €4,328m increase in the reinsurer's share of the liabilities. The €4,372m represents the earned liabilities as at 31 December 2020.

7.3.9 The increase of €313m for investments reflects the capital injection to increase LIC's Tier 1 capital as calculated under the Solvency II rules. The €75m increase in cash is because of the cash injection arising from the Part VII expense reserve. The receivables and payables remain unchanged as they only relate to the incepting business in 2019 and post.

7.3.10 LIC Solvency II capital required as shown by the ORSA, before taking account of any Part VII transfer is as follows:

LIC Solvency	**30-06-19 €m**	**31-12-19 €m**	**31-12-20 €m**
Underwriting risk	5	9	10
Market risk	12	16	17
Counterparty risk	55	92	131
Diversification credit	(10)	(15)	(17)
Operational risk	18	30	42
Pillar 2 adjustment	5	6	6
SCR	**85**	**138**	**189**
Own funds	160	240	249
Pillar 2 adjustment	0	(1)	(1)
Total own funds	**160**	**239**	**248**
Solvency surplus	**75**	**101**	**58**
Solvency Ratio (own funds/SCR as 9%)	**188%**	**173%**	**131%**

7.3.11 The standard formula incorporates a formulaic calculation of the solvency requirements which is referred to as the "Pillar 1" solvency requirement. Where management of an insurance entity consider the element of risk to be beyond the normal risk the Pillar 1 solvency requirements are enhanced to a higher solvency requirement referred to as a Pillar 2 solvency requirement.

7.3.12 The following are the Pillar 2 adjustments by LIC's management as at 30 June 2019 solvency:

	€ m
▪ Allowance for spread risk of 64% of investments in government bonds	2.0
▪ Allowance for very low interest rated understating interest risk	3.5
▪ Offset of above two factors within market risk	(2.8)
▪ Operational risk for data quality risk in early stage of LIC	3.3
Diversification of above factors	(1.5)
	4.6

There is also an adjustment to own funds under Pillar 2 to recognise the potential for increased early operational risk.

These risks are anticipated to reduce after 2019 as LIC's scale increases.

7.3.13 The Solvency Ratio for LIC as at 30 June 2019 was 188% because the company was newly established. The Solvency Ratio was therefore above the risk appetite of 125% set by the board of LIC and included in their latest ORSA.

7.3.14 The estimated impact, as at 31 December 2020, on LIC's solvency capital following the proposed Part VII transfer is expected to be as follows:

LIC Solvency	Before Part VII €m	After Part VII €m	Movement €m
Underwriting risk	10	18	8
Market risk	17	23	6
Counterparty risk	131	289	158
Diversification credit	(17)	(25)	(8)
Operational risk	42	91	49
Pillar 2 adjustment	6	11	5
SCR	**189**	**407**	**218**
Capital injection	0	313	313
Other own funds	249	222	(27)
Pillar 2 adjustment	(1)	(1)	-
Total own funds	**248**	**534**	**286**
Solvency surplus	**59**	**127**	**68**
Solvency Ratio	**131%**	**131%**	**-%**

7.3.15 The largest change is in respect of counterparty risk. The counterparty risk is the risk of a counterparty not settling amounts fully when due. This is primarily the reinsurance to Lloyd's for all LIC's insurance liabilities and takes into account the Lloyd's credit rating. The increase is due to the additional gross liabilities transferred to LIC under the proposed Part VII reinsurance.

7.3.16 Overall there is no material change in the Solvency Ratio for LIC as a result of the Part VII transfer as Lloyd's intends to increase LIC's Tier 1 capital in order to mitigate any adverse impact on LICs Solvency II capital requirements as a result of the Part VII transfer.

7.3.17 The impact of the Part VII transfer on LIC's perceived risks is expected to be as follows:

Risk	Narrative
Underwriting risk	A small amount of additional exposure arising from the additional reserving risks transferred in respect of business not yet fully earned. This is mainly unearned expense reserves.
Market risk	A small increase from some additional interest rate risk and spread risk mainly as a result of the additional €388m of investments and cash transferred. This mainly represents an additional €313m of capital injection and €75m of cash to cover the expenses of the Part VII transfer.
Counterparty risk	A significant increase in counterparty risk is the result of the transfer of the additional claims Reserves, which are 100% reinsured back to Lloyd's Syndicates under the QS Reinsurance Contracts resulting in a subsequent default risk of Lloyd's Syndicates in aggregate not meeting their liability
Diversification risk	A small additional diversity credit to offset the different overall larger components of risk following the Part VII transfer. This is a formulaic answer that recognises that the different risk elements are unlikely to all move in the same manner.
Operational risk	A large increase in operational risk arising from the larger scale of the other SCR factors. This is generated as a simple formulaic answer that acts as an additional gearing of around 30% on top of the SCR before this risk.
Pillar 2 assessment	There is also an adjustment to own funds under Pillar 2 to recognise the potential for increased early operational risk.

7.4 Review of the solvency calculations for LIC post part VII transfer

7.4.1 The board of LIC have modelled the company's solvency position based on the forecast profit and loss and balance sheets to 31 December 2022. The result of their modelling is set out below:

LIC Solvency	2020 €m	2021 €m	2022 €m
Market risk	23	23	23
Underwriting risk	18	18	17
Counterparty default	289	277	269
Operational risk	91	88	85
Diversification	(25)	(25)	(25)
Pillar II load	11	6	6
Total SCR	407	387	376
Own funds	534	568	607
Solvency Ratio	131%	147%	161%

7.4.2 The projected SCR requirement is expected to gradually reduce, primarily due to the counterparty risk decreasing as Part VII liabilities decrease, as they are settled, at a faster rate than new business liabilities are added. The reason for this reduction is that as part of LIC's assumptions in projecting its SCR requirement it is expected that loss ratios for new business, which is supported by Lloyd's market data, are slightly lower than the loss ratios of the Part VII Transferring Liabilities which gives rise to reduced future Reserves and therefore a lower counterparty risk in the future. The own funds gradually increase mainly through retained cash from the LIC retained commission on new business exceeding expenses and the release of the Part VII expense reserve. The resultant Solvency Ratio improves over the period and stays well above the 125% target risk appetite set out by the board.

7.4.3 **I have compared the results of the SCR produced by LIC with the results of re-performing their calculation using an alternative standard formula model, both before and after the transfer. I have also stress tested some of the more significant components of the SCR calculation. Therefore, I am satisfied that LIC's current Solvency Capital Requirements and its projected Solvency Capital Requirements following the Part VII transfer have been calculated on a reasonable basis.**

7.4.4 **In my opinion, the key risks in forecasting LIC's solvency capital is the counterparty risk. This is the risk that the Syndicate and the Lloyd's**

Central Fund will be unable to meet valid claims from LIC's current underwriting and the liabilities arising from the proposed Part VII transfer.

7.4.5 **For this purpose, the individual Syndicates and the Central Fund are treated as one entity. This counterparty default is the largest element within the SCR calculation. This risk would be significantly reduced if individual Members, or Syndicates, are treated as individual counterparties, but in my view, this is not practical and not in line with market practice.**

7.4.6 The SCR loading following the transfer of the proposed Part VII transfer is an increase of €218m based on an increase in ultimate insurance liabilities of €4.7bn which are then 100% reinsured back to the Members.

7.4.7 In the table below, I have calculated the effect on the SCR resulting from a potential underestimate of insurance liabilities of 5, 10 and 15 percent in the estimate of insurance liabilities being transferred under this proposed Part VII:

Percentage increase in Part VII liabilities %	Reduction in Solvency Ratio %
5	-4
10	-8
15	-11

7.4.8 **The above table shows even if the quantum of projected liabilities on the actuarial projections are understated by 15%, then LIC's Solvency Ratio, at the Effective Date, will reduce to 120% which is below LIC's risk appetite but above the minimum capital. In my opinion, as claims relating to the Part VII Transferring Liabilities are settled and recovered from the Members the counterparty risk reduces and the Solvency Ratio will increase and likely to exceed the 125% risk appetite by 31 December 2021.**

7.4.9 **The proposed capital injection by Lloyd's of €313m will, in my view, cater for any currently reasonably foreseeable underestimation in the calculation of insurance liabilities being transferred to LIC. In arriving at the above opinion, I have also considered Lloyd's current intention to provide enough funding to LIC to enable it to operate and meet its Solvency Capital Requirement going forward.**

7.4.10 **Accordingly, as a result of the above, I am able to conclude that there will be no material adverse effect for the current Policyholders of LIC as a result of this Part VII transfer.**

7.5 LIC's exposure to potential future risks

7.5.1 The board of LIC have identified the following additional potential risks which the company faces following the Part VII transfer:

- Decrease in gross premium written
- Increase in expenses (including Part VII expenses)
- Increase in exchange rate
- GDPR breach fine
- Rating down grade of the Lloyd's market to BBB.

7.5.2 The above risks together with the risk of the liabilities attaching to the Part VII transfer proving to be under reserved have been stressed by LIC in their latest ORSA of November 2019, the results of which are set out below:

Scenarios	2019	2020	2021	2022
Risk appetite minimum SCR ratio	125%	125%	125%	125%
Risk tolerance minimum SCR ratio	115%	115%	115%	115%
Baseline Pillar I	**182%**	**135%**	**149%**	**163%**
Baseline Pillar II	**173%**	**131%**	**146%**	**161%**
30% decrease in gross written premium	173%	135%	153%	169%
30% increase in expenses (incl. Part VII)	163%	123%	135%	147%
25% exchange increase against Euro	163%	124%	139%	154%
€1bn extra claims (incl. €0.5bn Part VII)	173%	115%	127%	140%
€20m GDPR breach fine	173%	127%	142%	156%
Rating downgrade for Lloyd's to BBB	80%	53%	61%	68%
Zero diversification credit across risks	76%	80%	88%	96%

7.5.3 The above table shows that in most of the scenarios, highlighted in green, LIC's solvency ratio remains above the minimum SCR and the risk appetite. In the scenario highlighted in yellow the Solvency Ratio is still above the minimum SCR but below the risk appetite. The scenarios in red fall below the minimum SCR requirements.

7.5.4 The £1bn extra claims scenario assumes that the liabilities transferred under Part VII are understated by €0.5bn and that a further €0.5bn reserve deterioration following a significant EEA catastrophic loss in 2020. The result of this combined €1bn impact scenario is a drop below the risk appetite level for 2020 but this then improves to a Solvency Ratio back above this level from 2021.

7.5.5 **In my opinion, the most significant risk on LIC's future solvency is the risk of downgrade on Lloyd's credit rating.**

7.5.6 Lloyd's current credit rating by the various credit agencies is as follows:

Agencies	Rating	Comments	EIOPA rating
Standard and Poor's	A+	Strong	2
Fitch Ratings	AA-	Very Strong	1
Best	A	Excellent	2

7.5.7 EIOPA allocated credit ratings in steps and these steps determine the SCR change for the amounts due from that counterparty under the standard formula.

7.5.8 The rating agencies have slightly different rating levels and different numbers of ratings across their range. To help standardise this EIOPA have divided the different agencies ratings into steps to aid comparability and to group together each agent's ratings into a smaller number of steps. For a 1 step reduction in EIOPA ratings there can be more than a single rating class downgrade according to the rating agent.

7.5.9 For S&P a two rating downgrade to A and for Fitch a single step downgrade to A would also not lead to a reduction to EIOPA credit quality step 3, however if the Best rating was downgraded by a single rating to BBB+ this would represent a reduction to EIOPA credit quality step 3. In any case two credit agencies would need to downgrade to generate an overall credit step reduction.

7.5.10 During the second half of 2019 Best and S&P rated Lloyd's outlook as stable. Fitch also upgraded Lloyd's from a negative to a stable outlook in November 2019 based on insurance pricing improvements and the ongoing Lloyd's profitability initiatives, although this has returned to a negative outlook in April 2020 following the emergence of the COVID-19 pandemic. A reduction down to EIOPA credit quality step 3 being a rating reduction of three grades to a BBB rating is not considered a likely risk in the immediate future.

7.5.11 The zero-diversification credit scenario is a theoretical situation where all of the different risk model elements' 1 in 200 years probability losses occurs at the same time. The standard formula recognises that it is unlikely that each area of shock at the 1 in 200 probability level will occur at the same time and results in a far higher probability than 1 in 200. The formula allows for diversification credits to recognise this fact and scale down the various factors to bring them back to an overall 1 in 200 probability. This stress test identifies what the impact would be if there were no correlations between the various risks and they could all occur at the same time with an overall 1 in 200 probability. **In my opinion, this is an extreme and unrealistic scenario but demonstrates that if the diversification correlations are incorrectly set or EIOPA recalibrated them, there could be a significantly different solvency position. This remote risk decreases as the counterparty risk decreases over the years.**

7.5.12 **Although the Part VII transfer potentially increases the risk for LIC in many scenarios there is no major solvency impact created by any of the stress scenarios modelled by LIC that I considered likely. The greatest impact, although I consider it to be unlikely, is that arising from a downgrading of Lloyd's credit risk.**

7.5.13 **Further, in my opinion, ultimately whether a Policyholder's valid claim is met will depend on the strength of Lloyd's Central Fund rather than a downgrade in Lloyd's credit risk. Lloyd's modelling shows that it would need a Lloyd's market wide loss of £20.2bn which the LIM's model predicts to be equivalent to a 1 in 450 years event (see paragraph 6.4.16) for the Central Fund to come under significant pressure. Although should the Central Fund come under pressure as a result of the matters set out in paragraph 6.4.16, this would likely lead to a downgrade of Lloyd's credit rating. Should the Part VII transfer not occur and the Lloyd's market suffer a future loss as set out above the Transferring Policyholders would still face the impact of a depleted Central Fund. Accordingly, the Transferring Policyholder's ability to recover any claim from the Central Fund in the event of such a loss would be no worse off than before the Part VII transfer.**

7.6 Operating model post transfer

7.6.1 The Part VII transfer is a significant development for LIC covering:

- €4.7bn of insurance Reserves will transfer
- 57 Managing Agents, representing 82 Syndicates, with Policy and claims information sitting on many different systems within their IT infrastructure
- The reinsurance of the Transferring Liabilities back to the current Syndicates
- Additional responsibilities, including regulatory and compliance obligations in Brussels.

7.6.2 LIC's original operating model and systems were designed solely to service new EEA business underwritten on behalf of the Syndicates. The current operating model depends on the electronic receipt of the original policy, and the subsequent attachment of electronic messages. This does not work for Part VII business as they are existing policies and where they are using the Xchanging system, which is not all policies, they are set up to send messages to the current Syndicates.

7.6.3 Because of this a new operating model has had to be designed to accept the Part VII business. The operational systems and processes that relate to the Part VII book of business are new to LIC. They therefore require new teams in operations, data and accounting to manage the processing of the policies and associated accounting and cash flows. This means that there is a new layer of additional costs that is generated by the proposed Part VII transfer.

7.6.4 The nature of the Part VII business increases complexity for LIC. Business processes such as complaints and complex claims management, that arise in a more mature insurance book, have to be developed to a more accelerated timetable than originally proposed.

7.6.5 LIC expects that, as a result of the Part VII transfer, 17 employees will be appointed to handle the additional responsibilities and requirements of the Part VII book of business.

7.6.6 New systems are being developed which themselves will add to the expense base of LIC through required ongoing licencing costs.

7.6.7 The detailed systems relating to the handling of the Part VII book of business are in development. There may also be changes to the proposed systems required depending on the amount of automation that can be built into the process, with higher automation leading to fewer resources and lower automation to higher resource requirements.

7.7 Operational framework post transfer

7.7.1 Lloyd's will require managing agents to enter into updated outsourcing agreements prior to the Effective Date so that they are in place before the Sanctions Hearing and triggered on the Effective Date. Under these agreements Managing Agents will be engaged to provide services in relation to the Transferring Business, including the administration relating to claims management services and appointment of Coverholders on behalf of LIC.

7.7.2 The provision of services to LIC by the Managing Agents will be done so as to comply with the requirements of Solvency II, the European Insurance and Occupational Pensions Authority (EIOPA) Guidelines and national requirements of the NBB (including as to the level of control, oversight and access that is exercised by LIC). The outsourcing agreements will ensure operational continuity and consistency of administration as between Transferring Policies and those which are not transferred, under the ultimate control and authority of LIC. The drafting of these outsourcing agreements is well advanced but not yet finalised and I will review the key terms of these agreements as part of my further review of the LIC operating model that will form part of my Supplementary Report.

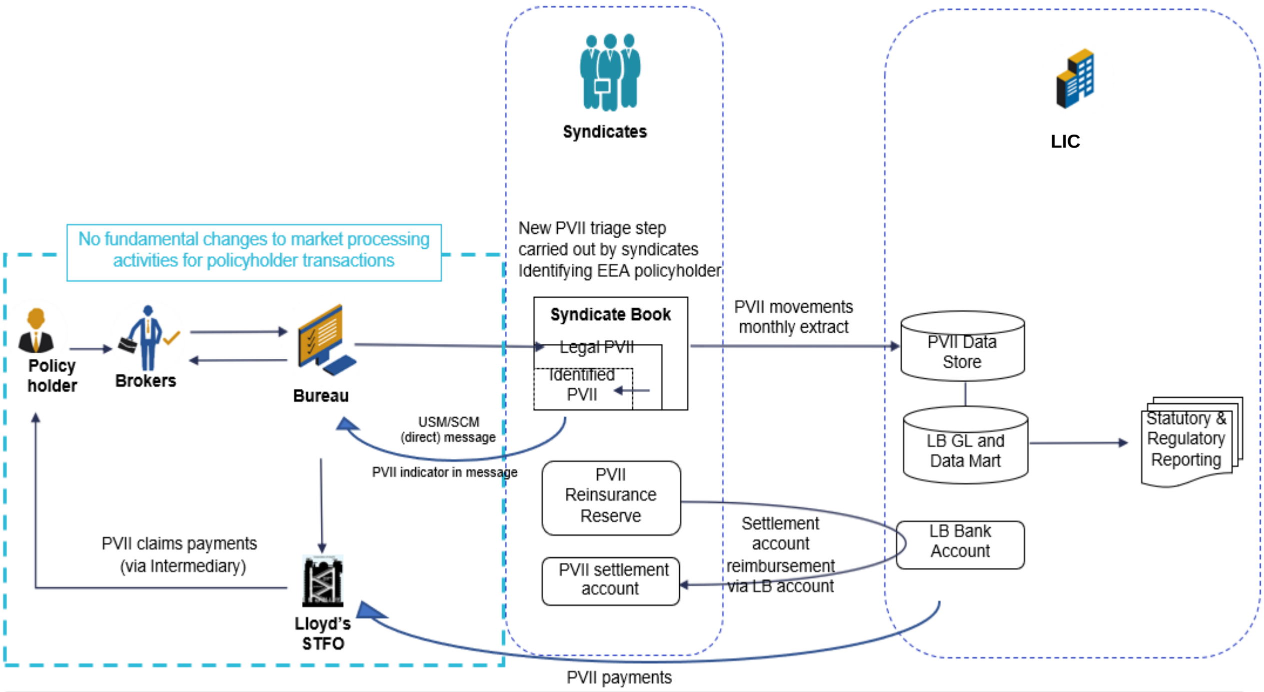
7.7.3 I have met with representatives of LIC and Lloyd's to understand the proposed operating model and in particular to gain an understanding of any impact on the Policyholder service levels.

7.7.4 The new operational process for LIC following the transfer of the liabilities has been designed with input from LIC, Lloyd's as well as regular consultation with market participants (Managing Agents and Brokers) with the intention of minimising any disruption to Policyholders and to adhere to the following standards:

- Consistency with the current operating model for the Lloyd's market
- Compliance with expected changes in regulation after Brexit
- Continuance of Claims payments to all existing Policyholders after Brexit

7.7.5 The overall operational framework LIC intends to adopt is outlined below:

Lloyd's Brussels Operational Framework



7.7.6 The key aspects of the operational framework design are:

- There are no fundamental changes to current pre-Part VII market processing activities for Policyholder transactions.
- LIC back office Operations and Finance activity is designed to avoid impacting Policyholder transaction processing time.
- Current central processing and settlement processes are largely unchanged.
- All Part VII transactions for premiums and claims are paid into and out of LIC Bank accounts.
- There will be no noticeable difference on the timing of when claims will be paid pre and post transfer.
- Each Syndicate will update its records to change Transferring Policies from direct to reinsurance.
- Managing Agents (on behalf of Syndicates) will administer the transferred business as a service provider to LIC.
- Managing Agents (on behalf of Syndicates) will report all Part VII transactions to LIC on a monthly basis.

7.7.7 For the operational framework to function Managing Agents (on behalf of Syndicates) will provide an initial load of data prior to, and shortly after, the transfer, which reports on all open claims and live policies which will be transferring. This dataset is separate from that used to calculate the transferring Technical Provisions and the look-back period and is subject to a separate data workstream exercise by the Lloyd's data lab Part VII Programme Data workstream.

7.7.8 As outlined in Section 3.2 most of the Policyholders are currently introduced to Lloyd's Members through intermediaries (Retail Brokers, Lloyd's Brokers, Coverholders, Service Companies). Post Brexit, these intermediaries are expected to have the necessary regulatory authorisations where required under the European Insurance Distribution Directive ("IDD") in order to continue to service these Policyholders. Where an intermediary connected to the Transferring Business does not have the requisite authorisation after Brexit to service that business, LIC and Managing Agents will ensure that alternative arrangements are made for LIC's servicing of the business through an authorised intermediary under the IDD.

7.7.9 In addition, all Policyholders will have a right to contact LIC.

7.7.10 However, following the transfer Managing Agents will no longer have the required regulatory permissions, including the current passporting rights to freedom of establishment and services within Europe which are enjoyed by UK insurers, to enable them to directly contact Policyholders to service the Transferring Policies.

7.7.11 **Although there are additional operational requirements for LIC and Lloyd's Members, I have concluded that the Policyholder does not need to navigate any new or unfamiliar processes as a consequence of the operating model following the proposed Part VII transfer. Accordingly, I have also concluded that there will be no impact on the service levels provided to policyholders following the proposed Part VII transfer.**

7.7.12 **In summary, I have concluded that the proposed Part VII transfer will have no material adverse effect on the Transferring Policyholders in respect of matters such as new business strategy, management, administration, claims handling, expense levels and valuation bases in relation to how they may affect the security of policyholders' contractual rights and levels of service provided to policyholders, particularly as the outsourcing agreements between LIC and the Managing Agents mean that the Transferring Policyholder will see no material change in the handling of their claims following the transfer.**

7.8 Contractual arrangements

7.8.1 Other than changing the parties to the contract from the Syndicates to LIC, the Transfer will have no material adverse effect on the contractual terms of the Transferring Policies. Additionally, for example, the Scheme includes wording on continuity of proceedings and is designed to ensure that proceedings can be continued by or against LIC after the Transfer.

7.9 Regulatory arrangements

7.9.1 Lloyd's primary regulators are currently the PRA and the FCA. Following the transfer there will be a change in regulatory environment for Transferring Policyholders as LIC's primary regulator is the NBB together with the Financial Services and Market Authority (Belgium).

7.9.2 Pre-transfer, the FCA is responsible for conduct supervision of all business written by UK authorised firms. Therefore, all Lloyd's policyholders fall within the FCA's oversight. Post transfer, conduct supervision for the Transferring Policyholders will be the responsibility of the Belgium Financial Services and Markets Authority.

7.9.3 Whilst the focus on conduct may be different as to that provided by the FCA in the UK, the European Insurance Distribution Directive ("IDD") implemented in October 2018 ensures a reasonable and adequate minimum standard of conduct regulation across Europe including Belgium. Given the regulatory environment in which LIC operates, claims handling standards will remain consistent for policyholders pre and post transfer.

7.9.4 Additionally, I have undertaken a high level review of the conduct framework in Belgium and discussed my findings with Lloyd's and their legal advisors to ensure that my understanding of the Belgium regulations was correct. It would appear that conduct obligations on insurers in Belgium are comparable to key FCA handbook provisions such as Principle 6 (treating customers fairly) and ICOBS 8.1.1 (insurers' claims handling provisions, and, for example, no unfair rejection of claims). In particular, under Belgium Law, insurance companies have a duty to act in good faith towards their contractual counterparties (i.e. policyholders) and to act honestly, fairly and professionally in accordance with the best interests of their customers. This general duty of good faith and acting in the interest of the customer has, in my opinion, a similar effect as Principle 6 and ICOBS 8.1.1, that an insurer must deal with its customers fairly and in good faith in all of its interactions (including in respect of rejection of claims). I also note that the provisions of the IDD have been implemented into Belgian law and even the strictest provisions that would only apply to life insurance products have been made applicable to most other insurance products as well, and this is a clear indication that Belgium takes a rigorous and robust approach to conduct matters.

7.9.5 **Overall although there will be a change in the prudential and conduct supervisor of the Transferring Policyholders, I do not believe the effect of any of these changes will be material, particularly as both Lloyd's and LIC are likely to continue to comply with the requirements of Solvency II and the EIOPA Guidelines for the foreseeable future.**

7.10 Access to the Central Fund

7.10.1 The Central Fund has historically been used by Lloyd's to meet a Member's liability to pay valid claims, arising on policies underwritten by the Member, should that Member's own funds not be sufficient to meet those liabilities in full. In this respect the Central Fund is effectively a fund of last resort to ensure all valid Lloyd's policyholders claims are met. The use of the Central Fund in this manner is subject to Lloyd's discretion. I have worked in the Lloyd's market for 35 years and during that time I am not aware of any incidence that Lloyd's has not used, its discretion, to use the Central Fund to meet a valid claim. Further Lloyd's uses the phrase "all valid claims have been paid" prominently in its marketing material and on its website and it's fundamental to its reputation.

7.10.2 All Transferring Policyholders will cease to be policyholders of the Members and become policyholders of LIC. However, as a result of the QS Reinsurance Contracts, LIC will become a policyholder of the Members (and fall within the Lloyd's security framework) and will have the assurance that Lloyd's may, at its discretion, continue to apply the Central Fund to support Members with whom they have entered into the QS Reinsurance Contract. I have obtained confirmation from Lloyd's that in exercising its discretion Lloyd's does not intend to distinguish between Members' liabilities to Policyholders (including LIC) or prioritise the use of assets to prefer one group of Policyholders over any other group of Policyholder.

7.10.3 At the effective date, all Transferring Policyholders will lose the security of the Central Fund should a Member of Lloyd's be unable to meet his or her insurance liabilities to claims arising on insurance policies they have written in full. However as explained above, LIC will now gain that security as a result of it becoming a policyholder of the Members through the QS Reinsurance Contract. This means that the Transferring Policyholders' access to the security provided by the Central Fund, subject to Lloyd's discretion, will be the same for all practical purposes, pre and post the proposed Part VII transfer.

7.10.4 **Therefore, I have been able to conclude that the loss of the Transferring Policyholders direct access to the security provided by the Central Fund will have no material adverse effect on the Transferring Policyholders ability to have their claims settled post transfer as LIC will gain the security of the Central Fund as a Policyholder of the Members, through the QS Reinsurance Contracts. Therefore for all practical purposes Transferring Policyholders will continue to have access to the security provided by the Central Fund.**

7.11 UK Financial Services Compensation Scheme (FSCS) and Financial Ombudsman Service (FOS)

7.11.1 The general insurance business sub-scheme of the Financial Services Compensation Scheme (FSCS) in the UK provides consumer protection for certain qualifying customers. This statutory "fund of last resort" compensates qualifying customers in the event of the default of a financial services firm. For general insurance, FSCS protection generally exists for individuals and small businesses in the situation where an insurer is unable to meet its liabilities for direct Policyholders only (i.e. reinsurance Policyholders are not covered) subject to certain eligibility rules.

7.11.2 For certain insurance that is compulsory in the UK (e.g. motor third party liability insurance), FSCS protection also exists for direct Policyholders whether or not they are individuals or small businesses. The FSCS will pay 100% of any eligible claim (arising from a protected contract of insurance) incurred for compulsory insurance (e.g. motor third party liability insurance) and 90% of claims incurred for non-compulsory general insurance (e.g. home insurance), without any limit on the amount payable. The FSCS is funded through levies on authorised firms. No protection is available for certain categories of policy or Goods in Transit, Marine, Aviation and Credit Insurance.

7.11.3 By virtue of an 'insurance market direction' under section 316 FSMA, Members are treated for the purposes of the Policyholder Protection Rules as if they are UK insurers. However, a policy issued by a Member is only a protected contract of insurance if it was entered into on or after 1 January 2004.

7.11.4 LIC currently has a passported branch in the UK. We understand that the relevant notifications have been made such that the branch will fall within the Temporary Permissions Regime (TPR) after exit day. The expectation is that LIC will then seek full UK authorisation for the branch before the end of the TPR period. If the UK branch of LIC does not obtain authorisation, then LIC will cease to be a relevant person for the purposes of the PRA's Policyholder Protection Rules when its deemed authorisation under the TPR ceases. The branch authorisation is not guaranteed but there is no reason to date to suggest that the branch will not be authorised before the end of the TPR period.

7.11.5 Where, as is expected, LIC has an authorised branch in the UK then transferring policies which were protected by the FSCS prior to the Transfer will also continue to be protected post-Transfer in respect of claims relating to acts or omissions occurring after the Transfer. Should LIC fail to establish or cease to have an authorised branch in the UK after the Transfer then transferring policyholders will lose the benefit of FSCS protection in respect of acts or omissions which occur after LIC ceases to have an authorised branch. Should LIC fail to establish or cease to have an authorised branch in the UK a protected claim by a Transferring Policyholder who is an eligible claimant, relating to acts or omissions arising before the Transfer would still be covered under the "successor" provisions of the PRA's Policyholder Protection Rules as set out below. I consider the risk that LIC will not be able to establish and maintain an authorised branch in the UK not to be a material risk.

7.11.6 The PRA's Policyholder Protection Rules provide protection where a "successor" (i.e. LIC) has assumed responsibility for acts and omissions of an authorised insurer (i.e. a Member). In this case, a policyholder who is an eligible claimant can also claim compensation from the FSCS in respect of an eligible claim when the successor is in default. My understanding, based on my review of the legal advice received by Lloyd's, is that LIC will be a successor to the Members in respect of Transferring Policies. Accordingly, if LIC were to become insolvent after the Transfer, Transferring Policyholders that are eligible claimants who would be able to claim against a Member for acts or omissions occurring prior to the proposed Part VII transfer (whether reported or unreported) and therefore will continue to be covered by the FSCS under the successor rules. The PRA's proposals published in respect of a possible no-deal Brexit stated that it did not intend to change its policy in relation to the scope of FSCS protection for liabilities assumed by successors. If these proposals are also applied from the Transition End Date of 31 December 2020, then the application of the successor rules set out above will continue to apply.

7.11.7 The PRA Rulebook provides that the FSCS will not settle a claim unless it is satisfied that the amounts which Lloyd's may provide from the Central Fund are, or are likely to be, insufficient to ensure that claims against the Member under a protected contract of insurance will be met to the level of protection that would otherwise be available under the PRA's policyholder protection rules. In other words, for Lloyd's policies written by Lloyd's Members the FSCS will only cover the policyholder where payments from the Central Fund are unlikely to compensate the policyholder. Following the transfer the Transferring Policyholders will no longer be insured by the Members, and, accordingly the FSCS will not have to determine whether the Central Fund is likely to compensate the Policyholder first before declaring LIC to be in default when applying its successor rules.

7.11.8 In practice as a result of the QS Reinsurance Contract that LIC will enter prior to the proposed Part VII transfer LIC will become a policyholder reinsured by Lloyd's Members, and as I have explained in Section 7.10.3, the Central Fund can still be applied to meet reinsurers obligations of Lloyd's Members to LIC. This provides a layer of protection before the FSCS is required to compensate Transferring Policyholders claims.

7.11.9 However, prior to the Effective Date, where a Member is unable to meet its liability to the Transferring Policyholders, and the Central Fund is unable to settle that liability on behalf of the Member, the Transferring Policyholder would have access to the FSCS if all relevant conditions apply. After the Effective Date as the Transferring Policyholder is not a Policyholder of the Member, as explained above, the right of access to the FSCS through this channel is lost. However if LIC is in default then the Transferring Policyholders would have access to the FSCS if all relevant conditions apply (i) in respect of claims relating to acts or omissions arising after the Transfer because LIC has established a passported branch in the UK; or (ii) in respect of claims relating to acts or omissions arising after the Transfer, provided LIC has established a branch with full UK authorisation once the Temporary Permissions Regime ends; or (iii) in respect of claims relating to acts or omissions arising before the Transfer, under the "successor" rules if LIC ceases to have or does not establish a UK branch. LIC has currently established a passported branch in the UK and, post exit, the intention is for LIC to seek full UK authorisation for this branch before the end of the Temporary Permissions Regime. Although the authorisation is not guaranteed, there is no reason to date to suggest that the branch will not be authorised. The loss of access to the FSCS for claims relating to acts or omissions arising after the Transfer only applies where LIC is insolvent and is unable to settle its liability to the Transferring Policyholders and has failed to establish or ceases to have a UK authorised branch. **Therefore I have concluded that the potential loss of access to the FSCS is not a material risk to the Transferring Policyholders in the circumstance described above.**

7.11.10 **The Transferring Policyholders loss of access to the FSCS set out in paragraph 7.11.5 and 7.11.9 would only occur, in my opinion, in unlikely circumstances, i.e. the failure by LIC to establish a branch with full UK authorisation once the Temporary Permissions Regime ends (paragraph 7.11.5) and the inability of LIC to meet a Transferring Policyholder claim in full (paragraph 7.11.9). I consider both these risks to be low probability events and accordingly I have concluded that the risk that Transferring Policyholders which had the protection of the FSCS prior to the proposed Part VII transfer of losing that protection after the proposed Part VII transfer is not a material risk. I have come to this opinion based on the advice received by Lloyd's from their legal advisers. I have reviewed this advice and concluded that it is appropriate for my considerations.**

7.11.11 The Financial Ombudsman Service (FOS) provides private individuals and microenterprises with a free, independent service for resolving disputes with financial companies. Micro-enterprises are defined to be businesses with less than €2m annual turnover and fewer than ten employees. It is not necessary for the private individual or micro enterprise to live or be based in the UK for a complaint regarding an insurance policy to be dealt with by the FOS. However, it is necessary for the insurance policy concerned to be, or have been, administered from within the UK and/or issued from within the UK. In cases of the Voluntary Jurisdiction scheme certain activities carried out in the EEA may also be in scope as set out below.

7.11.12 The FOS has a two-part system, a compulsory element applying to complaints relating to the acts or omissions of an authorised insurer carrying on regulated activities and a voluntary element which applies to complaints not covered by the Compulsory Jurisdiction relating to the acts or omissions of an insurer which has opted into the FOS's Voluntary Jurisdiction.

7.11.13 The Compulsory Jurisdiction of the FOS applies where:

- The complainant is eligible and wishes the complaint to be dealt with under FOS scheme;
- The respondent was an authorised person at the time of the act of omission to which the complaint relates; and
- The act or omission to which the complaint relates occurred at a time when Compulsory Jurisdiction rules were in force in relation to the activity in question.

7.11.14 Members are subject to the FOS Compulsory Jurisdiction as a result of insurance market direction issued by the FCA. Members are treated as if they are the authorised person for this purpose. The territorial scope of the FOS Compulsory

Jurisdiction covers complaints about the activities of a “firm” (including its appropriate appointed representative) carried out from an establishment in the United Kingdom.

7.11.15 Therefore prior to any transfer, only activities carried on from a UK establishment will be subject to the FOS Compulsory Jurisdiction and not activities carried on from the EEA.

7.11.16 As set out above LIC intends to establish a branch with full UK authorisation once the Temporary Permissions Regime ends. Accordingly, for the FOS Compulsory Jurisdiction scheme, I have concluded that (provided all other conditions are met):

- The FOS will continue to have jurisdiction in relation to the liabilities transferred to LIC where the relevant act or omission complained of took place prior to the proposed Part VII transfer. LIC’s responsibility for acts or omissions which occurred before the transfer will be based on the fact that it is a ‘successor’ to the business. FSMA 234B makes clear that FOS has jurisdiction over a successor who has ‘assumed a liability (including a contingent one) of a person’ who would have been the respondent to a complaint. The Part VII Scheme excludes certain liabilities from the transfer, including Non-Insurance Liabilities such as Conduct Liabilities. Therefore, if the act or omission complained of constitutes a Non-Insurance Liability LIC should not be liable as ‘successor’ and an eligible complainant can continue to bring their complaint against the Managing Agent or Member.

- Where the act or omission complained of takes place after the Effective Date the FOS compulsory scheme will have jurisdiction in relation to LIC provided the act or omission takes place in the UK or in the EEA, provided the services are being provided into the UK, and LIC’s UK branch has a deemed UK authorisation under the TPR or, once the TPR ends, the branch is fully UK authorised.

7.11.17 For the FOS voluntary scheme if the act or omission complained of took place prior to the transfer date, the FOS jurisdiction will continue to apply if the relevant Managing Agent or Member had opted into the Voluntary Jurisdiction scheme.

7.11.18 If the complaint constitutes or relates to a Non-Insurance Liability, then the eligible complainant should not need to bring their complaint against LIC but can bring it against the Managing Agent or Member.

7.11.19 However, for an act or omission that takes place following transfer the FOS Voluntary Jurisdiction will not apply unless the following conditions are met:

- The activity which is the subject of the complaint is carried on by LIC in the UK; or

- The activity which is the subject of the complaint takes place in the EEA and all of the following applies:

i. The activity is directed wholly or partly at the UK;

ii. The insurance contract is subject to English, Scottish or Northern Irish law; and

iii. LIC has informed its home regulator of its participation in the voluntary jurisdiction regime.

7.11.20 I have been informed that LIC has decided to enter into the FOS Voluntary Jurisdiction and will inform its own home regulators of its intentions. Accordingly, for acts or omissions that take place following the Effective Date, and meet the above conditions, the FOS Voluntary Jurisdiction will apply.

7.11.21 For activities falling within the scope of the Compulsory Jurisdiction, Transferring Policyholders who are eligible complainants will lose the benefit of the FOS scheme where activities which were previously carried on in the UK are, after the Transfer, carried on by LIC in Belgium (or elsewhere in the EEA) unless those activities constitute services provided into the UK and Lloyd's Brussels is covered by the TPR. This is in, my opinion likely to mean some Transferring Policyholders who are eligible claimants will not be able to bring complaints relating to acts or omissions which occur after the Transfer because the activity to which the complaint relates is no longer being carried on in the UK or does not constitute services provided into the UK.

7.11.22 **In my opinion, the loss of access to the FOS only applies in the limited circumstances referred to above and is somewhat mitigated by the complaint management scheme which LIC is intending to implement following the Part VII transfer. Further details are set out in section 7.12. Further, the number of complaints received by Lloyd's in respect of the underwriting years subject to the proposed Part VII transfer (which are expected to reduce as the underwriting years mature) are limited in number.**

7.11.23 **I have also concluded, based on my analysis, that the risk of a loss of access to the FOS Compulsory Jurisdiction scheme in the limited circumstances set out above is not a material risk when compared to the risk that it may become illegal for Members to pay valid claims if this proposed Part VII transfer does not proceed.**

7.11.24 For Transferring Policyholders who were unable to access the FSCS scheme and FOS scheme before the proposed Part VII transfer will continue not to be able to access the FSCS and FOS schemes after the proposed Part VII transfer.

7.11.25 The above analysis is based on legal advice obtained by Lloyd's on the application of the FSCS and FOS schemes both pre and post the Effective Date. I have reviewed and discussed this advice with both Lloyd's and their legal advisors. Lloyd's has confirmed to me that they are content with the legal advice provided by their legal advisors in connection with the application of the FSCS and FOS schemes to the proposed Part VII transfer.

7.11.26 Policyholders of Belgium-domiciled firms can apply to two complaint resolution services in Belgium as follows:

- Ombudsman des Assurance / Ombudsman van de Verzekeringen – a body established by law that can make non-binding recommendations regarding the matter.

- Ombudsfin – a private body that, for insurance, can make non-binding recommendations regarding the matter.

Policyholders transferred to LIC will be able to make representations to the above bodies, although they can only make non-binding recommendations unlike the FOS and accordingly I believe they provide less protection to Policyholders.

7.12 Administration and volumes of complaints

7.12.1 LIC intends to establish a complaint management system so that all complaints relating to Transferring Policies are handled in a similar manner and, in the same time frame, as pre-transfer. The volume of complaints is not expected to be significant. Based on past experience Lloyd's estimates

- The number of open complaints at the date of transfer will be between 20 to 30

- The number of new complaints relating to the Transferring Policies following the first 12 months of the transfer date to be circa 80 to 85

- Thereafter the number of monthly complaints to be between 7 and 8 per month.

7.12.2 Lloyd's intends to modify its complaints management Scheme so that any relevant future complaints can be readily identified as complaints relating to EEA policies transferred to LIC. All such complaints will be notified to LIC's complaints management system, who intend to adopt similar procedures as those currently in place in the Lloyd's market.

7.12.3 Under the terms of the outsourcing agreements complaints will be investigated and managed by the Managing Agents under the oversight of LIC.

7.12.4 **Therefore, based on my discussions with LIC and a review of the complaints system they intend to implement following the Part VII transfer, I have concluded that Transferring Policyholders ability to have their complaints dealt with post transfer will not be materially adversely affected as a result of the Part VII transfer.**

7.13 Impact of the Transfer on LIC's current Policyholders

7.13.1 As a consequence of the Transfer, although there are additional operational requirements and administrative costs for LIC to service the Transferring Policyholders as I have explained above, the current policyholders of LIC will be insured by the same legal entity, with the same governance structure, regulatory framework, policy terms and conditions, and their policies will be serviced in the same manner as prior to the Transfer.

7.13.2 **I have reviewed the increased administrative costs which LIC will incur to service the policies transferring under the proposed Part VII transfer which will be funded by Lloyd's. Accordingly, I have concluded that there should be no additional financial burden on LIC which could be detrimental to LIC's current Policyholders.**

7.13.3 I have reviewed LIC's regulatory capital position both pre and post transfer. Pre Transfer and post Transfer LIC meets its regulatory capital requirements by a significant margin.

7.13.4 **Therefore, in my opinion, the current policyholders of LIC will not be materially adversely affected as a result of the proposed Part VII transfer.**

7.14 Overall conclusion

7.14.1 Based on my review and analysis, set out above, of the impact of the proposed Part VII transfer on LIC's Solvency Requirements and on my understanding of the operating systems and procedures LIC intends to introduce, I can conclude the following:

- **I consider that the security of Transferring Policyholders' contractual rights is not materially disadvantaged by the proposed Part VII transfer. Therefore those Policyholders that are transferring under the proposed Part VII transfer will suffer no material adverse effect as a result of the proposed Part VII transfer; and**

- **The counterparty risk will reduce over time as the insurance liabilities attaching to the transfer are paid and recovered under the QS Reinsurance Contracts. LIC's projections estimate the Solvency Ratio will increase from 131%, immediately following the transfer, to 161% as at 31 December 2022. Accordingly, I have concluded that the current Policyholders of LIC will suffer no material adverse effect as a result of the proposed Part VII transfer.**

8 Notification strategy

8.1 Overview of notification strategy

8.1.1 The requirement under Part VII of FSMA is for Lloyd's to notify all Policyholders of the transferor and transferee of the proposed transfer. The definition of the Policyholders is construed very widely under FSMA (and the Financial Services and Markets Act 2000 (Meaning of Policy and Policyholder) Order 2001).

8.1.2 The design of Lloyd's strategy to notify the various Policyholders and stakeholders of this proposed Part VII transfer have been influenced by the following factors:

- the large number of policies issued by the Lloyd's market for the 1993 to 2020 underwriting years
- the lack of Policyholder details held centrally by Lloyd's and, in certain cases, by Managing Agents
- the cost and proportionality involved in tracing all Policyholder contact details.

8.1.3 Lloyd's is planning a notification strategy that incorporates digital, newspaper and direct mailing activities designed to bring the proposed transfer to the attention of as many impacted Policyholders and other parties as possible given the above constraints, and the time and costs involved in completing this exercise. Lloyd's plans to send direct notifications only to the following classes of stakeholders:

- Policyholders of policies within the period of cover at the Scheme Effective Date
- Policyholders of policies with open claims
- Policyholders which incepted within the look-back period (see section 8.2)
- Syndicate outwards reinsurers and, separately, the providers of security under such contracts of outwards reinsurance
- Coverholders whose Binding Authorities will transfer under the proposed Part VII transfer
- Third Party Administrators where their agreement relates in whole or in part to the servicing of Transferring Policies which will transfer under the proposed Part VII transfer
- Lloyd's Members on open years
- Lloyd's Members agents

This will require Lloyd's to seek a number of waivers from the Court as set out in Section 8.4.

8.1.4 The look-back period covers, on a classes of business basis, the period where a Policy has expired at the Effective Date but which, based on actuarial projections, less than 90% of all projected ultimate claims, by number, have been notified to (or settled by) the Lloyd's market at the Effective Date. This means those classes of business which historically are slower in reporting their claims to the Lloyd's market will have a longer look back period than those classes of business which historically have reported their claims more quickly.

8.1.5 The reasons Lloyd's has decided not to notify all expired Policyholders are summarised as follows:

- Lloyd's does not maintain a central database of Policyholder or reinsurer contact details and, based on Lloyd's consultation within the wider Lloyd's market, both Managing Agents and Lloyd's Brokers hold limited information on Policyholders contact details.

- The proportion of Policyholders who will make a claim in the future, and whose Policy has incepted prior to the look-back period is small, by definition less than 10% of the total value of claims covering the whole look back period will be made in the future. Given the large number of such policies, Lloyd's believes that notifying all Policyholders will require substantial resources, both in manpower and cost, which will be disproportionately large.

- Many of these Policyholders would have renewed their policies and will be notified as later Policyholders within the look-back period.

- Retail Brokers and Coverholders will have the primary relationship with these Policyholders and will be able to issue direct notification to the Policyholders if they believe it appropriate. Lloyd's will provide help and assistance to those Retail Brokers and Coverholders who wish to notify Policyholders.

- Lloyd's will undertake additional advertising through a number of information channels where all Policyholders will have an opportunity to understand and appraise the proposals and to request further information.

- There will be minimal effect on the Transferring Policyholders as the ultimate risk will be reinsured back into the Lloyd's market.

8.1.6 Lloyd's will issue direct notification to all reinsurers impacted by the proposed Part VII transfer, using contact details agreed with Managing Agents. The quality of data held by Managing Agents in respect of reinsurers will, in my opinion, vary across the market. **Based on my experience, Managing Agents are more likely to hold more accurate data regarding contact details of reinsurers on the more recent years.**

8.1.7 **For the reasons more fully explained in section 8.7, I have concluded that the above approach adopted by Lloyd's is reasonable and appropriate in view of the lack of records held centrally and the limitations of the records held by Managing Agents and Lloyd's Brokers in respect of Policyholders, and potentially reinsurers, contact details.**

8.2 Look-back period

8.2.1 The look-back period has been calculated for each Lloyd's class of business. This is to ensure that the look-back period is consistent with the classes of business used to value the Transferring Liabilities.

8.2.2 The look-back period was separately calculated for both the global book of business and the Transferring Business under the proposed Part VII Scheme. For each class of business both a 10 year and a five year weighted and simple average were calculated. The weighted average is a way of calculating the average so that underwriting years with a higher number of Policy counts carries more importance (weight) than other years in deriving the average.

8.2.3 The dataset used in the above analysis is not complete as any claims settled or notified for calendar years 2008 and prior will not be included in the dataset as this data is not available to Lloyd's. However, I understand that claims paid or notified (on the 2008 and prior calendar years) on or after 1 January 2009 will be part of the dataset and have been incorporated in the calculation of the look-back period. For example, on the 2006 year of account all claims reported from 1 January 2009 (i.e. in the fourth period of reporting) would be included in the dataset.

8.2.4 I have reviewed the general methodology and assumptions used by Lloyd's to calculate the look-back period and, in particular, I have selected 17 classes of business for more detailed scrutiny based on a number of criteria including:

- high claim counts
- high Policy counts
- the materiality of the gross written premium
- classes where the variations between the averages of the look-back period varied by five years or more
- classes where I might expect a high level of uncertainty (i.e. new classes).

8.2.5 For the above classes I have reviewed the methodology and assumptions in more detail. Further for these selected classes I arranged for the following work to be completed:

- Analysis of the volume of data used
- An assessment of the methodology used

- An assessment of the closeness of the fit of the selected claims notification pattern

- Consideration of whether the global and transferring claims displayed a significantly different notification pattern

- Consideration of whether any years of account, within the class of business, display a significantly different claims notification pattern

- An assessment of whether there is an indication of a change in business mix by year of account within each class of business

- Consideration of whether there is an indication of claims frequency trends

- An analysis to produce a simplified re-projection to sense check that the selected look-back result is within the expected range based on the data provided by Lloyd's

- Consideration of whether the selected look-back period is appropriate for Open Market business and non-open market business

- Consideration of whether the high-level assumptions underlying the Lloyd's methodology are reasonable.

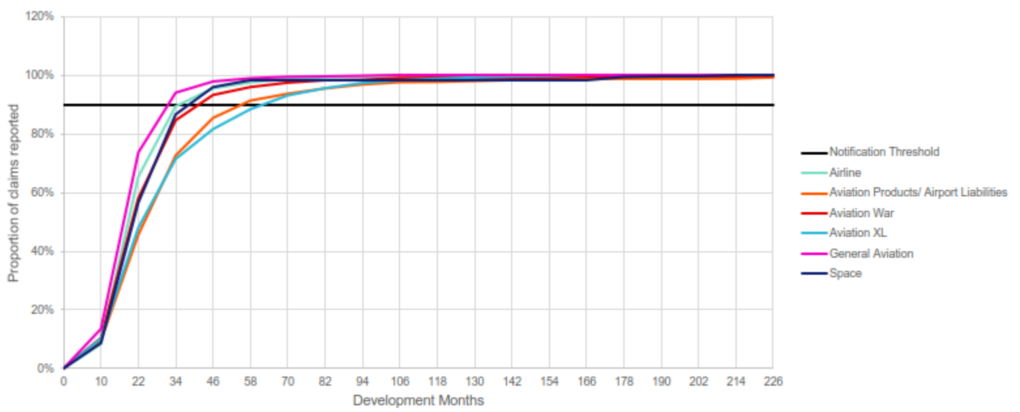
8.2.6 In completing the above work my team has complied with TAS 100: Principles for Technical Actuarial Work and TAS 200: Insurance as issued by the UK Financial Reporting Council. My team has also complied with the Institute and Faculty of Actuaries professional standards APS X1 and APS X2.

8.2.7 Generally, the average selected by Lloyd's for most classes was the Transferring Business 10 year weighted average. However, where there were any significant inconsistencies between the 8 averages calculated, these averages were reviewed and, based on these investigations and historical knowledge of the book of business written, Lloyd's selected a different average, if appropriate. **I have reviewed these classes of business which vary from the default average, and which would have a material impact on the number of Policyholders being notified, and I am satisfied that Lloyd's has applied their judgement, in selecting the lookback period, in a reasonable manner.**

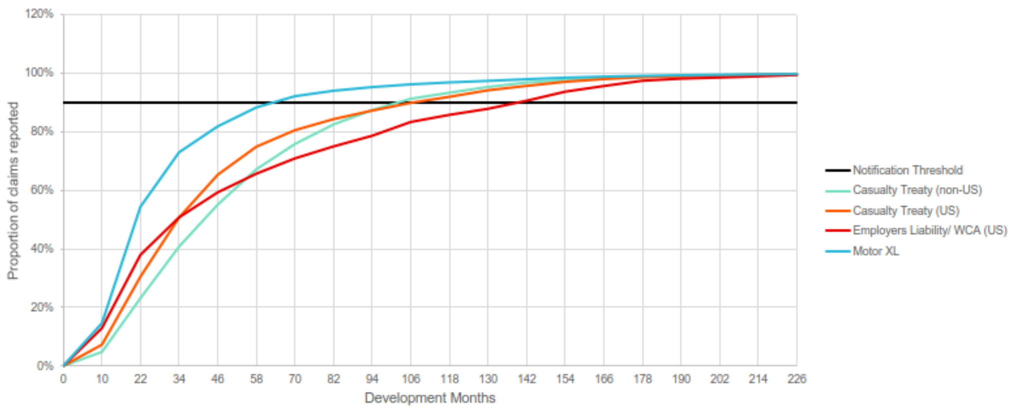
8.2.8 The above analysis has only been calculated for risks written on an Open Market basis. **Lloyd's has concluded, which I concur with, that there should be no reasons why business written by Coverholders would show different patterns of claims settlement or notification to business written on an Open Market basis. However, in my opinion, for Coverholders business there is likely to be a small delay in claims notification of between one to three months depending on terms of the appropriate Binding Authority contract**. In order to cater for this delay, I requested that Lloyd's analysed those classes of business, which included a high percentage of Coverholder businesses and where the look-back period was calculated to fall shortly after 31st December. For these classes the look-back period was extended by 12 months.

8.2.9 I have selected two development graphs which graphically illustrate that by the end of the look-back period, the majority (i.e. greater than 90%) of claims are likely to have been notified to the Lloyd's market:

Aviation



Casualty Treaty



8.2.10 As an illustrative example of how the look-back period has been calculated, the Employers Liability / WCA (US) charts show that, on average, 90% of all claims will have been notified at the 142 months stage. In order to calculate whether a Policy in this class of business will be directly notified the following steps will have to be applied:

Step 1	Assume that the Effective Date of the Part VII transfer will be October 2020
Step 2	Count back 142 months (11 years and 10 months) from the Effective Date to July 2008 (the look-back period)
Step 3	Move the look-back period to the beginning of the year to January 2008

Therefore, any Policy that has incepted before 1 January 2008, and currently has no active claims, will be outside the look-back period and will not be directly notified.

8.2.11 The look-back period for all classes of business are set out in Appendix 6.

8.2.12 Lloyd’s has also looked at the effect on the percentage of claims which fall into the look-back period if this look-back period was extended by one more year. This shows that the percentage of claims notified would increase for most classes by 1 to 4%. No class of business shows an increase greater than 9% as a result of extending the look-back period by one year.

8.2.13 **I have reviewed and assessed the calculation and assumptions behind the calculations of the look-back period and I consider the approach taken by Lloyd’s to be reasonable.**

8.3 Direct notification

8.3.1 Lloyd’s is not an insurance company and it does not hold Policyholder records such as contact details. The way the market operates, as set out in Section 3, means that Policyholder records and data are generally held by:

- Managing Agents
- Brokers (both Lloyd’s and non-Lloyd’s)
- Coverholders.

8.3.2 However, most of the Policyholder contact details maintained by the Managing Agents are held in databases which are no more than document storage facilities which may not be able to provide this data readily. Based on the market consultation Lloyd’s has concluded it would require each Managing Agent to obtain Policyholder’s details from numerous different sources. This would include staff of each Managing Agent to manually read each Policy and any related documents, in order to match and extract Policyholder’s details of the Transferring Policies.

8.3.3 To overcome these problems, Lloyd’s has decided that it will also need the assistance of Lloyd’s Brokers and Managing Agents’ community to extract contact details for both the Policyholder transferring under this proposed Part VII transfer, and the Syndicate outwards reinsurers.

8.3.4 In order to test the feasibility of this approach, Lloyd's produced a provisional list of Open Market business of the In-scope Transferring Policies. Lloyd's Brokers representing approximately 60% of the Lloyd's market, based on 2018 gross signed premium, were then asked to attach Policyholder's details to this list.

8.3.5 The objective of this exercise was to:

- identify items that were more frequently required by Lloyd's Brokers to match data held on their systems
- confirm the extent of Policyholder's details held by brokers
- to understand the technical and operational constraints and the time and effort required for brokers to complete this task.

This exercise was enhanced by a questionnaire sent to a further 253 Lloyd's Brokers not included within the above pilot study.

8.3.6 As a result of the above, the following factors have emerged:

- Significant consolidation has occurred in the broker market over recent years with many brokers inheriting legacy systems making the extraction of the required details a constraining factor and a resource intensive exercise.
- Lloyd's Brokers act as wholesale brokers providing access to the market for a large number of non-Lloyd's Retail Brokers. Policyholder contact details tend to be held only by the Retail Brokers most of which are not Lloyd's Brokers.
- Approximately 50% of the Open Market business is introduced to Lloyd's via Lloyd's Brokers acting in a wholesale capacity basis. For Lloyd's to obtain Policyholder details it would have to contact several thousand non-Lloyd's Retail Brokers.
- The success rate achieved by the Lloyd's Brokers to attach Policyholder data, in the pilot study, to the provisional list provided was low.
- A considerable lead time with extensive follow up was required by Lloyd's centrally to complete this exercise. Even after such an exercise the success rate of attaching Policyholder details to a list of transferring In-scope policies was low.

8.3.7 **In my opinion, based on the work completed by Lloyd's and my knowledge of the market, together with my liaison with the Lloyd's notification team over the past 12 months any engagement with the broker market and Managing Agents will require significant time and cost commitment by Lloyd's centrally as indicated by the above pilot schemes.**

8.3.8 Similar constraints on tracing Policyholder contact details applies to business written by Coverholders under Binding Authority agreements. There is a requirement for Coverholders to report, on a regular basis, details of claims and premiums written. These returns are referred to as bordereau by the market. How Managing Agents process this data varies across the market.

8.3.9 In some cases, just summary information is recorded while others process detailed Policy level information. The number of policies written under a Binding Authority agreement can vary from one to thousands. Therefore, the actual number of In-scope Transferring Policies under a binder cannot be reliably estimated with any accuracy. However, premiums and claims arising on those policies will, on the whole, be processed by Xchanging and will form part of the calculation of liabilities transferring to LIC.

8.3.10 Lloyd's has conducted a fact finding exercise by sending out a questionnaire to all Managing Agents asking whether they hold Policy level data for Coverholder business. The response to the questionnaire shows that 67% of the 56 Managing Agents have systems in place, for Coverholder business, which will enable Policyholder details to be matched to the Transferring Policies, although the quality of this data is unknown.

8.3.11 Where such systems are not operated, the Managing Agent will have to seek Policyholder contact details from Coverholders, some of whom may choose not to provide the information given the resources required to comply with Lloyd's request. **In my experience of dealing with a number of such organisations, a significant number of Coverholders will be small entities where resource requirements will be a significant burden given their size.**

8.3.12 In order to mitigate this issue Lloyd's intends to write directly to all Coverholders to request they notify their Policyholders of the proposed Part VII transfer with notification instructions (see below). Lloyd's also intends to assist Coverholders who request help with the notification process. **This approach together with Lloyd's intention to publish the proposed Part VII transfer in both UK and EEA newspapers and in the trade press is, in my opinion, a proportionate approach given the lack of Policyholder details held by Managing Agents and Lloyd's for Coverholders business.**

8.3.13 Lloyd's has decided that in order to increase the number of contact details for Policyholders and reinsurers they need to concentrate their resources on those entities within the Lloyd's market who are more likely to have the necessary contact details.

8.3.14 **Lloyd's spreading their resources across all potential data sources would, in my opinion, have the effect of increasing the cost of the proposed Part VII transfer without necessarily significantly increasing the number of contact details. Therefore I have concluded that the effort required both in time and human resources to try to extract all Policyholders and reinsurers contact details would be a significant exercise and is unlikely (based on the work Lloyd's have already completed) to identify all such contact details and would result in a disproportionate cost with little benefit.**

8.3.15 Given these constraints Lloyd's cannot reliably estimate either the number of Transferring Policies under binding authorities, or those that are In-scope for direct notification.

8.3.16 **In response to these issues, Lloyd's has developed, in my opinion, a proportionate approach for direct notification which reflects the increasingly disproportionate costs both to Lloyd's centrally and the wider Lloyd's market from sourcing Policyholder contact details from deeper within the market.**

8.3.17 Lloyd's intends to adopt the following approach for direct notifications:

Open Market Business:

- Lloyd's Brokers representing circa 80% of the In-scope Transferring Policies will be requested to provide Policyholder contact details
- All other Lloyd's Brokers and non-Lloyd's Retail Brokers, where they have been identified as owning the Policyholder relationship, will be provided with notification instructions as set out below.

Coverholders (Delegated Authority) Business:

- All Managing Agents will be requested to provide Policyholder contact details. Lloyd's will concentrate their effort on the 67% of Managing Agents who have systems that enable them to extract this information
- All service companies will be requested to provide Policyholder's contact details
- Coverholders, Retail Brokers and Third Party Administrators will be provided with notification instructions

8.3.18 Lloyd's will also create a Part VII transfer website as a section of their main website. The website will provide specific information of the proposed Part VII transfer and is central to Lloyd's notification strategy. The website will include an overview description of the rationale for the proposed transfer and its main effect, together with a library of the key documents, including my full and summary reports.

8.3.19 The website will have a language option drop down menu containing information in all 23 official languages of the EEA. The website will also include details of a telephone helpline for enquiries about the proposed transfer in the following languages:

- English
- German
- Italian
- French
- Spanish
- Dutch

8.3.20 These languages have been selected as they represent the most widely spoken mother tongues in the EEA countries as follows:

Language	Most widely spoken mother tongue %	Most widely spoken EEA foreign language %
German	16	11
Italian	13	-
English	13	38
French	12	12
Spanish	12	7

* The above data is from a European Commission report “Europeans and their Languages” dated March 2012.

** Dutch has also been selected as it represents the most commonly spoken language in Belgium, the country of domicile for LIC.

8.3.21 **In my opinion, the approach Lloyd’s intends to adopt, as set out in paragraphs 8.3.17 to 8.3.20 above, is a proportionate approach which will allow Lloyd’s and the wider Lloyd’s market, to concentrate on those entities which are more likely to be able to trace Policyholder records while at the same time provide details of the proposed Part VII transfer to as wide an audience as possible.** I have come to this view as a result of the following factors:

- The way the market operates which relies almost entirely on Retail Brokers and Coverholders having the primary relationship with Policyholders;
- The lack of Policyholder details held directly by Managing Agents, or Lloyd’s Brokers, which was highlighted by Lloyd’s pilot studies described above;
- The amount of time and effort that was required by Lloyd’s to assist those Lloyd’s Brokers who participated in the pilot study in tracing the policies and extracting Policyholder details;
- The other actions set out in this section, which Lloyd’s intends to take to inform Policyholders and other interested parties of the proposed Part VII transfer; and
- The fact that, in my opinion, Transferring Policyholders will not be materially worse off as a result of this proposed Part VII transfer and there will be no material impact on their ability to make and recover claims following the proposed Part VII transfer.

8.4 Waivers

8.4.1 As a result of the notification strategy Lloyd's intends to seek a number of waivers from the FSMA requirements from the Court. Full details of the waivers to be requested are set out in Appendix 7. However, a summary of the notification waivers is set out below.

Applicable to	Summary of key reasons
Non-Transferring Policyholders	• Volume of notification. • No change in terms and conditions. • Continued benefit from Lloyd's chain of security. • Difficulty in obtaining Policyholder's contact details.
Existing Policyholder of LIC from 1 January 2019	• Most Policyholders renewed into LIC from 1.1.2019. • Most will be In-scope for direct notification via the look-back period. • LIC security not negatively impacted by transfer. • Not materially disadvantaged by the Scheme
Policyholders with expired policies incepted prior to the look-back period Policyholders for whom no address, bad address or current contact details are held or are held in forms not easily extractable Third party claimant (not Policyholder) Kidnap and ransom policy holders	• Issues with obtaining contact details as set out above. • Limited data held electronically. • Prejudicial to Syndicate position • Security issues involved in protecting identity of Policyholders
Beneficiaries under master policies (i.e. Policyholders who have purchased insurance to provide benefit of insurance to others, usually individuals).	• All master Policyholders will be notified. • Request to master Policyholders to link to Lloyd's website where Scheme details are available. • Offer support to master Policyholders to send specific notification. • Short tail nature of business means few of the Schemes will fall into scope for direct notification. • Data gathering impractical to gather and coordinate.

Applicable to	Summary of key reasons
Employees of Employer	• Policyholders who are employers will be notified. • Support will be provided to employers should they choose to notify employees. • Data gathering would be impractical and impossible to coordinate. • Transfer will have no effect on employees' ability to make claims.
Outwards reinsurers for whom no address, bad address or current details are held or are held in forms not easily extracted Co-insurers	• Issues with obtaining contact details, in particular for earlier years. • Experienced and sophisticated participants will currently be aware of the proposed Part VII transfer. • Reinsurers' potential exposure will not change as a result of the Part VII transfer. • No central database on co-insurers and reinsurers.

8.4.2 Additionally, Lloyd's will seek a waiver from the regulatory requirement to publish the Legal Notice in one business newspaper in each EEA state as they intend to publish the Legal Notice in two national newspapers in each EEA state. A key part of Lloyd's consideration of this matter was the publishing of the Legal Notice where Lloyd's has transferring inwards reinsurance policies, which is solely from Germany. Their chosen national newspapers in Germany are Bild and Suddeutsche Zeitung which together have a large circulation but do not qualify as business papers. I consider this waiver application to be appropriate as these newspapers are expected to provide adequate coverage for the targeted recipients.

8.4.3 Lloyd's also proposes to directly notify only those Members with open years of account (such Members will be sent direct notifications at the address last notified to Lloyd's by such Members). Members of closed years of account will not be directly notified as Members on closed years have no material interest in Lloyd's as their potential liability will have been RITC to other underwriting years and Lloyd's will not have updated address records for these Members. Lloyd's will undertake additional advertising and will have a wide web presence through the Scheme Website so that such Members will have an opportunity to see the Legal Notice and request further information, raise queries and object if they wish to do so. I consider this to be appropriate.

8.4.4 Lloyd's will also notify security counterparties to ensure that they are aware of the proposed Part VII transfer and be able to raise queries and object if they wish to do so. I consider this to be appropriate.

8.4.5 **In my opinion, the reasons for the waivers that Lloyd's intends to apply for are appropriate given the matters referred to above and expanded on further in section 8.7.**

8.5 Communication Channels

8.5.1 Lloyd's will send a letter to Policyholders who will be directly notified of this proposed Part VII transfer; containing the following:

- A short summary of the terms of the Scheme
- A statement of my conclusions of the impact of the Scheme
- Details on how to contact Lloyd's, including the contact numbers and email address
- Details of how a Policyholder may object to the proposals
- Details of how a Policyholder may make representation to the Court
- A guide as to where key documents can be found on the Scheme dedicated area of the Lloyd's website.

8.5.2 For Reinsurers, providers of security under outwards reinsurance contracts, Coverholders, Third Party Administrators, current Members, and Members' Agents the same information as set out above will be sent tailored to their specific requirements. It is particularly important for the Reinsurers and associated collateral counterparties/security holders to be notified due to the fact that the Syndicates' outwards reinsurance agreements are not being transferred to LIC but will instead remain with the Members and be converted to retrocession cover under the Scheme.

8.5.3 The documents set out below will be translated into German, Italian, French, Spanish and Dutch. These languages have been selected for the reasons set out in paragraph 8.3.20:

- The Direct Notification Letter
- The Legal Notice
- The Scheme Summary
- A Summary of my Report
- FAQs.

8.5.4 Appendix 8 sets out Lloyd's approach to translations available to support this proposed Part VII transfer.

8.5.5 Lloyd's also intends to undertake checks of the websites for those market participants who have been requested to supply Policyholder contact information, together with a selection of other market participants to ensure that they have included the suggested text and the link to the appropriate section of the Lloyd's website.

8.5.6 Where Lloyd's has local language web pages for EEA Countries, generic information about the proposed Part VII transfer will be available in the local language. A link will be included on the relevant web page referring back to Lloyd's main Part VII transfer website.

8.5.7 For all of the documents translated into a foreign language, Lloyd's will request translators to provide a certificate verifying the accuracy of the translation. For all documents translated, I am relying on Lloyd's to ensure that the translations into each language are accurate.

8.5.8 PDF versions of the documents will be available from the website for stakeholders who wish to download the material.

8.5.9 All market participants, including those brokers and Coverholders who are not involved in obtaining Policyholder details, will be sent notification instructions containing the following:

- The direct notification
- The legal notice and publication approach
- A request they make their Policyholders aware of the proposal
- A request that they make new claimants aware of the proposal
- A request to publish a message on their website that Lloyd's is proposing to transfer EEA policies to Brussels and a link to the relevant area of the Lloyd's website
- Details of how Policyholder enquiries are to be dealt with, including objections
- Contact details to obtain additional information.

8.5.10 In addition to the above notification, Lloyd's will publish a notice (the legal notice) in the following publications:

- The London, Edinburgh and Belfast Gazette
- Five national newspapers in the UK
- Two national newspapers in any EEA State where the transferring risk is situated. This is likely to mean publication in all EEA States.

8.5.11 The Legal Notice will conform to the guidance issued by PRA and FCA and will be in a form approved by the PRA in consultation with the FCA.

8.5.12 Lloyd's also proposes to publish the Scheme details as follows:

- One industry specific publication per major line of business
- Market bulletins for advising the Lloyd's market and the wider Lloyd's market participants
- Any other publication or jurisdiction where requested by the PRA, the FCA and/or relevant EEA regulator.

8.5.13 Details of the publications currently selected and their circulation details are set out in Appendix 9.

8.6 Oversight of the notification process

8.6.1 As has been outlined in Section 4, there are significant difficulties for Lloyd's in relation to obtaining Policy data as it does not itself hold (or own the rights to) Policyholder records. Lloyd's has a direct relationship with only the Managing Agents over whom it has regulatory power. The primary contact with the Policyholder is through the Broker (for Open Market business) or the Coverholder (for Coverholder business).

8.6.2 Therefore, as outlined in Sections 8.3 *Direct Notification* and 8.5 *Communications Channels* Lloyd's has developed a framework for the notification process to meet the Regulatory Requirements and to assist market participants in the collection of the required Policyholder data.

8.6.3 I have met with Lloyd's throughout the notification design process to gain an understanding of how Lloyd's intends to communicate effectively with Policyholders regarding the Scheme. **I have been able to use these meetings to provide ongoing feedback on the notifications process so that, in my opinion, an appropriate communications strategy has been developed to meet the Regulatory Requirements.**

8.6.4 I have also reviewed the Policyholder notifications strategy document which provides the background to the notification design.

8.6.5 For notifications Lloyd's has appointed two third-party suppliers to undertake the translation, printing, mailing and responses to the direct notification. These third parties will manage the notification process including:

- Receipt of the Policy data extracted from Lloyd's from the data submitted by Managing Agents as described in Section 4;
- Transforming the data into Notification Control Lists ("NCLs"), i.e. a list of In-Scope Policies;
- Sending the NCLs to market participants (Brokers and Managing Agents) to obtain the relevant Policyholder contact details;
- Receive back these NCLs completed with Policyholder contact details;

- De-duplicate this data as far as possible, so that Policyholders only receive one notification;
- Translate the notification materials;
- Produce, post and email the direct notifications to Policyholders;
- Record and report responses from Policyholders regarding the Scheme.

8.6.6 Lloyd's will provide oversight and support over the third-party suppliers appointed as follows:

- They will work with Managing Agents and brokers to ensure contact details are provided to the suppliers to be matched against the data extracted by Lloyd's, from the data provided by the Managing Agent.
- Work with the suppliers to maintain a record of the volume of Policyholder's details provided to them to be notified and the volume actually mailed once the duplications have been eliminated.
- A review of the websites for these entities which have been asked to provide Policyholder's contact details, together with a selection of other market participants, to ensure that they have included the appropriate text in respect of the proposed Part VII transfer and have incorporate a link to the Lloyd's Part VII website.
- Monitor and report on the placement of the Legal Notice in the selected publications.
- Regular reports on the queries received by the response management centrally.

8.6.7 I have requested that I be informed on the progress of the above oversight on a regular basis, including the queries received and the response to those queries. In particular I have asked Lloyd's to keep me informed, on a regular basis, of any objections raised by policyholders or reinsurers. I will report on the objections received to the proposed Part VII transfer in my supplementary report.

8.6.8 The third parties will also be able to provide appropriate information to me, the regulators and the Court, as required.

8.6.9 Additionally, given the data and market capability issues with direct notifications as described above, Lloyd's approach to notifications is focused on promoting information on the transfer on the Lloyd's website and across the websites of Market Participants. I have had the opportunity to review the Part VII website specification paper and observed the website test site which provides an easily accessible format by which the following documents are made available to Policyholders:

- the Direct Notification and its variants;
- the Scheme Document and its summary;

- my IE report and it's summary;
- the Legal Notice; and
- a set of Frequently Asked Questions.

8.6.10 These documents will be available in an accessible format, giving access to chapters of the documents via drop down options, enabling readers to browse the material easily, without having to access or view pdf documents. Pdf versions of the documents will also be available for Policyholders who wish to access the material in that format or download specific documents.

8.6.11 **Therefore, for the following reasons I consider the framework and controls operated over the notifications process by Lloyd's to be appropriate:**

- The design of the notification Scheme followed detailed representations and pilot studies with the market;
- The engagement with the Brokers, Coverholders and Managing Agents to provide clear instructions about the data requirements for the direct notifications;
- The appointment of specialist third parties to carry out the physical notification and response management process on behalf of the Brokers and Managing Agents. Lloyd's will therefore receive the significant majority of queries regarding the Scheme, although some queries will be received by Policyholders' normal contacts, but Lloyd's has requested for these to be forwarded separately to Lloyd's;
- The development, in my opinion, of a clear advertising policy which aims to communicate the Scheme as widely as possible; and
- The design, in my view, of an easily accessible website which summarises the Scheme and provides Policyholders with an opportunity to see the Legal Notice and request further information, raise queries and object to the Scheme should they wish to do so.

8.7 COVID-19

8.7.1 COVID-19 does not currently present any technical issues to produce the contract data required from Managing Agents and brokers. Most of the Lloyd's market is working effectively but remotely, however potentially it may reduce the effectiveness of the data gathering exercise. The following issues are relevant:

- There are c.25,000 open market policies of which 80% are held by 31 brokers. These are large organisations who should have the resources available to complete the data extraction exercise.
- Other smaller brokers with less resources available to them, will be offered weekly surgeries with Lloyd's to discuss any issues. A lower response rate is anticipated from them.

- Lloyd’s has identified c.5000 Binding Authorities which include Transferring Policies. Some 60% of these are held by the Managing Agents who use commonly deployed bordereaux management systems which Lloyd’s is helping to develop software programmes to extract the data required. For the remaining Managing Agents Lloyd’s anticipate a lower response rate than is historically the norm.

- The postal system across the EEA and the USA is still functioning but some delays are likely in some of the countries. Lloyd’s intends to complete the notification process by 7 August 2020 some 8 weeks prior to the Sanctions Hearing and priority, as far as possible, will be given to overseas policyholders, in particular EEA based policyholders to allow for the longer delivery times that may result from the impact of COVID-19.

- In the event of a general failure to obtain data, undertake printing or posting for a specific country and the situation is forecast not to change across the publication period, Lloyd’s will undertake additional online advertising and signposting on the most frequently visited news websites.

- The response management supplier contracted by Lloyd’s is able to operate from multiple locations and therefore there should be no issues with the handling of email and postal enquiries.

8.7.2 **Although some reduction in the number of policyholders who will be directly notified of the proposed Part VII transfer as a result of the impact of COVID-19 is to be expected, Lloyd’s has, in my opinion, taken reasonable actions to mitigate the effect of COVID-19 on the notifications process.**

8.8 Managing Agents data

8.8.1 As set out in section 4.5, Lloyd’s intends to use data from Managing Agents as an additional source of information in identifying Transferring Policies. Any additional policies identified when this exercise is completed will be added to the list of Transferring Policyholders and notifications will be issued to the relevant policyholders. It is possible, due to the time required to compile this information, that these policyholders may receive the notification less than six weeks prior to the Sanctions Hearing for the proposed Part VII Transfer.

8.9 Overall conclusion on notification strategy

8.9.1 **Based on the procedures I have undertaken, and the information provided to me, I have concluded the following:**

- **Lloyd’s proposal to only directly notify Policyholders:**
  - **with open claims, or**

- **unexpired policies, or**
- **within the look back period;**

is a proportionate approach to adopt given the practicality and, in some cases, impossibility of obtaining the contact details for all Policyholders;

- In arriving at the above conclusion, I have taken into account the likely impact of the proposed transfer on both transferring and non-Transferring Policyholders which, in my opinion, is not material (see sections 6 and 7). I have also taken into account the commercial implication of the potentially significant time resource required in trying to obtain all Policyholders contact details;

- **Lloyd's direct notification approach, together with providing notification instructions to those brokers and Coverholders who act for Policyholders not being directly notified is, in my opinion, a sensible approach to take given the structure of the Lloyd's market;**

- **The reasons for the waivers that Lloyd's intends to apply for are appropriate given the advertising arrangements, the proposed website, the assistance Lloyd's will provide to those brokers and Coverholders who wish to notify their Policyholders and who will not receive direct notification, the time resource to contact all stakeholders and the likely impact of the proposed transfer;**

- **The number of reinsurers who will not be directly notified is, in my opinion, likely to be small and have the following characteristics:**

  - **Provide reinsurance cover only to older underwriting years**
  - **Not currently involved with the Lloyd's market in recent years**
  - **Have no active claims notification outstanding with the Lloyd's market**

- **Most reinsurers will provide cover to a number of Syndicates managed by a number of Managing Agents, over a period of years. Therefore, in my opinion, there is a high probability that their contact details will be held by one or more Managing Agent;**

- **Reinsurers tend to be sophisticated and experienced participants within the Lloyd's market and Lloyd's intention to place adverts in the trade press should, in my opinion, bring the proposed Part VII transfer to their attention if they have not been directly notified; and**

- **The population of reinsurers who would not be aware of the proposed Lloyd's Part VII transfer will, in my opinion, be small. I have concluded that the potential exposures of the reinsurers will be the same pre and post transfer and therefore, the impact of a reinsurer not being aware of this Part VII transfer will not be material.**

8.9.2 **I have reviewed the near final draft communication pack of documents and the proposed design of the dedicated website and I am satisfied that they are sufficiently clear and appropriate.**

8.9.3 **Based on my review of the overall communication strategy and associated documents, I am satisfied that Lloyd's overall approach is a proportionate approach and will ensure adequate coverage of all parties affected by the transfer**.

9 Other matters

9.1 Impact of COVID-19

9.1.1 I have considered the impact of the COVID-19 pandemic both on the insurance liabilities attaching to the Transferring Policyholders and on the non-Transferring Policyholders and on the investment assets held by Lloyd's in the Central Fund and the wider Lloyd's market.

9.1.2 The COVID-19 pandemic significantly affected the industrialised world in early January 2020 and will continue to have an impact during 2020 and future years. Insurance claims arising on COVID-19 may impact on insurance policies incepting prior to 1st January 2020, provided they were still on risk in 2020. Therefore, it is likely that the following Transferring Policies may be impacted by COVID-19 related claims:

- Policies written by those Coverholders who were not able to set up procedures in time to write EEA business through LIC with an inception date in 2019. See paragraph 1.3.3. for further details.
- Any multi-year policies which are still on risk in 2020.
- In-scope German reinsurance business which the members continue to underwrite in 2020.

9.1.3 An initial estimate was completed by Managing Agents of the impact of COVID-19 on the syndicates under their management as at 31 March 2020. These returns provided Lloyd's with an early view of the potential impact of COVID-19 on the Lloyd's market. Based on the information available so far, Lloyd's believe that Contingency, Political Risk, Credit and Financial Guarantee and Professional Indemnity classes are likely to be the highest impacted classes given their coverages are directly exposed to COVID-19. In addition, a secondary impact of COVID-19 due to an extended loss period could lead to higher losses on a wider range of classes including Political Risks, Credit and Financial Guarantee, Non-Marine General Liability, D&O and Property CAT XL classes. None of these classes contain material amounts of multi-year policies within the EEA market. It is therefore expected that the impact of COVID-19 losses on the Transferring Liabilities is likely to concentrate on the 2019 and 2020 underwriting years.

9.1.4 As 93% of the Transferring Liabilities relates to policies written prior to 2019, I would expect the impact on COVID-19 on ultimate claims/loss ratios to be relatively limited. The areas of Transferring business most likely impacted are German reinsurance written post the 2019 underwriting year and prior to the Transfer Date, and direct policies with unexpired exposures beyond the end of 2019, such as the small number of binders written in the first quarter of 2019 as set out above. Accordingly, Transferring Policies which are potentially exposed to claims resulting from COVID-19 will be limited by both numbers and by type.

9.1.5 To assess the materiality of the uncertainty of the impact of COVID-19, Lloyd's has performed a scenario test which applies a 50% increase to the initial expected loss ratios for Transferring Policies on the 2019 and 2020 underwriting years across all classes except for the Contingency class where a 250% increase to the initial expected loss ratio is applied reflecting its material exposure to COVID-19 losses based on the information from the Managing Agents' returns. This results in an increase in the Ultimate Reserves at the Transfer Date of €183m, which amounts to a movement of 3.9%. The classes most impacted by this increase are the Property classes and the Casualty Treaty class as they contain the highest amount of German reinsurance which constitutes the majority of the Transferring Policies on the 2019 and 2020 underwriting years. In aggregate, the assumed increase in loss ratios due to COVID-19 does not cause a material impact on the reserves at the Transfer Date, due to the limited amount of Transferring Policies on the 2019 and 2020 underwriting years. Note however that the level of stress applied in this scenario test should not be considered as an accurate indication of the actual loss ratio impact from COVID-19, which is currently subject to significant uncertainty given the evolving situation at this point in time.

9.1.6 The impact of COVID-19 will be mitigated by the QS Reinsurance Contracts which will result in the economic liabilities of COVID-19 related claims being ultimately borne by those Members who originally wrote the underlying policies giving rise to those liabilities. **Therefore, I have concluded that there will be no material adverse effect on the Transferring Policyholders as a result of claims arising from COVID-19.** The COVID-19 loss will, however, impact on LIC's solvency requirements as any increase in the gross Transferring Liabilities will increase LIC's counterparty risk. Lloyd's has stated its intention not to see a reduction of LIC's solvency requirements as a result of this proposed Part VII transfer. My understanding is that additional funds will be transferred from the Central Fund to LIC to cover any additional increase in LIC's counterparty risk.

9.1.7 The impact on the Lloyd's market of COVID-19 is much more difficult to assess at this early stage. Much will depend how the loss develops over the next 12 months. There are several significant unknowns which cannot be quantified, at this stage, with any degree of accuracy including the following:

- The impact, if any, on the Central Fund of underwriting losses arising from COVID-19
- The appetite of the Members to continue to underwrite in 2021 and beyond given the COVID-19 loss and any losses they experience outside the Lloyd's market
- The appetite for new investors to enter the Lloyd's market or to replace any Members which cease to underwrite in 2021 (Members are already committed for the rest of 2020)

9.1.8 Based on the returns submitted by the Managing Agents, Lloyd's early conclusion is that the final Lloyd's loss for COVID-19 could potentially be as significant as the loss resulting from hurricanes Harvey, Irma and Maria ("HIM") in 2017. The combined Lloyd's market net loss for these hurricanes was estimated to be £3.5bn. A further request has been made to Managing Agents for further details on their assessment of the expected COVID-19 related claims. The result of this exercise will not be known until early to mid-May.

9.1.9 Lloyd's recently published Annual Report states that, as at 19 March 2020, following the significant decrease in the valuation of the investment portfolios of Lloyd's and the Syndicates operating within the Lloyd's market, the CSCR and MWSCR solvency ratio continue to be above its risk appetites – its central solvency ratio is estimated to be 205% and the market-wide solvency ratio is estimated to be 146%. As at 13 April there has been a partial recovery in the value of the Lloyd's market investment portfolio for the CSCR and MWSCR. However, both the CSCR and MWSCR remain sensitive to movement in the valuation of the investment portfolios of Lloyd's and the Syndicates operating within the Lloyd's market. Lloyd's is closely monitoring the situation and is collecting the full extent of 1st quarter 2020 asset losses and incurred liabilities from the Members as part of the mid-year coming into line exercise in June 2020. Further capital collections will be used if appropriate given the development of the situation. The CSCR solvency ratio will also continue to come under pressure in order to cater for both the impact of COVID-19 and the requirement to fund LIC's capital requirement following the proposed Part VII Transfer and may well reduce below Lloyd's risk appetite but should remain above the minimum capital requirement for the Central Fund.

9.1.10 As part of the Managing Agents' initial assessment they were asked to report the impact of COVID-19 by geographical regions including Europe but not limited to EEA countries. Further these returns did not distinguish between claims arising on Transferring Policies and non-Transferring Policies. **Nevertheless, based on these returns and the sensitivity analysis completed by Lloyd's of the impact of COVID-19 claims, I have concluded that the amount of funds required to be transferred to LIC from the Central Fund to cover any increase in LIC's counterparty risk resulting from claims arising from COVID-19 is not material. Accordingly, I have concluded at this stage that the non-Transferring Policyholders will suffer no material adverse effect as the result of claims arising from COVID-19.**

9.1.11 However, I would stress that COVID-19's impact on the insurance market generally, and the Lloyd's market in particular, is at an early stage and it is difficult to assess the financial impact it may have with any degree of certainty. Lloyd's, at this stage, does not expect the impact of COVID-19 to affect its ability to satisfy regulatory solvency requirements. The impact of COVID-19 should become more quantifiable as more claims are reported and the economic effect of COVID-19 becomes clearer.

9.1.12 Lloyd's plans to publish a preliminary estimate of the COVID-19 impact on the Lloyd's market in early May. I will review the most recent information of the COVID-19 impact and report my further conclusion prior to the Sanctions Hearing in my supplementary report.

9.1.13 Additionally, the COVID-19 pandemic is causing social restrictions which are directly impacting the Lloyd's market. Until further notice, the majority of Lloyd's, LIC and the Managing Agents' employees are working remotely, the Underwriting Room in the Lloyd's Building has been closed and emergency trading and operating protocols that Lloyd's, LIC and the Managing Agents had prepared have been successfully activated.

- As part of this process Lloyd's has implemented a number of new controls to manage the impact on the Lloyd's market:
- Lloyd's has set up a dedicated contact point to provide policyholders with assistance and to help them find the right person to process a claim;
- Daily Catastrophe Group and Executive Committee meetings held to consider development of the global pandemic and implement business continuity plans in line with government advice;
- Emergency trading protocols have been invoked in conjunction with the wider market including the closure of the Underwriting Room and with personnel working remotely;
- Ongoing monitoring of the impact on Lloyd's assets and liabilities, claims, and solvency position with management well placed to respond to deficiencies as and when they arise; and
- Regular engagement with Lloyd's, LIC and Managing Agents and regulators via several forums.

9.1.14 Overall Lloyd's, LIC and the Market is well placed to manage the operational fallout from the COVID-19 pandemic.

9.2 Contingency plans

9.2.1 The proposed Part VII transfer assumes that following the exit of the UK from the European Union the freedom of establishment and freedom of services passporting rights will be withdrawn.

9.2.2 There continues to be significant uncertainty as to how the UK Government's Brexit negotiations will develop over the coming months.

9.2.3 Without the Transfer there is a significant risk that Lloyd's could be prevented by law from paying claims and servicing policies. This would be detrimental to all Policyholders as valid claims may not be legally settled and is the key reason for the proposed Part VII transfer to be enacted now. Delaying this proposed Part VII transfer until such time as the trading arrangements between the EU and UK have been finalised may not provide sufficient time to complete the proposed Part VII transfer should the passporting arrangements not be included in the future agreement between the two parties.

9.2.4 Under certain Brexit scenarios, a legal route for paying claims and servicing policies may be agreed by the UK Government and the European Union.

Notwithstanding this, I agree with Lloyd's conclusion that this proposed Part VII Transfer would be more certain, complete and cost effective and therefore overall better for Policyholders.

9.2.5 I will also consider the latest developments in the Brexit negotiations which could affect the proposed Part VII transfer as part of my Supplementary Report.

9.3 Supplementary Report

9.3.1 Before confirming my conclusions and my opinion I consider it necessary that I review the most recent information, up to the date of the Sanctions Hearing for the Proposed Transfer.

9.3.2 The matters that I have highlighted in this report which require further review include:

- The updated Chief Actuary's Report incorporating the Regulatory Reporting Data as at 31 December 2019
- An update of the impact of COVID-19
- Any significant changes to the proposed LIC operating model including my comments on the final outsourcing agreement between LIC and the Managing Agents
- Any significant developments in the Brexit negotiations which could affect the Scheme
- Any reinsurer and policyholder objections received.

9.3.3 I will consider these matters further as part of my Supplementary Report.

9.4 Approval of report

9.4.1 This report was approved on 1 May 2020.

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